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How Credit Managers Can Reduce Risk in Federal Contracting

Even though the federal government spends approximately \$500 billion per year on procuring goods and services, if you are wary of entering into the government contracts marketplace, your concerns are valid. Government-unique auditing and accounting requirements, specifications and standards, and other requirements have dissuaded many commercial contractors from selling their goods and services to the federal government.

What many commercial contractors do not realize, however, is that since federal acquisition reform in the 1990s, the government has been procuring supplies and services from commercial contractors on terms and conditions that are similar to commercial contracts.

Federal Acquisition Regulation (FAR) Part 12 sets forth policies and procedures unique to commercial items, establishes acquisition policies that more closely resemble the commercial marketplace and identifies the laws and regulations from which commercial item contractors are exempt.

Government Contractor Defined

The formation and administration of U.S. Government contracts is governed by FAR and more than 20 agency FAR supplements, including the Department of Defense FAR Supplement, the Department of Energy Acquisition Regulation and the General Service Administration Acquisition Manual (all are available electronically at www.acquisition.gov). Companies that receive a contract directly from the U.S. Government are considered “prime contractors” and companies that provide goods/services in support of a prime contract are considered “subcontractors.”

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Becoming a government subcontractor is an easy and effective way to enter the government contracts marketplace. FAR 44.101 defines subcontract as a contract entered into by a subcontractor to furnish supplies or services for performance of a federal government prime contract or subcontract. The term includes, but is not



THE PUBLICATION FOR CREDIT & FINANCE PROFESSIONALS \$7.00

limited to, purchase orders. Government contract laws, rules, regulations and contract clauses apply to subcontracts to the extent they are incorporated into the subcontract. Subcontracts are also governed by commercial law, such as the Uniform Commercial Code, other statutory laws or common law. There are some clauses the prime contractor or higher-tiered subcontractor must flow down to the subcontractor or it will be in breach of its prime contract or higher-tiered contract, but not all provisions have to be (or can be) flowed down.

What Qualifies as a Commercial Item?

Although the definition is lengthy in sum, the FAR's definition of a commercial item can be found in FAR 2.101. The definition is different for goods and services. A commercial item good is anything other than real property (land) that is customarily used for nongovernmental purposes and has been sold, leased or licensed to the general public; or offered for sale, lease or license to the general public.¹ A commercial item service is a service “offered and sold competitively in substantial quantities in the commercial marketplace based on established catalog or market prices for specific tasks performed or specific tasks to be achieved and under standard commercial terms and conditions.”²

Note that for both goods and services to qualify as a commercial item, a contractor needs only to demonstrate that the goods or services it is offering to the government is “of a type” of good or service currently being offered or sold to the general public. This does not require a contractor to show that the same exact item is being offered or sold to the general public or that the contractor itself offers or sells the item to the general public. The FAR does not, however, draw a clear line regarding the point at which the differences between

the commercial product and the product offered to the government are too significant to be considered “of a type.”

How Commercial Item Contracts Differ from Traditional Government Contracts

Importantly, commercial item contractors are exempt from the main regulatory requirements that increase administrative costs and risks, such as the Truth in Negotiations Act, Cost Accounting Standards and audits related thereto. The FAR also greatly reduces the intellectual property rights the government obtains from a commercial item contract or subcontract, allowing the contractor to more easily retain all rights. There are also exemptions for some commercial item contractors from the requirements to comply with the wage and hour restrictions in the Service Contract Labor Standards. That said, commercial item contractors can agree to be bound by these requirements through their contracts and must be vigilant in negotiating their contracts to confirm that they do not include such requirements.

Unique Requirements That Still Apply to Commercial Item Contractors

Even commercial item contractors need to comply with some government-unique requirements. For example, all government contracts require contractors to promote equal opportunity through required contract clauses. Commercial item contractors may also be required to draft a Code of Business Ethics and Conduct or comply with applicable import and export restrictions, restrictions on recruiting and hiring former government employees, the Anti-Kickback Act, lobbying restrictions, and laws that impose a preference on the use of domestic sources or materials.

Commercial item contractors are exempt from the main regulatory requirements that increase administrative costs and risks.

Moreover, all government contractors are subject to the government’s procurement fraud enforcement mechanisms, which come in a variety of forms. There are several important criminal statutes under which the government prosecutes “procurement fraud.” The statute the government uses most frequently to address all categories of procurement fraud is the False Statements Statute.³ This statute prohibits lying to the government, i.e., knowingly and willfully making a false statement.⁴ A “statement” under the False Statements Statute may be oral or written, and either sworn or unsworn.

Additionally, under the Civil False Claims Act, the United States may recover treble damages and penalties (generally up to an additional \$11,000 per invoice) for the submission of false claims to any federal agency or entity using federal funds to pay such claims.⁵ The Civil False Claims Act contains a “*qui tam*” provision authorizing private citizens with evidence of fraud against the government to file lawsuits in their own

names (on behalf of themselves and the government) and then keep a share of the government’s recovery.⁶ In addition, the False Claims Act protects employee “relators” from retaliation by their employers. *Qui tam* actions are often brought by disgruntled current or former employees who are aware of the company’s business practices in performing its government contracts. Relators often are “rewarded” with 15% to 25% of the total recovery from the company.⁷

All government contracts require contractors to promote equal opportunity through required contract clauses.

How to Start

Keep in mind that as a contractor enters the government contracts marketplace, there are a variety of different types of contracts it can enter into with the U.S. Government. If you buy or sell commercial items, it is important to make sure that the solicitation to which you respond contemplates the award of a FAR Part 12 prime contract or subcontract.

There are a variety of ways in which you can receive a solicitation from a U.S. Government agency. For example, you can find opportunities on the Federal Business Opportunities website at www.fbo.gov. This website enables you to search for solicitations and contract awards using a variety of identifying features, such as by agency, item code or keyword. You can also network with U.S. Government officials to understand your customers’ requirements and help shape their future needs. Further, you can work with lobbyists and government officials to advocate on your behalf.

Before you can submit proposals in response to government solicitations, however, there are a few administrative requirements you must fulfill. These include registering in the System for Award Management (“SAM”) at www.sam.gov. The FAR requires *all* federal government prime contractors to register in SAM prior to the award of any contract or purchase agreement.⁸ Prior to registering in SAM, the company must obtain a Dun & Bradstreet number. Note that since processing time takes about 48 hours, contractors should register in SAM as early as possible in the proposal process.

Contractors, including commercial item contractors, are required to make various representations and certifications (“reps and certs”) when contracting with the federal government. To streamline the process, rather than require contractors to provide written reps and certs to the government for each contract, contractors enter them into the SAM database once for all federal contracts. SAM also provides a basis for electronic payments from the federal government to contractors.

Contractors are required to update the information in SAM annually or when the information changes. Although population of the SAM database appears to be an administrative matter, ensuring that SAM is properly populated is important for federal government contractors. Intentional or fraudulent

misrepresentations in either database may subject the contractor to liability under the False Claims Act or be treated as a criminal false statement.

Conclusion

From a practical standpoint, taking advantage of FAR Part 12 makes sense for the government, prime contractors and subcontractors. Prime contractors will have a larger pool of suppliers willing to accept government subcontracts if they are more like commercial sales; and with fewer requirements, the cost should be lower. Subcontractors benefit by having less onerous government clauses and the ability to contract on normal commercial terms. The government, prime contractors and subcontractors all benefit in that there are fewer compliance-related requirements, thus reducing administrative costs and resulting in lower prices.

All government contractors are subject to the government's procurement fraud enforcement mechanisms.

That is not to say, however, that by becoming a commercial item government contractor there will not be additional risks associated with doing business with the government. All government contractors have to develop an effective compliance program to avoid liability under the False Claims Act or violations of the False Statements Statute. A contractor has to take appropriate corrective action when it discovers a real or potential violation. By limiting the type of contracts a contractor enters into with the government to commercial item contracts, however, a contractor will significantly reduce its risk exposure. ■

Author's Disclaimer: This article is not intended to be, nor should it be construed to be, legal advice. Circumstances vary greatly and the authors cannot possibly foresee all possible outcomes. Seek professional advice in the event of any doubt.

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1. FAR 2.101.
 2. *Id.*
 3. 18 U.S.C. § 1001.
 4. *Id.*
 5. 31 U.S.C. § 3729–3733.
 6. 31 U.S.C. § 3730.
 7. *Id.*
 8. See FAR Subpart 4.11