We often write about supply chain management—sometimes called subcontract management—and have told readers many times that effective supply chain management is the key to successful program execution. Well, yes. But we thought it went without saying that effective supply chain management included, you know, actually *paying* your subcontractors.

For a point of reference, the FAR states (in the Allowable Cost and Payment Clause, 52.216-7) that—

(1) For the purpose of reimbursing allowable costs (except as provided in paragraph (b)(2) of this clause, with respect to pension, deferred profit sharing, and employee stock ownership plan contributions), the term “costs” includes only—

(i) Those recorded costs that, at the time of the request for reimbursement, the Contractor has paid by cash, check, or other form of actual payment for items or services purchased directly for the contract;

(ii) When the Contractor is not delinquent in paying costs of contract performance in the ordinary course of business, costs incurred, but not necessarily paid, for—

(A) Supplies and services purchased directly for the contract and associated financing payments to subcontractors, provided payments determined due will be made—

(1) In accordance with the terms and conditions of a subcontract or invoice; and

(2) Ordinarily within 30 days of the submission of the Contractor's payment request to the Government;

(B) Materials issued from the Contractor's inventory and placed in the production process for use on the contract;

(C) Direct labor;

(D) Direct travel;

(E) Other direct in-house costs; and

(F) Properly allocable and allowable indirect costs, as shown in the records maintained by the Contractor for purposes of obtaining reimbursement under Government contracts; and

(iii) The amount of financing payments that have been paid by cash, check, or other forms of payment to subcontractors.

Note that the foregoing is but one example (of several) that we could have quoted.

So, generally, subcontractor costs are billable to the U.S. Government (or to a higher tier contractor) only when they have been actually paid or will be paid "in the ordinary course of business." Problems arise when subcontractors don't get paid—especially when costs have already been claimed as being "incurred" in invoices.

We have **previously discussed** the case of a subcontractor who had its indirect rate adjustment vouchers denied for payment by its prime. (The subcontractor successfully sued its prime.) Today we present two stories of subcontractors who didn't receive payment, and what happened to the higher-tier contractors involved.

First we offer **this story** about Red Sea Engineers and Constructors, a contractor that was identified as "the second-largest recipient" in Afghanistan of payments by the U.S. Joint Contracting Command. Red Sea E&C received roughly $500 million in contract awards between 2007 and 2009. The company has been in existence since 2002, but it's experienced some rough times recently. According to the Washington Post story, "The company's registration to be a U.S. government contractor expired in January, according to a federal database. Its license to do business in Afghanistan expired in September."

Among its recent problems, Red Sea's CEO, Roy Carver (age 75) was jailed by the Afghan government for failing to pay the company's Afghan suppliers. Ouch.

The situation is confusing. According to the Post's story, Rea Sea E&C said the "source of the problem is late payments by … DynCorp International, that had subcontracted work to Red Sea." But DynCorp said that "Red Sea was not paying its own Afghan workers, who then walked off the job site. To keep construction going, she said, DynCorp began paying the Afghan employees directly."

So the crux of the issue seems to be, were the Afghan subcontractors getting paid, or not? According to DynCorp, yes. According to the Afghan government, no. Meanwhile, Mr. Carver sat in an Afghan jail, where he "shares a cell with several inmates." Red Sea E&C employees were "taking food, medicine, and blankets" to their boss while he awaited resolution of the issue. (We note that Mr. Carver was subsequently released and is "working to make sure the vendors are compensated"—according to a January 5, 2011 article by the Washington Post (link in paragraph below. It's not clear why the suppliers would need to be paid if DynCorp had already paid them….)

The second story also comes from the Washington Post, who **reported** that two construction firms operating in Afghanistan were recently suspended from receiving future Federal contract awards "because of an ongoing investigation into allegations that they are not paying their Afghan subcontractors." According to the Post's article, "The military identified the firms as Bennett-Fouch Associates and K5 Global, both owned by a U.S. citizen identified as Sarah Lee."

The Post's story references an announcement from the U.S. Central Command. We searched but were unable to locate CENTCOM"s press release on the contractor suspensions. However, **an article** on ArmyTimes.com had this to say about the situation—

Coalition forces said in a statement that several Afghan companies brought allegations of nonpayment against Bennett-Fouch Associates and K5 Global, both of which are owned by the same person, identified as an American woman named Sarah Lee.

'The failure of firms to pay their local national workforce or local national subcontractors adversely affects counterinsurgency strategy,' the coalition said in the statement.

The local companies that brought the allegations provided documents showing that Bennett-Fouch, which was involved in construction contracts at military bases in Afghanistan, had claimed it had not been paid by the U.S. government, the statement said. However, the coalition said that 'in reality, the U.S. government had paid Bennett-Fouch for the work on the construction projects.'

The company had closed its local offices and bank accounts in Afghanistan, the coalition statement said.

'Bennett-Fouch's subcontractors were Afghan companies who depended on the revenue to pay workers and complete projects. U.S. law does not allow the government to pay subcontractors directly,' the statement said, adding that the local companies had been 'informed of their opportunity for recourse against the contractors through the U.S. court system.'

The suspension of could last 18 months while the case is being investigated, it said, and the companies could be barred from further contracts depending on the results of the investigation, meaning they would not be able to 'conduct business with the U.S. for a period commensurate with the seriousness of the crimes or causes of the debarment, normally not to exceed five years.'

The latter case seems a bit more cut-and-dried to us. Bennett-Fouch was (apparently) the prime contractor who submitted invoices to the U.S. Government (or agents thereof) that included costs of its Afghan subcontractors. Yet those subcontractors claim they never received payment. If the allegations are proven true, then the prime may be looking at possible violations of the False Claims Act (among other charges). There are criminal and civil versions of the False Claims Act—and either version might apply here, based on the fact pattern. Thus, suspension from new contract awards may turn out to be the least of the potential problems facing these companies.

Each of the three companies discussed in this article was accused of failing to pay its foreign subcontractors. These were very serious allegations, obviously taken very seriously by the governments involved. As we started off by saying, we often preach the importance of supplier management as the key to effective program management. That's true insofar as it goes. But before you get to effective program management, you need to first successfully master the basics. Like paying your suppliers.