

Is Your Company SCA Compliant? Figure It Out Before the United States Department of Labor Figures It Out for You!

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For nearly 50 years, the McNamara-O'Hara Service Contract Act (41 U.S.C. §§ 6701-6707) (SCA) has imposed certain minimum wage and fringe benefit payment obligations on federal service contractors. Although in many ways, general compliance with the core requirements imposed by the SCA (*i.e.*, payment of prevailing wage and fringe benefits, basic recordkeeping, and notification requirements) appears to be relatively straightforward, the “devil is in the details” when it comes to ensuring that your company will be able to successfully navigate a United States Department of Labor (DOL) SCA audit or investigation. The DOL's Wage & Hour Division has an active cadre of investigators reviewing contractors' compliance under SCA-covered contracts throughout the country. DOL SCA investigations can address a wide range of SCA compliance issues and, importantly, any SCA investigation can expand to include not only the areas of SCA compliance that triggered the audit, but also wholly unrelated areas of SCA compliance. Given the potential sanctions involved with SCA non-compliance—including statutory debarment absent “unusual circumstances”—there is no substitute for full compliance with all obligations imposed by the SCA.

Although many contractors tend to focus their attention on SCA compliance during the bid preparation phase, SCA compliance is an ongoing “living” obligation during contract performance. Indeed, there are many aspects of performance that can change during the life of the contract (*e.g.*, place of performance, wage determination requirements, job duties, company benefit offerings) and these changes can have a significant impact on SCA compliance. A failure

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to continually assess the impact of such changes during performance could expose a service contractor to significant liability under the SCA.

With this in mind, we have identified certain recurring SCA issues that can present significant challenges to contractors performing in today's federal service contracting environment. Although by no means the only SCA issues a federal service contractor could face, we expect these areas will continue to be the focus of DOL SCA investigations and, in some cases, present even more challenges for federal service contractors in the years to come as the nature of the work covered by the SCA continues to evolve. The issues we see most often include: (a) ensuring accurate labor classification mapping and work segregation, particularly on performance-based contracts; (b) ensuring wage determinations (WDs) are current and incorporated for the correct places of performance; (c) assessing the full scope of a company's fringe benefit offerings and whether these benefits qualify as "bona fide" fringe benefits under the SCA; and (d) monitoring SCA compliance practices of independent contractors performing under SCA covered contracts.

Labor Category Mapping and the Potential Impact of Cross-Training Personnel

One topic that is sure to be on a DOL investigator's list of areas to review as part of an SCA investigation is mapping individual service employees' duties to the labor categories set forth in an SCA covered contract's WD. Based on our experience, labor classification issues (or misclassification issues) are a common area for DOL SCA findings that can result in significant back wage liability.

Labor category mapping, however, is an inexact science at best and is often an exercise fraught with potential liability for federal service contractors. A typical DOL SCA WD contains a wide range of labor categories, and the DOL has published a SCA Directory of Occupations (link available online at <http://www.DOL.gov/whd/govcontracts/sca.htm>) to aid federal contractors in mapping personnel to the appropriate labor categories. While SCA labor category mapping may be obvious for certain types of traditional service contracts (*i.e.*, personnel that only clean windows as part of SCA covered contract are Window Cleaners, Occupation Code 11360), mapping becomes significantly more complicated and subjective for contracts requiring non-traditional SCA services. For instance, contractors providing personnel to staff a call center will often find that the WDs incorporated in their contracts do not include a labor category to which the personnel can be readily mapped. Certain contracts for more complex, but SCA covered, services only further increase the subjectivity and complexity, particularly if the applicable WD has not evolved to keep pace with the services' increasing complexity. With the burden of selecting the appropriate labor category resting squarely on contractors, selecting the "wrong" labor category or classification level within a labor category (*i.e.*, General Clerk I versus General Clerk II) can result in a costly back pay situation for the contractor.

This problem can become even more complicated if a contractor is performing under a fixed-price performance-based contract or similar contract where it is common for a contractor to cross-train its personnel to be able perform services covered by multiple labor categories or multiple classifications within a labor category. It is not unusual for such fixed-price contracts not to require the contractor to track hours spent by SCA-covered personnel on specific tasks or time spent performing a particular work function or performing

certain items. In fact, in some cases, the nature of the contractor performance model and/or existing business systems may prevent the recording of time spent by SCA personnel performing specific tasks or items of performance under the contract. Instead, contractors track the total time SCA personnel spend working on the SCA contract. Nevertheless, if a contractor's SCA-covered personnel perform work in multiple labor categories, it is the contractor's obligation to segregate hours worked in each labor category in its records and pay SCA covered personnel at the appropriate labor category rate for the work performed under that labor category by the employee. If a contractor cannot segregate the time its SCA personnel spend within each SCA labor category in a workweek, then the contractor must pay these employees for all SCA hours at the highest labor rate amongst the labor categories worked.

Contractors also may face similar challenges when utilizing personnel at contractor facilities that perform both SCA covered services for government customers as well as non-SCA covered services for commercial customers during the same work day or even within the same pay period. Unless the contractor elects to pay its SCA covered personnel at the SCA rates for all hours worked (even though the employee is not working all hours under an SCA contract), contractors need to have a way to segregate the SCA hours from the non-SCA hours. Without such segregation, there is a significant risk that DOL would direct the contractor to pay all hours worked by such an employee (whether for government customers or commercial customers) at the relevant SCA wage rate.

Contractors faced with these circumstances should consider one of two options. They should evaluate whether to modify their performance to segregate the SCA covered workers' hours as needed, or (b) pay SCA covered workers at the applicable SCA rate (or higher SCA rate, if choosing between two) for all hours worked in any week when the workers perform SCA covered work. Contractors should choose whichever option is more cost effective and more likely to ensure that the SCA employees receive no less than the prevailing wages as required by the SCA regulations.

Wage Determinations and Place of Performance

The SCA and implementing regulations contain detailed guidance on WD incorporation procedures and related topics such as place of performance. Simply put, however, contractors often overlook ensuring that the correct and current WDs are incorporated into the Contract (although DOL auditors and investigators tend to focus on that issue), and correcting the issue after its discovery can be a challenge. Under the SCA, contracting officers must request a WD prior to any of the following: (i) invitation for bids; (ii) request for proposals; (iii) commencement of negotiations; (iv) exercise of option or contract extension; (v) annual anniversary date of a multi-year contract subject to annual fiscal appropriations of the Congress; or (vi) biennial anniversary date of a multi-year contract not subject to such annual appropriations, if so authorized by the Wage and Hour Division. Revised WDs are to be incorporated into applicable federal contracts, which is typically done at an option year renewal; however, a contracting agency may elect to incorporate a revised WD prior to contract anniversary.

While the regulations on their face do not appear to impose any liability or obligation on the contractor to pay prevailing wages in a revised WD until action is taken by the contracting agency to incorporate the WD in the contract, we encourage clients to be proactive in this regard. First, it is unclear what position DOL or a Board of Contract Appeals would take on a contractor's liability, especially if a contractor had knowledge of the updated WD and was choosing to simply wait until the contracting officer acted (and as a result delayed paying any higher wages required by the updated WD). Second, failure to address the problem could lead to an inability for the contractor to obtain appropriate price adjustments. In any event, a contracting officer cannot waive the application of a federal statute like the SCA. If DOL discovers that a contracting officer has failed to incorporate the most recent WD, DOL may direct the contracting officer to include it in contract, which if incorporated "late" could again impact the contractor's ability to obtain appropriate price adjustments.

Another common issue we have observed involves post-award changes to the place of contract performance. For DOL WDs, the geographic locality or place of performance identified in the solicitation or by the contractor in its proposal will often determine which WD governs your obligations. (Note: The place of performance and applicable WDs may be identified in the solicitation, but they could be left open, per FAR 52.222-49, Place of Performance Unknown). As contract performance progresses, however, it is possible that the place of performance may change for many reasons. For instance, a contractor may acquire or open a new facility to support contract performance or may permit certain employees to telecommute and perform in a different locality than has been identified in the contract.

It is the contractor's responsibility to ensure that the contracting officer recognizes any place of performance change by reporting such changes in order to ensure that the appropriate WDs are incorporated into the contract to account for any new performance locations. A change in the place of performance that has not been properly coordinated with the contracting officer can result in a number of potential problems, including a failure to recover wage amounts that exceed the wage rates for the place of performance identified in the contract or, in extreme cases, default under the contract. Furthermore, if no WD was incorporated following any change, the contractor may not realize that a different WD applies, resulting in a potential underpayment of wages (or an overpayment). As noted, it is highly unlikely a contractor will be able to pass through these increased costs of performance without the WD(s) for the correct location(s) being incorporated into the contract.

We recommend being vigilant about incorporation of the appropriate WDs into the contract. A failure to do so can lead to confusion, potential problems in cost recovery, and uncomfortable discussions with DOL investigators about why the contractor is not paying per the appropriate WD.

Providing and Taking Credit for Bona Fide Fringe Benefits

The SCA requires payment of a minimum "fringe benefit," as described in the applicable WD. The health and welfare (H&W) fringe benefit is one of the required SCA fringe benefits, and the current fringe benefit is \$3.81 per hour. (Note: DOL will issue a new H&W fringe benefit rate in mid-June.) A company has wide discretion in determining how it satisfies the H&W fringe benefit requirement, but the SCA does require that any fringe

benefits provided to SCA covered employees qualify as “bona fide” in order to be credited against the H&W obligation. Because companies often change benefit packages, companies performing under SCA covered contracts should consider whether: (a) they are meeting the current (and annually changing) H&W fringe benefit requirements; (b) they have replaced benefits that may have been removed since they last evaluated their fringe benefit calculation; and (c) they are taking full credit for the full range of fringe benefits provided and determined that these benefits qualify and remain as “bona fide” fringe benefits.

Contractors of course must ensure that fringe benefits they count towards their H&W obligations are supportable as “bona fide” fringe benefits. The core requirements are set forth in 29 C.F.R. § 4.171(a), which requires that a “fringe benefit plan, fund or program” meet the following criteria (among others): (a) the plan's provisions must be specified in writing and communicated in writing to the affected employees; (b) contributions must be made pursuant to the terms of the plan; (c) any contributions made by employees must be voluntary (and pursuant to specified payroll deduction regulations, if applicable); (d) the primary purpose of the plan must be to provide systematically for the payment of benefits; (e) the plan must contain a definite formula for determining the amount to be contributed by the contractor and a definite formula for determining the benefits for each of the employees participating in the plan; and (f) any contractor contributions must be paid irrevocably to a trustee or third person pursuant to an insurance agreement, trust, or other funded arrangement.

There are some allowable deviations—for example, DOL may accept unfunded and self-insured plans, but a company must affirmatively seek DOL approval for any such plan. As part of the approval process, DOL considers factors such as whether the plan could be reasonably anticipated to provide the prescribed benefits and whether it is carried out under a financially responsible program. If a company utilizes a self-funded or unfunded insurance plan that has yet to be approved to offset the H&W fringe benefit requirement, that company risks a finding by DOL that amounts paid by the contractor for such a plan cannot be credited against the SCA H&W fringe benefit requirement.

Contractors should understand that many widely offered employee benefits may not be considered bona fide fringe benefits by DOL. Benefits that typically would not qualify as a bona fide fringe benefit under the SCA include some specifically disallowed under the SCA (e.g., gift cards and incentive rewards, referral bonuses) and others that are typically disallowed because they are considered to be primarily for the convenience of the contractor and not primarily for the benefit of the employee (e.g., language, travel, and security clearance incentives). Still, many programs beyond the “traditional” H&W benefits (medical insurance, disability insurance, etc.) may qualify as a creditable fringe benefit, including, tuition reimbursement, severance, and certain types of bereavement leave; however, the programs need to be carefully constructed not to run afoul of the foregoing issues. Each benefit must be evaluated on its specific facts and circumstances in light of the regulations.

We also add one reminder about the option of providing additional cash payments instead of fringe benefits to meet H&W obligations. As a general matter, a contractor “cannot offset an amount of monetary wages paid in excess of the wages required under the determination in order to satisfy his fringe benefit obligations

under the Act. . . .” However, Section 2(a)(2) of the SCA and 29 C.F.R. § 4.177 permit a contractor to provide cash equivalent payments to SCA covered employees in lieu of providing fringe benefits, but these fringe benefit cash equivalent payments must be “separate from and in addition to the monetary compensation required under” the SCA. In other words, the DOL regulations mandate that cash equivalent payments cannot be part of wages, but must be separately identified as fringe benefit payment amounts that are properly communicated to the employee and properly documented as fringe benefits.

Oversight of Independent Contractors

Independent contractors are covered as “service employees” under the SCA. The SCA’s coverage of service employees depends on whether their work for the contractor or subcontractor on a covered contract is that of a service employee as defined in section 8(b) of the SCA and “not on any contractual relationship that may be alleged to exist between the contractor or subcontractor and such persons.” According to DOL’s Field Operations Handbook, “If a person is engaged in performing any service work called for under a covered contract, such person must be paid the wage and FBs provided under the Act, irrespective of any alleged ‘independent contractor’ or non-employment relationship.”

It is the company’s responsibility to ensure that SCA covered independent contractors receive the appropriate wages and fringe benefits. A failure to do so can result in the company’s liability for any underpayments. This creates something of a burden for contractors who may have hired independent contractors to reduce their administrative burden in the first place. There are many solutions to this issue, though in choosing any of them, companies must limit their control of independent contractor work to avoid creating any appearance that they are “employees” (for tax and withholding purposes).

As potential solutions, contractors might consider requiring independent contractors to bill hourly or bill flat rates (but record time such that the contractor can ensure that the pay exceeds the minimum required under the WDs). Companies should also consider contractually requiring that independent contractors certify that they are paying the appropriate wages, allow auditing by the contractor and indemnify the company from any SCA violations. As part of a company’s ongoing contract administration procedures (perhaps annually), it should review independent contractor pay, recordkeeping, and certifications. (The same advice is applicable to subcontractors, which as the relevant SCA provisions are concerned, are really just larger independent contractors.)

Conclusion

SCA compliance can be difficult at best even for what appear to be the most straightforward issues. But many current compliance issues are far from straightforward and require difficult business judgments that may be questioned by aggressive DOL investigators down the road. If there is one unifying point to the issues discussed above, it is that SCA compliance cannot be delegated to just one company function. SCA compliance is a whole-company effort that requires coordination throughout an SCA covered contract’s lifespan between legal, human resources, program management, payroll, timekeeping, business capture, purchasing and supplier management, and executive leadership. Companies that take such a holistic

approach to compliance will find themselves well positioned should they ever be subject to an SCA investigation.