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## Service Contract Act

More and more DOL audits focus on whether a contracting agency failed to incorporate provisions applying the Service Contract Act to an already awarded contract. In these circumstances, the Labor Department may order contracting agencies to apply the SCA to contract performance both prospectively and retroactively. Such an order is often burdensome. But you can limit the financial impact, enforcement risk, and litigation risk for your organization.

### Going Retro: Back Pay Under the Service Contract Act



BY ERIC W. LEONARD AND CRAIG SMITH

Picture this: Your company has been awarded what appears to be a federal service contract, but the contracting officer has determined that the McNamara-O'Hara Service Contract Act of 1965 (SCA), 41 U.S.C. § 6701 *et seq.*, does not apply to your contract for any number of reasons. As a result, neither you nor your subcontractors are obligated to compensate service workers who perform under the contract at SCA prevailing wage and fringe benefits rates. But then, perhaps even years into performance, the Department of Labor (DOL) starts reviewing your federal service contract and asking both the contracting officer and you, the contractor, why the SCA should not apply to this

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contract, prospectively and retroactively. Is this scenario unique? Unfortunately, no.

More and more, we are seeing DOL audits that focus on whether a contracting agency failed to incorporate provisions applying the SCA to an already awarded contract. In these circumstances, the DOL may order contracting agencies to apply the SCA to contract performance both prospectively and retroactively.

Such an order is often burdensome. In particular, it may require providing back pay (wages and/or fringe benefits) to current and former "service employees" (i.e., non-exempt personnel). But you can limit the financial impact, enforcement risk, and litigation risk for your organization.

#### Review the Contract

At the outset, review the provisions in your contract. Confirm that it (or the underlying solicitation) has never incorporated SCA obligations, typically through FAR 52.222-41, Service Contract Labor Standards, and

wage determinations (WDs). If the agency has omitted these obligations, then FAR 22.1015 entitles (not just permits) the prime contractor to an equitable adjustment “to reflect any changed cost of performance resulting from incorporating a wage determination or revision.” On the other hand, if your review reveals that the SCA clause and WDs were incorporated into the contract by the contracting agency, then you may have a DOL enforcement matter looming — which may present a similar back pay calculation with a different balance of risks.

Assuming the SCA obligations were omitted, you should open communications with your contracting agency early in the matter. Explain that you intend to seek an equitable adjustment (as opposed to price adjustment; the distinction is critical) for any back pay that you may calculate. Try to agree to a process and timelines for calculating obligations and submitting a request for equitable adjustment (REA). Even if your agency isn’t the most communicative, these discussions may prompt earlier identification of any confusion or objections on the part of the agency.

Confusion and objections often materialize when agencies seek to modify the prime contract post-award to add the SCA (typically pursuant to direction from DOL), so review these documents carefully. Ask the following questions:

- Is this a bilateral modification, instead of a purported unilateral modification?
- Does the modification specify how far back retroactive application of the SCA will stretch?
- Does it incorporate FAR 52.222-41 and the applicable FAR price adjustment clause for future years (FAR 52.222-43 or -44)?
- Does it incorporate WDs covering all locations and time periods of performance? And does the modification specify when each WD (and WD version) applies to each time period?
- Finally, does the modification recognize and document your entitlement to an equitable adjustment for back pay?

These are all key issues to resolve before signing or accepting any modifications.

## Identify Personnel

While addressing the modification, start obtaining your company’s accounting, payroll, and benefits records for the period covered by DOL’s order. Start by identifying the personnel who performed the duties required for contract performance and who are not bona fide administrative, professional, or executive employees exempt from the Fair Labor Standards Act (FLSA). Ensure that your subcontractors, if any, are undertaking the same analyses.

The FLSA-exempt employees will also be exempt from SCA coverage. The non-exempt employees are considered “service employees” subject to the SCA and should be included in the next steps of the analysis.

For these non-exempt employees, you should next determine the hours they spent working on the contract during the retroactive period, the wages they were paid for those hours, and the fringe benefits they received during that time. For contractors that did not track employees’ time by contract during that period, determin-

ing hours worked on the contract may be more time-intensive, so start as early as possible.

Next, confirm which tasks the non-exempt employees performed on the contract during the retroactive period. You can start this analysis with internal job titles and job descriptions, but you will want to confirm with contract personnel that these descriptions match the non-exempt employees’ actual job duties. In particular, pay attention to employees who were cross-trained and may have filled multiple roles on the contract over time.

With this information in hand, you can then map service employees to SCA labor categories by mapping their actual duties to the job descriptions listed in DOL’s SCA Directory of Occupations. Then, based on those mappings, determine the “prevailing” wages required for each service employee by reviewing the applicable SCA WD for the geographic region where the employee’s work was performed. For a given SCA labor category, the wage rate required by SCA WDs typically varies by location. You will want to focus on service employees whose actual wage rates were below the prevailing wage rates required by applicable WDs.

The difference between those actual and prevailing rates, multiplied by hours worked in the relevant SCA labor category, will constitute the wage component of back pay for the affected service employees. For the REA, don’t forget to calculate resulting increases to your company’s tax obligations, such as for Social Security programs and unemployment insurance.

## Fringe Benefits

Fringe benefits make up another portion of your back pay analysis. SCA WDs divide fringe benefits into three basic categories: vacation, holiday, and health and welfare (H&W). Calculate the extent to which you provided these benefits to service employees, based on the cost to the company. These calculations can be complicated and often require support from accounting and benefits personnel to determine service employees’ actual holiday pay or the actual cost of their medical insurance in prior years.

If your company spent less on fringe benefits than the SCA WDs now retroactively require, you must make up the difference as back pay. Note that if you provided any service employees with fringe benefits that cost more than required by the applicable WD, you cannot credit the “excess” fringe benefits toward your wage obligations, and vice versa.

Because you can seek to recover the cost of these back wages and fringe benefits through an equitable adjustment, you can apply your indirect costs such as overhead and general and administrative costs, plus profit — elements of recovery not included in price adjustments under the SCA. You should consult your accounting personnel to ensure you have current and complete rates. In addition, you can seek to recover your costs of preparing the REA and bringing the company into compliance with the SCA in the middle of contract performance, so consider establishing separate charge codes or other methods of tracking time devoted to these efforts.

As noted earlier, the prime contractor may have subcontractors with potential back pay obligations, as well. Circumstances will dictate the mechanics of addressing subcontractor back pay. In some cases, you may want to submit REAs to the agency on your subcontractors’ behalf; in other cases, you may want to pay subcontract-

tors' REAs directly before submitting an REA solely on the prime's behalf.

But in all cases, the general back pay calculations are the same for your subcontractors. Each company should perform the mapping and calculations themselves. They (should) know their business records better than you do, and they also are in a better position to map their own service employees based on actual duties performed.

Your review should focus on consistency issues, such as whether the subcontractor applied the correct H&W rate(s) for the back pay periods or whether the subcontractor has identified hours worked on the subcontract that match the hours previously invoiced for those same service employees. When uncertainties arise, ask subcontractors questions and document their answers for your reference.

### **Final 'Package'**

As these steps are completed, you can start compiling a final "package" for the contracting agency. Your REA should include the calculations of back pay, indirect costs, profit, REA preparation costs, and compliance costs, as well as supporting business records. Those business records should show the subtraction of actual wages from required wages, multiplied by hours worked on the contract in the relevant period. If your subcontractors object to providing certain records to your company, arrange for the subcontractor to deliver a "sealed package" of records directly to the agency for review.

As time passes, strive to keep the REA moving forward through completion. These additional steps include providing back pay to your current and former service employees, obtaining assurances that your subcontractors have also distributed back pay, negotiating

a final adjustment with the agency, executing a modification, receiving payment, and remitting payment to subcontractors (if not already paid). As with many compliance activities, documenting these steps will help protect the company if and when the DOL seeks confirmation that affected service employees have received payments.

Finally, even if your company is experienced with SCA compliance, consider retaining professionals to augment your REA efforts. Among other services, attorneys can advocate the company's entitlement to all elements of an REA and provide legal advice on unusual situations that arise. Accountants can cost-effectively analyze your company's and your subcontractors' calculations and records. They can also spot issues you might not have considered, such as whether the overhead rate applied in your REA has been adjusted to reflect the back pay costs you've calculated for that same REA. These are just some of the contributions that we have seen professionals make to teams preparing REAs for SCA back pay.

This is just a basic playbook for minimizing financial burdens and legal risks when the DOL orders the SCA applied midcontract. We have yet to see an REA without any wrinkles or complications. Even in relatively straightforward REA efforts, the issues above have further layers of details and analysis to consider.

Thus, we encourage you to consider our final recommended step: Slow down and ensure the calculations are correct and supportable, no matter the imperatives from your business, the contracting agency, or the DOL. These are complicated issues. But with focused attention and documentation, you can protect your organization while ensuring service employees receive the compensation to which they have become entitled midcontract.