

ALERT

Final Rule on Compensation for Defense Contractors Continues the March Toward Lower Allowable Compensation for All Contractors

June 2, 2014

On May 30, 2014, the U.S. Department of Defense (DOD), General Services Administration (GSA), and National Aeronautics and Space Administration (NASA) issued a final rule that continues recent congressional and Executive branch efforts to limit the amount of contractor compensation that is allowable under federal government contracts. The final rule implements Section 803 of the National Defense Authorization Act (NDAA) for Fiscal Year 2012, which expanded the executive compensation cap from the five most highly paid executives to all contractor employees performing DOD, NASA, and Coast Guard contracts, as well as the five most highly paid executives performing contracts issued by all other agencies. *See* 79 Fed. Reg. 31195 (May 30, 2014). Under the final rule, the expanded compensation cap (currently \$952,308) will apply to all costs incurred under DOD, NASA, and Coast Guard contracts awarded on or after December 31, 2011.

The final rule adopted without change the interim rule issued on June 26, 2013. *See* 78 Fed. Reg. 38535 (June 26, 2013). Comments on the interim rule asserted that the expanded compensation cap could not be applied retroactively to contracts awarded in the 18 months between the enactment of the NDAA and the promulgation of the interim rule. The commenters relied on decisions by the Court of Federal Claims and Armed Services Board of Contract Appeals in *General Dynamics Corp. v. United States*, 47 Fed. Cl. 514 (2000) and *ATK Launch Systems, Inc.*, ASBCA No. 55395, Apr. 9, 2009, 09-1 BCA ¶ 34118, respectively, which found that a previous effort to apply a

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retroactive compensation cap to existing contracts was a breach of contract and could not be enforced. In implementing the final rule without change, the agencies concluded that *General Dynamics* and *ATK Launch Systems* are inapplicable because “those decisions did not specifically address contracts awarded during the period beginning on the date of enactment of the underlying statute through the date before implementation of the statute in the regulations.” As a result, the final rule applies the expanded compensation cap to all DOD, NASA, and Coast Guard contracts that were executed after the NDAA was enacted (December 31, 2011), even though the implementing regulations were not issued until 18 months later.

As if this weren’t confusing enough, more changes are on the horizon. As we previously discussed, the Bipartisan Budget Act of 2013 (BBA), Pub. L. No. 113-67, capped allowable compensation **for all contractor and subcontractor employees** at \$487,000, with annual Employment Cost Index adjustments. The BBA permits agencies to establish “narrowly targeted exceptions for scientists, engineers, or other specialists.” The BBA restrictions apply to costs incurred under contracts executed on or after June 24, 2014 (180 days after enactment of the BBA), but no implementing regulations have been issued to date. Based on the discussion of *General Dynamics* and *ATK Launch Systems* in the current final rule, it is likely that the next rule will apply the restrictions as of June 24, 2014—regardless of when the regulations are issued.

Given all of these changes, contractors must be vigilant in determining which rules apply to which contracts and ensuring that unallowable costs are accurately segregated.