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THE GOVERNMENT CONTRACTS UPDATE

DEPARTMENT OF ENERGY ISSUES NOTICE OF PROPOSED RULEMAKING REGARDING CONTRACTOR BUSINESS SYSTEMS

On April 1, the Department of Energy ("DOE") issued a notice of proposed rulemaking ("NPR") that would allow DOE to withhold a percentage of payments from a contractor whose business system contains "significant deficiencies." The DOE's proposal essentially adopts the business systems rule adopted by the Department of Defense ("DOD") in February 2012. The NPR notes that DOE considered the DOD rule in drafting the proposed clauses, and it would permit DOE to coordinate with DOD regarding the use of that system under a DOE contract. Notably, DOE's efforts to adopt its version of the DOD's business system rule could prompt action by the FAR Council to consider a similar requirement for all agencies under the FAR.

Under the DOE rule, as in the DOD rule, a contractor's "business systems" would include its (1) accounting system; (2) estimating system; (3) purchasing system; (4) earned value management system; and (5) property management system. A "significant deficiency" would be "a shortcoming in the system that materially affects the ability of officials at [DOE] to rely upon information produced by the system that is needed for management purposes." When a contracting officer determined that such a deficiency existed, interim payments could be withheld under cost-reimbursement contracts, incentive-type contracts, time-and-materials contracts, and/or labor-hour contracts. Progress and performance-based payments could be withheld on fixed-price contracts. The DOE proposes to limit withheld payments to no more than 5% for one or more significant deficiencies in any single contractor business system and no more than 10% for significant deficiencies in multiple contractor business systems. The amounts would be withheld by the contractor, who would be instructed by the contracting officer to withhold the appropriate amount from its invoices until the deficiencies are remediated. The proposed rule would apply to contracts throughout DOE except for Management and Operating ("M&O") contracts, though the NPR contemplates the future issuance of a separate rule covering M&O contracts.

Written comments on the NPR are due by June 2, 2014.

TREASURY FINALIZES NEW RULE REQUIRING CONTRACTORS TO MAKE "GOOD FAITH EFFORTS" TO HIRE WOMEN AND MINORITIES

The Treasury Department issued a final rule on March 20 that will require the inclusion of a contract clause requiring contractors to make "good faith efforts" to hire women and minorities in all contracts for services above the simplified acquisition threshold. The final rule, which will become effective on April 21, 2014, implements section 342 of the Dodd-Frank Act, 12 U.S.C. 5452, directing certain agencies to require contractors to "ensure, to the maximum extent possible, the fair inclusion of women and minorities in the workforce of the contractor, and as applicable, subcontractors." The mandatory clause provides that, upon written request from the contracting

officer, a contractor has ten days to provide satisfactory documentation demonstrating its good faith efforts to comply with the rule. Good faith efforts include efforts consistent with the Equal Protection Clause, Title VII of the Civil Rights Act of 1964, and Executive Order 11246, including the identification and removal of barriers to employment, expansion of employment opportunities, and other forms of outreach to minorities and women. The Rule specifies that documentation of good faith may include, but is not limited to,: (1) the percentage of the contractor's minority and women employees broken down by race, ethnicity and gender (e.g. an EEO-1); (2) a list of subcontract awards including dollar amount and date of award, the subcontractor's race, ethnicity, and/or gender ownership status and/or the same information for the subcontractor's workforce; and (3) the contractor's plan to ensure hiring and advancement opportunities for minorities and women.

The rule does not impose any hiring quotas or similar requirements. Still, a contractor that fails to make good faith efforts may be terminated for default or be referred to the Office of Federal Contract Compliance Programs. Prime contractors are required to flow down the clause in all subcontracts valued in excess of $150,000.

The final rule expressly states that most Treasury contractors are "already subject to and have implemented other FAR requirements that will satisfy this rule's requirements" because Treasury contracts are subject to FAR 52.222-26 (Equal Opportunity).

GSA AUDIT REPORT UNCOVERS BILLING SYSTEM, COMMERCIAL SALES PRACTICES, AND SALES MONITORING PROBLEMS AMONG MAS VENDORS

On March 25, the General Services Administration's ("GSA") Assistant Inspector General for Auditing released a memorandum summarizing preaward audit reports for Multiple Award Schedule ("MAS") contracts. The memorandum identifies three major issues.

First, nearly half of the audited contractors had what the report termed inadequate sales monitoring and billing systems to ensure proper administration of contract price reduction and billing provisions. The most common deficiency was overbilling, followed by ineffective price reductions clauses and unreported price deductions. These deficiencies resulted in $2.6 million of recommended monetary recoveries.

Second, the report said, audited contractors often submitted commercial sales practices ("CSP") disclosures that were untimely, inaccurate, and/or incomplete. GSA evaluated proposed prices for 25 contractors based on their submitted CSP disclosures; 84% contained inaccurate or incomplete information. When the correct information was substituted, GSA calculated potential cost savings of $188.5 million.

Third, according to the report, Federal Acquisition Service contracting officers only achieved 43% of the cost avoidances identified by preaward audits. One reason for the failure to achieve cost avoidances was the use of flawed negotiation techniques. When these cost issues were brought to the contracting officer's attention, the negotiations were reopened and resulted in $49.6 million in additional savings.

The memorandum makes no actionable recommendations. Rather, it directs the Federal Acquisition Service to be cognizant of these three issues. The report suggests that GSA MAS contractors will continue to face aggressive audit oversight in the negotiation and performance of their contracts.

DEPARTMENT OF LABOR LAUNCHES VEVRAA BENCHMARK DATABASE

The Vietnam Era Veterans' Readjustment Assistance Act of 1974 ("VEVRAA") prohibits employment discrimination against protected veterans by government contractors, and requires contractors to take affirmative action to employ protected veterans. Protected veterans include disabled veterans; veterans who served on active duty in the Armed Forces during a war, campaign, or expedition for which a campaign badge was authorized; veterans who, while serving on active duty, participated in a military operation for which a service medal was awarded pursuant to Executive Order No. 12985; and recently separated veterans. VEVRAA was recently revised to increase contractor accountability for compliance, clarify mandatory job list requirements, and establish hiring benchmarks to measure the effectiveness of contractor efforts. On March 24, the effective date of the VEVRAA revisions, the Department of Labor launched the benchmark database.

The database includes annual national and state percentages of veterans in the civilian labor force. Contractors covered by VEVRAA (those who have federal contracts in excess of $25,000) are required to develop an Affirmative Action Plan and either establish a hiring benchmark for protected veterans or adopt the national average. Covered contractors then compare their percentage of protected veterans to the benchmark to evaluate the effectiveness of their outreach and recruitment efforts.

DOD EXTENDS DEADLINE FOR RULEMAKING ON RAPID REPORTING OF CYBER PENETRATIONS

DOD delayed the deadline for new rapid reporting regulations to April 23 from the original due date of March 20. The rulemaking, DFARS Case 2013-D018, would implement section 941 of the National Defense Authorization Act for Fiscal Year 2013 ("NDAA FY2013"), which requires cleared defense contractors to report successful network and information systems penetrations and allows DOD personnel to access a contractor's equipment or information to conduct a forensic analysis. A cleared defense contractor is any private entity that has been granted clearance to "access, receive, or store classified information for the purpose of bidding for a contract or conducting activities in support of any [DOD program]." When making a rapid report, a cleared defense contractor must provide to DOD a description of the method used to penetrate the network, a sample of any identified malicious software, and a summary of any possibly compromised DOD information.

This pending rulemaking may ultimately be similar to the existing DFARS rule governing the safeguarding of unclassified controlled technical information ("UCTI"), as the Joint Statement of the Managers accompanying the NDAA FY 2013 Conference Report noted that the implementation of section 941 should be "compatible with, and provide[] support for" the then-pending DFARS UCTI rule.

CASE DIGEST

Federal Circuit Blocks HUD From Using Grants To Administer Public Housing Projects (*CMS Contract Mgmt. Servs. v. United States*, No. 2013-5093 (Fed. Cir. Mar. 25, 2014))

In a ruling that could have a major impact on how many Government agencies use cooperative agreements and grants, the U.S. Court of Appeals for the Federal Circuit ruled on March 25 that the Department of Housing and Urban Development ("HUD") could not use cooperative agreements to administer its Section 8 Housing Programs, notwithstanding HUD's contention that it was authorized to do so under both the Housing Act of 1937 and the Federal Grant and Cooperative Agreement Act ("FGCAA"), which provides agencies with considerable discretion in choosing between cooperative agreements and procurements.

Background

The Section 8 Housing Assistance Program ("HAP") provides rental assistance benefits to low-income individuals. HUD traditionally provided Section 8 benefits directly to project owners through HAP contracts. In 1974, amendments to the Housing Act allowed HUD to enter into Annual Contributions Contracts ("ACC") with a state, county, or municipal Public Housing Agency ("PHA"), which in turn entered into HAP contracts with project owners. HUD's authority to enter into HAPs for newly-constructed or substantially-rehabilitated dwellings was repealed in 1983. Nevertheless, HUD was still authorized to administer existing HAP contracts and to enter into new HAP contracts for existing Section 8 dwellings through a PHA.

In 1997, Congress passed the Multifamily Assisted Housing Reform and Affordability Act ("MAHRA"), allowing HUD to renew existing HAP contracts. Facing budget cuts, HUD began outsourcing contract administration services, but was still required to engage PHAs for any new HAP contracts. In 1999, HUD commenced a national competition to award performance-based ACCs ("PBACC") to a PHA in each state. The RFP for the PBACCs stated that the evaluation would be on a best value basis, but also noted that "this solicitation is not a formal procurement within the meaning of the [FAR] but will follow many of those principles." In 2011, HUD decided to recompete the PBACCs, but it faced opposition from incumbent PHAs, who filed 66 bid protests with the Government Accountability Office ("GAO"). HUD took corrective action and re-issued the solicitation, which was newly-labeled as a Notice of Funding Availability ("NOFA") and characterized the PBACCs as cooperative agreements (thus outside of the scope of federal procurement law). In May 2012, a number of PHAs filed pre-award protests at the GAO, arguing that the PBACCs were contracts and thus subject to federal procurement law, including the Competition in Contracting Act ("CICA").

GAO Ruling

The GAO found in favor of the protestors, rejecting HUD's argument that the PBACCs were properly labelled as cooperative agreements because, as HUD argued they "transfer a thing of value"—namely, the funds HUD provides to PHAs to make payments to project owners. Instead, GAO held that the relationship between HUD and PHAs "most closely resembles the intermediary or third party situation," where the PHA is "merely used to provide a service to another entity which is eligible for assistance." The GAO concluded that, because the principal federal purpose of the NOFA was for HUD's "direct benefit and use," PBACCs were procurement contracts for contract administration services, not cooperative agreements. GAO thus recommended that HUD properly re-solicit the services as contracts.

HUD disregarded the GAO recommendation and moved forward with the NOFA, prompting the protestors to file with the U.S. Court of Federal Claims.

Court of Federal Claims Ruling

At the Court of Federal Claims, the protesters alleged that the PBACCs under the NOFA were procurement contracts and, and even if they were cooperative agreements, the NOFA's anti-competition provisions were arbitrary and capricious. The court found for HUD, reasoning that HUD was not under any obligation to maintain HAP contracts going forward, that HUD's actions were consistent with the policy goals of the Housing Act to allow PHAs to take on more program responsibilities, and that HUD's cost savings from enlisting PHAs did "not convert the PBCA program into a procurement process that primarily benefits HUD, as opposed to the recipients of Section 8 assistance." The protestors appealed to the Federal Circuit, which issued an emergency injunction on August 27, 2013.

Federal Circuit Ruling

In its decision some six months later, the Federal Circuit agreed with the GAO. It found that HUD was required to use a procurement contract, not a grant or cooperative agreement, when the "principal purpose of the instrument is to acquire (by purchase, lease, or barter) property or services for the direct benefit or use of the United States government." The Federal Circuit found that the primary purpose of PBACCs was for the Government's direct benefit—specifically, to support HUD's staff and to assist with oversight and monitoring of Section 8 assistance. Additionally, the Federal Circuit cited the original RFP, which stated that HUD would evaluate proposals to determine the best value "*to the Department*," as well as statements by HUD that "PBCAs are integral to the Department's efforts to be more effective and efficient in the oversight and monitoring of this program."

This ruling will make it difficult for agencies to use cooperative agreements to circumvent full and fair competition requirements and bid protests. It also provides fodder for protesters who wish to contest the procurement instrument chosen for a particular solicitation.

HUD's Secretary has indicated that it will seek relief from the ruling in the form of legislation specifically permitting the agency to enter into cooperative agreements for PRCA services.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our government contracts practice group:

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