Every government contract has (or should have) a payment clause. The payment clause tells the contractor the government's expectations regarding what costs can be billed and how they will be billed. If you have a cost-type contract, you almost certainly have the payment clause 52.216-7 ("Allowable Cost and Payment") that, among many other things, invokes the cost principles of FAR Part 31 to be used in determining what costs will be reimbursed by the government customer. But that's not the only payment clause: there are other payment clauses for other contract types.

For example, there are at least ten individual payment clauses with prescriptions found in FAR Part 32, ranging from 52.232-1 ("Payments") to 52.232-10 ("Payments Under Fixed-Price Architect-Engineer Contracts"). There are other payment clauses to be used when progress payments are authorized, and there is another clause to be used when performance-based payments are authorized. There are a lot of payment clauses and the one you have to comply with is the one that's in your contract. Indeed, your contract may have more than one clause related to payment and you need to comply with all of them.

Have you read your contract's payment clause(s)? Are you confident that you are fully complying with the requirements of the payment clause(s)?

If you have a T&M contract the payment clause should be 52.232-7 ("Payments Under Time-and-Materials and Labor-Hour Contracts"). Have you read the clause? Are you confident that you are complying with its requirements?

Go look at the date of the payment clause in your contract. With respect to the 52.232-7 payment clause, the date is extremely important. The current clause (as of today) is dated August, 2012. You need to know whether you are required to comply with the requirements of the current clause or the requirements of the previous clause, because the requirements changed. Granted, that was five years ago, so most contracts will have the current clause—but not all of them will, because sometimes the government is slow to modify its contract-writing software and old clauses stick around for longer than they should. If you have the old clause in your contracts, you are lucky. The old clause is more permissive than the current clause. Compliance is easier and disallowance of payments is harder. Go you!

The current clause is quite prescriptive. We are not going to delve into all the intricacies. From

a high level the clause breaks billings down to two elements: (1) hourly rates, and (2) materials. (*Duh*! It's a T&M contract. What did you expect?) Hourly rates are used for payment "for labor that meets the labor category qualifications of a labor category specified in the contract" that are (a) performed by the contractor; (b) performed by the subcontractors; or (c) transferred between divisions, subsidiaries, or affiliates of the contractor. The clause requires that the hourly rates "shall include wages, indirect costs, general and administrative expense, and profit." In other words, the "T" part of the T&M contract is a fully burdened through profit "wrap-rate."

But wait! How can every entity performing the work have the same wrap-rate? Doesn't each entity have its own direct labor rates, its own overhead rates, and its own profit rates? Yes! You are correct!

If you want to bill subcontractors or inter-organizational transfers under the "T" hourly rate portion of the contract, you must establish a *separate billing schedule for each entity in your prime contract* . You must submit the entity's wrap-rates and negotiate the wrap-rates and get those wrap-rates incorporated into the contract. That's the only way to do it under the requirements of the August, 2012 clause language. (If you have the old clause you have more options. Go you!)

But what happens if you don't do all that? What happens if the prime contract just has hourly rates for the prime contractor? In that case, the clause requires that the other entities' labor be billed under as "materials"—under the "M" side of the T&M contract. The clause defines "materials" as including "subcontracts for supplies and incidental services for which there is not a labor category specified in the contract." If you didn't specify then you bill the labor as materials, to which you can apply appropriate indirect costs *but to which you cannot bill any fee/profit* . Yep, you just lost profit on your subcontractors' or affiliates' costs. Not good from a financial perspective.

But what happens if you didn't negotiate individual hourly rates in your prime contract but you billed subcontractor labor as your own prime contractor labor using the prime contractor's hourly billing rates? In that case, you end up before the ASBCA, just as Access Personnel Services (APS) did. (Link to case **here** .)

APS is an 8(a) firm, which means it is small and socioeconomically disadvantaged. Perhaps we should not have expected a firm in that position to understand, and comply with, the terms

of its T&M payment clause in its Navy contract. However, when DCAA disallowed subcontractor costs, then APS realized the price it was going to pay—and so it appealed to the ASBCA.

Importantly to us the clause in question was the older version (December, 2002) and not the current version. Judge McNulty didn't think that difference was as important as we would have thought. The fact that APS was represented by its CEO rather than an attorney versed in government contract law may have contributed to the situation.

APS told its subcontractor (PSA) to bill it for hourly labor at the prime contract rates; there were no separate rates for any subcontractor. DCAA audited the contract and issued a Form 1, disallowing six elements of cost. APS appealed only one of those cost disallowances—the disallowance that was based on the difference between the PSA's hourly rates and the hourly rates that APS used to bill them. There were some nuances in the situation that we are not going to write about; we suggest you read the case.

Judge McNulty, writing for the Board, found that APS was entitled to be reimbursed for its subcontractor costs, but only for its subcontractor's costs. To the extent APS billed the government for amounts in excess of its subcontractor's costs, it was not entitled to reimbursement.

Now we have to say—as non-attorneys and as not offering any legal advice whatsoever—that we think the outcome may well have been different, had APS engaged a skilled government contracts attorney to represent it before the Board. We believe that the old clause language is more flexible than the current clause language. Regardless of our beliefs, however, the case was decided how the case was decided.

APS is a small business, socioeconomically disadvantaged. Perhaps we should not expect such a firm to understand its contract requirements, to comply with them, or to know how to defend itself when challenged by DCAA or its contracting officer. Perhaps APS lacked the financial resources to hire a contract administrator, or a consultant, or an attorney.

On the other hand, if APS wasn't fully capable of complying with the requirements of its contract, then perhaps it is not ready to be a government contractor.

Don’t be an APS.

Read your contract—all of it.

Read the payments clause. Understand it. Comply with its requirements.

Otherwise you might find yourself before the ASBCA, arguing contract interpretation with thousands of dollars (or more!) on the line.