

Should Contractor Payment Withholds Be Mandatory?

Written by Administrator
Friday, 26 February 2010 00:00

Readers with excellent memories may recall that we [posted](#) back in January that the Defense Department had issued a proposed DFARS revision that would impact oversight activities related to contractor “business systems” (which is the new description for what used to be called internal control systems). The first thing we want to do is to remind you that comments on the proposed rule are due March 16, 2010. If you want to submit comments—and, believe us, you *really do* want to submit comments—follow the link above and you’ll see how and where to submit comments.

One of the more controversial aspects of the proposed rule is that, for contractors who have their business systems determined to be “unapproved” or “inadequate” or to “contain significant deficiencies”, the Government will impose payment withholds on the payments it would otherwise be making. (By the way, the proposed rule seems to use those three terms interchangeably, which is a good indication of the amount of thought and effort that went into the proposed language.) How much can the Government withhold? Glad you asked. The proposed language seems to say that the first step is a 10% withhold, meaning

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that if you billed the Government \$1,000, the Government would pay you \$900 and keep \$100 until you corrected your business system deficiencies to its (read: DCAA's) satisfaction. If you needed that \$100 to make payroll or pay vendors, that's too bad.

But the proposed rule permits the DOD Administrative Contracting Officer (ACO) to withhold even larger percentages—as much as 50 percent. In some situations, where the ACO determines “that there are one or more system deficiencies that are highly likely to lead to improper contract payments being made,” then “the ACO will withhold up to one-hundred percent of payments....” Ouch!

And note the language, the use of the imperative “will withhold”. Many would argue, and will be arguing on March 16th, that the FAR already gives the ACO discretion to withhold or otherwise reduce payments to protect the Government's interests. They ask why the DOD needs a new rule, when the existing rule works just fine, thank you very much. We'll tell you why: the new rule takes away the ACO's discretion and makes the payment withholds *mandatory*.

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Why is that such a big deal, we hear you asking. Well, take a look at [this story](#) over at GovExec.com. Mr. Robert Brodsky (who regularly reports on oversight and audit matters, and does a good job at it) reports that two “commanding generals” directed a Contracting Officer to ignore DCAA’s recommendation to implement payment withholds on invoices submitted by KBR, Inc. under its LOGCAP III contract. According to the story, the generals were swayed by KBR’s warnings that such impacts to its cash flow would hurt its ability to continue to support the troops in Iraq. KBR also promised to pass on the payment withholds to its subcontractors, which would negatively impact them as well. According to the DOD IG report on which the article is based, the Army accepted without verification KBR’s warnings and deferred the payment withholds.

There’s more to the story, of course. In this case, the issue was not with KBR’s business systems (which the DCAA was in the [process of shredding](#) anyway). The issue was that KBR’s LOGCAP Task Order(s) were “

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undefinitized

contract actions” (UCAs)—meaning that KBR was told to start work even though it had not yet negotiated a final price with the Army. The FAR directs that, in such circumstances, payments cannot exceed 85 percent of costs incurred. Normally this should not be an undue hardship

, since the FAR requires definitization within six months. But in this case the period in which KBR was performing under the UCA extended for

more than three years

. The IG report does not say what the hold-up was, but we bet DCAA’s preoccupation with KBR’s alleged estimating system deficiencies had something to do with it.

So the DOD IG (and most of the mainstream media reporting the story) thinks

the Army improperly showed favoritism to KBR and “illegally” waived mandatory payment withholds.

Maybe.

But maybe the independent discretion vested in a warranted Contracting Officer should mean something, as well. Maybe we need flexibility in our procurement rules that permits field personnel to do what’s necessary—especially in times of war.

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We might also point out another lesson that comes from this story. This was an instance of mandatory payment withholds that weren't implemented. What makes anybody think other Contracting Officers won't ignore the new DFARS mandatory withhold rule as well? Think about it. If the potential impact(s) of a 15 percent withhold could be used to persuade commanding generals that imposition would adversely affect their mission, how will the potential impact(s) of a 50% or even 100% payment withholds be perceived? Our guess is that DOD's military and civilian leadership will be even more reluctant to impose those withholds—and we bet that the Courts will be reluctant to enforce such punitive measures that lack any relationship to the Government's risk of overpayment.