

# BRIEFING PAPERS®



## SECOND SERIES

PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

### FINANCING GOVERNMENT CONTRACTS / EDITION II—PART I

By John W. Chierichella and David S. Gallacher

**R**elatively few companies have the financial wherewithal or desire to finance, from their own resources, the performance of Government contracts and to defer the receipt of payments for months and perhaps years until delivery and acceptance by the Government of the supplies and services called for by their contracts. In recognition of this fact, the Government provides an array of financing techniques to facilitate performance by its contractors. By so doing, it is

able to minimize the “cash drain” on contractors that would otherwise attend performance, to expand the base of suppliers willing to compete for its contracts, and, hopefully, to obtain the price benefits that normally ensue from increased competition.

Resources and procedures for financing Government contracts are outlined in Federal Acquisition Regulation Part 32. FAR Part 32 touches on a wide variety of topics, ranging from permissible payment methods to loan guarantees, from interest payments to debt collection. Owing to the vast amount of materials covered by these topics, this BRIEFING PAPER is the first of two PAPERS providing a comprehensive guide to understanding the availability of and requirements of the procedures relating to Government financing for contracts. This Part I focuses on financing for noncommercial item purchases. It describes the *principal methods* that are available to you as a Government contractor to expedite cash flow from the Government during

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performance, the *circumstances* in which they may be employed, and the *procedural* and *substantive limitations* imposed on their use. Part II, to be published next month, continues the discussion of those issues in relation to financing for *commercial item purchases*. In addition, Part II addresses *statutory constraints* that could affect your ability to use private sources of funding in support of performance and the Government's ability to *interrupt payments* if and when performance difficulties afflict one or more of your contracts and the measures you can and should take to forestall that prospect. It also addresses some of the *liabilities* inherent in receiving money from the Government—namely potential False Claims Act violations and payment of interest.

There have been many significant changes in the area of financing Government contracts in the 18 years since the subject first received treatment in June 1986 in BRIEFING PAPERS No. 86-7.<sup>1</sup> This two-part Edition II BRIEFING PAPER supersedes both that 1986 version of this PAPER and its subsequent 1988 Revision Note. Relevant and current portions of the previous versions of this BRIEFING PAPER have been incorporated and updated herein, while unique issues arising in the intervening period—e.g., the distinctions between commercial and noncommercial payments, differences between performance-based and cost-based payments, and changes relating to prompt payment requirements and electronic payments—are addressed for the first time.

## General Policy

Contract financing is addressed principally in FAR Part 32. Part 32 identifies a variety

of financing techniques, describes the different policy considerations and procedures appropriate for the various financing techniques, and explains whether and how each technique should be used for commercial item purchases<sup>2</sup> and noncommercial purchases.<sup>3</sup> Throughout the FAR, the basic policy is the same—that prudent contract financing can be a useful tool in Government acquisition by expediting the performance of essential contracts.<sup>4</sup>

There have been significant changes to FAR Part 32 in recent years. Historically, the FAR did not distinguish between “commercial” and “noncommercial” financing options.<sup>5</sup> In practice, contract financing provisions were considered generally inapplicable to commercial transactions.<sup>6</sup> That practice changed drastically with the passage of the Federal Acquisition Streamlining Act (FASA) in 1994<sup>7</sup> when Congress expressly instructed the Government to adopt provisions for financing commercial purchases.<sup>8</sup> While the regulations applicable to commercial and noncommercial contracts are similar in many respects (even to the point of recognizing that certain noncommercial financing provisions may be adapted and applied to commercial contracts),<sup>9</sup> they differ in terms of the dollar amount that may be advanced to the contractor, the contract types on which certain financing methods may be used, and the procedures that must be employed by the Contracting Officer. COs are cautioned to gain a complete understanding of the different contracting environments when developing and implementing commercial contract financing arrangements.<sup>10</sup>



## BRIEFING PAPERS

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## Financing For Noncommercial Item Purchases

FAR Subpart 32.1 sets forth the policies and procedures applicable to contract financing and payment for purchases other than that of commercial items,<sup>11</sup> i.e., for more traditional Government contract acquisitions. In practice, most of these policies and procedures are broadly applied to any FAR-based acquisition that does not involve a commercial item.<sup>12</sup>

### ■ Noncommercial Item Policy

There is no absolute requirement that a CO include a provision for financing in a solicitation. If such a provision is incorporated, however, your need or desire for contract financing should not affect your ability to compete. As long as you can otherwise establish your status as a “responsible” contractor under the standards prescribed by the regulations,<sup>13</sup> the CO may not treat your need for financing as a handicap in the award process.<sup>14</sup> Thus, it would be improper for the CO to treat a request for financing—such as progress payments or performance-based payments—as a basis, in and of itself, for a determination of nonresponsibility or, in a negotiated procurement, as a negative evaluation factor in source selection.<sup>15</sup> (Note, however, that with commercial contracts, where the offerors separately propose individualized commercial financing terms in their proposals, the CO must adjust the proposal price based on the proposed financing terms to ensure a fair comparison between and among offerors.)<sup>16</sup> Moreover, the mere fact that you may have failed to indicate a need for contract financing *before* award does not preclude you from seeking and obtaining such financing *after* award.<sup>17</sup>

A request for contract financing may, however, touch off a review by the procuring agency to ensure that you truly need contract financing and to determine the most appropriate financing method. With Department of Defense contracts, COs must obtain “the type and depth of financial and other information that is required to establish a contractor’s financial capability or disclose a contractor’s financial condition.”<sup>18</sup> This information may include

(1) balance sheets and income statements for the past two years and forecasts for each year of contract performance, (2) a summary history of the contractor and its principals, identifying any instances of insolvency, (3) a statement of all affiliations, including all material financial interests in the contractor, (4) a statement of all forms of planned compensation to officers and managers for the past two years and compensation forecast for each year of contract performance, (5) business bases and forecasts describing the market, (6) cash forecasts for the duration of the contract, (7) any additional financing arrangements, (8) statements regarding state, local, and federal taxes, as well as other mandatory payments, and (9) a detailed description of asset or sales statistics, as well as other miscellaneous financial issues.<sup>19</sup> Your unwillingness or inability to provide the requested information may be a material fact in the CO’s determination of your responsibility.<sup>20</sup>

The CO or the procuring agency has the discretion to use, and to choose between and among, the various contract financing methods outlined in the FAR.<sup>21</sup> In so doing, COs are directed to consider specific criteria as to whether financing is appropriate or even needed. In weighing these considerations, the FAR instructs COs to resolve reasonable doubts in favor of *including* contract financing provisions in solicitations.<sup>22</sup> The CO must:<sup>23</sup>

(1) Provide Government financing *only to the extent actually needed for prompt and efficient performance, considering the availability of private financing and the probable impact on working capital of the predelivery expenditures and production lead-times associated with the contract, or groups of contracts or orders (e.g., issued under indefinite-delivery contracts, basic ordering agreements, or their equivalent);*

(2) Administer contract financing so as to aid, not impede, the acquisition;

(3) Avoid any undue risk of monetary loss to the Government through the financing;

(4) Include the form of contract financing deemed to be in the Government’s best interest in the solicitation (see [FAR] 32.106 and 32.113); and

(5) Monitor the contractor’s use of the contract financing provided and the contractor’s financial status.

### ■ Available Methods Of Financing

Contract financing methods are designed to be “self-liquidating” through contract performance. Consequently, contract financing is available only to supplement a contractor’s working capital, not to support the acquisition of fixed assets.<sup>24</sup> Generally speaking, the FAR identifies four basic techniques that are available to help underwrite the performance of non-commercial contracts: (1) progress payments,<sup>25</sup> (2) performance-based payments,<sup>26</sup> (3) advance payments,<sup>27</sup> and (4) loan guarantees.<sup>28</sup>

*Progress payments* are periodic payments made by the Government as performance on the contract proceeds. Such payments are based either on costs incurred by the contractor in performing the contract<sup>29</sup> or on a percentage or stage of completion achieved under the contract.<sup>30</sup> The regulations prescribe “customary” limits on the percentage of incurred costs for which progress payments will be made available.<sup>31</sup> Progress payments at higher rates are considered “unusual” progress payments and require special agency approval.<sup>32</sup>

*Performance-based payments* are contract financing payments of predetermined amounts that are made when a contractor satisfies predefined contract events or criteria.<sup>33</sup> Conceptually, performance-based payments are a “type” of progress payment, triggered by completion of certain pre-identified events or criteria (instead of incurred costs). Performance-based payments are *not* payments for accepted items.<sup>34</sup> Rather, they are simply “advances” based on work performed. Similar to progress payments, performance-based payments are fully recoverable from you in the event of a default.<sup>35</sup> Consequently, performance-based payments are the preferred Government financing method when the CO finds them practical, and the contractor agrees to their use.<sup>36</sup> The widespread use of performance-based payments was introduced in 1994 with FASA.<sup>37</sup> Because of the similarities between progress payments and performance-based payments, they are discussed together in this BRIEFING PAPER, highlighting key conceptual and procedural differences between each payment method.

*Advance payments*, as the term suggests, are advances made to the contractor before, in

anticipation of, and for the purpose of completing one or more contracts.<sup>38</sup> Such payments are not measured by, or based on, your performance. They constitute, in effect, a direct Government loan to facilitate performance. Because the payments precede performance, this method of financing is the least preferred method as it is considered to pose the greatest risk to the Government.<sup>39</sup>

*Loan guarantees* are made by Federal Reserve Banks to help contractors obtain financing from private sources to support national defense contracts.<sup>40</sup> Such loans are guaranteed by a federal agency, which is obligated to purchase a stated percentage of the loan and to share any losses sustained under the loan in the amount of the guaranteed percentage.<sup>41</sup>

In addition to these four financing methods, the Government is also authorized to make *partial payments*<sup>42</sup>—payments for accepted supplies and services that represent only a part of the total deliverables called for under the contract.<sup>43</sup> Because such payments depend upon delivery and acceptance, they are not technically considered a method of “financing.”<sup>44</sup> Such payments can, however, reduce your need for financing by avoiding the postponement of payment until contract completion. Under the standard “Payments” clause applicable to fixed-price supply contracts, partial payments are authorized generally, unless the contract specifically provides to the contrary, where the contractor requests such payments and the amounts due are at least \$1,000 or 50% of the total contract price.<sup>45</sup> Because partial payments are not technically “financing payments,” the Government is required under the Prompt Payment Act<sup>46</sup> to make partial payments in a timely manner, which is not the case in connection with true financing payments such as progress payments, performance-based payments, or advance payments.<sup>47</sup>

Another financing method that is similar to partial payments and available under DOD contracts is *provisional delivery payments*.<sup>48</sup> Provisional delivery payments are available to pay DOD contractors “for the costs of supplies and services delivered to and accepted by the Government” under letter contracts contemplat-

ing a fixed-price contract, orders under basic ordering agreements, unpriced equitable adjustments on fixed-price contracts, and orders under indefinite-delivery contracts.<sup>49</sup> The DOD is instructed to use provisional delivery payments sparingly, to price them conservatively, and to reduce the payments by liquidating previous progress payments.<sup>50</sup>

#### ■ Order Of Preference

The regulations establish an order of preference among the various financing methods described above. Given the understandable desire on the part of the Government to avoid any unnecessary risk to its own funds and to minimize whatever risk it may be willing to assume, coupled with the desire to avoid payment based on subjective or unreliable data, the preference, in the order of the most preferable to the least, is as follows:<sup>51</sup>

- (1) Private financing.
- (2) “Customary” contract financing (which includes performance-based payments and customary progress payments).
- (3) Loan guarantees.
- (4) “Unusual” contract financing.
- (5) Advance payments.

#### Customary Contract Financing

Customary contract financing is achieved through *progress payments*<sup>52</sup> and *performance-based payments*.<sup>53</sup> While progress payments have historically been the preferred method,<sup>54</sup> the Government has long investigated alternate financing methods. For example, in 1992, the General Accounting Office (now the Government Accountability Office) issued a report criticizing the DOD for not paying full attention to contractor performance data in issuing progress payments.<sup>55</sup> Also in 1992, the National Aeronautics and Space Administration explored payment alternatives that focused on the attainment of contract milestones.<sup>56</sup>

With the passage of FASA in 1994, Congress explicitly provided for the use of performance-

based payments as a form of progress payment “whenever practicable.”<sup>57</sup> As a relatively new concept, the “best practices” for using and benefiting from performance-based payments are still evolving. The DOD has published a “User’s Guide to Performance Based Payments” to assist Government personnel and contractors in maximizing the benefits that can come from performance-based payments.<sup>58</sup> Still, recognizing that the best practices are still evolving, the Director of Defense Procurement and Acquisition Policy for the DOD recently issued a notice requesting public comment on how the DOD can continue to improve its use of performance-based payments.<sup>59</sup> Currently, performance-based payments are the preferred Government financing method.<sup>60</sup> Still, in practice, agencies customarily use both payment methods, although the Government continues to emphasize the use of performance-based methods.<sup>61</sup>

Customary progress payments (including performance-based payments) more closely resemble cost-reimbursement provisions than other forms of true financing such as advance payments and loan guarantees. Nevertheless, the “financing” aspect of progress payments or performance-based payments is clear—they theoretically convert an otherwise fixed-price contract into a “provisional” cost-reimbursement contract (with significant limitations and, of course, a cap) for the purpose of generating funds that otherwise would be payable to the contractor only on delivery or contract completion.

The regulations do not define the term “progress payment.”<sup>62</sup> Certain aspects of progress payments are well established, however. Although they are based on costs, progress payments are different from the payments periodically made to contractors under cost-reimbursement contracts.<sup>63</sup> Instead, progress payments are payments made under fixed-price contracts that are based on a percentage of “total costs” and limited by the contract price.<sup>64</sup> The Government will make progress payments when requested as work progresses, but not more frequently than once a month and not for amounts less than \$2,500.<sup>65</sup>

Performance-based payments are very similar. Performance-based payments are not avail-

able under cost-reimbursement contracts, construction contracts or shipbuilding contracts that provide for progress payments based on a percentage or stage of completion, or contracts awarded through sealed-bid procedures.<sup>66</sup> Performance-based payments are payments that are based on (1) performance measured by objective, quantifiable methods, (2) accomplishment of defined events, or (3) other quantifiable measures of results.<sup>67</sup> The Government will make performance-based payments as objectives are met, but not more frequently than once a month.<sup>68</sup> Unless otherwise authorized by the CO, the contractor must include all performance-based payments in any period for which payment is being requested in a single request, “appropriately itemized and totaled.”<sup>69</sup>

The major difference between performance-based payments and progress payments is that progress payments are based on a contractor’s *costs*, while performance-based payments are based on objectively measured *events* or *criteria* and prenegotiated payment amounts. Despite the Government’s touting of performance-based payments as the superior and more advantageous form of financing for contractors, there is some debate as to whether performance-based payments are truly a superior payment method providing the contractor with increased cash flow when compared to progress payments.<sup>70</sup>

## Types Of Progress Payments

The FAR identifies two types of progress payments—progress payments based on percentage or stage of completion<sup>71</sup> and progress payments based on incurred costs.<sup>72</sup> While, technically, performance-based payments are a “third” type of progress payment, they are given separate treatment under the FAR and therefore not labeled as a type of “progress payment.”<sup>73</sup> However, many of the considerations and procedures are the same for each of these payment types.

### ■ Progress Payments Based On Percentage Or Stage Of Completion

You may obtain progress payments based on percentage or stage of completion,<sup>74</sup> most com-

monly under construction,<sup>75</sup> shipbuilding, or ship conversion, alteration, or repair contracts.<sup>76</sup> Agency procedures govern the specific use of this type of progress payments, and the agencies are instructed to “ensure that payments are commensurate with work accomplished, which meets the quality standards established under the contract.”<sup>77</sup> For example, the Department of Energy Acquisition Regulation (DEAR) provides that progress payments based on percentage or stage of completion may be authorized by an agency head only “when a determination is made that progress payments based on costs cannot be practically employed and that there are adequate safeguards provided for the administration of progress payments based on a percentage or stage of completion.”<sup>78</sup> In practice, progress payments based on percentage or stage of completion are very similar to performance-based payments, with certain “stages” or “events” triggering payment.

Payments are usually made monthly (although more frequent intervals are authorized), based on the overall progress and the overall quality of performance.<sup>79</sup> If the CO determines that satisfactory progress has been made, the CO must authorize *payment in full* for the work accomplished under a definitized contract.<sup>80</sup> For an undefinitized contract, the progress payment may not exceed 80%.<sup>81</sup> Separate and apart from the ceiling on progress payments for undefinitized contracts, the CO may retain up to 10% of the amount of any payment until satisfactory progress is achieved.<sup>82</sup> When the work is substantially complete, the CO may retain from previously withheld funds and future progress payments any amount the CO deems adequate to protect the Government’s interests.<sup>83</sup> On completion and acceptance of each building or separate division of the contract for which a separate price is identified in the contract, the CO should offer payment for the completed work without retention of a percentage.<sup>84</sup>

### ■ Customary Progress Payments Based On Costs

Progress payments based on costs may be either “customary” or “unusual.”<sup>85</sup> “Customary progress payments” are those made un-

der the general guidance in FAR Subpart 32.5 using the customary progress payment rate, the cost base, and frequency of payment established in the “Progress Payments” clause.<sup>86</sup> With the exception of performance-based payments (which, for purposes of definitional convenience, can be considered “customary,” even though the FAR does not define them as such), any other progress payments are considered “unusual progress payments.”<sup>87</sup>

The customary progress payment rate has varied over the years. Under the FAR, the current customary rate “is 80 percent, applicable to the total costs of performing the contract.”<sup>88</sup> The FAR provides a higher rate of 85% for small businesses.<sup>89</sup> Progress payment rates under DOD contracts differ slightly from the FAR rate. For DOD contracts, including contracts that contain foreign military sales requirements, the customary progress payment rates are 80% for large business concerns, 90% for small business concerns, and 95% for small disadvantaged business concerns.<sup>90</sup>

The total amount payable as customary progress payments is limited to a specified percentage of the “contract price.”<sup>91</sup> With respect to fixed-price contracts, the FAR provides that “the contract price is the current contract price plus any unpriced modifications for which funds have been obligated.”<sup>92</sup> Auditors for the Defense Contract Audit Agency are cautioned to verify “contract price” to the most current contract modification to establish the limits on payments on future deliveries.<sup>93</sup> Specific cost-reimbursement portions of the contract must be excluded from the “contract price” in determining the limitation on progress payments.<sup>94</sup> The limitation regarding “obligated funds” is particularly significant in multiyear procurements where, despite the ceiling imposed by the “Cancellation” clause, the contractor chooses or is compelled to incur costs in advance of program year obligations because future year obligations will not be included in the total “contract price.”<sup>95</sup>

The DOD defines “contract price” in a different manner. The DOD FAR Supplement states that the CO “may approve progress payments when the contract price exceeds the

funds obligated under the contract; provided, the contract contains an appropriate Limitation of Funds clause.”<sup>96</sup> However, the regulation makes it clear that progress payments must be limited to the lesser of the “applicable rate (i.e., the lower of the progress payment rate, the liquidation rate, or the loss-ratio adjusted rate) or “100 percent of the funds obligated.”<sup>97</sup> The “Limitation Of Funds” clause,<sup>98</sup> which the regulation requires under its modified definition of “contract price” and which is customarily used in fully funded or incrementally funded cost-reimbursement contracts,<sup>99</sup> is used as well in incrementally-funded fixed-price contracts.<sup>100</sup>

The FAR requires the CO to obtain additional approval from the contract finance office before allowing for customary progress payments if the rate is higher than the customary rate or if the CO deviates from any of the procedures prescribed in the FAR.<sup>101</sup> Additionally, the contract finance office must provide approval for progress payments to a contractor (1) the financial condition of which is in doubt, (2) that has had an advance payment or loan guarantee denied for financial reasons within the previous 12 months, or (3) that is named on the “Hold-up List”—a list of contractors that owe the United States money.<sup>102</sup>

#### ■ Unusual Progress Payments

In cryptic fashion, the FAR defines “unusual progress payments” as “[a]ny other progress payments” that do not qualify as “customary.”<sup>103</sup> Unusual progress payments are payments made at a higher rate or with greater frequency than is customary.<sup>104</sup> Unusual progress payments may be used only in exceptional circumstances with advance agency approval.<sup>105</sup> The FAR authorizes unusual progress payments only when the contract necessitates significant predelivery expenditures and when the contractor fully documents the need for such unusual payments.<sup>106</sup>

#### ■ (Customary) Performance-Based Payments

While the FAR does not divide performance-based payments into “customary” and “unusual” categories, it is clear based on the congress-

sional preference expressed in FASA that performance-based payments are “customary” and preferred.<sup>107</sup>

Instead of basing payment on costs and a predetermined payment rate, a performance-based payment schedule identifies mutually agreeable payment amounts based on meeting certain contract events or criteria.<sup>108</sup> The FAR provides as follows:<sup>109</sup>

The basis for performance-based payments may be either specifically described events (e.g., milestones) or some measurable criterion of performance. Each event or performance criterion that will trigger a finance payment must be an integral and necessary part of contract performance and must be identified in the contract, along with a description of what constitutes successful performance of the event or attainment of the performance criterion. The signing of contracts or modifications, the exercise of options, or other such actions must not be events or criteria for performance-based payments. An event need not be a critical event in order to trigger a payment, but the Government must be able to readily verify successful performance of each such event or performance criterion.

According to the DOD, the advantages to performance-based payments over other forms of financing payments are (1) enhanced technical and schedule focus, (2) reinforced roles of Government program managers and integrated product teams in contract performance, (3) broadened contractor participation in managing the contract, (4) potentially improved cash flow for the contractor, and (5) reduced costs of oversight and compliance (because the contractor is not required to exercise such extreme cost-based oversight).<sup>110</sup>

## “Progress Payments” Clause

### ■ Availability

The inclusion of a “Progress Payments” clause<sup>111</sup> in a solicitation is discretionary. However, this discretion is not unfettered,<sup>112</sup> and COs may be required to include the clause for small business concerns.<sup>113</sup>

Under the FAR, use of the “Progress Payments” clause is sanctioned in two situations. *First*, the clause is sanctioned for use where

the contractor cannot bill “for the first delivery of products for a substantial time after work must begin” and must “make expenditures for contract performance during the predelivery period that have a significant impact on the contractor’s working capital.”<sup>114</sup> The term “substantial time” has a different meaning for large and small businesses. For small businesses, the term normally means four months or more; for other businesses, the term means six months or more.<sup>115</sup> *Second*, the clause is sanctioned where the contractor demonstrates actual financial need or the unavailability of private financing.<sup>116</sup> This second criteria may be particularly applicable to a small business as opposed to a large Government contractor. For example, for DOD contracts, if the contractor is a small disadvantaged business, progress payments may be available if the contract will involve as little as \$50,000 or more.<sup>117</sup>

From a practical standpoint, a CO often has no idea when posting a solicitation whether a small or large business ultimately will receive award of the contract. For this and other reasons, the regulations contain a solicitation provision whereby a CO may notify offerors that progress payments will be available only to small businesses.<sup>118</sup>

Other regulatory considerations relating to the availability of progress payments involve contract price and business size. For small businesses, absent agency authorization for a lower threshold, either the contract must exceed the simplified acquisition threshold of \$100,000<sup>119</sup> or (for an indefinite-delivery contract) the expected value of orders must exceed the simplified acquisition threshold.<sup>120</sup> For other businesses—again, absent specific agency approval for a lower threshold—the contract or expected value of the orders must be at least \$2 million.<sup>121</sup>

A final consideration regarding the availability of progress payments is whether the contractor has “an accounting system and controls adequate for the proper administration of the [“Progress Payments”] clause.”<sup>122</sup> The administering office “must keep itself informed of the contractor’s overall operations and financial condition,” with careful monitoring in certain situations.<sup>123</sup> If the controls lapse or are deemed



inadequate by Government auditors, then the CO should suspend progress payments until the necessary corrections have been made.<sup>124</sup>

#### ■ Effect On Evaluation For Award

When a solicitation contains the “Progress Payments” clause, a bid indicating that progress payments will be sought does not affect the validity of that bid.<sup>125</sup> But if a solicitation does not include the clause or does not invite offerors to request progress payments, a bid conditioned on the receipt of progress payments is nonresponsive.<sup>126</sup>

#### ■ Billable Costs

The current “Progress Payments” clause sets forth a general description of costs that may be billed for progress payment purposes. Although the clause does not entirely describe the types of costs that *may* be billed, it accomplishes this purpose by setting forth the types of costs that *may not* be included in “total costs incurred” for the purposes of calculating progress payments.<sup>127</sup>

*First*, the contractor may not include in the total cost base costs that are not “reasonable, allocable to this contract, and consistent with sound and generally accepted accounting principles and practices.”<sup>128</sup> Note that the term “allocable” most likely imparts all the notions of allocability contained in the FAR Part 31 cost principles and in the Cost Accounting Standards for the purposes of assessing the propriety of progress billings.<sup>129</sup>

*Second*, the clause also excludes from the cost base those costs that are ordinarily capitalized and subject to depreciation or amortization, except for the properly depreciated or amortized portion of such costs.<sup>130</sup> Special test equipment and special tooling are treated differently and are fully allocable to the contract unless, with relatively minor expense, these items can be made suitable for “general purpose use.”<sup>131</sup>

*Third*, the clause excludes from the calculation of the “total costs incurred” those “costs incurred by subcontractors or suppliers” and payments made to subcontractors or suppli-

ers for work or products to which you have not acquired title.<sup>132</sup> The FAR provides that contractors must demonstrate adequate systems for reviewing and administering progress payments to subcontractors.<sup>133</sup>

*Fourth*, the clause also excludes from a progress payment cost base the “accrued costs of contractor contributions under employee pension plans until actually paid,” *unless* the contractor’s routine practice is to make quarterly payments or the contribution does not remain unpaid 30 days after the end of the quarter.<sup>134</sup>

In a perfect world, it would be advisable to obtain advance agreements covering the progress billing of cost elements, particularly indirect costs, so as to reduce or eliminate the prospect of later disagreements that could alter the flow of cash under the “Progress Payments” clause. The world, however, is not perfect and such costs will often long since have been incurred and paid by you before you reach an agreement with the CO as to the allowability or allocability of certain costs. Still, it might be possible to ameliorate the cost impact in this regard through well-defined and well-explained decrements in your periodically adjusted billing rates.<sup>135</sup>

#### ■ When Costs May Be Billed

Historically, a large contractor (small businesses were exempted from this requirement) could not recognize incurred costs for purposes of progress billing until “payment by cash, check, or other form of actual payment” had been *actually* made. This was known as the “paid cost rule,” and it required prime contractors to “front” payments to subcontractors before they could submit a progress payment request for the subcontractor’s bills. However, in 2002,<sup>136</sup> the FAR (but *not* Standard Form (SF) 1443, pursuant to which progress payments are requested<sup>137</sup>) was amended allowing all contractors (both large and small) to invoice the Government for unpaid amounts determined to be due and payable to subcontractors, as long as the contractor ordinarily pays the amount within 30 days of the submission of the contractor’s payment request to the Government.<sup>138</sup>

The DCAA is charged with (1) verifying the amounts included on SF 1443 to the contractor's accounting records, (2) evaluating the propriety of the progress payment request in accordance with the provisions of the contract, and (3) determining whether undue financial risk to the Government will result if the request is granted.<sup>139</sup> The FAR cautions that a CO should not routinely ask for audits of progress payment requests, but if there is reason to question the reliability or accuracy of the request or to believe that the contract will involve a loss, the CO should ask for an audit.<sup>140</sup>

Despite the DCAA's vigilance, it admittedly forgives (and in fact *sanctions*) omissions on SF 1443. As already noted, SF 1443 was *not* updated in 2002 when the paid cost rule was eliminated to allow large contractors to submit requests for progress payments for unpaid incurred costs on the same basis as small businesses. As the form currently stands, Item 9 requires a contractor to declare its "*paid costs* eligible under Progress Payment clause," while Item 10 requires a contractor to separately declare its "*incurred costs* eligible under Progress Payment clause."<sup>141</sup> With the paid cost rule eliminated, the information required in Item 9 should be *irrelevant*. Recognizing this fact, the DCAA has counseled its auditors that "large contractors should not complete [Item 9] and should follow the same instructions to complete SF 1443 as provided for small contractors. All contractors should complete [I]tem 10."<sup>142</sup> While the DCAA's internal guidance ignores a glaring irregularity to achieve the overall regulatory purpose, the fact remains that large contractors must certify their SFs 1443.<sup>143</sup> Those certifications should be based on the information and instructions provided on the face of the form. A form that is outdated and requires contractors to ignore the form's own instructions has no place in the federal system. For such a form to require certification is an outrage.

Recognizing the inadequacy of SF 1443, the DOD recently requested comments on "what improvements could be made to the form," hoping to simplify the form and to improve consistency with the "Progress Payments" clause.<sup>144</sup> As this BRIEFING PAPER goes to press, the DOD has not

published a description of the comments it received, but hopefully, the DOD will recognize the clear and obvious inadequacy of SF 1443 and update it to reflect the current regulations.

#### ■ Liquidation

Progress payments represent, in effect, "loans" or a "debt" owed by the contractor to the Government that is "liquidated" by contract performance. Liquidation can occur in a number of ways. The "Progress Payments" clause states that "all progress payments shall be liquidated by deducting from any payment under this contract, other than advance or progress payments, the unliquidated progress payments, or 80 percent of the amount invoiced, whichever is less."<sup>145</sup> In simpler terms, progress payments are liquidated by deducting them, up to a point, from payments due for completed contract performance. The amount of the unliquidated progress payments may not exceed either (1) the progress payments made against incomplete work, or (2) the value of the incomplete work.<sup>146</sup>

Normally, the liquidation rate is the same as the progress payment rate.<sup>147</sup> However, the CO can adjust the liquidation rate if all of the following criteria are present:<sup>148</sup>

- (1) The contractor requests a reduction in the rate;
- (2) The rate has not been reduced in the preceding 12 months;
- (3) The contract delivery schedule extends at least 18 months from the contract award date;
- (4) Data on actual costs are available—
  - (i) the products delivered, or
  - (ii) if no deliveries have been made, for a performance period of at least 12 months;
- (5) The reduced liquidation rate would result in the Government recouping under each invoice the full extent of the progress payments applicable to the costs allocable to that invoice;
- (6) The contractor would not be paid for more than the costs of items delivered and accepted (less allocable progress payments) and the earned profit on those items;
- (7) The unliquidated progress payments would not exceed the limit prescribed in...the Progress Payments clause;

(8) The parties agree on an appropriate rate; and

(9) The contractor agrees to certify annually, or more often if requested by the contracting officer, that the alternate rate continues to meet the conditions of subsections 5, 6, and 7 of this section. The certificate must be accompanied by adequate supporting information.

The FAR provides detailed guidance on calculating alternate liquidation rates.<sup>149</sup> It reminds COs that they must ensure that a liquidation rate is:<sup>150</sup>

(1) High enough to result in Government recoupment of the applicable progress payments on each billing; and

(2) Supported by documentation included in the administration office contract file.

Liquidation can occur in other ways as well. For example, if the amount of unliquidated progress payments exceeds the limits, then the CO may require immediate liquidation and repayment by the contractor.<sup>151</sup> If a contract is terminated for default, unliquidated progress payments are “liquidated” through repayment by the contractor on demand of the CO.<sup>152</sup> The Government may also liquidate at an “increased” rate if the CO determines on substantial evidence that the contractor has endangered performance, failed to comply with material contract requirements, or is delinquent in paying subcontractors or suppliers or that unliquidated progress payments exceed the fair value of work accomplished under the contract.<sup>153</sup> Under those circumstances, the CO theoretically can “call” the repayment of all progress payments to reduce or eliminate the Government’s potential losses. Additionally, the clause authorizes the Government to “unilaterally change from the ordinary liquidation rate to an alternate rate when deemed appropriate for proper contract financing.”<sup>154</sup>

#### ■ Suspension Or Reduction Of Payments

COs may reduce or suspend progress payments for the same reasons that they may increase the rate of progress payment liquidation. The “Progress Payments” clause states:<sup>155</sup>

The Contracting Officer may reduce or suspend progress payments, increase the rate of liquidation, or take a combination of these

actions, after finding on substantial evidence any of the following conditions:

(1) The Contractor failed to comply with any material requirement of this contract....

(2) Performance of this contract is endangered by the Contractor’s (i) failure to make progress or (ii) unsatisfactory financial condition.

(3) Inventory allocated to this contract substantially exceeds reasonable requirements.

(4) The Contractor is delinquent in payment of the costs of performing this contract in the ordinary course of business.

(5) The unliquidated progress payments exceed the fair value of the work accomplished on the undelivered portion of this contract.

(6) The Contractor is realizing less profit than that reflected in the establishment of any alternate liquidation rate...and that rate is less than the progress payment rate....

Because the clause establishes a “substantial evidence” standard, decisions to reduce or suspend progress payments may be reviewed for compliance with that standard.<sup>156</sup> In one case, however, the ASBCA apparently evaluated a CO’s failure to make progress payments under an “abuse of discretion” standard.<sup>157</sup> Note that the “substantial evidence” standard does not require the CO to demonstrate that a performance failure was a predictable certainty. Instead, the CO need only demonstrate that a “realistic and reasonably foreseeable danger” threatened performance.<sup>158</sup>

Cases have also arisen in which sureties have attempted to block the Government’s payment of progress payments to contractors and have sued when the Government has refused to do so. In those cases, the standard of review is whether the Government’s actions were a reasonable exercise of discretion or an arbitrary disregard of the surety’s rights.<sup>159</sup>

Some types of contracts, including time-and-materials and labor-hour contracts, require the CO to withhold “5 percent of the amounts due...but the total amount withheld shall not exceed \$50,000.”<sup>160</sup> These withheld amounts are held by the Government until a final release is executed at contract conclusion, whereupon the withheld amounts are paid to the

contractor.<sup>161</sup> In 2003, the DOD amended the DFARS to make this withholding requirement permissive instead of mandatory when the contractor had a record of timely submitting its final releases.<sup>162</sup> Following suit in May 2004, the FAR Council published a proposed rule amending the FAR to conform with the DOD rule and making the withholding requirement permissive based on the contractor's background.<sup>163</sup> The reason this change is contemplated is because the current provisions are administratively burdensome and because the requirement often results in withholding more money from the contractor than is necessary to protect the Government's interest.<sup>164</sup>

If the CO suspends a material amount of progress payments without "substantial evidence," any negative impact on performance is arguably excusable. Thus, the ASBCA has ruled that liquidated damages cannot be assessed against a contractor delayed by an improper suspension of progress payments.<sup>165</sup> Similarly, a default termination can be converted to a termination for convenience where performance failure was caused, in significant part, by an improper failure to make progress payments.<sup>166</sup>

Beyond these narrow precepts, the effects of the Government's improper withholding of progress payments are not entirely clear. The central issue is whether a wrongful and substantial withholding of progress payments is a material breach of contract by the Government that justifies a contractor's refusal to proceed with performance, or whether the Government's failure to pay is merely a compensable constructive change. In several cases involving a contractor's failure or refusal to proceed, courts and boards have concluded that a Government failure to pay over an extended period can constitute a material breach justifying a contractor's cessation of performance.<sup>167</sup> Note, however, that the mere failure to make a progress payment, absent additional circumstances, will not in and of itself, justify abandonment of a Government contract.<sup>168</sup>

On the other hand, the ASBCA has also held, in the face of equitable adjustment claims, that an improper Government failure to pay gives rise to a compensable constructive change,

ruling by implication that such payment failures are not "breaches" justifying contract abandonment, but instead are within the scope of the "Changes" clause.<sup>169</sup> Clearly, a significant and wrongful failure to pay cannot be a breach of contract for some purposes and within the scope of the "Changes" clause for others. At least one board of contract appeals has voiced concern over this dilemma,<sup>170</sup> but no court or board has reconciled the two positions.

#### ■ Financing Payments To Subcontractors

If you are a prime contractor receiving progress payments, the FAR requires that you flow down the "Progress Payments" clause to all of your subcontracts, enabling your subcontractors also to receive progress payments or some other type of contract financing.<sup>171</sup> Notably, as discussed below, performance-based payments carry the same requirement.<sup>172</sup>

You *must* pay your suppliers and subcontractors in a timely manner. In fact, you must certify this fact when submitting a request for progress payment.<sup>173</sup> "If the contractor is delinquent in paying the costs of contract performance in the ordinary course of business, the contracting officer shall evaluate whether the delinquency is caused by an unsatisfactory financial condition" and may suspend further progress payments or require the contractor to correct the delinquencies.<sup>174</sup> If the contractor has, in good faith, disputed amounts claimed by suppliers or subcontractors, then the CO should not consider the contractor delinquent until after the dispute is resolved and the amounts remain unpaid; however, the disputed amount should not be included in the costs eligible for progress payments.<sup>175</sup>

If a contractor is delinquent in its payments to its suppliers or subcontractors, the supplier or subcontractor may ask the CO whether progress payments have been made to the contractor.<sup>176</sup> If payments have been made, but the supplier or subcontractor has not received payment from the contractor, the supplier or subcontractor may inform the CO of the delinquency, whereupon the CO may investigate to confirm whether the contractor has made payments and whether the contractor's certifications with its progress

payment requests were correct.<sup>177</sup> If the CO determines that the subcontractor was correct and that payments have not been made, the CO may “(1) [e]ncourage the contractor to make timely payment to the subcontractor or supplier; or (2) [i]f authorized by the applicable payment clauses, reduce or suspend progress payments to the contractor.”<sup>178</sup> If the CO determines that a certification was inaccurate “in any material respect,” the CO can initiate administrative or remedial action as appropriate, which could include a possible referral of the allegedly false certification as a potential violation of the False Claims Act.<sup>179</sup> False certifications and the False Claims Act<sup>180</sup> are discussed in greater detail below and in Part II of this PAPER, to be published next month.

Historically, while there were some regulatory protections to ensure payment to subcontractors or suppliers, there was no absolute requirement to pay subcontractors or suppliers in a timely manner.<sup>181</sup> However, in the early 1990s, Congress began to investigate whether subcontractors were timely paid by contractors receiving financing payments.<sup>182</sup> Concluding that subcontractor payment was not adequately addressed by the regulations, Congress included subcontractor payment requirements as part of FASA.<sup>183</sup> The FASA requirements made applicable Government-wide subcontractor payment requirements that had already been applied to DOD contracts in 1991.<sup>184</sup> By 1995, the statutory requirements were incorporated in the FAR.<sup>185</sup>

#### ■ Title

As security for progress payments, the Government obtains title to all “property” allocable or chargeable to the contract. Title to such property vests on the date of the contract for property acquired or produced before that date.<sup>186</sup> Otherwise, vestiture occurs when the property “is or should have been allocable or properly chargeable to this contract.”<sup>187</sup> For purposes of the “Progress Payments” clause, “property” is defined as:<sup>188</sup>

(i) Parts, materials, inventories, and work in process;

(ii) Special tooling and special test equipment to which the Government is to acquire title under any other clause of this contract;

(iii) Nondurable (*i.e.*, noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and

(iv) Drawings and technical data, to the extent the Contractor or subcontractors must deliver them to the Government by other clauses of this contract.

You may not dispose of any property to which title has vested in the Government under the clause without the approval of the CO,<sup>189</sup> except that you may sell scrap without the CO’s approval, provided you promptly credit the proceeds against the cost of performance.<sup>190</sup> If approval is obtained from the CO to sell property, then the contractor must exclude the allocable costs of the sold property from the costs of contract performance and repay any amount of unliquidated progress payments allocable to the property.<sup>191</sup> On the other hand, when the contractor satisfies all of its obligations under the contract, title to all property not delivered to and accepted by the Government or incorporated in supplies delivered to and accepted by the Government vests in the contractor.<sup>192</sup>

The FAR also imposes an affirmative duty on the CO to ensure that the Government’s title to the items of property affected by the “Progress Payments” clause “is not compromised by other encumbrances.”<sup>193</sup> The existence of any such encumbrances is a violation of the contractor’s obligations under the contract.<sup>194</sup> Ordinarily, a contractor’s certification alone that the property is not subject to competing encumbrances is sufficient,<sup>195</sup> but if the CO becomes aware of any facts that might impair the Government’s title, the CO may order “additional protective provisions” as necessary,<sup>196</sup> including:<sup>197</sup>

(a) Personal or corporate guarantees.

(b) Subordinations or standbys of indebtedness.

(c) Special bank accounts.

(d) Protective covenants of the kinds [contemplated under the “Advance Payments” clause].

The FAR specifically warns a CO that “if the contractor fails to disclose an existing encumbrance in the progress payments certification,

the [Administrative] CO should consult with legal counsel concerning possible violation of 31 U.S.C. § 3729, the False Claims Act.”<sup>198</sup>

The “title” provisions of the “Progress Payments” clause have been the subject of some dispute. Most often, the “title” issue arises during bankruptcy proceedings in which the Government asserts outright ownership to the bankrupt contractor’s property by reason of the “Progress Payments” clause. Amidst charges that the clause conveys only a lien or “naked title,” courts and boards of contract appeals have nevertheless ruled that the Government receives real title under the clause.<sup>199</sup> However, an opposite result was reached when U.S. Court of Appeals for the Federal Circuit affirmed a lower court’s ruling that the Government’s interest under the “Progress Payments” clause is a lien interest.<sup>200</sup> The boards appear to have followed the Federal Circuit and the predecessor Court of Claims in applying a lien theory.<sup>201</sup>

The “title” issue has also received different treatment in tax cases, where the contractor asserts that the Government has title to avoid property taxes. Strangely enough, some cases have held that the “title” provision, for tax purposes, merely vests “naked title” in the Government, leaving a taxable “equitable” title in the contractor.<sup>202</sup> Other cases have held, however, that payment by the Government vests title in the Government, exempting contractors from state taxation.<sup>203</sup> There is no consensus on this issue.

#### ■ Risk Of Loss

Despite the fact that title of the property lies with the Government, the FAR is clear that the risk of loss on the property remains with the contractor before delivery to and acceptance by the Government, unless the Government expressly agrees otherwise.<sup>204</sup> If property is damaged, lost, stolen, or destroyed, the CO will require you to repay the Government an amount equal to the unliquidated progress payments allocable to that property.<sup>205</sup> Note, however, that even if the Government assumes the risk, a serious loss may impede your ability to continue to perform on the contract, which could cause

the CO to reduce or suspend your progress payments.<sup>206</sup> Note also that property to which the Government acquires title under the “Progress Payments” clause does not necessarily become Government-furnished property, and liability for this property remains with the contractor.<sup>207</sup>

#### ■ Certification

In submitting a request for a progress payment with SF 1443, you must certify the following facts:<sup>208</sup>

- (1) That the statement of costs provided with the request for progress payment was prepared from the contractor’s books and records in accordance with the contract requirements;
- (2) That, to the best of your knowledge and belief, the statement of costs is correct;
- (3) That, to the best of your knowledge and belief, all the costs of contract performance (except as reported in SF 1443) have been paid to the extent described, or will be paid when due, in the ordinary course of business;
- (4) That, to the best of your knowledge and belief, the work reflected in SF 1443 has been performed and that the quantities and amounts involved are consistent with the requirements of the contract;
- (5) That there are no encumbrances against the contract property that would impair the Government’s title (except as otherwise reported in writing);
- (6) That there has been no materially adverse change in the financial condition of the contractor since the submission of the most recent written invoice;
- (7) That, to the extent any contract provision limits progress payments pending first article approval, such provision has been complied with; and
- (8) That after the making of the requested progress payment the unliquidated progress payments will not exceed the maximum unliquidated progress

payment amount permitted by the contract.

Because a false certification could lead to criminal liability<sup>209</sup> or civil liability under the False Claims Act,<sup>210</sup> you must make sure that your progress payment requests accurately represent and satisfy all of the certification requirements. DCAA auditors are charged with verifying, “at a minimum,” the “amounts on the contractor’s certified SF 1443 to the contractor’s accounting books and records.”<sup>211</sup>

In light of this, it is worth noting *again* that SF 1443 has *not* been updated to reflect the regulatory changes made to the paid cost rule in 2002. The DCAA instructs its auditors to “ignore” this fact and instructs large contractors to fill out the form “as provided for small contractors.”<sup>212</sup> Instead of suggesting that a large contractor submit a certification that is inconsistent with the text of the form in which the certification is embedded, the Government should simply update this 22-year-old form to reflect current regulatory requirements. In the alternative, in the interim, large contractors may want to consider “qualifying” their SF 1443 certifications to note the revised regulations and the qualifying DCAA guidance. Hopefully, following on the DOD’s recent call for comments on how to improve SF 1443,<sup>213</sup> this problem will soon be corrected.

## “Performance-Based Payments” Clause

### ■ Availability

As with the “Progress Payments” clause, inclusion of the “Performance-Based Payments” clause<sup>214</sup> is discretionary, provided the following conditions are met:<sup>215</sup>

- (a) The contracting officer and offeror are able to agree on the performance-based payment terms;
- (b) The contract is a fixed-price type contract; and
- (c) The contract does not provide for other methods of contract financing, except that advance payments...or guaranteed loans...may be used.

As with progress payments, the availability of performance-based payments depends on the contract price and business size, absent agency regulations to the contrary. For small businesses, either the contract must exceed the simplified acquisition threshold of \$100,000<sup>216</sup> or (for an indefinite-delivery contract) the expected value of orders must exceed the simplified acquisition threshold;<sup>217</sup> for other businesses, the contract or expected value of the orders must be at least \$2 million.<sup>218</sup>

### ■ Effect On Evaluation For Award

As with progress payments, if a solicitation contains a “Performance-Based Payments” clause, a bid indicating that payments will be sought does not affect the validity of that bid.<sup>219</sup> However, unlike with progress payments, the regulations are unclear as to whether a bid conditioned on the receipt of performance-based payments, despite the fact that the solicitation does not mention performance-based payments, is responsive.<sup>220</sup> In fact, the ambiguity in the standard solicitation provision seems to indicate that as long as the proposed performance-based financing terms satisfy the requirements of the regulations, the terms would be sufficient.<sup>221</sup>

### ■ Predetermined Events Or Criteria

Instead of basing payment on costs and a pre-set payment rate, a performance-based payment schedule identifies mutually agreeable payment amounts based on meeting certain significant contract events or criteria.<sup>222</sup> Events should represent integral and meaningful aspects of contract performance and should signify true progress in completing the contract effort; events that do not require meaningful effort or action (e.g., signing the contract or exercising an option) should not be selected as events.<sup>223</sup>

Events or criteria may be either severable or cumulative.<sup>224</sup> The FAR explains: “The successful completion of a severable event or criterion is independent of the accomplishment of any other event or criterion. Conversely, the successful accomplishment of a cumulative event or criterion is dependent upon the previous accomplishment of another event.”<sup>225</sup> Consequently,

the contract must specifically identify severable events or criteria, as well as the preconditions for cumulative events or criteria. The CO will not pay you for cumulative events or criteria until the precedent events have occurred.<sup>226</sup> Additionally, the CO may, at any time, require you to substantiate the successful performance of an event or criterion that you claim has occurred and on which a payment is due.<sup>227</sup> Where there is a Government-caused delay, the CO may renegotiate the payment amounts to permit billing for those portions of the delayed events or criteria that have been successfully accomplished.<sup>228</sup>

Performance-based payments may be made based on the contract as a whole or on a deliverable item basis—the difference is based on how the parties agree on payment and how the event or criterion is identified and priced in the contract.<sup>229</sup> For example:<sup>230</sup>

[A] contract line item for 10 airplanes, with a unit price of \$1,000,000 each, has 10 deliverable items—the separate planes. A contract line item for 1 lot of 10 airplanes, with a lot price of \$10,000,000, has only one deliverable item—the lot.

The DOD’s “User’s Guide to Performance Based Payments” advises: “Once the candidate events have been selected, it is essential to define them as clearly and precisely as possible so that their accomplishment can in fact be determined. Ideally, the definitions of these events and the measurements or other indicators to be used to determine their achievement should be such that there can be no argument or uncertainty about whether they warrant making [a performance-based payment].”<sup>231</sup> The DOD offers more specific guidance and examples, but it is important to remember that each event must be determined by the program objectives, the statement of work, and your need for financing payments. It is absolutely critical that the parties arrive at a clear definition of events, agreeing on the basis for payment and exactly what is required to qualify for payment.<sup>232</sup>

Despite the fact that performance-based payments “feel” like payment for work completed to date (similar to partial payments), performance-based payments are contract financing

payments, *not* payment for accepted items.<sup>233</sup> Consequently, performance-based payments are not subject to the interest penalty provisions of the Prompt Payment Act,<sup>234</sup> and unliquidated payments may be recovered by the Government if the contractor fails to meet its contractual obligations.<sup>235</sup>

#### ■ Establishing Performance-Based Payment Amounts

The CO “must establish a complete, fully defined schedule of events or performance criteria and payment amounts when negotiating contract terms. If a contract action significantly affects the price, or event or performance criterion, the contracting officer responsible for pricing the contract modification must adjust the performance-based payment schedule appropriately.”<sup>236</sup> The total performance-based payment amount must reflect “prudent contract financing,” which will be provided only to the extent needed for contract performance. Additionally, the payment amount cannot exceed 90% of the contract price, if on a whole contract basis, or 90% of the delivery, if on a delivery item basis.<sup>237</sup>

The contract must specifically state the amount of each performance-based payment “either as a dollar amount or as a percentage of a specifically identified price” (such as the contract price or a unit price).<sup>238</sup> In determining the payment amount, COs may use “any rational basis,” including (1) engineering estimates of stages of completion, (2) engineering estimates of hours or other measures of effort to be expended in performance of an event or achievement of a performance criterion, or (3) the estimated projected cost of performance of particular events.<sup>239</sup> Payment of a performance-based payment by the Government does not constitute “acceptance” and does not excuse the contractor from any performance under the contract.<sup>240</sup>

#### ■ Submitting Requests For Performance-Based Payments

Requests for payment from the DOD are submitted to the Defense Contract Management Agency. While there is no official Government-wide form that you must use to re-



quest a performance-based payment, the DOD has a standard form attached to its “User’s Guide” that it “strongly encourages” contractor’s to use.<sup>241</sup> Different from the information requested on the SF 1443 for progress payments, the DOD form requires only identification of a CLIN, an “event description,” quantity, and a requested payment amount.<sup>242</sup> As discussed in greater detail below, this form also requires a contractor certification.

One point worth noting on requests for performance-based payments is that these requests are based on achieving predetermined events—not *costs*. Consequently, you are not required to explain your incurred costs in requesting a performance-based payment. Still, in practice, many agencies have had a difficult time letting go of the familiar procedures associated with cost-based progress payments, and the Government may still ask you for incurred cost information.

#### ■ Liquidation

As with progress payments, performance-based payments to the contractor are a type of “debt” that is liquidated by contract performance. The “Performance-Based Payments” clause states:<sup>243</sup>

Performance-based finance amounts paid prior to payment for delivery of an item shall be liquidated by deducting a percentage or a designated dollar amount from the delivery payment. If the performance-based finance payments are on a delivery item basis, the liquidation amount for each such line item shall be the percent of that delivery item price that was previously paid under performance-based finance payments or the designated dollar amount. If the performance-based finance payments are on a whole contract basis, liquidation shall be by either predesignated liquidation amounts or a liquidation percentage.

The CO must specify the liquidation rate or designated dollar amount in the contract.<sup>244</sup> Because the liquidation rate is predetermined, performance-based liquidation rates do not have the same type of elaborate cost-based calculations as do progress payment liquidation rates.<sup>245</sup>

Still, as with progress payments, liquidation can occur in other ways beyond simply adjust-

ing the liquidation rate. If the contractor defaults on the contract, the Government may insist on immediate repayment.<sup>246</sup> Additionally, similar to progress payments, as discussed below, the CO may reduce or suspend performance-based payments based on a contractor’s failure to pay its suppliers or subcontractors<sup>247</sup> or for other reasons relating to its perceived financial condition.<sup>248</sup>

#### ■ Suspension Or Reduction Of Payments

As with progress payments, the CO may reduce or suspend performance-based payments based upon certain conditions:<sup>249</sup>

The Contracting Officer may reduce or suspend performance-based payments, liquidate performance-based payments by deduction from any payment under the contract, or take a combination of these actions after finding upon substantial evidence any of the following conditions:

(1) The Contractor failed to comply with any material requirement of this contract (which includes [the Contractor’s obligation to maintain adequate records supporting the performance-based payments and the Government’s right to review these records]).

(2) Performance of this contract is endangered by the Contractor’s (i) failure to make progress, or (ii) unsatisfactory financial condition.

(3) The Contractor is delinquent in payment of any subcontractor or supplier under this contract in the ordinary course of business.

As in the case of progress payments, reductions or withholding of performance-based payments must satisfy a “substantial evidence” standard.<sup>250</sup> In fact, the FAR specifically incorporates the progress payment rules and procedures for reducing or suspending performance-based payments.<sup>251</sup>

#### ■ Financing Payments To Subcontractors

As with progress payments, if you are a prime contractor receiving performance-based payments, the FAR requires that you flow-down the “Performance-Based Payments” clause to all of your subcontracts, enabling your subcontractors to also receive contract financing payments.<sup>252</sup> As with progress payments, you *must* pay your suppliers and subcontractors in a timely manner.<sup>253</sup>

### ■ Title

Again, as with progress payments, the Government obtains title to all property allocable or chargeable to the contract.<sup>254</sup> “Property” for purposes of this clause has the exact same meaning as under the “Progress Payments” clause.<sup>255</sup> Moreover, the title provisions of the “Performance-Based Payment” clause mirror those of the “Progress Payments” clause,<sup>256</sup> and the FAR likewise imposes a duty on the CO to monitor contract property and ensure that no unauthorized encumbrances burden the property.<sup>257</sup>

### ■ Risk Of Loss

Similarly, the risk of loss provisions of the “Performance-Based Payments” clause mirror those of the “Progress Payments” clause. Despite the fact that title of the property lies with the Government, the risk of loss remains with the contractor before delivery to and acceptance by the Government, unless the Government expressly agrees otherwise.<sup>258</sup>

### ■ Certification

When you submit your request for a performance-based payment, there is no standard form that must be completed (although the DOD does have a recommended form for submitting payment requests).<sup>259</sup> Instead, the “Performance-Based Payments” clause prescribes the content of the request, including (1) the name and address of the contractor, (2) the date of the request for performance-based payment, (3) the contract number or order number, (4) such information and documentation as is required by the contract’s description of the basis for payment, and (5) a certification.<sup>260</sup>

The certification, which is substantially similar to the certification made with SF 1443 request for progress payment, is as follows:<sup>261</sup>

I certify to the best of my knowledge and belief that—

(1) This request for performance-based payment is true and correct; this request (and attachments) has been prepared from the books and records of the Contractor, in accordance with the contract and the instructions of the Contracting Officer;

(2) (Except as reported in writing on \_\_\_\_\_), all payments to subcontractors and suppliers under this contract have been paid, or will be paid, currently, when due in the ordinary course of business;

(3) There are no encumbrances (except as reported in writing on \_\_\_\_\_) against the property acquired or produced for, and allocated or properly chargeable to, the contract which would affect or impair the Government’s title;

(4) There has been no materially adverse change in the financial condition of the Contractor since the submission by the Contractor to the Government of the most recent written information dated \_\_\_\_\_; and

(5) After the making of this requested performance-based payment, the amount of all payments for each deliverable item for which performance-based payments have been requested will not exceed any limitation in the contract, and the amount of all payments under the contract will not exceed any limitation in the contract.

## Noncommercial Advance Payments

As already noted, performance-based payments and progress payments are the preferred ways of providing contract financing for noncommercial purchases.<sup>262</sup> The third financing technique for noncommercial contracts is advance payments. While advance payments are a form of contracting financing available under the FAR, they are the least preferred method used by the Government.<sup>263</sup>

Unlike progress payments or performance-based payments, the availability of advance payments is not keyed to performance (i.e., meeting certain predesignated events or criteria or based on total contract costs),<sup>264</sup> although the contract price serves as a ceiling for advance payments. Rather, advance payments are unique, statutorily authorized<sup>265</sup> payments made by the Government to a prime contractor “before, in anticipation of, and for the purpose of complete performance under one or more contracts.”<sup>266</sup> Only prime contractors are eligible for advance payments. They may, in turn, however, advance all or portions of such payments to their subcontractors.<sup>267</sup> Unlike with progress payments and performance-based payments, there is no absolute requirement for a contractor to pay its suppliers or subcontractors with proceeds

from an advance payment. In the normal course of events, advance payments, like progress payments, are liquidated from payments due the contractor for completed performance.<sup>268</sup>

#### ■ Statutory Authority

Government agencies generally are prohibited from paying for goods and services in advance of their receipt.<sup>269</sup> However, both the Armed Services Procurement Act (governing military agencies) and the Federal Property and Administrative Services Act (governing civilian agencies) authorize advance payments where (1) the contractor provides adequate security, (2) such payments do not exceed the unpaid contract price, and (3) the head of the agency determines, in writing, that advance payments are in the public interest or facilitate the national defense.<sup>270</sup> Agencies may also authorize advance payments, either before award or during contract performance, pursuant to their residual powers under Public Law 85-804 to grant extraordinary contractual relief, based on a written determination by the appropriate agency official that such payments would facilitate the national defense.<sup>271</sup>

#### ■ Availability

Although advance payments may be provided under any type of contract, this form of contract financing is to be used “sparingly.”<sup>272</sup> It is the least preferred method from the Government’s perspective, and agencies are encouraged to avoid such payments if alternate financing methods are reasonably available to the contractor.<sup>273</sup> The FAR, however, specifically identifies certain contracts as potential candidates for advance payments, based on the subject matter of the contract or the legal status of the contractor.<sup>274</sup> For example, contracts for experimental research or development work with nonprofit educational or research institutions are appropriate for advance payment financing, as are contracts with small business concerns, contracts for the management and operation of Government-owned plants, and classified contracts whose sensitive subject matter bars more traditional commercial financing through assignment of contract proceeds.<sup>275</sup>

In addition, the FAR recognizes a number of factual situations in which advance payments may be approved.<sup>276</sup> Specifically, advance payments are appropriate where commercial financing is, as a practical matter, unavailable, such as where commercial interest rates are deemed excessive, where a financing institution refuses to assume a reasonable portion of the risk under a guaranteed loan, or where the remote location of contract performance would preclude effective administration of a guaranteed loan.<sup>277</sup> Advance payments may also be authorized where unspecified “exceptional circumstances” make this type of financing the most advantageous for both the Government and the contractor.<sup>278</sup> Factors such as urgent supply schedules and delivery delays anticipated because of inadequate financing may constitute such “exceptional circumstances.”

Provided the underlying statutory and regulatory restrictions are met, the CO “shall generally recommend that the agency authorize advance payments.”<sup>279</sup> Additionally, advance payments may be authorized in conjunction with partial or progress payments under the same contract.<sup>280</sup> Therefore, if you are having difficulty obtaining adequate commercial financing and if your contract or the circumstances of performance fall within the foregoing categories, a request for advance payments should be considered.

#### ■ Effect On Evaluation

You may request advance payments before contract award, notwithstanding the absence of an advance payments provision in the solicitation.<sup>281</sup> However, bear in mind that any bid conditioned on the subsequent authorization of advance payments will be rejected as nonresponsive.<sup>282</sup> Moreover, you should recognize that the decision to authorize advance payments is within the agency’s discretion. Award to you may, therefore, be disapproved on grounds of nonresponsibility if your request for advance payments is denied and you are otherwise unable to obtain sufficient working capital to ensure timely contract performance.<sup>283</sup>

### ■ Restrictions

In addition to the statutory limitations outlined above, the FAR prescribes five additional underlying determinations essential to an advance payment authorization.<sup>284</sup> *First*, the advance payments must not exceed your interim cash flow needs.<sup>285</sup> *Second*, such payments must be necessary to supplement other funds or credit available to you.<sup>286</sup> *Third*, the CO must find that you otherwise qualify as a “responsible” contractor.<sup>287</sup> *Fourth*, the Government must obtain some type of prospective benefit from such payments.<sup>288</sup> And *fifth*, the contract to be financed must fall within the categories for which advance payments are expressly authorized, as described above.<sup>289</sup>

### ■ Application For Payments

Your request for advance payments, whether sought before contract award or during performance, must be submitted in writing to the CO.<sup>290</sup> The application must include a reference to the solicitation or contract, a cash-flow forecast for the contract period, the total amount of advance payments sought, the name of the financing institution designated to hold such payments, and a statement of your efforts to obtain alternative financing.<sup>291</sup> You should also include in your application any additional information that might assist the CO in making a determination that advance payments are warranted. In particular, any information bearing on your overall financial condition, your ability to perform the contract without loss to the Government, and any anticipated financial safeguards necessary to protect the Government’s interests should be spelled out in your application.<sup>292</sup>

Advance payments may be used to finance several contemporaneous contracts that you may be performing for different agencies. For the sake of convenience, all such payments may be held in a single payment pool administered by a single Government office.<sup>293</sup>

Based on the CO’s review of your application and any investigations deemed necessary, the CO will transmit your advance payment request, together with a recommendation for approval or disapproval, to the designated re-

viewing authority.<sup>294</sup> If the CO recommends that your application be approved, the CO will include the prescribed determination and authorization and a statement of the amount and proposed terms pursuant to which the payments will be made.<sup>295</sup>

### ■ Security

Understandably, any advance payments made by the Government must be supported by adequate security,<sup>296</sup> and failure to obtain the necessary security can make the payment illegal.<sup>297</sup> The nature and extent of the security required is determined on a case-by-case basis. In virtually all instances, however, the Government will demand that a special bank account be established at the financing institution designated in your advance payment application.<sup>298</sup> Pursuant to a written agreement executed by your bank, the Government, and you, the bank will hold the advance payments in a separate account to be drawn down for incurred direct labor and materials charges and allowable overhead expenses.<sup>299</sup> In cost-reimbursement type contracts, such funds may be used only for allowable incurred cost items.<sup>300</sup>

The “Agreement For Special Bank Account” will incorporate a number of substantive and procedural restrictions on the advance payments. Specifically, the agreement must grant the Government a lien, superior to that of the bank, on the account funds.<sup>301</sup> In addition, the bank must agree to be bound by the terms of your contract with the Government and to act only on the written direction of the CO or the CO’s duly authorized representative.<sup>302</sup> Moreover, the bank must make available to the Government, on request, all books and records it maintains relative to your advance payment account.<sup>303</sup>

By virtue of the “Advance Payments” clause incorporated in your contract, the bank may not commingle advance payments with other funds you may have at that bank.<sup>304</sup> Moreover, such funds may be released only on a check countersigned by the CO or the CO’s authorized representative.<sup>305</sup> The countersignature requirement may be waived if your company is financially sound and has had a favorable contract performance and audit track record.<sup>306</sup>

Apart from its priority lien on the special bank account, the Government's interest in advance payments is further secured by a paramount lien on all materials, supplies, equipment, and other things acquired for or allocated to the performance of the contract.<sup>307</sup> You will be required to identify and segregate all equipment and supplies subject to the Government's lien,<sup>308</sup> and you must carry adequate insurance to cover the risk of any loss of that property.<sup>309</sup> This priority lien in favor of the Government precludes, of course, any assignment by you of contract proceeds or claims under the contract, at least until such time as all advance payments are liquidated.<sup>310</sup>

The foregoing security provisions are considered to be the *minimum* essential to protect the Government's interests. The Government may, in its discretion, seek supplementary security in the form of personal or corporate endorsements or guarantees, pledges of collateral, subordination of other indebtedness, or controls or limitations on, for example, profit distributions, salaries, bonuses, and capital expenditures. In rare cases, an advance payment bond may be sought.<sup>311</sup> Finally, the Government reserves the right—at any time during performance—to require that you post additional security if it determines that the security previously furnished is inadequate.<sup>312</sup>

#### ■ Interest

You will be required to pay interest on the daily unliquidated balance of all advance payments at the higher of (1) the published prime rate at the bank in which your advance payments are deposited or (2) the rate established by the Secretary of the Treasury by statute.<sup>313</sup> Interest will be computed monthly and will be adjusted for prime rate variations.<sup>314</sup> Remember that such interest costs may not be charged to any Government contracts you may be performing.<sup>315</sup> However, agencies are authorized to *exempt* interest charges on advance payments made in connection with contracts for experimental research or development work with non-profit education or research institutions, contracts solely for the management and operation of Government-owned plants, and cost-

reimbursement contracts with state or local governments or their instrumentalities.<sup>316</sup>

#### ■ Liquidation

Like progress payments and performance-based payments, advance payments are liquidated as contract performance progresses. In addition, should you so desire, you may, without penalty, accelerate repayment of any or all of the funds advanced to you by the Government.<sup>317</sup> In any event, you are obligated to repay any funds in excess of your current needs if the CO requests that you do so.<sup>318</sup> The standard liquidation provision in the "Advance Payments" clause provides that when the sum of all unliquidated advance payments, unpaid interest charges, and other payments exceed an agreed-upon percentage of the contract price, the Government will withhold further payments to you.<sup>319</sup>

Upon completion of your contract, the Government will deduct from any balance due to you the amount of any unliquidated advance payments. If the remaining amounts owed to you are insufficient to make the Government whole, it will seek immediate repayment from you.<sup>320</sup> If your contract is terminated for default, you have breached any of the contractual warranties or covenants, or performance is otherwise jeopardized, the Government may—pursuant to a special "Default" provision—withdraw all monies remaining in your advance payment account, demand immediate repayment of the unliquidated advance payments, and foreclose on any and all contract property.<sup>321</sup>

#### Loan Guarantees

Federal loan guarantees are the fourth method under the FAR available to finance noncommercial contracts. Pursuant to the Defense Production Act,<sup>322</sup> the FAR sets forth procedures governing contractor loans guaranteed by the Government.<sup>323</sup> Loan guarantees are available only to "borrowers performing contracts related to national defense."<sup>324</sup> "National defense" is defined as "any activity related to programs for military or atomic energy production or construction, military assistance to any foreign nation, stockpiling, or space."<sup>325</sup>

The Government may guarantee loans through other methods as well—through an exercise of its extraordinary contractual relief powers<sup>326</sup> or by special legislation. For example, Congress enacted special legislation in 1980 to “bail-out” the Chrysler Corporation<sup>327</sup> and took immediate measures following the September 11, 2001 terrorist attacks in New York City and Washington, D.C. to prop up the airline industry.<sup>328</sup> Such special, statutory loan guarantees are indeed rare, following extraordinary events, and should not form the basis of any reasonable financing plan adopted by the contractor.

#### ■ Procedure

Under the regulations, a contractor does not receive a guaranteed loan directly from the Government, nor is a loan guaranteed at the request of the contractor. Instead, a contractor (or subcontractor or supplier) requiring operating funds to perform a contract related to national defense applies to a financial institution for a loan, and the financial institution then applies to the Federal Reserve Bank in its district for the guarantee.<sup>329</sup> The Federal Reserve Bank sends the application for review to the Federal Reserve Board, which in turn transmits the application to a “guaranteeing agency” to determine the contractor’s eligibility.<sup>330</sup> The following agencies are designated “guaranteeing agencies” under the FAR: (1) DOD, (2) Department of Energy, (3) Department of Commerce, (4) Department of the Interior, (5) Department of Agriculture, (6) General Services Administration, and (7) NASA.<sup>331</sup>

If the guarantee is approved, the Federal Reserve Bank merely acts as the “fiscal agent of the United States” on behalf of the guaranteeing agency in guaranteeing the loan, leaving the guaranteeing agency ultimately responsible for the financial implications of the guarantee.<sup>332</sup> However, it is the responsibility of the private financial institution to disburse and collect funds and to administer the loan in accordance with regulations promulgated by the Federal Reserve Board.<sup>333</sup> Note that guaranteeing agencies may only guarantee loans up to statutory limits imposed by Congress in annual authorization acts.<sup>334</sup>

#### ■ Eligibility

The FAR generally warns COs that contract financing methods should only be used to finance working capital, not expansion of capital assets.<sup>335</sup> However, through loan guarantees, exceptions to this general rule may be made for expansion of a contractor’s permanent facilities.<sup>336</sup>

Contractor eligibility for guaranteed loans is determined by COs at the request of the agency’s contract financing office or another interested agency.<sup>337</sup> A certificate of eligibility must include determinations that the supplies or services to be acquired are essential to the national defense, that the contractor has the facilities and ability required for contract performance, and that there is no “practicable alternate source for the acquisition without prejudice to the national defense.”<sup>338</sup> This latter determination is not required if the contractor is a small business.<sup>339</sup> The FAR also contains provisions governing percentage limitations of guarantees, assignment of claims, collateral security, surety bonds, and other borrowings.<sup>340</sup> These provisions should be reviewed before entering into guaranteed loans since they may affect your overall credit picture as a contractor.

The Department of Energy identifies additional criteria that it considers essential to determining a contractor’s eligibility.<sup>341</sup> The CO must make a determination that (1) the materials or services to be furnished by the contractor are necessary to the Government’s interest, (2) the materials or services cannot, as a practical matter, be obtained from alternate sources without delay or impeding the Government’s interest (except that no small business concern will be held ineligible for the issuance of such a guarantee by reason of alternative sources of supply), and (3) the contractor is competent to perform the contract.<sup>342</sup> Additionally, the Chief Financial Officer must determine that (a) the contractor has demonstrated its inability to obtain the necessary financing in conventional credit channels without the guarantee, and (b) there is reasonable assurance that the loan can be repaid.<sup>343</sup>

## ★ GUIDELINES ★

These *Guidelines* are intended to assist contractors and financing institutions in understanding the various financing techniques available to support the performance of Government contracts, the preconditions to their use, and the correlative rights of the Government, the contractor, and the financing institution—and the associated risks—when financing is made available. They are not, however, a substitute for professional representation in any specific situation.

1. Consider the need for financing as an integral part of your preproposal strategy with respect to any Government contract opportunity. Review all solicitations carefully to determine whether they provide for financing payments.

2. Remember that the time to address the failure of a solicitation to provide for financing payments is *before* submission of your offer.

3. If the solicitation does not provide for progress payments, do not condition your bid on the availability of progress payments. Such a condition will render your bid nonresponsive.

4. Bear in mind that postaward requests for progress payments will in all likelihood only be considered if you offer some consideration for the implementing contract modification. Instead, request that the solicitation be amended to permit progress payments, particularly if you qualify as a small business concern.

5. If the contract anticipates multiple deliveries, it may be amenable to partial payments, which are far preferable, for a variety of reasons, to financing payments. If that is the case, make sure the solicitation does not prohibit partial payments; if it does, request a presubmission amendment of the solicitation in that regard.

6. If you are receiving progress payments based on costs, recognize that you may now include in your SF 1443 a request for payment of amounts due and owing to subcontractors, but not yet paid. Subcontractor costs that you may include are those that will ordinarily be paid within 30 days of your progress payment

request and in accordance with the subcontracts' terms and conditions, even though you have not yet paid the subcontractor those amounts. Because the SF 1443 has *not* been updated, consider annotating your SF 1443 certification to identify the regulations and guidance that authorizes such billings.

7. At all times, ensure that there are procedures in place for the review and verification of the entries recorded in your SF 1443 submissions and that those procedures have been followed before submitting the payment request. Remember, each SF 1443 requires a certification with respect to the content of and bases for the payments sought. Each and every incorrect SF 1443 that is knowingly, recklessly or indifferently prepared and submitted—including, in particular, the estimates at completion that will underlay possible suspensions or reductions in payments or increases in the liquidation rate—could well be characterized by the Government as a separate and distinct false claim. If the error relates to an indirect cost entry, this could well subject every SF 1443 submitted over the course of an extended period of time to a separate statutory penalty (currently up to \$11,000 per claim) under the False Claims Act.

8. If your contract will permit performance-based payments, make sure that the payment “triggers” are well defined and objectively verifiable and that the projected cost of achieving the payment milestone is not disproportionately small to the amount of the payment. Given the risk assumed with performance-based payments, you should not agree to a payment schedule that is likely to reduce your cash flow below what you would expect under more customary cost-based progress payments.

9. If you are a noncommercial item subcontractor, you should request either progress payments based on cost or performance-based payments. Prime contractors that themselves receive progress payments must provide either, if the applicable preconditions are satisfied, but not both.

## ★ REFERENCES ★

- 1/ Chierichella et al., "Financing Government Contracts," Briefing Papers No. 86-7 (June 1986).
- 2/ FAR subpt. 32.2.
- 3/ FAR subpt. 32.1.
- 4/ FAR 32.104(a); see also FAR 32.202-1(a).
- 5/ See generally Chierichella, supra note 1.
- 6/ See, e.g., FAR 32.502-1(c)(4) (1984) (indicating that progress payments are generally inapplicable to "standard commercial items not requiring a substantial accumulation of predelivery expenditures by the contractor").
- 7/ Pub. L. No. 103-355, 108 Stat. 3243 (1994).
- 8/ Pub. L. No. 103-355, §§ 2001(f), 2051(e) (codified at 10 U.S.C. § 2307(f) and 41 U.S.C. § 255(f), respectively).
- 9/ FAR 32.202-1(c).
- 10/ FAR 32.202-1(c).
- 11/ FAR 32.100.
- 12/ FAR 32.002(b).
- 13/ FAR 9.104-1.
- 14/ FAR 32.107(a).
- 15/ FAR 32.107(a).
- 16/ FAR 32.205(c).
- 17/ FAR 32.107(b).
- 18/ DFARS 232.072-2(a).
- 19/ DFARS 232.072-2(b).
- 20/ DFARS 232.072-2(a).
- 21/ 10 U.S.C. § 2307(a); 41 U.S.C. § 255(a).
- 22/ FAR 32.104(a).
- 23/ FAR 32.104(a) (emphasis added).
- 24/ FAR 32.105.
- 25/ FAR subpt. 32.5.
- 26/ FAR subpt. 32.10.
- 27/ FAR subpt. 32.4.
- 28/ FAR subpt. 32.3.
- 29/ FAR 32.102(b).
- 30/ FAR 32.102(e).
- 31/ FAR 32.501-1(a).
- 32/ FAR 32.501-1(b).
- 33/ FAR 32.102(f).
- 34/ FAR 32.1001(b).
- 35/ FAR 32.1001(c).
- 36/ FAR 32.1001(a).
- 37/ Pub. L. No. 103-355, §§ 2001(b), 2051(b), 108 Stat. 3243 (1994) (codified at 10 U.S.C. § 2307(b) and 41 U.S.C. § 255(b), respectively).
- 38/ FAR 32.102(a).
- 39/ FAR 32.106(e), 32.402(b).
- 40/ FAR 32.102(c).
- 41/ FAR 32.303(d).
- 42/ 10 U.S.C. § 2307; 41 U.S.C. § 255.
- 43/ FAR 32.102(d).
- 44/ FAR 32.102(d).
- 45/ FAR 52.232-1.
- 46/ 31 U.S.C. §§ 3901-3907; 5 C.F.R. pt. 1315.
- 47/ FAR 32.901(b).
- 48/ DFARS 232.102-70.
- 49/ DFARS 232.102-70(a).
- 50/ DFARS 232.102-70(b).
- 51/ FAR 32.106.
- 52/ See FAR subpt. 32.5.
- 53/ See FAR subpt. 32.10.
- 54/ See generally Chierichella, supra note 1.
- 55/ GAO, Defense Contracting: Key Data Not Routinely Used in Progress Payment Reviews (GAO/NSIAD-92-01, Jan. 1992).
- 56/ 57 Fed. Reg. 30,933 (1992).
- 57/ Pub. L. No. 103-355, §§ 2001(b), 2051(b), 108 Stat. 3243 (1994) (codified at 10 U.S.C. § 2307(b) and 41 U.S.C. § 255(b), respectively).
- 58/ See DOD, User's Guide to Performance Based Payments (Revision 1, Nov. 30, 2001) (available at <http://www.acq.osd.mil/dpap/Docs/PBPGuideNov2001.pdf>).
- 59/ 69 Fed. Reg. 54,651 (Sept. 9, 2004).
- 60/ FAR 32.1001(a).
- 61/ See Office of Federal Procurement Policy, Performance-Based Service Acquisition: Contracting for the Future (July 2003) (available at <http://www.whitehouse.gov/omb/procurement/0703pbsat.pdf>); see also 46 GC ¶ 355 (discussing OFPP goals to have 40% of all service actions using performance-based methods).
- 62/ See FAR subpt. 32.5.
- 63/ FAR 32.500(a).
- 64/ FAR 32.500, 32.501-1, 32.501-3.
- 65/ FAR 52.232-16.
- 66/ FAR 32.1000.
- 67/ Pub. L. No. 103-355, §§ 2001(b), 2051(b), 108 Stat. 3243 (1994) (codified at 10 U.S.C. § 2307(b) and 41 U.S.C. § 255(b), respectively); see also FAR 32.102(f), 32.1002.



- 68/ FAR 52.232-32, para. (b).
- 69/ FAR 52.232-32, para. (b).
- 70/ See 37 GC ¶ 243 (discussing comments from the Electronic Industries Association criticizing performance-based payments).
- 71/ FAR 32.102(e).
- 72/ FAR subpt. 32.5.
- 73/ FAR subpt. 32.10.
- 74/ FAR 32.102(e).
- 75/ FAR 32.103.
- 76/ 10 U.S.C. § 2307(g); DFARS 232.102(e)(2).
- 77/ FAR 32.102(e)(2).
- 78/ DEAR 932.102(e)(2).
- 79/ FAR 52.232-5, para. (b).
- 80/ FAR 52.232-5, para. (e).
- 81/ FAR 32.102(e)(2), 52.232-5, para. (i).
- 82/ FAR 52.232-5, para. (e).
- 83/ FAR 52.232-5, para. (e).
- 84/ FAR 52.232-5, para. (e).
- 85/ FAR 32.501.
- 86/ FAR 32.501, 52.232-16.
- 87/ FAR 32.501.
- 88/ FAR 32.501-1(a).
- 89/ FAR 32.501-1(a).
- 90/ DFARS 232.501-1(a).
- 91/ FAR 52.232-16, para. (a)(6); see FAR 32.501-3 ("contract price").
- 92/ FAR 32.501-3(a)(1).
- 93/ DCAA Contract Audit Manual § 14-205(b) (Jan. 2005).
- 94/ FAR 32.501-3(a)(6); see also DCAA Contract Audit Manual § 14-202.3 (Jan. 2005).
- 95/ See FAR 52.217-2.
- 96/ DFARS 232.501-3(b).
- 97/ DFARS 232.501-3(b).
- 98/ FAR 52.232-22.
- 99/ FAR 32.705-2(c).
- 100/ DFARS 232.705-70, 252.232-7007.
- 101/ FAR 32.502-2(a), (b).
- 102/ FAR 32.502-2(c).
- 103/ FAR 32.501.
- 104/ FAR 32.114, 32.501-1(b)(1).
- 105/ FAR 32.114, 32.501-2(a).
- 106/ FAR 32.501-2(a)(1), (2).
- 107/ 10 U.S.C. § 2307(b); 41 U.S.C. § 255(b); see FAR 32.102(f), 32.104(d), 32.1001.
- 108/ FAR 32.1004(b).
- 109/ FAR 32.1004(a)(1).
- 110/ DOD, *supra* note 58, at 1–3.
- 111/ FAR 52.232-16.
- 112/ See *Vinyl Tech., Inc.*, ASBCA 47967, 97-1 BCA ¶ 28,974, 39 GC ¶ 365 (recognizing that a CO has discretion in authorizing progress payments, but noting that this discretion is "not unfettered," especially given that FAR 32.104 requires a CO to give "special attention" to a small business' need for financing). But see *Americana Corp.*, ASBCA 14417, 71-1 BCA ¶ 8886 (holding that because a contractor conditioned its continued performance on receiving financing payments, the CO had the right to declare anticipatory breach).
- 113/ 10 U.S.C. § 2307(a)(2); 41 U.S.C. § 255(a)(2); FAR 32.104(b), 32.502-3(b).
- 114/ FAR 32.104(d)(1)(i).
- 115/ FAR 32.104(d)(1)(i).
- 116/ FAR 32.104(d)(1)(ii).
- 117/ DFARS 232.502-1(b)(1).
- 118/ FAR 32.502-3(b)(2), 52.232-14.
- 119/ FAR 32.104(d)(3)(i).
- 120/ FAR 32.104(d)(3)(ii).
- 121/ FAR 32.104(d)(2).
- 122/ FAR 52.232-16, para. (f).
- 123/ FAR 32.503-2(b), (c), 32.503-3.
- 124/ DCAA Contract Audit Manual § 14-202.1(f) (Jan. 2005).
- 125/ FAR 32.107(a).
- 126/ FAR 32.502-1, 52.232-15.
- 127/ FAR 52.232-16, para. (a)(4).
- 128/ FAR 52.232-16, para. (a)(4)(i).
- 129/ See FAR pt. 31.
- 130/ FAR 52.232-16, para. (a)(4)(iii).
- 131/ See FAR 31.205-40(c).
- 132/ FAR 52.232-16, para. (a)(4)(ii), (iv).
- 133/ FAR 32.504(d).
- 134/ FAR 52.232-16, para. (a)(3).
- 135/ FAR 32.503-2(d), 31.109.
- 136/ 67 Fed. Reg. 70,520 (Nov. 22, 2002); see also 65 Fed. Reg. 16,274 (Mar. 27, 2000) (revising the paid cost rule by creating exceptions, while still leaving the principle in the FAR).
- 137/ FAR 53.301-1443 (SF 1443, "Contractor's Request for Progress Payment" (Oct. 1982)). See DCAA Contract Audit Manual § 14-205(d) (Jan. 2005) (recognizing that SF 1443 was not amended when the paid cost rule was deleted).

- 138/** FAR 32.504(b), 52.232-16, para. (a)(2); see also FAR 52.216-7, 52.232-7; DCAA Contract Audit Manual § 14-205(d) (Jan. 2005).
- 139/** DCAA Contract Audit Manual § 14-203(a) (Jan. 2005).
- 140/** FAR 32.503-4(b).
- 141/** FAR 53.301-1443 (emphasis added).
- 142/** DCAA Contract Audit Manual § 14-205(d) (Jan. 2005).
- 143/** FAR 53.301-1443.
- 144/** 69 Fed. Reg. 67,899 (Nov. 22, 2004).
- 145/** FAR 52.232-16, para. (b).
- 146/** FAR 52.232-16, para. (a)(5).
- 147/** FAR 32.503-8.
- 148/** FAR 32.503-9(a).
- 149/** FAR 32.503-9, 32.503-10, 32.503-12.
- 150/** FAR 32.503-10.
- 151/** FAR 52.232-16, para. (a)(7).
- 152/** FAR 52.232-16, para. (h).
- 153/** FAR 52.232-16, para. (c).
- 154/** FAR 52.232-16, para. (b).
- 155/** FAR 52.232-16, para. (c); see also FAR 32.503-6 (describing each criteria in detail).
- 156/** See, e.g., *Davis v. United States*, 180 Ct. Cl. 20 (1967); *McDonald Welding & Mach. Co.*, ASBCA 36284, 94-3 BCA ¶ 27,181.
- 157/** *G&C Indus., Inc.*, ASBCA 26111, 84-1 BCA ¶ 16,999.
- 158/** *Davis v. United States*, 180 Ct. Cl. 20 (1967).
- 159/** *Reliance Ins. Co. v. United States*, 27 Fed. Cl. 815 (1993); *U.S. Fid. & Guar. Corp. v. United States*, 676 F.2d 622 (Ct. Cl. 1982).
- 160/** FAR 52.232-7, para. (a)(2).
- 161/** FAR 52.232-7, para. (a)(2).
- 162/** 68 Fed. Reg. 69,631 (Dec. 15, 2003) (amending DFARS 232.111(b), 252.232-7006).
- 163/** 69 Fed. Reg. 29,838 (May 25, 2004) (proposing amendments to FAR 32.111(a)(7), 52.232-7).
- 164/** 69 Fed. Reg. 29,838.
- 165/** *National Radio Co.*, ASBCA 14707, 72-2 BCA ¶ 9486.
- 166/** See, e.g., *Sterling Millwrights, Inc. v. United States*, 26 Cl. Ct. 49 (1992), 35 GC ¶ 114; Bill J. Copeland, AGBCA 1999-182-1, 02-2 BCA ¶ 32,049; *Monarch Enters., Inc.*, VABCA 2239, 86-3 BCA ¶ 19,281; *H.E. & C.F. Blinne Contracting Co.*, ENGBCA 4174, 83-1 BCA ¶ 16,388. But see, e.g., *Florida Engineered Constr. Prods. Corp. v. United States*, 41 Fed. Cl. 534 (1998) (holding that a CO's permissive withholding of progress payments did not excuse a default termination).
- 167/** *Northern Helix Co. v. United States*, 455 F.2d 546 (Ct. Cl. 1972); see also *Fotorecord Print Center, GPOBCA 9-98*, 1999 WL 1203833; *A.A. Beiro Constr. Co.*, DCCAB D-822, 1992 WL 695519; cf. *Morganti Nat'l, Inc. v. United States*, 49 Fed. Cl. 110 (2001), 43 GC ¶ 166 ("[F]ailure to pay progress payments when due is not a material breach per se. Materiality must be shown by the totality of the facts and circumstances.").
- 168/** *Morganti Nat'l, Inc. v. United States*, 49 Fed. Cl. 110 (2001), 43 GC ¶ 166; *Defense Sys. Co.*, ASBCA 50918, 00-2 BCA ¶ 30,991; *Jones Plumbing & Heating Inc.*, VABCA 1845, 86-1 BCA ¶ 18,659.
- 169/** *Ingalls Shipbldg. Div., Litton Sys., Inc.*, ASBCA 17717, 76-1 BCA ¶ 11,851; *Aerojet-General Corp.*, ASBCA 13548, 70-1 BCA ¶ 8245.
- 170/** *Lockheed Shipbldg. & Constr. Co.*, ASBCA 18460, 77-1 BCA ¶ 12,458.
- 171/** FAR 32.504(e); see also FAR 32.504(a).
- 172/** FAR 32.504(f); see also FAR 52.232-32(e)(3), (m)(2).
- 173/** FAR 53.301-1443.
- 174/** FAR 32.503-6(e)(1).
- 175/** FAR 32.503-6(e)(2).
- 176/** FAR 32.112-2.
- 177/** FAR 32.112-1(a).
- 178/** FAR 32.112-1(b).
- 179/** FAR 32.112-1(c).
- 180/** 18 U.S.C. § 287; 31 U.S.C. §§ 3729-3733.
- 181/** See GAO, DOD Contracting: Techniques To Ensure Timely Payment to Subcontractors" (GAO/NSIAD-93-136, May 1993).
- 182/** See *id.*
- 183/** Pub. L. No. 103-355, § 2091, 108 Stat. 3243 (1994).
- 184/** See National Defense Authorization Act for Fiscal Years 1992 and 1993, Pub. L. No. 102-190, § 806(a)(4), 105 Stat. 1290 (1991); see also 57 Fed. Reg. 42,707 (Sept. 16, 1992).
- 185/** 60 Fed. Reg. 48,206 (Sept. 18, 1995).
- 186/** FAR 52.232-16, para. (d)(1).
- 187/** FAR 52.232-16, para. (d)(1).
- 188/** FAR 52.232-16, para. (d)(2).
- 189/** FAR 32.503-15(d), 52.232-16, para. (d)(5).
- 190/** FAR 32.503-15(c), 52.232-16, para. (d)(4).
- 191/** FAR 32.503-15(d), 52.232-16, para. (d)(5).
- 192/** FAR 32.503-15(e), 52.232-16, para. (d)(6).
- 193/** FAR 32.503-14(a).
- 194/** FAR 32.503-14(c).
- 195/** FAR 32.503-14(a).
- 196/** FAR 32.503-14(b).
- 197/** FAR 32.501-5.

- 198/** FAR 32.503-14(c).
- 199/** See, e.g., *In re American Pouch Foods, Inc.*, 769 F.2d 1190 (7th Cir. 1985); *In re Double H Prods. Corp.*, 462 F.2d 52 (3d Cir. 1972).
- 200/** *Welco Indus., Inc. v. United States*, 8 Cl. Ct. 303 (1985), *aff'd*, 790 F.2d 90 (Fed. Cir. 1986); see also *First Nat'l Bank of Geneva v. United States*, 13 Cl. Ct. 385 (1987); *Midland Bank v. United States*, 231 Ct. Cl. 496 (1982).
- 201/** *Ralcon, Inc., ASBCA 43176*, 94-2 BCA ¶ 26,935.
- 202/** *TRW Space & Def. Sector v. County of Los Angeles*, 50 Cal. App. 4th 1703 (1996); see also *Consolidated-Hammer Dry Plate & Film Co. v. Comm'r*, 317 F.2d 829 (7th Cir. 1963); *American Motors Corp. v. City of Kenosha*, 80 N.W.2d 363 (Wis. 1957), *aff'd*, 356 U.S. 21 (1958); *Boeing Co. v. Omdahl*, 169 N.W.2d 696 (N.D. 1969); *In re S.R.A., Inc.*, 7 N.W.2d 484 (Minn. 1942).
- 203/** *Hughes Aircraft Co. v. County of Orange*, 96 Cal. App. 4th 540, 550-51 (2002). See generally Nash, "Postscript III: Title to Overhead Items," 18 *Nash & Cibinic Rep.* ¶ 56 (Dec. 2004).
- 204/** FAR 32.503-16(a), 52.232-16, para. (e).
- 205/** FAR 32.503-16(b), 52.232-16 para. (e).
- 206/** FAR 32.503-16(c).
- 207/** FAR 32.503-15(a), 52.232-16, para. (d)(7).
- 208/** FAR 53.301-1443 (SF 1443); see also FAR 32.503-1(a).
- 209/** 18 U.S.C. § 287.
- 210/** 31 U.S.C. §§ 3729-3733.
- 211/** DCAA Contract Audit Manual § 14-205 (Jan. 2005).
- 212/** DCAA Contract Audit Manual § 14-205(d) (Jan. 2005).
- 213/** 69 Fed. Reg. 67,899 (Nov. 22, 2004).
- 214/** FAR 52.232-32.
- 215/** FAR 32.1003; see also DCAA Contract Audit Manual § 14-910.1(a) (Jan. 2005).
- 216/** FAR 32.104(d)(3)(i).
- 217/** FAR 32.104(d)(3)(ii).
- 218/** FAR 32.104(d)(2).
- 219/** FAR 32.107(a).
- 220/** See FAR 52.232-28.
- 221/** FAR 52.232-28, paras. (c), (d), (e).
- 222/** FAR 32.1004(b), 52.232-32, para. (a).
- 223/** DOD, *supra* note 58, at 11.
- 224/** FAR 32.1004(a)(2).
- 225/** FAR 32.1004(a)(2).
- 226/** FAR 32.1004(a)(2), 32.1007(d), 52.232-32, para. (c)(1).
- 227/** FAR 52.232-32, para. (c)(1).
- 228/** FAR 32.1007(e).
- 229/** FAR 32.1004.
- 230/** FAR 32.1004.
- 231/** DOD, *supra* note 58, at 12.
- 232/** *Id.*
- 233/** FAR 32.1001(b), (e), 52.232-32, para. (c)(2).
- 234/** FAR 32.1001(b), (e), 52.232-32, para. (c)(2); see 31 U.S.C. §§ 3901-3907.
- 235/** FAR 52.232-32, para. (j).
- 236/** FAR 32.1004(b)(1).
- 237/** FAR 32.1004(b)(2).
- 238/** FAR 32.1004(b)(3).
- 239/** FAR 32.1004(b)(4).
- 240/** FAR 52.232-32, para. (c)(3).
- 241/** DOD, *supra* note 58, app. E.
- 242/** *Id.*
- 243/** FAR 52.232-32, para. (d)(1).
- 244/** FAR 32.1004(d).
- 245/** Cf. FAR 32.503-8, 32.503-9, 32.503-10, 32.503-12.
- 246/** FAR 32.1001(c), FAR 52.232-32, para. (j).
- 247/** FAR 52.232-32, para. (e)(3).
- 248/** FAR 52.232-32, para. (e)(2).
- 249/** FAR 52.232-32, para. (e); see also FAR 32.504(f).
- 250/** FAR 52.232-32, para. (e).
- 251/** FAR 32.1008; see FAR 32.503-6(a), (b), (c), (e).
- 252/** FAR 32.504(f).
- 253/** FAR 52.232-32, paras. (e)(3), (m)(2).
- 254/** FAR 52.232-32, para. (f).
- 255/** Compare FAR 52.232-32, para. (f)(2) with FAR 52.232-16, para. (d)(2).
- 256/** Compare FAR 52.232-32, para. (f) with FAR 52.232-16, para. (d).
- 257/** FAR 32.1009.
- 258/** Compare FAR 32.1010, 52.232-32, para. (g) with FAR 32.503-16, 52.232-16 para. (e).
- 259/** DOD, *supra* note 58, app. E.
- 260/** FAR 52.232-32, para. (l).
- 261/** FAR 52.232-32, para. (m).
- 262/** FAR 32.106(b).
- 263/** FAR 32.106(e).
- 264/** FAR 32.102(a).
- 265/** 10 U.S.C. § 2307(d); 41 U.S.C. § 255(d); 50 U.S.C. §§ 1431-1435.
- 266/** FAR 32.102(a).

- 267/** FAR 32.102(a).
- 268/** FAR 32.102(a), 52.232-12, para. (f)(1)(iii).
- 269/** 31 U.S.C. § 3324.
- 270/** 10 U.S.C. § 2307(c), (d); 41 U.S.C. § 255(c), (d); FAR 32.402(c)(1).
- 271/** 50 U.S.C. § 1431; FAR 32.405. But see FAR 50.203(b)(4) (requiring advance notification to Congress of funding obligations in excess of \$25 million). See generally Mullen, "Extraordinary Contractual Relief Under Public Law 85-804," Briefing Papers No. 02-13 (Dec. 2002).
- 272/** FAR 32.402(b).
- 273/** FAR 32.106, 32.402(b).
- 274/** FAR 32.403.
- 275/** FAR 32.403.
- 276/** FAR 32.403(f).
- 277/** FAR 32.403(f).
- 278/** FAR 32.403(h).
- 279/** FAR 32.402(c).
- 280/** FAR 32.402(d).
- 281/** FAR 32.405(b).
- 282/** FAR 32.405(b).
- 283/** FAR 32.405(c)(3); see also 9.104-1(a) (regarding responsibility determinations).
- 284/** FAR 32.402(c)(2).
- 285/** FAR 32.402(c)(2)(i).
- 286/** FAR 32.402(c)(2)(ii).
- 287/** FAR 32.402(c)(2)(iii), 9.104.
- 288/** FAR 32.402(c)(2)(iv).
- 289/** FAR 32.402(c)(2)(v).
- 290/** FAR 32.408.
- 291/** FAR 32.408(b).
- 292/** FAR 32.408(b)(6).
- 293/** DFARS 232.470.
- 294/** FAR 32.409; see FAR 32.402(e).
- 295/** FAR 32.409-1, 32.410.
- 296/** FAR 32.409-3.
- 297/** Federal Aviation Administration Negotiations With Pacific Gas & Elec. Co., Comp. Gen. Dec. B-260063, 96-1 CPD ¶ 122.
- 298/** FAR 32.411.
- 299/** FAR 52.232-12, para. (g).
- 300/** FAR 52.232-12, para. (c).
- 301/** FAR 32.411, 52.232-12, para. (h).
- 302/** FAR 32.411.
- 303/** FAR 32.411.
- 304/** FAR 52.232-12, para. (b).
- 305/** FAR 52.232-12, para. (b).
- 306/** FAR 32.412(b).
- 307/** FAR 32.409-3, 52.232-12, para. (i).
- 308/** FAR 32.409-3, 52.232-12, para. (i)(2).
- 309/** FAR 52.232-12, para. (j).
- 310/** FAR 52.232-12, para. (l).
- 311/** FAR 32.409-3(d).
- 312/** FAR 52.232-12, para. (n).
- 313/** FAR 32.407(a), 52.232-12, para. (f).
- 314/** FAR 32.407(b), 52.232-12, para. (f).
- 315/** FAR 32.407(f).
- 316/** FAR 32.407(d).
- 317/** FAR 52.232-12, para. (d).
- 318/** FAR 52.232-12, para. (d).
- 319/** FAR 52.232-12, para. (e).
- 320/** FAR 52.232-12, para. (e).
- 321/** FAR 52.232-12, para. (k).
- 322/** 50 U.S.C. app. § 2091.
- 323/** FAR subpt. 32.3.
- 324/** FAR 32.300.
- 325/** FAR 2.101.
- 326/** 50 U.S.C. §§ 1431-1435. See generally Mullen, *supra* note 271.
- 327/** Pub. L. No. 96-185, 93 Stat. 1324 (1980).
- 328/** Air Transportation Safety and System Stabilization Act, Pub. L. No. 107-42, tit. IV, 115 Stat. 230 (2001).
- 329/** FAR 32.304-1.
- 330/** FAR 32.304-1(b).
- 331/** FAR 32.302.
- 332/** FAR 32.302.
- 333/** FAR 32.303.
- 334/** FAR 32.303(a).
- 335/** FAR 32.105(a).
- 336/** FAR 32.105(a).
- 337/** FAR 32.304-2(a).
- 338/** FAR 32.304-2(d).
- 339/** FAR 32.304-2(d).
- 340/** FAR 32.304-3 to 32.304-8.
- 341/** DEAR 932.7004.
- 342/** DEAR 932.7004-2, 932.7004-3.
- 343/** DEAR 932.7004-2, 932.7004-3.