

Service Contract Act: What You Really Need to Know Before You Submit That Proposal

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The McNamara-O'Hara Service Contract Act of 1965 (SCA) (also known as the Service Contract Labor Standards) continues to present challenges to government contractors, including both new and experienced industry players. As discussed in depth in our prior article, assessing the potential impact of the SCA on service contracting opportunity during the proposal preparation process is essential. And now with the new change in administration, service contractors should be prepared for heightened scrutiny and increased enforcement activity in the Department of Labor's Wage & Hour Division.

In an SCA enforcement environment where DoL investigators find violations in approximately 70% of all SCA audits, thorough consideration of the SCA's requirements at the pre-award stage can help prevent troubles during contract performance and mitigate audit risk. To that end, we have summarized below several issues that contractors should consider when bidding on an SCA-covered contract. However, because of the complexities of the SCA and its implementing regulations, this summary is meant only as general guidance and not a substitute for a thorough fact-specific analysis of a particular SCA-covered opportunity.

Where applicable, the SCA wage and fringe benefit requirements can materially affect how contractors (and subcontractors) compensate certain service employees, and strict compliance with the SCA is mandatory. Failure to comply with the SCA (even in ways a service contractor may deem to be immaterial) can result in numerous consequences during or after contract performance, including Department of Labor (DoL) investigations, whistleblower actions, payment of deficient wages to existing and prior employees,

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and even potential debarment. Therefore, we strongly encourage contractors establish an SCA assessment process that considers these important issues when starting a capture effort.

Step 1: Will the Resulting Contract Be Covered by the SCA?

The first question to consider is whether the contract to be awarded is covered by the SCA. While this may sound like a straightforward question, that is not always the case, and may be even more difficult to determine if you are a subcontractor. This inquiry has become even more complicated as SCA coverage has expanded to include certain complex IT and related contracts that simply did not exist in 1965 when the SCA was enacted. Step one is to check whether the solicitation (or an amendment thereto) provides indications that the contract will be subject to the SCA. That is, does it (i) incorporate the applicable Federal Acquisition Regulation (FAR) clause, FAR 52.222-41, (ii) an SCA prevailing wage determination and/or (iii) otherwise state that it is subject to the SCA? If one or multiple of these items are present, contractors should expect the contract will be covered by the SCA and price their proposals accordingly to include SCA prevailing wages.

Even if the solicitation does not address the SCA directly in one of the foregoing ways, the resulting contract could still be covered by the SCA if all of the following factors are met: (a) award by the United States Government or the District of Columbia; (b) the contract is principally one for services (as opposed to construction, manufacturing or product work) that will be performed by “service employees,” a broadly defined term that includes most workers not exempt from the Fair Labor Standards Act (FLSA) minimum-wage and overtime requirements (whether as employees, independent contractors, or temporary and contract workers)); (c) the contract is expected to exceed \$2,500; and (d) at least some portion of the services will be performed in the United States or its territories. If the answer to these four questions is yes, you may still need to consider the applicability of the SCA and should probably seek legal counsel for advice—even if the FAR SCA clause and/or a wage determination are not included with the solicitation.

If the solicitation is silent on SCA applicability, contractors can, and should, still inquire about the SCA throughout the bidding process if there is any doubt as to whether the SCA applies. This issue is best raised by direct communication with the contracting officer in writing. For example, an inquiry into the SCA’s applicability on a contract can easily be asked during any question and answer (Q&A) sessions. In addition, a contractor can also use that same opportunity to ask about the applicability of related clauses, such as federal sick leave and federal contractor minimum wage. If the agency makes an affirmative determination, in writing that the SCA does not apply, a contractor can point to this fact if the DoL later determines the SCA should have applied to a specific procurement or if an attempt is made to “read in” the SCA provisions by a court later through the *Christian* doctrine (which likely would not apply to this circumstance). This upfront communication can save contractors money and a headache down the road if the SCA is later determined to apply, yet the Agency failed to put it in the solicitation and contractors therefore did not price for it.

Keep in mind that the SCA does have some exceptions and exemptions that may apply under certain circumstances. If an exemption is applicable, an otherwise SCA-covered contract may not require SCA compliance (or compliance may not be required with respect to certain employees outside the scope of SCA coverage). One common exemption is that all or substantially all of the employees who will perform the

required effort are considered bona fide executive, administrative or professional workers under FLSA, based on their salary and the nature of their job duties. DoL outlines tests that must be met for each of these exemptions and anyone that qualifies is exempt from SCA coverage. It is important to note that while the duties aspect of these tests has remained consistent over the years, the salary threshold has been in flux so be sure to review current FLSA guidance in any exempt coverage analysis.

There are also some narrow categories of services that fall into one of the statutory or administrative exemptions (for example, public utility services). Most of these exemptions, however, are narrowly crafted and interpreted. The application of these exemptions is very fact specific, and we would recommend seeking legal counsel as part of making (and documenting) any exception or exemption determination—especially because DoL and the FAR both require certain exemptions to be supported by contractor certifications.

Step 2: What Governs Wages and Benefits Under the SCA?

Next, you will need to consider the SCA-specific requirements that govern the wages and benefits you will pay SCA covered employees under the contract or subcontract. If the contract is subject to the SCA, you must determine what SCA wage determination or agreement dictates the minimum wages and fringe benefits. There are two types of documents that govern wages and fringe benefits under the SCA: (i) an area wage determination, or (ii) collective bargaining agreements (CBAs).

For area wage determinations, the geographic locality or place of performance will determine which wage determination governs your obligations. However, with so many personnel now operating in a remote environment, this inquiry has become all the more complicated. These wage determinations should be included with the solicitation but are also publicly available now at beta.sam.gov. If a contractor seeks to perform in a location not included in an attached wage determination, it is incumbent on the contractor to raise that issue with the contracting officer.

For solicitations that incorporate a predecessor contractor's CBA, it is extremely important to get access to a copy of that CBA as early in the procurement process as possible since under the SCA, a successor contractor—even a non-unionized successor contractor—will likely be obligated to compensate its employees at the wage and fringe benefit rates specific in the predecessor contractor's CBA for at least a portion of the contract performance period. This is so even if the contracting agency fails to provide the CBA because these obligations are self-executing.

Furthermore, it is also critical, regardless of the type of wage determination incorporated into the solicitation, to keep an eye out for any changes made by the new administration that may affect wage determinations. As explored in depth in our other article, it would not be surprising if the Biden administration seeks to implement new policies affecting SCA prevailing wages. For example, the administration has stated its intention to increase the federal contractor minimum wage, which would affect wages. In addition, the administration may bring back the non-displacement rules; these rules contained significant obligations regarding potential staffing by requiring successor contractors in most circumstances to offer employment to predecessor employees. This rule also could impact SCA fringe benefit obligations, particularly SCA vacation benefits that

are based on employee years of service with a contractor or a predecessor contractor. No matter what steps the administration takes next, contractors should be aware that the SCA and prevailing wages (directly or indirectly) may be affected.

Step 3: Mapping

For all non-exempt SCA-covered employees, contractors must identify the specific job duties each employee will perform under the contract or subcontract and “map” those duties to an appropriate DoL wage determination labor category, in order to determine each employee's SCA minimum wage. In some cases, the government solicitation documents (or even prior classifications by the predecessor contractor) may provide some guidance as to the appropriate labor category, but keep in mind that the contractor is ultimately responsible for selecting the appropriate labor category and will be liable for the impact of any inaccurate mapping.

The SCA mapping process typically will include the following steps:

- **Job Duties:** Analyze the contract's Performance Work Statement or Statement of Work, any incumbent contract information, Statement of Equivalent Rates in the Solicitation provided pursuant to FAR 52.222-42 and other guidance to determine scope of contract employees' job duties.
- **Coverage Analysis:** Conduct a coverage analysis that identifies each contract employee's actual job duties and responsibilities, and determine which employees are “service employees” who will be subject to SCA coverage and which, if any, will be classified as FLSA-exempt or excludable under any other relevant SCA regulations. See, e.g., 29 C.F.R. 4.153.
- **Labor Categories:** For all service employees, consult the wage determination, Statement of Equivalents information and DoL SCA Directory of Occupations (which is available online at DoL's website) to map each employee to an appropriate DoL labor category in the wage determination. If labor categories are missing from a wage determination, or not clearly defined in DoL's Directory of Occupations, consult legal counsel to consider engaging in a conformance procedure under the SCA regulations.
- **Document Decisions:** All coverage determinations and labor category assignments should be supported by adequate written documentation.

Contractors must also consider the issues faced by using subcontractors and/or independent contractors to perform SCA covered work. As Wiley recently covered, the DoL has finalized its rule on how to classify workers as employees or independent contractors under the FLSA, although the new administration has proposed to withdraw this rule, causing even greater uncertainty in this area. Contractors need to ensure that all members of its team are on the same page regarding what employees are covered by the SCA and which are exempt, and if considered exempt why. All subcontractor and independent contractor service employees subject to the SCA need to be properly identified.

Higher-tiered contractors are jointly and severally liable for SCA violations by lower-tier contractors and it is critical to include required SCA clauses and wage determinations in every SCA covered subcontract. Higher-tiered contractors also may want to consider also including subcontractor indemnity provisions in the event a

subcontractor or independent contractor fails to comply with the SCA. To properly oversee subcontractor compliance, a contractor must develop a plan or process to monitor its subcontractors at all levels for compliance with the SCA.

Step 4: Pricing

When developing pricing for an SCA-covered contract, contractors should consider the following:

- **Wage Determination:** As discussed above, identify the prevailing wage rates and fringe benefit rates in the geographic locality for the labor categories that will be used to perform the contract or subcontract, as reflected in the wage determination or relevant CBA rates, if applicable.
- **Escalation: Consider the prospect of future increases in the prevailing wages and fringe benefits. Your options for applying an escalation factor for these potential increases may depend on how the SCA-covered labor is priced.** For labor priced on a fixed-price, time-and-materials, or labor-hour basis, the FAR's Price Adjustment Clause, FAR 52.222-43, entitles contractors to price adjustments to cover the cost of future increases in prevailing wages or fringe benefits. As a tradeoff, the same clause prohibits contractors from including "any contingency" in pricing "to cover increased costs" that can be compensated under the clause. In contrast, cost-type labor is not subject to FAR 52.222-43, so you should look to the solicitation for any directions on escalating labor costs for the out years.
- **Wages and Price Adjustment Clause:** If you intend to pay any service employees in excess of the SCA prevailing wages or benefits, assess how the Price Adjustment Clause will impact your ability to seek price adjustments in future contract years. It is important to remember that even if you can recover costs, you must have the proper documentation to do so. It is wise to keep these documents centralized, so that they are easy to collect when the time comes to present your case for a price adjustment to the agency.
- **Fringe Benefits:** Identify the minimum fringe benefit amounts in the wage determination (measured by the actual cost of the benefit to the employer, not the value of benefits actually received by the employee) and assess your plan to satisfy those requirements and how it affects proposal pricing. Also, you need to determine: (a) whether your planned health and welfare (H&W) benefits qualify as "bona fide" fringe benefits under the SCA; (b) whether your method for calculating vacation is consistent with SCA requirements; (c) how you plan to account for paid holidays; and (d) whether you will need to provide cash equivalents in lieu of any benefits if you are unable to satisfy the minimum fringe benefit requirements with "bona fide" fringe benefits. [Note: Paying an employee at a wage rate in excess of the SCA prevailing rate cannot be used to offset fringe benefit requirements.]
- **No Offsets:** Other applicable laws may require additional fringe benefits (e., worker's compensation, unemployment insurance, Social Security) that cannot be used to offset or meet SCA benefit requirements. Also keep in mind that paid sick leave provided to satisfy the federal sick leave requirements (if applicable under Executive Order 13706, 29 C.F.R. part 13, and FAR 52.222-62) cannot also be counted as a "bona fide" fringe benefit; however, SCA wage determinations contain do include a lower H&W fringe benefit rate for contracts covered by the federal paid sick leave requirements that

contractors also should consider for pricing purposes.

- **Employee Notice:** Service employees must receive notice of the wage and benefits they will receive and pay stubs should inform them precisely which amount received is for wages versus fringe benefits.
- **Deductions:** Any deductions that an employer makes from service employee paychecks must be permitted by the SCA, with notice to employees in advance. Where required, proper employee approval also must be received.

Although the discussion above is focused on pre-award and pricing considerations, contractors also need to stay vigilant when transitioning from pre-award to performance under SCA-covered contracts. During performance, contractors must (i) ensure they are paying the proper wage and fringe benefits to all SCA covered service employees, (ii) monitor the SCA compliance of their subcontractors, (iii) monitor whether revised wage determinations have been issued by DoL and incorporated into the contract by the contracting officer upon the exercise of any options, or as otherwise required under the SCA and its implementing regulations, and (iv) continually assess whether changes to the contract or subcontract Statement of Work require new labor categories, or whether changes in employee job duties require revised coverage analyses, labor category assignments, or updated place(s) of performance.

While the SCA certainly can present many challenges in all phases under SCA-covered contracts, there simply is no substitute for early identification and assessment as to how a contractor plans to address these challenges.