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Service Contracts

View From Wiley Rein: Let's Rethink Applying the Service Contract Act to Commercial Services Contracts

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Fifty years ago, Congress enacted the McNamara-O'Hara Service Contract Act ("SCA") to require federal contractors to pay prevailing wages and fringe benefits to service employees performing a wide range of federal contracts for services. The SCA text and accompanying regulations implemented by the Department of Labor ("DoL") have been updated and expanded in the half-century since then, though they have not had a substantive update since narrow exceptions were added for a small number of commercial services almost fifteen years ago.

Without major updates in the past decade and a half, the SCA and its regulations have not kept pace the government's continued emphasis on purchasing commercially developed goods and services in pursuit of significant savings over government-specific offerings. Nor do the SCA and its regulations account for the extent to which present-day contractors leverage commercial services and facilities (basically non-traditional models) to perform services for the government.

The continued evolution of federal service contracting is evident all over federal procurement: agencies' increased ordering of commercial services from General Services Administration schedules; application of the SCA to orders from those schedules, including from the Mission Oriented Business Integrated Services ("MOBIS") schedule for high-skill services; increased contracting for services previously performed by federal employees, often at federal sites; technological advances allowing for steadily increasing shares of services to be performed remotely; and increased purchasing of commercial and commercial-off-the-shelf items, which are often in turn serviced by commercial service providers.

Yet when the government orders commercial services, the SCA often applies and subjects contractors to significant prevailing-wage, fringe-benefit, and other obligations inconsistent with prevailing commercial practices. For example, the SCA requires contractors to track in detail their service employees' performance of covered contracts. In particular, contractors must contemporaneously track service employees' actual hours worked on each SCA-covered contract and pay the applicable SCA-required wages and fringe benefits for those hours worked. If the contractor cannot segregate the hours worked on SCA-covered contracts from hours worked on commercial contracts, then DoL's regulations dictate that the contractor must treat each service employee's hours worked during the workweek as SCA covered if the service employee performed any work on an SCA covered contract that week. The same rule applies when service employees perform different job duties on an SCA-covered contract during the same week, in that the contractor must segregate the time by job du-

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ties (i.e., labor category) or pay the highest applicable rate for all SCA-covered work (and potentially all work) during that week.

These requirements are burdensome and expensive on many fronts: often, the wages and fringe benefits required by the SCA are higher, and sometimes much higher, than those dictated by the relevant labor markets—eroding or eliminating the profitability of SCA-covered contracts. These compensation requirements also lead to significant recordkeeping burdens for tracking time worked, duties performed, and compensation provided.

For contractors providing commercial-item services that are intermingled with identical or comparable services for commercial customers, these obligations are particularly burdensome because the contractors' commercial business models are many times built around employees' not recording their time spent performing tasks for each individual client. Yet the SCA and its regulations give contractors no practical and cost-effective alternatives to reduce these burdens.

Costly Options. Indeed, contractors' options are costly in these circumstances. As one example, the contractors could require employees to record their time spent on each specific task, then develop new business, accounting, and payroll systems to total the employees' hours by contract (in particular, SCA-covered contracts) and pay the required or market-based compensation, as appropriate, for those hours. But these new systems, while providing a compliant solution, would add significant recordkeeping burdens, reduce efficiency (as employees stop to record their time as often as every few minutes depending on the workflow), and require substantial resources to change contractors' processes and systems.

Another compliance option would be equally burdensome. Contractors could funnel their services provided under SCA-covered contracts to sites or specific service employees who would perform exclusively SCA-covered work and would be compensated at SCA-required rates. This approach offers a reduced recordkeeping burden when compared to the prior compliance option, but this approach will leave workers idle during ebbs and flows in SCA-covered work. Further, this approach may not be possible for all contractors because some, for contractual or practical reasons, may not be able to segregate work by site or employee. (It may not be possible or financially practicable to funnel tasks to specific work sites if, for example, physical items must be shipped at significant costs or if short turnaround times are required for certain tasks.)

One final alternative option may reduce recordkeeping and logistics burdens but may also impose the greatest cost burdens. Contractors can elect not to segregate or track time by task and instead pay all service employees the highest potentially applicable SCA-required wages and fringe benefits for all hours worked at sites where any SCA-covered work is performed during the week—regardless of how many hours each employee works on SCA-covered contracts. But as you can imagine, this option forces contractors to pay employees compensation much higher than is called for by the commercial labor market, erasing the efficiencies of contractors' commercially developed processes.

Given these unappealing options, why would any commercial service provider subject its performance of commercial services to such a burdensome regime? Many likely do not, depriving the government of commercially developed services and methods, as well as the accompanying cost savings.

Exempting Contracts From the SCA. DoL could alleviate this problem by revisiting its authority to exempt contracts from the SCA.[1] Section 4(b) of the SCA allows DoL to ''prescribe . . . exemptions'' to the SCA when DoL finds the exemption to be ''necessary and proper in the public interest or to avoid the serious impairment of Federal Government business'' and to be consistent with the SCA's remedial purpose. To that end, beginning in 2001, DoL exempted from SCA coverage contracts for certain commercial services when the contracts meet the following requirements:

- The services are commercially available and sold to the general public, and the pricing will be based on established catalog or market pricing;
- The contract will be awarded either sole source or based on an evaluation that includes significant nonprice factors;
- The contractor will use the same compensation plan for employees working on the government contract as is used for employees performing other (e.g., commercial) contracts;
- The contractor's employees will spend an average of less than 20% of their time working on the contract; and
- The agency expects all or nearly all competing offerors to meet these requirements.

Under DoL's regulations, if a contract meets the requirements above, the contract will be SCA exempt if it is for a small set of services, including many automobile-maintenance services; financial services involving the issuance and servicing of credit cards and other similar cards; and transportation services by common carrier of persons. (There additional narrowly defined services listed at 29 C.F.R. § 4.123(e)(2)(i); Section 4.123 lists other SCA exemptions as well.) These services share the salient characteristic that, in general, they can be or are usually performed by contractors at their own facilities, or at other facilities not owned or operated by the contracting agency, and through the same systems used to serve commercial clients.

What DoL Should Do Now. With that in mind, DoL should broaden the existing exemption to apply to contracts and subcontracts for all types of commercial services when the contracts meet the bulleted requirements above. If a contractor proposes to provide the same services as it does in the commercial marketplace, using service employees who perform those same services for commercial customers, under the same compensation plan, then there is no reason to apply the SCA based solely on the exact type of service provided. Instead, DoL should exempt all such contracts so as to encourage competition from commercial providers in all sectors in which the government purchases services.

DoL should also consider reducing the burden for contractors providing services under contracts meeting

[1] In theory, Congress could effect the same changes we describe through legislation.

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some but not all of the Section 4.123(e)(2)(i) requirements bulleted above. For example, a contractor may meet all the requirements above except that the relevant service employees will spend half their time on SCA-covered work and half on other work—but because of the contractor's fully integrated service processes, the contractor will still not have a cost-effective method of tracking their time to identify exactly who performs SCA-covered work and exactly when. In circumstances such as these, DoL should give commercial-item contractors flexibility in demonstrating compliance with time-tracking requirements.

DoL has many options to revise its regulations for when tracking actual time is not practicable, not cost-effective, or both. For example, contractors could be permitted to determine employees' SCA-covered time based on the share of the company's sales volume or contract volume made up of SCA-covered work. Or contractors could perform time-motion studies to estimate how long particular tasks take to perform, then apply those estimates to the number of each task performed by each service employee. Other models and methods may also be appropriate based on contractors' business models.

What is most important, though, is that DoL must recognize that the SCA needs to continue evolving along with the federal market for services to which the Act often applies. DoL cannot rely on a single set of selective exemptions implemented 15 years ago to stay current. By updating the SCA regulations, DoL will reduce the cost of providing many more types of services to the government and lower barriers to entry in the federal market—barriers that have been raised recently with the Obama administration's proposed Fair Pay and Safe Workplaces rules and guidance. It's time, for once, for common sense and business realities to return to prominence. If the government wants to attract commercial services providers, it should provide a compliance framework that will be attractive to those providers.