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

Winter 2013

The McNamara-O’Hara Service Contract Act of 1965 (SCA) continues to present challenges to government contractors, including both new and experienced industry players. We have found that a thorough consideration of the SCA’s requirements at the pre-award stage can help prevent troubles during contract performance. To that end, we have compiled a summary of issues that contractors should consider when bidding on an SCA-covered contract. However, because of the complexities of the SCA and its implementing regulations, this summary is meant only as general guidance and not a substitute for a thorough fact-specific analysis of a particular SCA-covered opportunity.

Where applicable, the SCA has a material impact on the manner in which contractors (and subcontractors) must compensate certain service employees, and strict compliance with the SCA is mandatory. Failure to comply with the SCA can result in numerous problems during or post performance, including Department of Labor (DoL) investigations, whistleblower actions, payment of deficient wages to existing and prior employees, and potential suspension and debarment. Therefore, we strongly encourage contractors to establish an SCA compliance program that considers these issues at the inception of the proposal preparation process.

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

The first question to consider is whether the contract to be awarded is covered by the SCA. While this may sound like a straightforward question, that is not always the case, and may be even more difficult to determine if you are a subcontractor. Step one is to check whether the solicitation (or an amendment thereto) provides indications that the contract will be subject to the SCA. That is, does it (i) incorporate the applicable Federal Acquisition Regulation (FAR) clause (FAR Clause 52.222-41), (ii) an SCA prevailing wage determination and/or (iii) otherwise state that it is subject to the SCA? Even if the solicitation does not address the SCA directly in one of the foregoing ways, the resulting contract could still be covered by the SCA if all of the following factors are met: (a) award by the United States Government or the District of Columbia; (b) the contract is principally one for services (as opposed to construction, manufacturing or product work).
that will be performed by “service employees” (a term that includes independent contractors, temporary and contract workers) who are not exempt under the Fair Labor Standards Act; (c) the contract is expected to exceed $2,500; and (d) at least some portion of the services will be performed in the United States or its territories. If the answer to these four questions is yes, you may still need to consider the applicability of the SCA and should probably seek legal counsel for advice—even if the FAR SCA clause and/or a wage determination are not included with the solicitation or contract.

Keep in mind that the SCA does have some exceptions and exemptions that may apply under certain circumstances. If an exemption is applicable, an otherwise SCA-covered contract may not require SCA compliance (or compliance may not be required with respect to certain employees outside the scope of SCA coverage). One common exemption is that all or substantially all of the employees who will perform the required effort are considered bona fide executive, administrative or professional workers under the Fair Labor Standards Act, based on their salary and the nature of their job duties. There are also some narrow categories of services that fall into one of the statutory or administrative exemptions (for example, public utility services). Most of these exemptions, however, are narrowly crafted and interpreted. The application of exemptions is very fact specific, and we would recommend seeking legal counsel as part of making (and documenting) any exception or exemption determination.

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

Next, you will need to consider the SCA-specific requirements that govern the wages and benefits you will pay SCA covered employees under the contract or subcontract. If the contract is subject to the SCA, you must determine what SCA wage determination or agreement dictates the minimum wages and fringe benefits. There are two types of documents that govern wages and fringe benefits under the SCA: (i) a DoL wage determination, or (ii) collective bargaining agreements (CBAs). For DoL wage determinations, the geographic locality or place of performance will determine which wage determination governs your obligations. These wage determinations should be included with the solicitation, but are also publicly available at www.wdol.gov. For solicitations that incorporate a predecessor contractor’s CBA, it is extremely important to get access to a copy of that CBA since under the SCA, a successor contractor—even a non-unionized successor contractor—will likely be obligated to compensate its employees at the wage and fringe benefit rates specific in the predecessor contractor’s CBA. Furthermore, it is also critical, regardless of the type of wage determination incorporated into the solicitation, to determine whether the current solicitation or contract is subject to the recently enacted rules covering non-displacement of qualified workers. See Wiley Rein alert, “FAR Council Issues Final Rule on Non-Displacement of Qualified Workers Under Service Contracts.” These non-displacement rules contain significant obligations and could impact potential staffing under the contract and fringe benefit obligations, especially involving vacation benefits that are typically based on employee years of service with a contractor or a predecessor contractor.

**Step 3: Mapping**

For all non-exempt SCA-covered employees, contractors must identify the specific job duties each employee will perform under the contract or subcontract and “map” those duties to an appropriate DoL wage determination labor category, in order to determine each employee’s SCA minimum wage. In some cases, the government solicitation documents (or even prior classifications by the predecessor contractor) may provide some guidance as to the appropriate labor category, but keep in mind that the contractor is ultimately responsible for selecting the appropriate labor category and will be liable for the impact of any inaccurate mapping. The SCA mapping process typically will include the following steps:
• **Job Duties:** Analyze the contract’s Performance Work Statement or Statement of Work, any incumbent contract information, Statement of Equivalent Rates in the Solicitation provided pursuant to FAR 52.222-42 and other guidance to determine scope of contract employees’ job duties.

• **Coverage Analysis:** Conduct a coverage analysis that identifies each contract employees’ actual job duties and responsibilities, and determine which employees are “service employees” who will be subject to SCA coverage and which, if any, will be classified as “exempt” under the Fair Labor Standards Act or excludable under any other relevant SCA guidance. See, e.g., 29 C.F.R. 4.153.

• **Labor Categories:** For all service employees, consult the wage determination, Statement of Equivalents information and DoL Directory of Occupations (which is available online at DoL’s website) to “map” each employee to an appropriate DoL labor category in the wage determination. If labor categories are missing from, or not clearly defined in, the DoL’s Directory of Occupations, consult legal counsel to consider engaging in a conformance procedure under the SCA regulations.

• **Document Decisions:** All coverage determinations and labor category assignments must be supported by adequate written documentation.

• **Subcontractor/Independent Contractor Issues:** Include the SCA requirements in every subcontract, and consider adding subcontractor indemnity provisions in the event a subcontractor fails to comply with the SCA. Ensure all subcontractor and independent contractor “service employees” are properly identified. Assess the procedures that you have in place to oversee and monitor subcontractor compliance to ensure the subcontractors at all levels are complying with the SCA.

**Step 4: Pricing**

With respect to development of pricing under an SCA-covered contract, contractors should consider the following:

• **Wage Determination:** As discussed above, identify the prevailing wage rates and fringe benefit rates in the geographic locality for the labor categories that will be used to perform the contract or subcontract, as reflected in the wage determination or relevant CBA rates, if applicable.

• **Pricing:** Ensure your pricing strategy appropriately takes into account SCA minimum wage and fringe benefits payments required for each affected labor category and does not include wage and fringe benefit rate increases for the option years, if not permitted under FAR 52.222-43. See FAR 52.222-43(b) (“The Contractor warrants that the prices in this contract do not include any allowance for any contingency to cover increased costs for which adjustment is provided under this clause.”)

• **Wages and Price Adjustment Clause:** If you intend to pay any service employees in excess of the SCA minimum wages or benefits, assess how the Price Adjustment Clause will impact your ability to seek price adjustments in future contract years.

• **Fringe Benefits:** Identify the minimum fringe benefit amounts in the wage determination (measured by the actual cost of the benefit to the employer, not the value of benefits actually received by the employee), and assess your plan to satisfy those requirements and how it affects proposal pricing. Also, you need to determine: (a) whether your planned health and welfare benefits qualify as “bona fide” fringe benefits under the SCA; (b) whether your method for calculating vacation is consistent with SCA requirements; (c) how you plan to account for paid holidays; and (d) whether you will need to provide cash equivalents in lieu of any benefits if you are unable to satisfy the minimum fringe benefit requirements with “bona fide” fringe benefits. [Note: Paying an employee at a wage rate in excess of the SCA minimum rate cannot be used to
offset fringe benefit requirements.]

- **No Offsets:** Other applicable laws may impose additional fringe benefit requirements (i.e., workmen’s compensation, unemployment insurance, Social Security) that cannot be used to offset or meet SCA benefit requirements.
- **Employee Notice:** Service employees must receive notice of the wage and benefits they will receive, and pay stubs should inform them precisely which amount received is for wages versus fringe benefit.
- **Deductions:** Any deductions that an employer makes from service employee paychecks must be permitted by the SCA, with notice to employees in advance. Where required, proper employee approval also must be received.

Although this discussion is focused on pre-award and pricing considerations, contractors also need to stay vigilant when transitioning from pre-award to performance under SCA-covered contracts. During performance, contractors must (i) ensure they are paying the proper wage and fringe benefits, (ii) monitor the SCA compliance of their subcontractors, (iii) monitor whether revised wage determinations have been issued by DoL and incorporated into the contract by the contracting officer upon the exercise of any options, or as otherwise required under the SCA and its implementing regulations, and (iv) continually assess whether changes to the contract or subcontract Statement of Work require new labor categories, or whether changes in employee job duties require revised coverage analyses, labor category assignments, or updated place(s) of performance. While the SCA certainly can present many challenges in all phases under SCA-covered contracts, there simply is no substitute for early identification and assessment as to how a contractor plans to address these challenges.