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PROMPT PAYMENT ACT:  
AN INTEREST(ING) REMEDY FOR GOVERNMENT LATE PAYMENT

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# INTRODUCTION

We don't want the Government to be a deadbeat, either, so I will soon sign the Prompt Payment Act to make sure the Government pays its debts on time.<sup>1</sup>

Former President Reagan spoke these words seven days before signing the Prompt Payment Act (PPA).<sup>2</sup> While the appropriateness of the "deadbeat" label is debatable,<sup>3</sup> the fact that Government agencies were (and are)<sup>4</sup> often paying their bills late to vendors is beyond question.

Timeliness of payments is of great importance to both contractors and the Government. Getting paid is the obvious inducement for contractors to undertake work. Moreover, receiving payment on time is often essential to provide the necessary funds to continue work on the contract. From the Government's perspective, its concern with paying on time is tied to the frequently repeated maxim that the Government's primary contractual

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<sup>1</sup> Remarks on Presenting the Small Business Person of the Year Award, May 13, 1982, PUBLIC PAPERS OF THE PRESIDENTS OF THE UNITED STATES, 1 RONALD REAGAN 616-17 (1982).

<sup>2</sup> Pub. L. No. 97-177, 96 Stat. 85 (1982), codified as amended at 31 U.S.C. §§ 3901-06 (1982).

<sup>3</sup> General Accounting Office, *The Federal Government's Bill Payment Performance Is Good But Should be Better*, GAO/FGMSD 78-16 (Feb. 1978).

<sup>4</sup> In 1989, agencies made 1.9 million of 56.2 million payments (3.3 percent) late. In terms of dollars, \$4.4 billion of \$162.8 billion (2.7 percent) was late. Office of Management and Budget, *Prompt Payment: 1989 Report to Congress* (Mar. 22, 1990).

obligation is to make prompt and proper payment for services performed.<sup>5</sup>

Failure to make payment in the amounts and times required by the contract may constitute a breach.<sup>6</sup> In some instances the breach may be so substantial as to be a "material" breach,<sup>7</sup> entitling the contractor to cease its own performance.<sup>8</sup> Even where a late payment is not a material breach, a contractor may now, thanks to the PPA, recover interest from the Government.<sup>9</sup>

This thesis focuses exclusively on the Prompt Payment Act, for two reasons. First, absent a material breach, a contractor's sole hope for redress of a late payment is interest.<sup>10</sup> Second, in the words of the

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<sup>5</sup> DeKonty Corp., ASBCA No. 32140, 90-2 BCA ¶ 22,645; Christian Contractors, ENG BCA No. 5461, 89-1 BCA ¶ 21,236 at 107,113; Consumers Oil Co., ASBCA No. 24172, 86-1 BCA ¶ 18,647 at 93,712; J. Cibinic and R. Nash, ADMINISTRATION OF GOVERNMENT CONTRACTS 873 (2d ed. 1986).

<sup>6</sup> Robert K. Adams, ASBCA No. 34519, 89-2 BCA ¶ 21,699; TEM Associates, Inc., DOT BCA No. 2024, 89-1 BCA ¶ 21,266, citing Pigeon v. United States, 27 Ct. Cl. 167, 175-76 (1892).

<sup>7</sup> See Consumer's Oil, ASBCA No. 24172, 86-1 BCA ¶ 18,647, and the cases compiled therein.

<sup>8</sup> DeKonty Corp., ASBCA No. 32140, 89-2 BCA ¶ 21,586, modified in part, 90-2 BCA ¶ 22,645 (since it was the contractor which elected to terminate the contract, it was not entitled to a convenience-termination settlement; rather, its recovery was limited to whatever common law damages it could prove that resulted from the Government's breach). For further discussion of material breach caused by late payment, see Nash, Default for Failure to Proceed: The "No Pay - No Way" Defense, 1 NASH & CIBINIC REPORT 5, ¶ 39 (1987).

<sup>9</sup> For a summary of other harms to the Government caused by its late payment, see the text accompanying note 47, *infra*.

<sup>10</sup> Courts and boards generally cannot order Government agencies to pay monies to comply with their contracts. The inability to compel injunctive or mandamus type relief is due to a lack of jurisdiction. King v. United States, 395 U.S. 1 (1961); Inslaw, Inc., DOT BCA Nos. 1609 et al., 90-2 BCA ¶ 22,701. See also, J. Cibinic and R. Nash, ADMINISTRATION OF GOVERNMENT CONTRACTS 907 (2d ed. 1986).

ASBCA, "This Act is the only authority for the payment of interest for delayed payment under a Government contract."<sup>11</sup>

Chapter 1 lays the groundwork for analyzing the PPA. Historically, Government vendors have been denied any interest, including interest for late payment, based on the doctrine of sovereign immunity. Unless the Government expressly waives its immunity by contract or statute, interest is not allowed. Part I traces the development of this "no-interest" rule and its application to federal procurement contracts. Part II examines the contractual and statutory exceptions. A summary of the key provisions of the PPA and its 1988 Amendments, as well as a brief discussion of the implementing regulations, provide the overview for the later chapters.

Chapter 2 analyzes the major provisions of the PPA. Part I examines the threshold issue of how to determine if a payment is late. Generally, an agency has 30 days from its receipt of a proper invoice before it must pay. Part II discusses the penalties required for an untimely payment. How the standard penalty is calculated, whether the penalty is automatic, the possibility of an extra penalty and who pays are all covered. The chapter concludes by reviewing several issues peculiar to construction contracts and the PPA's annual reporting requirements.

The third chapter probes the breadth of coverage of the PPA. Part I discusses the effective dates of the PPA and its Amendments, including the unsettled question of the effect of an option on an otherwise premature

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<sup>11</sup> Engine Power Co., ASBCA No. 32487, 87-1 BCA ¶ 19,362 (emphasis added). The board's sweeping statement is substantially correct. However, there is one exception. A contractor may "convert" an agency's late payment into a claim under the Contract Disputes Act and receive interest pursuant to that statute. That technique is discussed beginning at pages 78 and 150, *infra*. Two other theories of recovery, discussed at notes 36 and 45, are no longer viable.



contract. Part II addresses which agencies, which parties seeking interest, and what types of contracts are subject to the statute. Part III questions the circumstances under which withholding an amount from an otherwise proper invoice will trigger an interest penalty. The intricate topic of financing comprises Part IV, since payments made solely for financing purposes are not covered by the act. Finally, the thesis concludes with a brief summary of how well the agencies are meeting their payment deadlines.

# CHAPTER 1

## HISTORICAL CONTEXT OF THE PPA

Interest is not recoverable from the Government in the absence of a contract provision or statute allowing such recovery. This chapter opens by tracing the development of this rule in general and as applied to federal contracts. The exceptions to the rule are then discussed, with primary emphasis on the PPA. Key provisions of the PPA and its 1988 Amendments are synopsized. Finally, the regulatory framework is summarized.

### *I. DEVELOPMENT OF THE NO-INTEREST RULE*

#### *A. The Rule In General*

At common law, where a dispute for nonpayment or late payment of money has been purely between private litigants, the only form of damages allowed has been limited to interest.<sup>12</sup> If the dispute over delayed payment arose on a contract where payment was the sole remaining issue after a contractor had fully performed (i.e., a "pure" delay), the rule

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<sup>12</sup> New Orleans Insurance Co. v. Piaggio, 83 U.S. (16 Wall.) 378 (1872) ("Where a principal sum is to be paid at a specific time, the law implies an agreement to make good the loss arising from a default by the payment of interest").

has been the same.<sup>13</sup> However, when the delinquent party is the United States, the rule has always been different. Unlike a private party, the United States is shielded by the "no-interest" rule -- the Government is liable for nothing, not even interest, unless it expressly waives its sovereign immunity by statute or contract.<sup>14</sup>

A Comptroller of the Treasury opinion is the earliest concise formulation of the no-interest rule found in a Supreme Court case. The opinion states:

The rules of settlement of the treasury do not permit the allowance of interest, except where it is specially provided for in case of contracts, or expressly authorized by law . . . . [Furthermore, not even] the discretion to settle the claim on principles of 'justice and equity' . . . confer[s] the power to allow interest.<sup>15</sup>

The Supreme Court in 1879 applied this doctrine in Tillson v. United States,<sup>16</sup> which has been the first and only Government procurement

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<sup>13</sup> Loudon v. Taxing Dist. of Shelby County, 104 U.S. 771 (1881) ("All damages for delay in the payment of money owing upon contract are provided for in the allowance of interest, which is in the nature of damages for withholding money that is due. The law assumes that interest is the measure of all such damages"). But see the discussion beginning at page 9, *infra*.

<sup>14</sup> Even though section 706(k) of Title VII, 42 U.S.C. § 2000c-5(k) (1988) provides that "the United States shall be liable for costs the same as a private person," the statute was strictly construed and interest denied in Library of Congress v. Shaw, 478 U.S. 310 (1986) ("[T]he term 'costs' has never been understood to include an interest component"). Thus, as the Court acknowledged, the "no-interest" rule puts the Government in a favorable position vis-a-vis private parties.

<sup>15</sup> Quoted in plaintiff's summary of argument in United States v. McKee, 91 U.S. 442 (1875). In McKee, the Court nevertheless awarded interest since Congress had expressly authorized interest in a May 7, 1787 ordinance. 1 Laws U.S. at 662. The Comptroller's opinion accorded with that of the earliest view of the U.S. Attorney General, found at 1 Ops. Atty. Gen. 268 (1819). The no-interest rule had been obliquely referenced earlier in Gordon v. United States, 74 U.S. (7 Wall.) 188 (1869).

<sup>16</sup> 100 U.S. 43 (1879).

controversy involving the no-interest rule to reach that tribunal. While the contract wording in Tillson sounds of olden days, the fact pattern could not be more up-to-date.

After Tillson "delivered horse equipments and infantry accoutrements" to the Government, he submitted his vouchers. Some of the vouchers went unpaid for 114 days. Tillson consequently was forced to borrow money to meet his own obligations and subsequently presented his claim for interest. The Court denied the claim.<sup>17</sup> Acknowledging that, at common law, interest "would have been recoverable as against a citizen, if the payments were unreasonably delayed," the Court nevertheless stated, "with the Government, the rule is different." It reasoned that "the statute under which the Court of Claims is organized expressly declares 'that no interest shall be allowed on any claim up to the time of the rendition of judgment thereon in the Court of Claims, unless upon a contract expressly stipulating for interest.' Rev. Stat., sect. 1091. This is conclusive."<sup>18</sup>

Numerous decisions followed these early Supreme Court precedents.<sup>19</sup> The Court took the opportunity presented in one of these cases to strengthen and clarify both exceptions to the rules denying interest. In

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<sup>17</sup> Tillson's additional claim for damages was rejected as too remote. See note 31 *infra* for a discussion of special damages.

<sup>18</sup> Whereas the Court's quotation of the statute closes with "stipulating for interest," the section actually reads: "stipulating for the payment of interest." Revised Statutes of the United States (1875). This section eventually became 36 Stat. 1141, section 177(a), then section 284(a) of former Title 28, and now is embodied in section 2516(a) of Title 28. Currently, the section reads: "Interest on a claim against the United States shall be allowed in a judgment of the United States Claims Court only under a contract or Act of Congress expressly providing for payment thereof." 28 U.S.C. § 2516(a) (1982).

<sup>19</sup> For an extensive listing see Annot., 24 A.L.R.2d 928, § 19 (1952).

United States v. Thayer-West Point Hotel Co.,<sup>20</sup> the Court held the statutory exception applies only if the intention of Congress to permit interest is "expressly and specifically set forth in the statute." Alternatively, if a contract is the basis for recovery of interest, the provision "must be affirmative, clear-cut, unambiguous." Two weeks after Thayer, the Court handed down two more decisions discussing the Government's obligation to pay interest, Albrecht v. United States<sup>21</sup> and United States v. New York Rayon Importing Co.<sup>22</sup> The former opinion merely echoed Thayer, but the latter further refined the no-interest doctrine:

[I]n the absence of constitutional requirements, interest can be recovered against the United States only if express consent to such a recovery has been given by Congress. And Congress has indicated in § 177(a) that its consent can take only two forms: (1) a specific provision for the payment of interest in a statute; (2) an express stipulation for the payment of interest in a contract duly entered into by agents of the United States. Thus there can be no consent by implication or by usage of ambiguous language . . . . The consent necessary to waive the traditional immunity must be express, and it must be strictly construed.<sup>23</sup>

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<sup>20</sup> 329 U.S. 585 (1947).

<sup>21</sup> 329 U.S. 559 (1947).

<sup>22</sup> 329 U.S. 654 (1947).

<sup>23</sup> The constitutional requirement referred to in the initial phrase of the quotation is the "just compensation" clause of the Fifth Amendment. U.S. Const. amend. V.

### **B. The Rule Applied To Federal Procurement**

After such a strong trilogy of decisions, none of which dealt with the procurement of construction, services, or supplies,<sup>24</sup> the Supreme Court has been called upon to invoke the no-interest doctrine only rarely, and then in cases not involving procurement.<sup>25</sup> Thus, with the lone exception of Tillson,<sup>26</sup> application of the doctrine to federal procurement controversies has been left entirely to the lower courts, boards of contract appeals, and the Comptroller General.

The leading case in such subordinate forums is Ramsey v. United States.<sup>27</sup> After the War Department procrastinated three years before paying for the delivery of caskets, the contractor claimed the Government breached its duty to pay within a reasonable time and sought both interest and special damages. Ramsey claimed interest on the delayed amount; his claim for special damages was based on the theory that his shortage of working capital caused by the payment delay forced him to declare

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<sup>24</sup> Thayer decided whether interest was payable under a "just compensation" provision in a contract for the lease of a hotel. Albrecht was concerned with a land-purchase arrangement and condemnation proceedings. Rayon involved the refund of customs duties to the claimant. This trilogy of cases is cited collectively hereinafter as Thayer.

<sup>25</sup> Library of Congress v. Shaw, 478 U.S. 310 (1986) (racial discrimination); United States v. Louisiana, 446 U.S. 253 (1980) (impoundment of funds in the Treasury); United States v. Alcea Band of Tillamooks, 341 U.S. 48 (1951) (a Fifth Amendment "taking" of claimant's lands).

<sup>26</sup> 100 U.S. 43 (1879).

<sup>27</sup> 121 Ct. Cl. 426, 101 F. Supr. 353 (1951), cert. denied, 343 U.S. 977 (1952).

bankruptcy. By designating part of his claim as special damages, Ramsey hoped to avoid the no-interest rule.

The court apparently agreed that special damages, in addition to interest, is theoretically possible for a breach consisting solely of a delayed payment. Rather than flatly state interest is the only remedy, it hedged its view of the law by declaring interest is "generally" the only remedy.<sup>28</sup> The court then addressed the special damages theory at some length, only to conclude that none were compensable.

A portion of the claimed damages were too speculative and too remote. For the remainder, the court cut through the "special damages" labelling ploy to call a rose a rose: "Calling interest 'damages' or loss does not deprive it of being interest."<sup>29</sup> With this portion of claimant's special damages argument thus merged with its claim for interest, and unable to find an express statute or contract provision allowing interest, the court simply applied the traditional no-interest rule and denied the claim. Subsequent procurement decisions have steadfastly adhered to that portion

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<sup>28</sup> "The law is well-settled that, as a general rule, special damages, beyond the amount recognized as legal interest, cannot be recovered for a breach of contract to pay money which results only in a delay in payment." Curiously, the court cited for this proposition two cases which indicated interest is the sole remedy, Loudon v. Taxing Dist. of Shelby County, 104 U.S. 771 (1881) and Kendall v. Stokes, 44 U.S. (3 How.) 87 (1845) ("the legal measure of damages . . . would undoubtedly have been the amount due on the award, with interest on it").

<sup>29</sup> Citing Moran Brothers Co. v. United States, 61 Ct. Cl. 73, 106 (1925), 121 Ct. Cl. at 432, 101 F. Supp. at 356; accord Library of Congress v. Shaw, 478 U.S. 310 (1986) ("The force of the 'no interest' rule cannot be avoided simply by devising a new name for an old institution"), and Myerle v. United States, 33 Ct. Cl. 25 (1897) (whether "claimed in the guise of a damage caused by delay, or in some other form, it remains in fact a claim for interest").

of Ramsey which applied the no-interest rule.<sup>30</sup> No tribunal has awarded special damages for late payment in a procurement case.<sup>31</sup>

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<sup>30</sup> New York Guardian Mortgage Corp. v. United States, No. 90-5053 (Fed. Cir. Oct. 11, 1990); Chevron U.S.A., Inc. v. United States, No. 100-88C (Cl. Ct. Aug. 3, 1990), 36 CCF 75,916; Ocean Technology v. United States, 19 Cl. Ct. 288 (1990); Radcliffe Constr. Co., Inc., ASBCA Nos. 39252, 39253, 90-2 BCA ¶ 22,651; City of Aberdeen, Comp. Gen. B-226231, Oct. 23, 1987; 51 Comp. Gen. 251 (1971). There was some initial doubt whether the Ramsey decision applied to the agency boards because the language in 28 U.S.C. § 2516(a) restricts the application to the Claims Court. See note 18, *supra*. However, the ASBCA in Praxis Assurance Joint Venture, ASBCA No. 27189, 83-1 BCA ¶ 16,250, dispelled the doubt by ruling the statute applied.

<sup>31</sup> The strict view of Loudon v. Taxing District of Shelby County, 104 U.S. 771 (1881), that interest is the sole remedy for late payment, is an exception to the general rule regarding special damages for breach of contract. As a general principle, contractors may recover special or consequential damages for a Government breach of contract so long as the damages are foreseeable at the time the contract is executed. San Carlos Irrigation and Drainage Dist. v. United States, 877 F.2d 961 (Fed. Cir. 1989), citing Prudential Ins. Co. of Am. v. United States, 801 F.2d 1295 (Fed. Cir. 1986). Perhaps this more general rule is what the Ramsey court based its reasoning on. Arguably, the Claims Court still believes that certain factual patterns may give rise to the award of special damages for delays in payment, since in a relatively recent case, Esprit Corp. v. United States, 6 Cl. Ct. 546 (1984), *aff'd*, 776 F.2d 1062 (Fed. Cir. 1985), it adopted verbatim the Ramsey language. However, even though Ramsey was decided nearly 40 years ago, no clear-cut award appears in any federal procurement decision.

Perhaps one or both of two recent disputes will surface again at the ASBCA and provide the vehicle for the first award of special damages for delayed payment. Both cases indicate the board considers such a remedy a theoretical possibility. In Robert K. Adams, ASBCA No. 34519, 89-2 BCA ¶ 21,699, a personal services contract contained a clause requiring compliance with IRS and Social Security Act regulations. The IRS wrongfully withheld excessive amounts from the contractor's paycheck before refunding them a year later. The contractor claimed breach and entitlement to recover the costs of borrowing money for office furniture, which he said was necessitated by the withholding. In refusing to grant the Government's motion to strike, and instead ordering it to file a reply to the complaint, the board stated,

The nexus between contract performance and borrowing French francs for office furniture is certainly obscure, and how repeatedly denying appellant full compensation 'inevitably produced' that borrowing is not obvious either. Nevertheless, these are points which go to whether damages are provable, not whether the claim is remediable. We cannot say beyond doubt that appellant will not be able to demonstrate and then prove compensable damages.



## II. EXCEPTIONS TO THE NO-INTEREST RULE

### A. Borrowings

As previously stated, the traditional doctrine allows interest where the contract so provides. A line of cases granting interest eventually sprang from several contract clauses: changes, delayed work, differing site conditions, and suspension of work. The rationale was that the Government-drafted clauses operated as consent to equitably adjust the contract price for the required contract changes.

The landmark decision came in 1968. In Bell v. United States,<sup>32</sup> the contractor was allowed to recover interest on money it borrowed to finance increased costs resulting from a change order to slow down. The court was extremely careful in distinguishing this claim from Ramsey, wherein that contractor was also forced to borrow money. The distinction the court

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In the second dispute, Dekonty Corp., ASBCA No. 32140, 90-2 BCA ¶ 22,645, the breach might more accurately be described as a complete failure to pay rather than as mere late payment. The board found the Government unequivocally manifested an intent not to pay; thus, it anticipatorily breached its payment obligation. The board concluded the contractor should be able to recover "such common law damages as it may prove resulted from the Government's breach."

Given the long history since Ramsey, it would appear that unless further litigation in Robert K. Adams or Dekonty actually results in the award of special damages, the theoretical possibility of special damages raised by the Ramsey's "as a general rule" caveat is a sham. A more honest appraisal would conclude the *de facto* rule is that special damages for delayed payment in federal procurement cases are not allowed -- no exceptions. Such a rule would be consistent with the stricter view taken in Loudon. It would also accord with several recent non-procurement cases not involving the United States as a party which followed Loudon, namely, Union Mutual Life Insurance Co. v. Chrysler Corp., 793 F.2d 1 (1st Cir. 1986), and Pollack v. Crocker, 660 F. Supp. 1284 (S.D.N.Y. 1987).

<sup>32</sup> 186 Ct. Cl. 189, 404 F.2d 975 (1968).

drew was that, in Bell, the "borrowings" were an increased cost of performance resulting from the change and thus analogous to tangible costs of performance. In contrast, the "borrowings" in Ramsey resulted solely from the Government's "breach" in not making timely payment.

Currently, Bell has limited vitality because of the Cost Principles, which expressly make such interest unallowable.<sup>33</sup> Even where Bell is still applicable,<sup>34</sup> it has been refined so as to allow interest only on debt rather than equity capital.<sup>35</sup> More to the point, the high wall separating

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<sup>33</sup> FAR 31.205-20, previously DAR 15-205.17. Sol Flores Constr., ASBCA Nos. 32278, 32726, 89-3 BCA ¶ 22,154.

In Servidone Construction Corp., ENGBCA No. 4736, 88-1 BCA ¶ 20,390, the board said the plain meaning of the Pricing of Adjustments clause, DFARS 252.243-7001, which incorporates the Cost Principles, clearly makes interest on borrowings unallowable. In denying interest, it explicitly distinguished Bell and Entwistle Co. v. United States, 6 Cl. Ct. 281 (1984), because the contracts in those cases did not have clauses incorporating the Cost Principles.

The Transportation Board did not reach the interest issue in XPLO Corp., DOT CAB No. 1409, 86-3 BCA ¶ 19,280. However, it said recovery under an equitable adjustment should make the contractor whole unless the "costs are [specifically] made unallowable under section 15 of the procurement regulations [DAR 15.205-17]." In contrast, the board did reach the issue in A.T. Kearney, Inc., DOT CAB No. 1580, 86-1 BCA ¶ 18,613, wherein it cited Bell without any discussion of the Pricing of Adjustments clause. Such absence is curious, as this cost-type contract was awarded in 1978, long after the Cost Principles came into being for cost-type contracts (1949) and eight years after the DAR made the Cost Principles mandatory for use in fixed-price contracts.

<sup>34</sup> Gevyn Constr. Corp. v. United States, 827 F.2d 753 (Fed. Cir. 1987) (contract awarded prior to effective date of the Cost Principles); Lockheed-Georgia Co., A Div. of Lockheed Corp., ASBCA No. 27660, 90-3 BCA ¶ 22,957 at 115,291-92 (contract awarded prior to effective date of Cost Principles); Automation Fabricators & Eng'g Co., PSBCA No. 2701, 90-3 BCA ¶ 22,943 (Cost Principles not included in contract since agency not required to do so); Berkeley Constr. Corp., VABCA No. 1962, 88-1 BCA ¶ 20,259 (contract provision expressly negating the effects of the Cost Principles).

<sup>35</sup> In a relatively recent case involving a fixed-price contract awarded in 1963, which, of course, did not include the clause, the Court of Appeals for the Federal Circuit affirmed the bright line distinction between equity capital and debt. Gevyn Constr. Corp. v. United States,

the equitable adjustments theory from delayed payment claims remains intact -- no interest is allowed for the latter absent an express waiver by contract or statute of the sovereign's immunity.<sup>36</sup>

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827 F.2d 753 (Fed. Cir. 1987). Gevyn filed a claim for extra expenses incurred for Government-caused changes and delays. Successful on this claim for equitable adjustment, Gevyn also claimed for itself and on behalf of its subcontractor the cost of financing the extra work. For itself, Gevyn claimed imputed interest on its equity collateral; for its subcontractor, Gevyn claimed interest on borrowings. The court denied both claims. While it could have disposed of the first claim merely on the basis of the court below's finding that Gevyn failed to prove it used its own equity capital, it went further. The court said, even had Gevyn used its own equity capital, "binding precedent" precluded recovery. Citing the key cases of Framlau Corp. v. United States, 215 Ct. Cl. 185, 586 F.2d 687 (1977), Singer Co. v. United States, 215 Ct. Cl. 281, 568 F.2d 695 (1977), and Dravo Corp. v. United States, 219 Ct. Cl. 416, 594 F.2d 842 (1979), the court held that only borrowings are recoverable under Bell. Gevyn's claim on behalf of its subcontractor was rejected for failure to prove either of the two circumstances under which interest on borrowings is recoverable. The first possibility -- where work is directly traceable to a specific loan -- was not placed in issue. The second possibility -- where the necessity for increased borrowing is caused by extra work or delay caused by the Government -- was not proved by the evidence. Rather, the evidence showed the subcontractor had to borrow because Gevyn, not the Government, wrongfully withheld payments from it.

<sup>36</sup> Integral Biomedical Eng'g Inc., IBCA No. 2069, 88-2 BCA ¶ 20,570; Entwistle Co. v. United States, 6 Cl. Ct. 281 (1984) (but rule held inapplicable). The high wall was breached only slightly in two ASBCA cases, but even those now seem to be of historical interest only. In both cases, the Bell logic of an equitable adjustment was applied to facts which looked more like a commonplace delayed payment scenario. Aerojet-General Corp., ASBCA No. 17171, 74-2 BCA ¶ 10,863 (wrongful nonpayment of progress payments); Ingalls Shipbuilding Div., Litton Systems Inc., ASBCA No. 17717, 76-1 BCA ¶ 11,851 (delay in payment of retainages). The Cost Principles limit whatever precedential value these case might have to fixed-price contracts entered into prior to 1970. Systems Consultants, Inc., ASBCA No. 18487, 75-2 BCA ¶ 11,402 (Cost Principles prohibit extension of Aerojet theory to cost contracts). In any event, no cases have followed these two anomalies. For a discussion of Bell and its progeny, see Walters, *The Matter of Interest in Federal Government Contracting*, 14 Pub. Cont. L.J. 96 (1983-84).

## **B. Delayed Payment Of Claims**

### **1. The "Interest" Clause**

Until 1972, there was no contractual or statutory basis permitting a contractor to recover interest from the Government. In that year, the Payment of Interest on Contractor's Claims clause was added to the procurement regulations specifically to allow contractors to recover interest when the Government delayed paying a disputed claim.<sup>37</sup> The clause provides for simple interest, calculated according to the rates established by the Secretary of the Treasury pursuant to the Renegotiation Act, to accrue from the date a contractor files an appeal from a contracting officer's final decision until either a final court judgment has been rendered or the parties execute a supplemental agreement.<sup>38</sup>

The genesis of the clause can be traced to the Commission on Government Procurement, created by Congress in 1969.<sup>39</sup> Among the Commission's many conclusions was the conviction that requiring the Government to pay interest on claims would give it an incentive to settle them.<sup>40</sup> The Deputy Secretary of Defense then asked the Comptroller General whether it would be permissible to implement the Commission's recommendation via a contractual provision. Soon after the Comptroller

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<sup>37</sup> DAR (ASPR) 7-104.82, 37 Fed. Reg. 15152 (1972).

<sup>38</sup> For a discussion of the decisional law surrounding this clause, see J. Cibinic and R. Nash, ADMINISTRATION OF GOVERNMENT CONTRACTS 902-05 (2d ed. 1986).

<sup>39</sup> Pub. L. No. 91-129, 83 Stat. 269 (1969).

<sup>40</sup> SUMMARY OF THE REPORT OF THE COMMISSION ON GOVERNMENT PROCUREMENT 94 (1972).

General opined such a provision would be lawful,<sup>41</sup> the clause was promulgated.

## 2. Contract Disputes Act

While the "Interest" clause was used pervasively in contracts awarded from 1972 until 1979, it was superseded on March 1, 1979, by the Contract Disputes Act (CDA).<sup>42</sup> Section 12 of the statute provides for interest in the same manner as the "Interest" clause except that interest accrues from an earlier event -- from the time the claim is received by the contracting officer. Allowability of interest under the CDA has generally followed the same rationale used by the boards in interpreting the clause.<sup>43</sup>

Thus, although from 1972 vendors could recover interest on their disputed claims, they could still not recover interest for "pure" payment

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<sup>41</sup> 51 Comp. Gen. 251 (1971).

<sup>42</sup> Pub. L. No. 95-563, 92 Stat. 2838 (1988), codified at 41 U.S.C. §§ 601 et seq. (1982).

<sup>43</sup> E.g., Monaco Enters. Inc., ASBCA No. 24110, 80-1 BCA ¶ 14,282.

delays under either the clause<sup>44</sup> or the statute.<sup>45</sup> For that relief they had to wait for the Prompt Payment Act.

### **C. Late Payment Of Amounts Not In Dispute**

#### **1. Catalyst for the PPA**

The catalyst for a statutory solution to the no-interest rule for "pure" payment delays can be traced to a 1978 GAO report to Congress.<sup>46</sup> GAO had conducted an audit to determine how well the Government was doing as a bill payer in response to complaints sent directly to the Comptroller General and those he received from members of Congress on behalf of their constituents. The audit found that 39 percent of the bills and 29 percent of the dollar total were paid more than 30 days after the invoice date. By the 60th day, the number of bills unpaid dropped to 15 percent, representing only 2 percent of the dollar total. After adjusting for delays caused by contractors and other delays beyond the Government's

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<sup>44</sup> Engineering, Inc., ASBCA No. 22342, 78-2 BCA ¶ 13,489 (clause does not allow interest for late payment of undisputed invoice).

<sup>45</sup> The GSBCA took the view in several cases, beginning with Dawson Construction Co., GSBCA No. 5777, 80-2 BCA ¶ 14,817, that the legislative history of the CDA indicated an unreasonably delayed payment of an already negotiated settlement of a claim in and of itself constituted a claim and therefore awarded interest. The ASBCA rejected Dawson's rationale in Granite Construction Co., ASBCA No. 26023, 83-2 BCA ¶ 16,843. The GSBCA refused to extend its reasoning to the late payment of invoices, Safeguard Maintenance Corp., GSBCA No. 6054, 83-1 BCA ¶ 16,276, and eventually abandoned Dawson in Nash Janitorial Service, Inc., GSBCA No. 6935, 84-1 BCA ¶ 17,201 (concurring opinion of Lieblich, J.) ("those decisions are no longer good law").

<sup>46</sup> General Accounting Office, *The Federal Government's Bill Payment Performance Is Good But Should be Better*, GAO/FGMSD 78-16 (Feb. 1978).

control, statistics showed only 30 percent of the bills and 18 percent of the dollar total were unpaid at the 30-day mark.

Based on these findings, as well as on the fact that only 16 percent of the companies, when questioned, said they were dissatisfied with how quickly they were paid, the report concluded that the Government's performance was "good." Nevertheless, it recognized the need for improvement since late payments harm both contractors and the Government. According to the report, the primary harm contractors experience is damage to their cash flow. The report estimated \$9.8 billion during the 6-month audit period was paid more than 30 days after the invoice date. At an interest rate of 7 and 3/4 percent, this had cost contractors \$30 million. Additionally, late payments may cause contractors to expend time and resources tracking down their unpaid bills.

The report concluded the Government is harmed by its untimely payments in four ways: (1) increased administrative costs from following up on overdue bills; (2) lost prompt payment discounts from failure to meet the discount deadline; (3) lost prompt payment discounts because some contractors stop offering them after agencies take discounts even after the discount periods have expired; and (4) a shrinking competitive base of the military-industrial establishment because late payments cause some contractors to quit doing business with the Government.<sup>47</sup>

In addition to the late payments, the GAO audit also found agencies were paying too many bills excessively (more than five days) early. Such

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<sup>47</sup> *Id.* at 10-11. This fourth conclusion was based on a Department of Defense study, *Profit 76 Summary Report*, Dec. 7, 1976.

practice violates "a fundamental principle of good cash management"<sup>48</sup> since the Treasury is forced to borrow unnecessarily. Consequently, the GAO said agencies should pay "as close to the due date as possible, making sure bills are not paid late."<sup>49</sup> The report concluded these dual problems of late and early payments were caused primarily by lack of standards for computing bill due dates. As a result, the GAO recommended standards be promulgated to specify both the starting point for computing the due date and the number of days allowed for payment.

Three years later, the GAO issued another report which announced that "adequate corrective actions [had] not yet been taken" by the federal agencies.<sup>50</sup> The GAO estimated the lack of appreciable improvements in reducing late payments had caused contractors' costs to balloon in 3 years from \$60 million annually to between \$150 million and \$375 million annually (assuming yearly late payments of \$11 billion and a higher interest rate of 12 percent). Similarly, the early payment costs to the Government had also mushroomed. Correcting this latter deficiency could save the agencies between \$900 million and \$3.8 billion annually.

Not surprisingly, this second report fueled the legislative fires already burning in Congress that had been ignited by the first report. By this time, several bills had already been introduced and another would

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<sup>48</sup> General Accounting Office, *The Federal Government's Bill Payment Performance Is Good But Should be Better*, GAO/FGMSD 78-16 at 24 (Feb. 1978).

<sup>49</sup> *Id.*

<sup>50</sup> General Accounting Office, *Actions to Improve the Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars*, GAO/AFMD-82-1 (Oct. 1981).



shortly follow.<sup>51</sup> A substantial hue and cry accompanying these bills was raised on the floor of Congress. Senator Weicker was the most vociferous. Focusing on the disproportionate ill effects late payments have on small business -- a focus so universally shared by members of Congress that one of the bills was devoted exclusively to small business<sup>52</sup> -- he declared:

[T]hese chronic late payments cause an unfair financial burden on small firms . . . . [T]his legislation [S.1131] will put an end to irresponsible federal payment practices . . . .<sup>53</sup>

Small businesses are failing at a rate unseen since the Great Depression, and those that have not failed are hanging on by their thumbnails. In this climate, with blows raining down on them from all sides, the last thing our small business owners need is to get sucker-punched by their own Government.<sup>54</sup>

I view late payments by the Government . . . to be one of the most inexcusable of all Federal practices . . . .<sup>55</sup>

[T]here is absolutely no excuse for this kind of continuing negligence by the U.S. Government.<sup>56</sup>

Other speakers also used colorful language to express their displeasure with the problem. (E.g., "The problem [is] a national shame;"<sup>57</sup> "[Late

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<sup>51</sup> Late Payments Act of 1981, S. 30 (introduced Jan. 5, 1981); H.R. 2036 (introduced Feb. 24, 1981); Delinquent Payments Act of 1981, S. 1131 (introduced May 6, 1981), H.R. 3494 (introduced May 7, 1981); Prompt Payment Act of 1981, H.R. 4709 (introduced Oct. 7, 1981); H.R. 4895 (introduced Nov. 4, 1981).

<sup>52</sup> H.R. 4895 (introduced Nov. 4, 1981).

<sup>53</sup> 97 CONG. REC. S8619 (daily ed. May 6, 1981).

<sup>54</sup> 98 CONG. REC. S9277 (daily ed. May 11, 1982).

<sup>55</sup> 97 CONG. REC. S31,283 (daily ed. Dec. 15, 1981).

<sup>56</sup> Id. at 31,284.

<sup>57</sup> Id. at 31,286 (remarks of Sen. Mattingly).

payment] is an outrageous abuse of Government power;"<sup>58</sup> "[T]hese are only a few examples of the scandalous realities of chronic late payment by agencies of the Federal Government."<sup>59</sup>)

Underlying this rhetoric was the recognition that the \$11 billion in annual late payments identified by the GAO -- an involuntary, interest-free loan from private businesses -- was causing the harms to industry and Government identified by the GAO. Balanced against the need to solve these problems was the countervailing apprehension that requiring the Government to pay a penalty for late payments might cost it millions of dollars. The Congressional Budget Office voiced most of the concern.<sup>60</sup> It estimated that, if no improvement in agency bill paying occurred, the cost to the Government each fiscal year between 1983 and 1987 would be approximately \$70 million to \$100 million.<sup>61</sup> The House Committee on Government Operations rejected that estimate because it believed the CBO failed to consider the savings the proposed legislation would secure. It explained as follows:

The CBO estimate ignores an important point which the Committee learned in its hearings on this legislation: the Federal

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<sup>58</sup> 98 CONG. REC. H5016 (daily ed. Mar. 23, 1982) (remarks of Rep. Lagomarsino).

<sup>59</sup> *Id.* at 5022 (remarks of Rep. McDade)

<sup>60</sup> However, an article introduced by Rep. English revealed that taxpayers were also concerned. The article stated, "But if private business has its way in persuading Congress, those Government delays will start costing the Government -- and the taxpayer -- millions of dollars in interest charges for past-due payment of bills." 97 CONG. REC. H9052 (daily ed. May 7, 1981).

<sup>61</sup> H.R. REP. NO. 461, 97th Cong., 2d Sess. 12-13 (1982) (hereinafter H.R. REP. NO. 97-461) (CBO review of H.R. 4709). A relatively similar estimate had accompanied S. 1131 four months earlier. See S. REP. NO. 302, 97th Cong., 1st Sess. 12-13 (1981) (hereinafter S. REP. NO. 97-302).

Government is the principal loser when it engages in late payment practices; significant benefits would accrue from a policy of paying bills on time. These benefits include:

- [1] Procurement of cheaper and better goods and services as more firms become willing to do business with the Government;
- [2] Savings through lower bids on contracts, as firms cease inflating estimates to compensate for anticipated late payments of bills; and
- [3] More efficient billing systems and more productive use of personnel.

Although precise dollar estimates of these benefits cannot be made, there is ample evidence that significant savings will be realized. Such savings and related benefits must be considered in making a net cost estimate of the legislation's effects. It is entirely conceivable that once the value of these benefits is factored in the cost estimate, [the PPA] will be found to result in net savings for the Government, as well as for business concerns which deal with it.<sup>62</sup>

The Committee's rosy assessment was reflected several days later when final passage of the bill was debated. As one Congressman remarked, "How about that -- the bill we have before us today will not only assist the small businessman, make the Government responsible for its contractual

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<sup>62</sup> H.R. REP. NO. 97-461, *supra* note 61, at 13. A more questionable explanation for why the new act would cost the taxpayers nothing is as follows: "[S]ince the interest penalties would be paid directly from each agency's existing operating funds, enactment of this legislation [S. 1131] would not result in any additional costs to taxpayers." 97 CONG. REC. S8619 (daily ed. May 6, 1981) (remarks of Sen. Weicker). Such reasoning necessarily presumes interest penalties spent by an agency in one year are never replenished by a subsequent appropriation to meet agency budgetary needs. The more realistic assessment was made by the CBO when it commented on the 1988 Amendments, "In the short-term, such costs would come from program funds. . . . Over a longer period, appropriation levels might be affected (though the [PPA] does not allow appropriations specifically for the purpose of paying interest penalties)." H.R. REP. NO. 784, 100th Cong., 2d Sess. 41 (1988) (hereinafter H.R. REP. NO. 100-784).

debts, but will result in a savings to the American taxpayer."<sup>63</sup> On that optimistic note, Congress passed the Prompt Payment Act of 1982.<sup>64</sup>

## *2. Synopsis of the PPA and 1988 Amendments*

The PPA as originally enacted contained the following key provisions:

(1) Unless a contract establishes a specific due date, payments are due 30 days after an agency receives a proper invoice.

(2) Shorter time periods are provided for perishable food and agricultural products.

(3) An invoice is considered received on the later of the date it physically arrives in the designated payment office or on the date the agency accepts the goods or services.

(4) An agency must notify a contractor within 15 days if it considers an invoice to be improper.

(5) Payment is considered made on the date annotated on the Government check.

(6) Agencies have a 15-day grace period after the due date in which to pay. Payment made after the grace period triggers an interest penalty which accrues from the due date until either one year elapses or the contractor files a claim under the CDA.

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<sup>63</sup> 98 CONG. REC. H5020 (daily ed. Mar. 23, 1982) (remarks of Rep. Rousselot).

<sup>64</sup> On May 21, 1982, S. 1131 became Pub. L. No. 97-177. See also CONGRESSIONAL QUARTERLY, *Government Operations* 1228 (May 22, 1982).

(7) The interest rate is the same rate as that prescribed for CDA interest; however, whereas CDA interest is simple interest, PPA interest compounds every 30 days.

(8) If an agency does not pay the penalty automatically, a contractor may file a claim for the interest under the CDA.

(9) An improperly taken prompt payment discount precipitates an interest penalty.

(10) Agencies must pay any penalty out of funds already appropriated for the program for which the penalty is incurred; Congress will not appropriate additional money for the penalty.

(11) No penalty is required for delayed payments (a) when there is a dispute regarding the proper amount or contract compliance, (b) when the payment is temporarily withheld in accordance with a contract provision, or (c) when the payment is solely for financing purposes.

(12) Annual reports are required to assess how well agencies are complying with the act.

After several years had elapsed from passage of the act, the small business community began calling for Congressional hearings and legislation to remedy some of the problems stemming from application of the new law. Although small businesses conceded the PPA had substantially improved the bill paying practices of some agencies, they argued that ambiguities in the statute allowed agencies to avoid the penalties by delaying the start of their "payment clocks" and by construing certain

payments, such as construction progress payments and partial payments under supply and service contracts, as beyond the reach of the PPA.<sup>65</sup>

Congress heeded the call. In response to a request from the House Government Operations Committee, the GAO conducted a review of the PPA's implementation and issued its findings in August 1986.<sup>66</sup> Its principal findings included: (1) 24 percent of payments, involving \$7.7 billion, were late; (2) agencies paid only one of every six penalties owed; (3) 23 percent, covering \$44 billion, were paid too early; (4) the need for more accurate agency reporting; and (5) the need for the FAR to implement the PPA.<sup>67</sup> The following month the House Committee issued a report<sup>68</sup> containing many of the same findings and recommendations.<sup>69</sup>

For its part, the Senate introduced and passed a remedial bill in 1986 which the House did not take up.<sup>70</sup> Almost immediately upon reconvening in January, the Senate introduced another bill,<sup>71</sup> which, after modification

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<sup>65</sup> S. REP. NO. 78, 100th Cong., 1st Sess. 5 (1987) (hereinafter S. REP. NO. 100-78).

<sup>66</sup> General Accounting Office, *Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits*, GAO/AFMD 86-69 (Aug. 1986).

<sup>67</sup> *Id.* at 3-4.

<sup>68</sup> H.R. REP. NO. 927, 99th Cong., 2d Sess. (1986).

<sup>69</sup> The report is summarized in H.R. REP. NO. 100-784, *supra* note 62, at 11-12.

<sup>70</sup> *Prompt Payment Amendments of 1986*, S. 2479 (introduced May 21, 1986).

<sup>71</sup> *Prompt Payment Act Amendments of 1987*, S. 328 (introduced Jan. 20, 1987).

by the House, became the 1988 Amendments.<sup>72</sup> The Amendments contained the following key provisions:

(1) The starting point of the "payment clock" is clarified. The designated payment office is the place or person the agency designates to first receive an invoice. Receipt is deemed to occur on the later of actual receipt of an invoice or 7 days after goods are delivered or services are completed.

(2) Agencies now have only 7 days to notify contractors if an invoice is defective.

(3) The 15-day grace period is eliminated.

(4) If an agency fails to pay an interest penalty automatically, it may be subject to an additional "double" penalty.

(5) Construction progress payments and partial payments for partial deliveries are explicitly covered by the act.

(6) Agencies have only 14 days in which to pay construction progress payments.

(7) Construction prime contractors must substantiate and certify their invoices; they must also flow down certain PPA provisions to their subcontractors.

(8) FAR implementation of the statute is required.

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<sup>72</sup> Pub. L. No. 100-496, 102 Stat. 2455 (1988), codified at 31 U.S.C. §§ 3901-07 (1988) (hereinafter PPA Amendments or Amendments).

### 3. Regulatory Implementation

The 1982 Act require<sup>d</sup> the Office of Management and Budget to prescribe regulations implementing the law.<sup>73</sup> OMB complied by issuing OMB Circular A-125.<sup>74</sup> It subsequently revised the Circular in 1987<sup>75</sup> and again in late 1989 to incorporate the Amendments.<sup>76</sup> The PPA as originally enacted did not mandate DAR implementation. Nevertheless, the FAR eventually included coverage in October 1988, albeit after a gap of six years.<sup>77</sup> The Amendments corrected the oversight by requiring FAR treatment.<sup>78</sup>

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<sup>73</sup> 31 U.S.C. § 3903 (1982).

<sup>74</sup> OMB Circular A-125, 47 Fed. Reg. 37321 (1982), Attachment 1, 49 Fed. Reg. 28140 (1984), Attachment 2, 50 Fed. 14688 (1985) (cited collectively hereinafter as Circular (1982)).

<sup>75</sup> 52 Fed. Reg. 21926 (1987).

<sup>76</sup> 54 Fed. Reg. 52700 (1989) (hereinafter Circular (Rev.)).

<sup>77</sup> FAC 84-33, 53 Fed. Reg. 3688 (1988). The most current version, which reflects the Amendments, is FAC 84-45, 54 Fed. Reg. 13332 (1989).

<sup>78</sup> Pub. L. No. 100-496, § 11 (not codified).



## CHAPTER 2

# MAJOR PROVISIONS OF THE PPA

This chapter deals with the mechanics of the Prompt Payment Act, as amended. Part I explores the basic issues surrounding the determination of whether a late payment penalty is due. Assuming a penalty is due, Part II examines how the assessment must be calculated, whether it is automatically paid, and which funds pay it. Part III addresses several topics unique to construction contracts. Finally, the annual reports required of the agencies and of OMB are covered in Part IV.

### **I. DETERMINING WHETHER PAYMENT IS LATE**

Because the PPA only applies to late payments, a threshold issue is how to determine whether a payment is "late." Such a determination requires knowledge of (a) what starts the payment "clock" ticking, (b) how many days are allowed for payment once the clock has been started, and (c) what stops the clock. Coverage of these three topics follow.

## ***A. Starting The Clock***

The payment clock begins ticking for an agency when it either (1) receives a proper invoice, (2) receives a proper request for progress payments on a construction or fixed-price architect-engineer contract, (3) improperly takes a prompt payment discount, or (4) unreasonably withholds an amount from a contract.

### *1. Receipt of a Proper Invoice*

#### *a. "proper invoice" defined*

##### *i. statutory and regulatory definitions*

Since receipt of a "proper invoice" starts the payment clock,<sup>79</sup> understanding which invoices are "proper" is vital. Section 3901(a)(3) of the PPA defines "proper invoice" as "an invoice containing or accompanied by substantiating documentation the Director of the Office of Management and Budget may require by regulation and the head of the appropriate agency may require by regulation or contract." In its section-by-section analysis of the PPA, the Senate explained why OMB and agency regulations are necessary:

[N]ot all late payments are the fault of the Government. For example, a contractor may submit a faulty invoice, lacking identification, which makes it impossible for the Government to pay the account. A contractor should not be able to demand

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<sup>79</sup> 31 U.S.C. § 3903(a)(1)(B) (1988); Circular (Rev.), *supra* note 76, § 4(e); FAR 32.905(a)(1).

interest when a payment is late if the contractor's errors in preparing or submitting an invoice are the cause for late payment. The Committee also recognizes, however, that disparate agency rules respecting invoices can contribute to contractor errors. The promulgation of uniform regulations . . . should help minimize such problems.<sup>80</sup>

The checklist of information required by OMB to constitute a proper invoice includes:

- (1) Name of contractor and invoice date . . . .
- (2) Contract number, or other authorization for delivery of property or services . . . .
- (3) Description, price, and quantity of property and services actually delivered or rendered.
- (4) Shipping and payment terms.
- (5) Other substantiating documentation or information as required by the contract.
- (6) Name (where practicable), title, telephone number, and complete mailing address of responsible official to whom payment is to be sent.<sup>81</sup>

In addition to OMB's checklist, the FAR requires one extra piece of information to accompany the invoice: the "name (where practicable), title, phone number, and mailing address of person to be notified in event of a defective invoice."<sup>82</sup> It seems highly unlikely, however, that failure to include this information alone would stop the clock from ticking. Imagine an invoice that met all of the OMB requirements. The FAR would treat such an *otherwise proper* invoice as *improper* on the sole basis that it failed to specify whom to notify if the invoice were improper! One

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<sup>80</sup> S. REP. NO. 97-302, *supra* note 61, at 9.

<sup>81</sup> Circular (Rev.), *supra* note 76, § 5b. The checklist is virtually unchanged from the original Circular, 47 Fed. Reg. 37321 (1982), where it was found at Section 6b. Note that Section 5b requires the information provided to be "correct." Although Sections 5a and 5c require additional documentation from the contract and receiving report, respectively, this further paperwork is only to ensure agencies have the flexibility to process billings effectively. As Section 6b points out, the sole criteria for determining a proper invoice is contained in Section 5b.

<sup>82</sup> FAR 32.905(e)(7).

would hope a board or court would not allow an agency to avoid late payment interest on that basis. Nevertheless, even the possibility of wasteful litigation ought to be foreclosed. The FAR should be amended to encourage, rather than mandate, contractors to provide the additional information. No doubt most contractors would willingly comply, as it is in their best interest to do so.

*ii. case law*

*(a). required documentation missing*

Only a few requests for PPA interest have been denied because the contractor failed to supply the required documentation. The most glaring oversight was described in Radcliffe Construction Co.<sup>83</sup> The contractor's so-called invoice was merely an in-house estimate, which did not appear on its face to be a demand, and which in any event was never sent to the Government. The case stands for the elementary proposition that, to be proper, an invoice must at the very least be submitted to the Government. In Consolidated Construction Co.,<sup>84</sup> several contract clauses relating to labor standards required the submission of payrolls along with the invoices. Since the contractor failed to submit its subcontractor's payrolls, interest was denied. The same result was obtained in Ross

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<sup>83</sup> ASBCA Nos. 39252, 39253, 90-2 BCA ¶ 22,651.

<sup>84</sup> GSBGA No. 8871, 88-2 BCA ¶ 20,811.

Plumbing and Heating Company,<sup>85</sup> because the contractor did not supply the documentation required by the agency's regulations.

Although an agency has the contractual right to prescribe and change the necessary documentation and format, it must do so prior to the submission of the invoice. If it fails to exercise that right on time, the invoice is deemed proper and the payment clock begins ticking.<sup>86</sup>

*(b). modifications to contract price*

When the Government delays in acting on a change order or contractor proposal for an upward equitable adjustment, the decisions have uniformly, save one, denied PPA interest on the grounds that the invoice is not proper. In the leading case of Ricway, Inc.,<sup>87</sup> the contractor completed the portion of work required by a change order and submitted an invoice for progress payments. At the time the invoice was submitted, the "total" contract price had not yet been adjusted upward to include the value of the changed work. Since progress payments are based on the "total" contract price and the percentage of work complete, the board ruled that the invoice was not a "proper invoice" for the value of the changed work. In view of the fact that the board held a second invoice, which was submitted after the price adjustment modification, to be proper, the case

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<sup>85</sup> HUD BCA No. 85-932-C7, 85-3 BCA § 18,478.

<sup>86</sup> Toombs & Co., ASBCA Nos. 35085, 35086 (Sept. 18, 1990). Although the "invoice" in question was really a progress payment request, the same logic should apply to invoices.

<sup>87</sup> ASBCA No. 30205, 86-1 BCA § 18,539.

highlights the absolute need for an actual contract modification to incorporate the value of the changed work.

The one case in which an invoice was held to be proper even though it was submitted prior to execution of a price adjustment modification is Bruce-Anderson Co.<sup>88</sup> However, that decision is not inconsistent with Ricway. Unlike the "Payments to Contractor" clause in Ricway, which based progress payments on the total contract price, Bruce-Anderson had a specialized clause which based progress payments on the total value of work completed, irrespective of whether that value had been incorporated into the contract. Although the board agreed with the Ricway rule, it found the rule inapplicable.

Although the Ricway rule is well-settled,<sup>89</sup> its rationale was not fully explained until Columbia Engineering Corp.<sup>90</sup> was handed down. In that case, the contractor argued the invoice was proper because it had satisfied all the regulatory requirements prescribed by OMB and the FAR. In rejecting that argument, the board reasoned as follows:

There is an obvious problem with [the contractor's] position in that it presupposes that the amount claimed by appellant for the added or changed work is correct and therefore promptly

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<sup>88</sup> ASBCA No. 34489, 88-1 BCA ¶ 20,355.

<sup>89</sup> See EMS, Inc., GSBGA Nos. 9588, 9771, 90-2 BCA ¶ 22,876 at 114,892 n.7; Sociedade De Construcoes Soares Da Costa, ASBCA No. 37875, 90-2 BCA ¶ 22,691; Radcliffe Constr. Co., 90-2 BCA ¶ 22,651; D.H. Blattner & Sons, Inc., IBCA Nos. 2589 et al., 89-3 BCA ¶ 22,230; Sociedade De Construcoes, ASBCA No. 37949, 89-3 BCA ¶ 22,028; Hunter Constr. Co., ASBCA No. 32193, 89-3 BCA ¶ 21,970; Columbia Eng'g Corp., IBCA No. 2322, 89-2 BCA ¶ 21,762; G. Issaias & Co. (Kenya), Ltd., ASBCA No. 30359, 88-1 BCA ¶ 20,441; Sol-Mart Janitorial Services, Inc., ASBCA No. 32873, 87-3 BCA ¶ 20,120; Ricway, Inc., ASBCA No. 30204, 86-3 BCA ¶ 19,234; H.Z. & Co., Ltd., ASBCA No. 31005, 86-2 BCA ¶ 18,976. But see Bruce-Anderson Co., ASBCA No. 3489, 88-1 BCA ¶ 20,355.

<sup>90</sup> IBCA No. 2322, 89-2 BCA ¶ 21,762.

payable. This position does not allow for the exercise of any judgment by Government personnel in evaluating the claimed compensation and determining it to be in error or excessive. Acceptance of this position would be tantamount to saying that amounts claimed by contractors for changes become immediately due and payable without negotiation, evaluation for merit or error, or other considerations of validity . . . .

The documentation submitted by appellant for each of the modifications were simply proposals for adjustment of the contract price to pay for the changed work . . . . Until a proposal is accepted by the Government, and incorporated into the contract, there exists no sum certain owing to the contractor. Therefore, there cannot be a proper invoice . . . .<sup>91</sup>

There is a certain degree of logic to the board's rationale. The Government should not be subject to an interest penalty when it is diligently trying to negotiate a fair price<sup>92</sup> or cull the invoice for errors. Indeed, one of Columbia's four invoices was reduced when the Government discovered the invoice erroneously contained certain overhead charges. However, the rationale does not adequately explain why interest should not accrue when the Government dawdles in accepting the contractor's proposal. There is no mistaking the board intended its decision to cover such Government tardiness, for it prefaced its conclusion with the statement, "Assuming *arguendo*, that Government *fault* could be shown to account for the delays . . . ."<sup>93</sup> Perhaps an unstated reason for this breakdown in rationale is a problem of proof: how to distinguish between hard bargaining and lack of diligence.

While the rationale generally supports the board's statement that the invoice is not proper until the proposal is accepted by the Government,

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<sup>91</sup> *Id.* at 109,509-10.

<sup>92</sup> Harrell-Patterson Contracting, Inc., ASBCA Nos. 30801 et al., 87-2 BCA ¶ 19,805 (no PPA interest where the Government unsuccessfully tried for 10 months to negotiate a price for the changed work).

<sup>93</sup> 89-2 BCA at 109,509.

it totally fails to explain why the agreement must then be incorporated into a modification. Once any errors are removed from the invoice and a firm price is negotiated, how can the rationale justify a denial of interest if the Government delays 6 months, 1 year, 3 years, etc., before cutting the modification?

Such a situation can, and did, occur. In Hunter Construction Co.,<sup>94</sup> the board pointedly noted that the record did not explain why the Government delayed cutting the modification for 6 months and therefore criticized the Government's action as a "failure to act in an appropriate and business-like manner." While "sympathetic to appellant's plight," the board nevertheless applied the Ricway rule.<sup>95</sup>

The boards should either articulate a defensible rationale for requiring a written contract modification or pare back Ricway so that the invoice is deemed proper once price agreement is reached.<sup>96</sup> In the

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<sup>94</sup> ASBCA No. 32193, 89-3 BCA ¶ 21,970. See also Sociedade De Construcoes, ASBCA No. 37949, 89-3 BCA ¶ 22,028 (10-month delay between negotiation of price and execution of modification).

<sup>95</sup> *Id.* at 110,514.

<sup>96</sup> In addition to equitable considerations, some support for paring back the Ricway rule is found in the pre-PPA case of Granite Construction Co., ASBCA No. 26023, 83-2 BCA ¶ 16,843. The board refused to award CDA interest to the contractor after the Government unreasonably delayed paying an amount the parties had orally agreed upon as the appropriate adjustment for changes in the work because it equated this type of late payment with the late payment of undisputed invoices. In the board's view, it

perceive[d] no valid basis for distinction between Government caused delays in payment of undisputed invoices and similar delays in payments of amounts agreed upon in negotiations for change order work with regard to the Government's liability for interest pursuant to the [Disputes] Act.

The PPA, of course, now allows interest for late payment of undisputed invoices. Just as the board concluded there are no perceptible



meantime, if contractors want more than sympathy, they will have to convert their price adjustment proposals to CDA claims pursuant to that statute.<sup>97</sup>

*(c). the "continuing" invoice*

In several of the cases discussed in the preceding section, including Ricway, the invoices were totally proper but for the fact they were submitted prior to execution of the modification. It is one thing for the boards to say premature invoices are improper; it is quite another to say that a totally new invoice must be prepared and submitted after the modification is cut in order to start the PPA clock. Why could not the invoice continue to live dormant until the impediment (unexecuted contract modification) was removed and then gain vitality? The boards did not explain why such invoices must be considered "dead"; perhaps they were not asked. It seems an undue burden to require contractors to undertake this extra step, especially in view of the Congressional intent to make interest payments automatic for delayed payments.

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distinctions between the two types of delayed payment for CDA purposes, the author believes there are no differences for PPA purposes. Thus, the analogy previously used to deny CDA interest might now be used to grant PPA interest.

<sup>97</sup> See Radcliffe Constr. Co., ASBCA Nos. 33252, 39253, 90-2 BCA ¶ 22,651 at 113,813 n.6 (suggesting contractors can obtain CDA interest by filing a claim for the delay in executing the modification); Hunter Constr. Co., ASBCA No. 32193, 89-3 BCA ¶ 21,970 (although PPA interest was denied based on Ricway, contractor recovered CDA interest where, even before submitting a proper invoice, it filed a claim for the unreasonable delay in cutting the modification -- moral: file a claim ASAP).

A more enlightened view was taken under analogous circumstances by the board in Steven E. Jawitz.<sup>98</sup> The contractor submitted a proper invoice which went unpaid because the contracting officer invoked the contract's "Withholding of Funds" clause. After the reason for the withholding no longer existed, the invoice still went unpaid. The board construed the contractor's argument for interest to be that the invoice "was a 'continuing' invoice on which payment was due whenever proper, i.e., whenever the withheld retainage became available for release." The board agreed, rejecting the notion that the invoice was improper.<sup>99</sup> The Jawitz rationale ought to be applied to the Ricway scenario.

It ought also be applied to any other situation where an impediment to payment has been removed and an otherwise proper invoice has been submitted. For example, the rationale should have been embraced in Professional Design Constructors,<sup>100</sup> where a progress payment request was never processed because it was submitted only 2 weeks after a previous request and the contract specified the interval between requests must be at least 30 days. To hold the request "improper" until 30 days had elapsed would be correct; to hold the request "improper" forever seems unduly burdensome.

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<sup>98</sup> ASBCA No. 33610, 87-3 BCA ¶ 20,011.

<sup>99</sup> *Id.* at 101,332-33.

<sup>100</sup> GSBCA No. 8554 (Sept. 28, 1990).

(d). final payment and release

Paragraph (f) of the Payments to Contractor clause<sup>101</sup> reads in pertinent part:

Upon completion and acceptance of all work, the amount due the Contractor under the contract shall be paid upon the presentation of a properly executed voucher and after the Contractor shall have furnished the Government with a release of all claims . . . other than claims in stated amounts as may be specifically excepted by the Contractor . . . .

This clause appears to require an invoice to be accompanied by a final release before there can be final payment. Indeed, that seems to be the view of the Armed Services Board, although its statement on the subject was dicta. In Steven E. Jawitz,<sup>102</sup> it said that "without a final release, as required by paragraph (f) of the "Payments" clause, [the invoice] may not have been a proper invoice within the meaning of the Act for the purpose of final payment."<sup>103</sup> With this rule apparently in mind, but apparently not also cognizant of the fact that a release can contain exceptions, the contractor in Sol Flores Construction<sup>104</sup> presented an invoice for 99 percent of the work even though 100 percent had been completed and accepted. The contractor was concerned that presenting a 100 percent invoice would be a demand for final payment and necessitate a release without exceptions, thus barring the claims it wished to preserve. The Government tried to explain that claims could be reserved

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<sup>101</sup> DAR 7-602-7. This provision is now in the Payments under Fixed-Price Construction Contracts clause, FAR 52.232-5, at paragraph (h).

<sup>102</sup> ASBCA No. 31173, 86-1 BCA ¶ 18,564.

<sup>103</sup> *Id.* at 93,233.

<sup>104</sup> ASBCA No. 32608, 90-1 BCA ¶ 22,365.

in a release, but Sol Flores would not amend its invoice. The Government delayed payment for several months since it did not want to undergo the administrative burden of keeping a physically complete contract open; eventually, however, it paid the 99 percent invoice. In defending against Sol Flores' claim for PPA interest, the Government argued the "Payments" clause required the contractor to submit a final invoice with a release because 100 percent of the work was complete; since Sol Flores had not done so, the invoice should be considered improper. The board rejected that reasoning, simply stating that the "Payments" clause does not mandate a 100 percent invoice upon final acceptance of the work.<sup>105</sup>

(e). *contract interpretation*

The determination of whether an invoice is proper, like other questions of contract interpretation, can sometimes be influenced by the actions of the parties. The PPA and its regulations require the Government to notify the contractor of a defect in the invoice which would prevent the clock from starting.<sup>106</sup> If the Government fails to make such notification, then in a questionable case the inaction might be viewed as some evidence that the invoice was proper.<sup>107</sup> Another evidentiary factor is if the Government eventually pays an invoice which it has steadfastly asserted is improper. One board has observed that, if the invoice is proper enough to make a payment, it is proper enough for the purpose of

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<sup>105</sup> *Id.* at 112,361.

<sup>106</sup> Coverage of the notification requirement begins at page 45, *infra*.

<sup>107</sup> Steven E. Jawitz, ASBCA No. 31173, 86-1 BCA ¶ 18,564.

assessing an interest penalty.<sup>108</sup> A final evidentiary matter involves invoice labeling. Where a contractor mislabeled a request for progress payments as a "final invoice," the board ruled the invoice was nevertheless proper.<sup>109</sup>

*b. "receipt" of a proper invoice*

"Receipt" of a proper invoice is a term of art requiring two distinct events: physical receipt of an invoice and acceptance of the work by the Government. The original PPA stated that "receipt" was deemed to occur on the later of the two events, i.e., after both (a) the invoice appeared at the "designated payment office or finance center," and (b) the agency "accept[ed] the applicable property or service."<sup>110</sup> The two conditions are treated separately below.

*i. physical receipt*

What the Senate Committee intended by this provision was merely to ensure the clock did not start before the agency received the invoice.<sup>111</sup> That legislative desire was enforced at least once, where a contractor who

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<sup>108</sup> Id. at 93,233; Sol Flores Constr., ASBCA No. 32608, 90-1 BCA ¶ 22,365 at 112,361.

<sup>109</sup> Steven E. Jawitz, ASBCA No. 31173, 86-1 BCA ¶ 18,564.

<sup>110</sup> 31 U.S.C. § 3901(a)(4) (1982).

<sup>111</sup> S. REP. NO. 97-302, *supra* note 61, at 10 ("agency payment office cannot be held responsible for failure to pay an invoice until it receives the invoice").

argued the clock should start upon submission was rebuffed.<sup>112</sup> However, the drafters of the "receipt" language did not contemplate the potential problems and outright abuses that might arise from that provision.

An example of the former occurred in Morin Industries, Inc.,<sup>113</sup> where the contract did not clearly designate where to send the invoices. The contract provided for invoices to be sent to a cross-referenced address for the contracting officer, but it also provided that payment would come from the finance office, whose address was spelled out. While acknowledging the contract was confusing, the board nevertheless said the contractor's responsibility was to read the contract carefully. Thus, sending the invoice to the finance office did not constitute receipt. Morin's moral is that invoices must not only reach the designated finance office but must also be sent to the designated location for receipt if the two are not the same.

Potential agency abuse of this provision of the original act is best described in the two Committee reports accompanying the Amendments:

Without a doubt the single most abused and ambiguous section of the current law relates to government "receipt" of a "proper" invoice. The date on which the designated payment office or finance center actually receives a proper invoice is the date the clock begins to tick in the payment process. Interest penalties begin accruing thirty days from that date, but frequently one to three months pass before an invoice works its way through the paperwork channels and officially reaches a "payment center."<sup>114</sup>

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<sup>112</sup> Ricway, Inc., ASBCA No. 30205, 86-1 BCA ¶ 18,539 at 94,955.

<sup>113</sup> ASBCA Nos. 33611 et al., 87-2 BCA ¶ 19,856.

<sup>114</sup> S. REP. No. 100-78, *supra* note 65, at 18. This agency internal flow of paperwork was not counted by OMB when it reported that 99 percent of payments were paid on time; in contrast, the GAO counted that flow time, as well as other differences, and found only 75 percent were timely paid. H.R. REP. No. 99-927, 99th Cong., 2d Sess. 15-16 (1986). OMB's error was roundly criticized by industry during Committee hearings. E.g.,

For example, [HUD] may require invoices to be sent by one contractor to another HUD contractor for review, but then may not recognize the invoice as received until it actually reaches HUD's finance or payment office.<sup>115</sup>

Congress recognized this loophole in the original PPA and so stipulated in the Amendments that receipt is deemed to occur on "the date on which the place or person designated by the agency to first receive such invoice actually receives a proper invoice."<sup>116</sup>

Even with this reform, not all problems for contractors are solved, for, presumably, they will still have the burden of proving their invoices were received at the designated place if the agency claims they were "lost."<sup>117</sup> They will not, however, still have to prove *when* the invoice was received.<sup>118</sup> The statute and regulations now provide that, if the designated place of receipt fails to annotate on the invoice the date it

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*Prompt Payment Act Amendments of 1987: Hearing on S. 328 Before the Senate Comm. on Govt. Affairs, 100th Cong., 1st Sess. 81, 148 (1987).*

<sup>115</sup> H.R. REP. NO. 100-784, *supra* note 62, at 14.

<sup>116</sup> 31 U.S.C. § 3901(a)(4)(A)(i) (1988); Circular (Rev.), *supra* note 76, § 1n(1); FAR 32.902 (definition of "designated billing office"); FAR 32.905(a)(1). The Amendments also deem receipt to occur if there is constructive acceptance of the work, a provision discussed in the following section.

<sup>117</sup> E.g., Morin Indus., Inc., ASBCA Nos. 33611 et al., 87-2 BCA ¶ 19,856. Apparently, the phenomenon of "lost" invoices is frequently experienced by contractors. See *Prompt Payment Act Amendments of 1987: Hearing on S. 328 Before the Senate Comm. on Govt. Affairs, 100th Cong., 1st Sess. 149 (1987)*. See also Nagle, *Prompt Payment Discounts in Government Contracts*, 13 PUB. CONT. L.J. 2 (1983) (suggests using certified mail to combat the "mysteriously vanishing invoice," a technique also advocated by the board in Morin).

<sup>118</sup> Morin Indus., Inc., ASBCA Nos. 33611 et al., 87-2 BCA ¶ 19,856; Swinging Hoedads, AGBCA No. 85-308-3, 86-3 BCA ¶ 19,135.

was received, receipt is deemed to occur on the date stamped on the invoice by the contractor.<sup>119</sup>

*ii. acceptance*

As stated above, the original PPA provided that "receipt" could not occur until the agency "accept[ed] the applicable property or service." The drafter's "only concern [was] that an agency not be held liable for failure to pay an invoice before the agency [had] even 'accepted'" the property or services.<sup>120</sup> What Congress failed to realize was that the law left a gaping loophole. "Acceptance," in federal contracting parlance, is distinct from simply delivering the goods or completing some work. Acceptance constitutes Government acknowledgment that the effort successfully conforms to the terms and conditions of the contract. Since acceptance is wholly within Government control, so too is the "receipt" date. Testimony during the Amendments hearings confirmed that agencies were able to postpone the "receipt" date by delaying acceptance.<sup>121</sup>

The PPA Amendments correct this deficiency by injecting the concept of "constructive" acceptance. For purposes of determining whether "receipt" has occurred, acceptance is deemed made on one of three dates: (1) on the 7th day after delivery of the goods or completion of performance; (2) on the date of actual acceptance if it occurs before the

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<sup>119</sup> 31 U.S.C. § 3901(a)(4)(B) (1988); Circular (Rev.), *supra* note 76, § 1n(2); FAR 32.905(a)(2).

<sup>120</sup> S. REP. NO. 97-302, *supra* note 61, at 10.

<sup>121</sup> H.R. REP. NO. 100-784, *supra* note 62, at 15.



7th day after delivery of the goods or completion of performance; or (3) at a later date if the contract so specifies.<sup>122</sup>

As the FAR points out, constructive acceptance does not compel agency officials "to accept supplies or services, perform contract administration functions, or make payment prior to fulfilling their responsibilities."<sup>123</sup> But constructive acceptance does compel the accrual of interest if the Government takes longer than 7 days to fulfill its responsibilities<sup>124</sup> even though the interest itself is not to be paid until after actual acceptance.<sup>125</sup> The contract can, of course, specify more time for acceptance, but only if (1) the contract is not for a brand-name commercial item authorized for resale;<sup>126</sup> (2) the solicitation specifies the longer period;<sup>127</sup> (3) the extra time is needed solely for purposes of

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<sup>122</sup> 31 U.S.C. § 3901(a)(4)(A)(ii) (1988); Circular (Rev.), *supra* note 76, § 1n(1); FAR 32.905(a)(1)(ii).

<sup>123</sup> FAR 32.905(a)(1)(ii).

<sup>124</sup> *Id.*

<sup>125</sup> Circular (Rev.), *supra* note 76, § 7b(1).

<sup>126</sup> 31 U.S.C. § 3901(a)(4)(A)(ii) (1988); FAR 32.905(a)(1)(ii). The Circular has apparently omitted this restriction.

<sup>127</sup> Circular (Rev.), *supra* note 76, § 1n(1); FAR 32.905(a)(1)(ii). Although the Amendments require notification only in the contract and not in the solicitation, the drafters expected the regulations to so specify in order to permit competing contractors to adjust their bids to account for the increased financing costs. S. REP. NO. 100-78, *supra* note 65, at 17; H.R. REP. NO. 100-784, *supra* note 62, at 16.

inspecting, testing, and evaluation;<sup>128</sup> and (4) the justification is documented in the contract file.<sup>129</sup>

*c. notification of an improper invoice*

*i. statutory and regulatory guidance*

When an agency receives an improper invoice, it must notify the contractor of the defect. Failure to do so will affect the amount of days allowed for payment. The PPA as originally enacted required that "within 15 days after an invoice is received, the head of an agency [must] notify the business concern of a defect or impropriety in the invoice that would prevent the running of the time period" allowed for payment.<sup>130</sup> The reason for this section is explained in the Senate report:

[This section] provides that an invoice shall be considered a proper invoice, even if technically deficient, if the government fails to notify the contractor promptly of deficiencies in the invoice. In such circumstances, the invoice will still be deficient, and the contractor may still have to resubmit the invoice or provide additional substantiation of performance in order to obtain payment on the contract. However, the government will not be able to avoid an interest penalty simply because the invoice is deficient. The Committee has included this provision in order to protect a contractor from having an invoice rejected for technical deficiencies weeks after it was submitted, a frequent complaint of government contractors.<sup>131</sup>

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<sup>128</sup> 31 U.S.C. § 3901(a)(4)(A)(ii) (1988); Circular (Rev.), *supra* note 76, § 1n(1); FAR 32.905(a)(1)(ii).

<sup>129</sup> FAR 32.905(a)(1)(ii).

<sup>130</sup> 31 U.S.C. § 3903(5) (1982).

<sup>131</sup> S. REP. No. 97-302, *supra* note 61, at 9-10.

To the Senate Committee's rationale can be added the comments of the House Committee: "[The Act is intended] to eliminate those situations in which vendors have remained unpaid for inordinate amounts of time with no knowledge of the reasons for the Government's failure to remit."<sup>132</sup>

The original OMB Circular not only mirrored the statutory language,<sup>133</sup> it implemented the legislative intent as well. It said that, if the agency failed to notify the contractor within 15 days (3 days for meat or meat-food products, and 5 days for perishable commodities), then the amount of time the agency had to pay was reduced by the same number of days its notification was late; furthermore, interest, if any, would accrue from the adjusted date.<sup>134</sup> The FAR followed suit.<sup>135</sup>

Despite the regulations, many agencies apparently ignored them. According to testimony during the hearings related to the 1988 Amendments, compliance with this provision was "almost nonexistent."<sup>136</sup> Because of the recognized hardship on contractors caused by noncompliance, the 1988 Amendments codified OMB's requirements: untimely notification would result in a day-for-day reduction in the amount of time the agency had to pay and interest would run from the adjusted date. The Amendments also (a)

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<sup>132</sup> H.R. REP. NO. 97-461, *supra* note 61, at 9.

<sup>133</sup> Circular (1982), *supra* note 74, § 6b.

<sup>134</sup> *Id.* § 9.

<sup>135</sup> FAR 32.905(e); FAR 32.907-1(b).

<sup>136</sup> H.R. REP. NO. 100-784, *supra* note 62, at 30.

required the agency to return the invoice and to explain why it was defective and (b) reduced the notification time from 15 days to 7 days.<sup>137</sup>

Even this legislative tightening, however, cannot prevent nitpicking by an agency, if it is so inclined. As described in testimony during the Congressional hearings, "Often the 'defective' feature of an invoice is a mistake in quoting the contract number, modification number, or in filling out the highly complicated 'DD250.'"<sup>138</sup> It can be hoped that defects of this type would be corrected on the spot by the agency or deemed by a board or the Claims Court not to be so significant as to make an invoice improper.

#### ii. case law

Even in a case arising prior to the Amendments, a board enforced the OMB rule that lack of notification results in a reduction of available time to pay. Under a contract for alterations of a satellite control facility, the Government notified the contractor 6 days after the 15-day review period had elapsed. Since payment was not made within the grace period, interest on an additional 6 days was due.<sup>139</sup> More recently, the

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<sup>137</sup> 31 U.S.C. § 3903(a)(7) (1988). The Circular, at sections 6b and 7a(7), and the FAR have been accordingly revised. This section of the Amendments, subparagraph (a)(7)(A), also clarifies that only invoices which are "improper" within the meaning of section 3901(a)(3) require notification. No notice is required, for example, when an invoice goes unpaid because of a dispute over the amount of payment or contract compliance.

<sup>138</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 586 (1988).*

<sup>139</sup> Bruce-Anderson Co., ASBCA No. 34489, 88-1 BCA ¶ 20,355.

fact that an agency failed to notify a contractor of claimed deficiencies within the required time was considered strong evidence that the invoice was in fact proper.<sup>140</sup>

A troubling interpretation was rendered by the HUD board prior to passage of the Amendments in Ross Plumbing and Heating Company.<sup>141</sup> The contractor failed to submit along with its invoice certain documents required by HUD regulations. The board said that, because HUD had published its requirements, the contractor was

*charged with notice of the defects in the invoices. [Since the contractor] did not prove it had properly invoiced its claims ... any technical failure by HUD to provide notice of defects or impropriety in the invoices ... is insignificant, because such notice is not required under these circumstances.*<sup>142</sup>

What the board was driving at is unclear. If, by the phrase, "these circumstances," the board meant that Ross never did revise its invoice to conform to the regulations and therefore no interest penalty was due, all is well. Such a statement accords with the Circular. However, if that was what was meant, there would have been no reason to talk about charging the contractor with notice. On the other hand, if the board meant by the phrase, "these circumstances," that merely publishing invoice requirements serves as constructive notice of the defects, thereby precluding a shortening of the time allowed to make timely payment, such an interpretation would completely thwart the intent of the statute and Circular. The Amendments should foreclose any such interpretation in the future.

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<sup>140</sup> EMS, Inc., GSBGA Nos. 9588, 9771, 90-2 BCA ¶ 22,876.

<sup>141</sup> HUD BCA No. 85-932-C7, 85-3 BCA ¶ 18,478.

<sup>142</sup> *Id.* at 92,819 (emphasis added).

## *2. Receipt of a Proper Request for Construction Progress Payments*

### *a. proper request defined*

The 1988 Amendments explicitly extend coverage of the PPA to progress payments on construction contracts. The statute clearly distinguishes requests for such progress payments from invoices. To submit a "proper" request for a progress payment,<sup>143</sup> a prime contractor must substantiate and certify the amount requested.<sup>144</sup>

### *i. substantiation*

Although the PPA does not elaborate on what it takes to substantiate the amount requested, the Circular, taking its cue from the legislative history,<sup>145</sup> lists five items which must be included:

- (a) an itemization of the amounts requested related to the various elements of work required by the contract covered by the payment request;

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<sup>143</sup> Construction progress payments include "monthly percentage-of-completion progress payment[s] or milestone payments for completed phases, increments, or segments of any project." 31 U.S.C. § 3903(a)(6)(A) (1988); Circular (Rev.), *supra* note 76, § 10a(1).

<sup>144</sup> 31 U.S.C. § 3903(b)(1) (1988); Circular (Rev.), *supra* note 76, § 10b; FAR 32.905(c)(1).

<sup>145</sup> H.R. REP. No. 100-784, *supra* note 62, at 25. The committee listed two items of substantiation it felt were the minimum required to "deter false valuation of progress payments requests to the Government and, concurrently, to deter prime contractors from diverting funds from their subcontractors." For a more complete explanation of OMB's five items, see Section 8d of the Supplemental Information accompanying promulgation of the Revised Circular at 54 Fed. Reg. 52700 (1989).

- (b) a listing of the amount included for work performed by each subcontractor under the contract;
- (c) a listing of the total amount of each subcontract under the contract;
- (d) a listing of the amounts previously paid to each such subcontractor under the contract; and
- (e) additional supporting data in a form and detail required by the contracting officer.<sup>146</sup>

The FAR clause<sup>147</sup> does not appear to require as many particulars but, like the Circular, leaves it to the contracting officer's discretion to request more detail.

#### *ii. certification*

In addition to substantiating its request, a contractor must certify to the best of its knowledge and belief that (1) its request covers only amounts expended for performance in accordance with contract specifications and terms, (2) it paid its subcontractors and suppliers from previous payments it received under the contract and will timely pay those same parties from the proceeds of the requested payment, and (3) its request does not include any amount it intends to withhold or retain from

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<sup>146</sup> Circular (Rev.), *supra* note 76, § 5d(1). The form and detail must be specified prior to submission of the progress payment request. See Toombs & Co., *supra* note 86 and accompanying text.

<sup>147</sup> FAR 52.235-5(b).

a subcontractor or supplier.<sup>148</sup> Certification is not to be construed as final acceptance of a subcontractor's performance.<sup>149</sup>

*b. receipt/notification rules*

Since the concept of acceptance is inapplicable to progress payments, the payment clock is started upon actual receipt of a request for a construction progress payment.<sup>150</sup> An agency must notify a contractor within 7 days of receipt of an improper progress payment request.<sup>151</sup>

*c. confusing organization of the FAR*

As already mentioned, the statute clearly distinguishes requests for construction progress payments from invoices. This is accomplished simply by covering the two concepts in different sections of the law. In precisely the same manner, the Circular scrupulously separates the two systems of obtaining payment. In contrast with this logical approach, the FAR creates confusion through its organization. It lumps construction progress payments and "real" invoice payments together in the same section

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<sup>148</sup> 31 U.S.C. § 3903(b)(1)(B) (1988); Circular (Rev.), *supra* note 76, § 5d(2); FAR 52.232-5(c).

<sup>149</sup> H.R. REP. NO. 100-784, *supra* note 62, at 25; Circular (Rev.), *supra* note 76, § 10c. The FAR is silent on this point.

<sup>150</sup> While neither the PPA nor the Circular state actual receipt is required, the legislative history so indicates. H.R. REP. NO. 100-784, *supra* note 62, at 23.

<sup>151</sup> 31 U.S.C. § 3903(b)(2) (1988); Circular (Rev.), *supra* note 76, § 10d; FAR 32.905(e).



-- a section entitled "Invoice payments."<sup>152</sup> Moreover, it defines "invoice payment" as including all payments made under FAR clause 52.232-5, which is the clause controlling construction progress payments.<sup>153</sup> Consequently, the term "invoice payment" has a broader meaning in the FAR than it does in the PPA and Circular. The FAR should be revised to carve out separate sections dealing with construction progress payments, thereby eliminating this unnecessary confusion.

### 3. Improperly Taken Prompt Payment Discounts

In an effort to get paid quickly, contractors often offer a price discount for early payment. Although the legislature thought it should have been obvious that agencies should not take such discounts when they do not pay within the discount period, it decided to include an explicit prohibition of the practice in the PPA after hearing testimony that such impropriety was widespread.<sup>154</sup> It gave teeth to the prohibition by mandating interest for this unauthorized loan.<sup>155</sup>

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<sup>152</sup> FAR 32.905.

<sup>153</sup> FAR 32.902.

<sup>154</sup> S. REP. NO. 97-302, *supra* note 61, at 8. Upon hearing this, Congressman Brooks commented that the practice was as reprehensible as if agencies were stealing from vendors. H.R. REP. NO. 99-927, 99th Cong., 2d Sess. 6 (1986).

<sup>155</sup> 31 U.S.C. § 3904 (1982). However, the Circular provided that if the agency corrected the error within 15 days of the underpayment (a grace period), no penalty was due. Circular (1982), *supra* note 74, § 8b. This was in accord with the legislative intent. H.R. REP. NO. 97-461, *supra* note 61, at 15. However, since the Amendments eliminated the grace period, an improper discount taken now must be repaid prior to the specified discount date in order to avoid a penalty. FAR 32.907-1(c).

Even though the boards faithfully applied the law and awarded interest for improper discounts,<sup>156</sup> they continued to be taken. A 1986 GAO study reported that agencies took about 146,000 improper discounts during the 4 months under investigation.<sup>157</sup>

The PPA Amendments tightened up the section by specifying that the last day the agency can make payment is calculated from the date of the invoice.<sup>158</sup> This change is in sharp contrast to the general rule that receipt of a proper invoice is the crucial factor and overrules several board rulings on that point.<sup>159</sup> It also places the burden of accomplishing acceptance and making payment in time to qualify for a discount on the agency. If the agency fails to qualify and takes the discount anyway, the PPA interest clock starts running. This is true even if a dispute exists over the amount of the discount or the discount terms.<sup>160</sup>

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<sup>156</sup> *E.g.*, Gemini Services, Inc., ASBCA No. 29276, 85-3 BCA ¶ 18,403; Professional Window & House Cleaning, Inc., GSBCA No. 7603 (Apr. 2, 1985) (small claims under Board Rule 13 so no precedential value); Professional Carpet Service, GSBCA Nos. 7162 et al. (Aug. 8, 1984) (Board Rule 13 so no precedential value) (where invoice was \$225 and Government remitted \$95 and took a \$5 discount, board awarded PPA interest, holding "entitlement to a prompt payment discount is implicitly conditioned on full payment"); cf. Dan's Janitorial Service, Inc., ASBCA No. 29486, 86-3 BCA ¶ 19,238 (mailing a check to wrong address was not "payment" for purposes of entitlement to a discount but did not trigger PPA interest since a corrected check was mailed within the 15-day grace period).

<sup>157</sup> S. REP. No. 100-78, *supra* note 65, at 27; H.R. REP. No. 100-784, *supra* note 62, at 32.

<sup>158</sup> 31 U.S.C. § 3904 (1988); Circular (Rev.), *supra* note 76, §§ 4i, 7a(6); FAR 32.902.

<sup>159</sup> Gemini Services, Inc., 85-3 BCA at 92,318 (payment period begins when the invoice reaches the designated billing point); Mark Dunning Indus. Inc., ASBCA No. 29611, 84-3 BCA ¶ 17,685 (payment period calculated from the day after receipt of a proper invoice).

<sup>160</sup> 31 U.S.C. § 3907(c) (1988).

#### 4. *Improper Withholding*

Improperly withheld money from an otherwise proper invoice can in certain circumstances start the payment clock ticking. The complexities of this issue are discussed in Part III of Chapter 3.

##### B. *Time Allowed For Payment*

This section discusses the amount of time an agency has to pay once it receives a proper invoice or a progress payment request on a construction contract before it becomes liable for late payment interest.<sup>161</sup> This section does not apply to improperly taken prompt payment discounts or improper withholding, since in those situations interest begins accruing on the date the improper action is taken.<sup>162</sup>

##### 1. *Time Tolloed if Dispute Exists*

Before considering any of the various rules below, one overriding principle must be kept in mind: if a dispute exists between the agency and the contractor concerning the amount of payment or compliance with the

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<sup>161</sup> For a comparison in tabular form of due dates for various types of payments made under Government contracts, see Cibinic, *Payment Due Dates: Complexity as an Art Form*, 3 NASH & CIBINIC REPORT 8, ¶ 59 (1989).

<sup>162</sup> A proper withholding assumes no dispute exists between the agency and the contractor concerning the amount of payment or compliance with the contract.

contract, the payment period is tolled.<sup>163</sup> Such a rule makes sense. As the Senate noted, "It should go without saying that a contractor cannot fail to meet the obligations of a contract and then seek to avail himself of the interest penalties provided in this bill when the Government refuses to pay."<sup>164</sup>

## 2. Generally 30 Days Allowed

The PPA and Circular provide that the due date is either the date specified in the contract or, if a date is not designated in the contract, 30 days after an agency receives a proper invoice.<sup>165</sup> This language arguably grants agencies the flexibility to draft contracts which would allow them substantially more time in which to pay their bills. The only limit might be reasonableness -- measured perhaps by industry norms for the type of goods or services being purchased<sup>166</sup> -- and the tempering knowledge that the PPA and Circular can be amended again.

However, such agency flexibility has been virtually impossible since the promulgation of the FAR. The FAR mandates that all solicitations and

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<sup>163</sup> 31 U.S.C. § 3907(c) (1988); Circular (Rev.), *supra* note 76, §§ 7c(1), 13a(3); FAR 32.905(a)(1)(ii), 32.907-1(f). See the discussion beginning at page 126, *infra*.

<sup>164</sup> S. REP. NO. 97-302, *supra* note 61, at 8.

<sup>165</sup> 31 U.S.C. § 3903(a)(1) (1988); Circular (Rev.), *supra* note 76, § 4e.

<sup>166</sup> S. REP. NO. 97-302, *supra* note 61, at 5 ("there may be certain kinds of purchases where -- due to industry practice or other factors -- 30-day payment terms are inappropriate"); H.R. REP. NO. 100-784, *supra* note 62, at 32-33 ("when the Government enters an essentially commercial market, it should conform its payment terms to those of the market, unless compelling reasons dictate otherwise").

contracts subject to the PPA specify payment due dates.<sup>167</sup> Moreover, the FAR requires due dates that are generally the later of 30 days after receipt of a proper invoice or 30 days after acceptance of the supplies delivered or services performed.<sup>168</sup>

By requiring solicitations and contracts to include a specific due date, the FAR not only restricts previous agency flexibility<sup>169</sup> but also prevents a repeat of the scenario in Ashland Chemical Company.<sup>170</sup> In that case, the solicitation did not specify a due date. Consequently, the 15-day payment period included in the winning vendor's bid was incorporated into the contract.

The one area where some agency discretion is still available is for purchases made outside the United States from foreign vendors. FAR implementation of the PPA does not extend to these contracts.<sup>171</sup> Although FAR implementation also does not extend to those contracts where payment terms and late payment penalties are set by other governmental authority (e.g., tariffs),<sup>172</sup> agency discretion to designate payment dates is by

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<sup>167</sup> FAR 32.903.

<sup>168</sup> FAR 32.905(a)(1).

<sup>169</sup> E.g., Maintenance Eng'rs, GSBGA No. 10364 (Nov. 15, 1990) (Rule 13 so no precedential value) (due date on 75th day after invoice since contract allowed additional 45 days to make adjustments for unsatisfactory performance); Professional Design Constructors, GSBGA No. 8554 (Sept. 28, 1990) (due date 30 days after approval of the work rather than 30 days after submission of invoice).

<sup>170</sup> Comp. Gen. B-216954, 85-1 CPD ¶ 555.

<sup>171</sup> FAR 32.901.

<sup>172</sup> *Id.*

definition foreclosed. Moreover, the payment period established by tariff may be shorter than 30 days.<sup>173</sup>

### 3. *Special Time Periods*

#### a. *food products and perishables*

The drafters of the original PPA determined "very prompt payment" was justified as a matter of right for the procurement of both meat and meat-food products and perishable agricultural commodities. Since meat packers and produce vendors are required by federal laws to pay their suppliers promptly, the legislature decided it only fair to hold the agencies accountable to the same standards.<sup>174</sup> The act set the due date for meat products at 7 days after delivery. This statutory time period cannot be altered by contract. In contrast, the PPA left it to OMB to set the due date for perishables,<sup>175</sup> which the Circular established at 10 days unless otherwise specified by contract.<sup>176</sup> Despite these abbreviated due dates,

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<sup>173</sup> National Park Service--Late Payment Charges for Utility Services, Comp. Gen. B-222944, Oct. 23, 1987 (due date 15 days after invoice received); Social Security Administration--Late Payment Charges for Utility Services, 63 Comp. Gen. 517 (1984) (due date 15 days after invoice postmarked).

<sup>174</sup> S. REP. NO. 97-302, *supra* note 61, at 5-6.

<sup>175</sup> 31 U.S.C. § 3903(2) (1982).

<sup>176</sup> Circular (1982), *supra* note 74, § 7.

no interest was due unless payment was made after the grace period, which for meat products was 3 days and for perishables was 5 days.<sup>177</sup>

With the elimination of the grace period by the Amendments, the two due dates were brought into conformity with industry standards. The Amendments also expanded the definition of meat products to include poultry and eggs<sup>178</sup> and added a new section requiring payment within 10 days of receipt of a proper invoice for purchases of dairy products and edible fats and oils.<sup>179</sup> This 10-day period may not be varied by contract.

*b. farm producers*

The 1988 Amendments added a new section extending PPA coverage to producers on a farm whose payments are pursuant to an agreement entered into under the Agricultural Act of 1949. The established due dates are generally 30 days; however, 91 days are allowed for certain deficiency payments.<sup>180</sup>

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<sup>177</sup> 31 U.S.C. § 3902(b)(1), (2) (1982); Circular (1982), *supra* note 74, § 9.

<sup>178</sup> 31 U.S.C. § 3903(a)(2) (1988).

<sup>179</sup> 31 U.S.C. § 3903(a)(4) (1988); Circular (Rev.), *supra* note 76, § 4f(3); FAR 32.905(d).

<sup>180</sup> 31 U.S.C. § 3902(h) (1988); Circular (Rev.), *supra* note 76, §§ 4(h), 9.

c. progress payments on construction contracts

The Amendments also added an extensive treatment of construction contracts. While the general 30-day rule applies to delayed payments of retainages<sup>181</sup> and final payments (which include payments for partial deliveries that have been accepted by the Government),<sup>182</sup> progress payment requests must be paid within 14 days of receipt unless a longer period is specified in the solicitation. A longer period is only allowable if the Government requires more time to adequately inspect the work and determine the adequacy of the contractor's performance.<sup>183</sup> The legislative history emphasizes extensions are not appropriate for simple repair or alteration contracts, the convenience of Government employees, or merely to avoid an interest penalty.<sup>184</sup> Compliance with the legislative intent should be aided by the FAR requirement that the contract file contain justification for an extension.<sup>185</sup>

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<sup>181</sup> 31 U.S.C. § 3903(6)(B) (1988); Circular (Rev.), *supra* note 76, § 10a(2); FAR 32.905(c)(2). Once the contracting officer has approved a retained amount for release, interest is owed if payment is not made by the day specified in the contract or, in the absence of a particular date, by the 30th day after final acceptance.

Retainage is a percentage of a progress payment otherwise due a contractor but retained by the Government.

<sup>182</sup> Circular (Rev.), *supra* note 76, § 10a(3); FAR 32.905(c)(3).

<sup>183</sup> 31 U.S.C. § 3903(a)(6)(A) (1988); Circular (Rev.), *supra* note 76, § 10a(1); FAR 32.905(c)(1).

<sup>184</sup> H.R. REP. NO. 100-784, *supra* note 62, at 23.

<sup>185</sup> FAR 32.905(c)(1).



d. "Fast Pay" procedures

Section 253(g) of the Federal Property and Administrative Services Act<sup>186</sup> permits the implementation of procedures which enable contractors to receive payments prior to delivery and acceptance of goods. This "Fast Pay" procedure is available only for certain individual purchases under \$25,000.<sup>187</sup> The Amendments imposed an interest penalty for "Fast Pay" payments made later than 15 days after receipt of a proper invoice.<sup>188</sup>

e. mixed invoices

Sometimes invoices may be submitted containing items which have different payment due dates. The OMB Circular deals with this problem.<sup>189</sup> If the agency waits to pay the entire invoice until the last due date, it is liable for interest on items due earlier. However, the agency need not pay the entire invoice on the earliest due date since the Circular permits agencies to split payments. While the Government may encourage contractors to submit separate invoices for each category of payment period, it may not require them to do so.

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<sup>186</sup> 41 U.S.C. § 253(g).

<sup>187</sup> Circular (Rev.), *supra* note 76, § 12; FAR 13.3

<sup>188</sup> Pub. L. No. 100-496 § 11(b)(1)(c) (not codified); FAR 52.232-25(c).

<sup>189</sup> Circular (Rev.), *supra* note 76, § 4g.

#### 4. Due Date Falling on a Nonworking Day

Some confusion has existed regarding the due date -- whether or not it is specified by contract -- when it falls on a federal non-working day. The 1982 OMB Circular did not address the situation. The FAR, on the other hand, originally defined the "due date" as the next working day in these circumstances.<sup>190</sup> After the Amendments, the FAR definition deleted its treatment of the issue, thereby implying payment is now due on the 30th calendar day even if it falls on a non-working day.<sup>191</sup> Subsequent to the FAR change, OMB issued its revised Circular. The Circular echoes the earlier FAR edition, providing that payments falling due on a non-working day may be made on the following business day without incurring a late payment penalty.<sup>192</sup> Thus, the Circular and the FAR are currently in conflict.

#### 5. Grace Period

Congress in 1982 built a 15-day grace period into the PPA for the purchase of most property and services. Thus, whether a due date was specified by contract or established by receipt of a proper invoice, no interest would accrue so long as payment was made on or before the 15th

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<sup>190</sup> FAR 32.902 (FAC 84-33, 53 Fed. Reg. 3688 (1988)).

<sup>191</sup> *Id.* (FAC 84-45, 54 Fed. Reg. 13332 (1989)). Comment 31 in FAR Case 88-69 clearly indicates no extensions are allowed for due dates falling on federal non-working days.

<sup>192</sup> Circular (Rev.), *supra* note 76, § 4n.

day after the due date. However, interest would accrue from the day after the due date if the agency paid after the grace period.<sup>193</sup> In other words, payment made on or before the 45th day after receipt of a proper invoice would trigger no penalty (assuming the contract did not set an alternate due date), whereas payment on the 46th day would result in 16 days of accrued interest.<sup>194</sup>

The Administration requested the grace period to be included in the original act to protect agencies from the substantial administrative burden and expense anticipated from having to pay a large number of small interest penalties that might result from short, unintentional delays while the agencies adjusted their bill paying systems to the PPA's standards.<sup>195</sup> However, inclusion of this safety net in no way diminished Congressional intent that the agencies pay by the due date, i.e., within 30 days.<sup>196</sup>

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<sup>193</sup> 31 U.S.C. § 3902(b)(3) (1982); Circular (1982), *supra* note 74, § 9; FAR 32.907-1(a)(4).

<sup>194</sup> Professional Design Constructors, GSBCA No. 8554 (Sept. 28, 1990) (no penalty for payment on 36th day; interest for payments made on 53rd and 61st days); Toombs & Co., ASBCA Nos. 35085, 35086 (Sept. 18, 1990) (no penalty for payment on 42nd day; interest accrued for 36 days for payment on 66th day); Akon, Inc., ENG BCA No. 5593 (Aug. 17, 1990) (payments on 37th and 40th day did not trigger penalty); Sol Flores Constr., ASBCA No. 32608, 90-1 BCA ¶ 22,365 (interest paid from 31st day for payment after 45th day).

<sup>195</sup> S. REP. No. 100-78, *supra* note 65, at 19; H.R. REP. No. 100-784, *supra* note 62, at 17.

<sup>196</sup> H.R. REP. No. 97-461, *supra* note 61, at 10.

## 6. Grace Period Eliminated

Despite Congressional intent that payment be made by the due date rather than during the grace period, some agencies viewed the expiration of the grace period as the "real" due date.<sup>197</sup> This is not surprising, for even OMB, whose Circular reflected the legislative intent, did not count payments made during the grace period as "late" when it conducted a study.<sup>198</sup> As stated by two commentators, the grace period was effectively "converted from its intended administrative safety valve function to an administrative *carte blanche* to pay bills up to 45 days after receipt of

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<sup>197</sup> H.R. REP. No. 100-784, *supra* note 62, at 17 ("Some Federal agencies, as a matter of course, pay most of their bills within 45 rather than 30 days"). The House Report and its Senate companion, S. REP. No. 100-78, *supra* note 65, at 19, apparently chose to ignore the contradictory testimony of the GAO, which stated:

We found that about 15 percent of payments occurred during grace periods. However, we did not find any intentional abuse of grace periods, such as agencies routinely paying as closely as possible to the end of such periods. Instead, almost 60 percent of grace-period payments were made within 5 days after the due date.

*Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 72 (1988).*

<sup>198</sup> Critique of OMB in General Accounting Office, *Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits*, GAO/AFMD 86-69 (Aug. 1986), at 58-63.

a proper invoice."<sup>199</sup> To end these abuses, the 1988 Amendments eliminated the grace period.<sup>200</sup>

### *C. Stopping The Clock*

#### *1. Date of Check or Electronic Funds Transfer*

Payment is deemed to be made either on the day a check is dated or on the date an electronic funds transfer is made.<sup>201</sup> The Amendments codified the latter method of stopping the payment "clock," which had already been established by the 1982 Circular.<sup>202</sup>

Using the date on a check as the payment date for PPA purposes, rather than the date the payee receives the check, is a radical departure from

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<sup>199</sup> Donnally and Stone, *The Prompt Payment Act in 1987: Collecting from Uncle Sam*, 21 NAT. CONT. MGT. J. 45 (1987).

<sup>200</sup> Elimination was against the advice of the GAO, which recommended only shortening the period from 15 to 7 days. According to the GAO, elimination would greatly increase the Government's administrative costs, as well as cause further delays for some payments. *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations*, 100th Cong., 2d Sess. 57-60, 81-83 (1988).

<sup>201</sup> 31 U.S.C. § 3901(a)(5) (1988); Circular (Rev.), *supra* note 76, § 1m; FAR 32.902, 52.232-28.

As pointed out by the Treasury Department comments in FAR Case 88-69, there are two types of electronic funds transfers -- wire transfers and ACH transactions. The former are same-day transactions in that settlement occurs on the same day the transaction is transmitted to the Federal Reserve System. In contrast, ACH transactions must be transmitted to the Federal Reserve System several days prior to the settlement date. The issue of whether an ACH transaction is "made" for PPA purposes on the date the transaction is forwarded to the Federal Reserve System or on the date of settlement has not yet been litigated.

<sup>202</sup> Circular (1982), *supra* note 74, § 4h.

customary business practice and even from ordinary federal procurement procedure.<sup>203</sup> Although the legislature recognized that brief delays might occur between the date on the check and the date the contractor receives the money, it drafted the law in this manner to enable an agency to determine if an interest penalty is owed before it issues a check.<sup>204</sup> At least two contractors lost their attempts to keep the clock running until they received the check.<sup>205</sup> On the other hand, the same statutory provision was invoked to foil the Government's attempt to stop the clock prior to issuing a check by merely approving and signing a progress payment request.<sup>206</sup>

The Comptroller General has held that if an agency dates the check on time, but subsequent events which are beyond the control of the agency thwart timely payment, the Government is not liable for PPA interest.<sup>207</sup> The decision also implies no interest would be due even if the agency were at fault for the subsequent problems. First, the decision does not state that interest would be due if an agency were at fault. More importantly,

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<sup>203</sup> See Consumers Oil Co., ASBCA No. 24172, 86-1 BCA ¶ 18,647 at 93,712-13 n.21; J.S. Latsis Group of Cos./Petrola Eng'g Int'l, ENG BCA No. 4016, 85-3 BCA ¶ 18,212 at 91,411; Effective Date of Payment in Determining Liability of U.S. Government for Late Payment Charges, Comp. Gen. B-201384, 82-1 CPD ¶ 70. For a brief discussion of the changes to the definition of the payment date, see Propriety of Vouchers Presented for Certification, Comp. Gen. B-214446, Oct. 29, 1984.

<sup>204</sup> S. REP. No. 97-302, *supra* note 61, at 11.

<sup>205</sup> Toombs & Co., ASBCA Nos. 35085, 35086, 89-1 BCA ¶ 21,402; Ricwav, Inc., ASBCA No. 29983, 86-2 BCA ¶ 18,841. Compare Delfour, Inc., Docket Nos. VABCA 2049 et al., 89-1 BCA ¶ 21,394 at 107,860, where the board stated the rule would preclude PPA interest even though the contractor did not specifically claim interest under the PPA.

<sup>206</sup> Batteast Constr. Co., ASBCA No. 34420, 87-3 BCA ¶ 20,044.

<sup>207</sup> Four Square Constr. Co., Comp. Gen. B-215703, 84-2 CPD ¶ 480.

the ruling reiterates the principle that waivers of sovereign immunity must be narrowly construed, thereby indicating a timely date on the check conclusively satisfies the statute.

Concluding that the date on the check is dispositive is not only consistent with the mandate to construe waivers of sovereign immunity narrowly, it is also consistent with the legislative intent. The Senate stated that, if a check is timely dated, no interest is payable "even though the check might not reach a contractor until three or five days later."<sup>208</sup> While the unavailability of PPA interest may seem harsh, subsequent willful or negligent actions by the Government that prevent a contractor from timely receiving the check may well support a contractor's claim under the CDA based on the theory that the Government breached its implied obligation to act in good faith. Of course, a contractor can totally avoid this scenario, as well as the possibility of a check being genuinely lost in the mail, by arranging for payment by electronic funds transfer.<sup>209</sup>

Although the PPA specifies that the date on the check or the date of electronic funds transfer is dispositive for interest purposes, it does not say these dates control Government entitlement to a prompt payment discount. The statute instead leaves entitlement to be governed by the terms of the contract.<sup>210</sup> Thus, under an earlier version of the standard Discounts clause, under which payment was deemed made on the date the

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<sup>208</sup> S. REP. NO. 97-302, *supra* note 61, at 11.

<sup>209</sup> The procedures for payment by electronic funds transfer are set out in FAR 52.238-28.

<sup>210</sup> 31 U.S.C. § 3904 (1988); Circular (Rev.), *supra* note 76, § 4m; FAR 52.232-8(a).

check was mailed,<sup>211</sup> the Comptroller General opined that a check dated on the last day of the specified discount period but mailed several days later failed to earn the discount but did not trigger an interest penalty.<sup>212</sup> Newer editions of the Discounts clause have removed this dichotomy, deeming payment to be made on the date appearing on the check or when electronic transfer of funds occurs.<sup>213</sup>

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<sup>211</sup> DAR § 7-1902.11 (DAC No. 76-17, Sept. 1, 1978).

<sup>212</sup> Island Heating and Air Conditioning, Comp. Gen. B-214948, 84-1 CPD ¶ 553. Accord Dan's Janitorial Service, Inc., ASBCA No. 29486, 86-3 BCA ¶ 19,238 (check mailed to the wrong address within the discount period did not entitle a discount but did not trigger PPA interest since a corrected check was mailed within the 15-day grace period). See also Commercial Transfer Systems, Inc., Comp. Gen. B-213466, 84-1 CPD ¶ 532 (check mailed to wrong address earned no discount; interest not sought).

<sup>213</sup> FAR 52.232-8(b). Although the newer editions of the Discounts clause clarified the rule regarding checks, they did not remove all uncertainty regarding electronic transfer of funds. As discussed in note 201, *supra*, an ACH transfer requires several days before settlement. Whether the settlement date or the date the transaction is forwarded to the Federal Reserve System determines entitlement to a discount has not yet been litigated. What's more, it should never have to be litigated if the Discounts clause is properly amended. Unlike the wording for interest penalty eligibility, which is statutory, discount eligibility is determined by contract. Even though the FAR drafters were urged to clarify the Discounts clause (use of the settlement date was suggested), they failed to do so, reasoning, "No action required. This interpretation of EFT transmission date is something the Agencies are currently working with Treasury on to resolve. It more appropriately would be covered in Agency instructions to the paying offices." FAR Case 88-69, Comment 53. Agency instructions to paying offices are not part of a contract, and thus will not avoid unnecessary disputes.



## 2. *Stopping the Clock Too Early Prohibited*

As stated above, Congress realized brief delays might occur between the date on the check and the date the contractor receives the money. To mitigate delays, the drafters intended that checks would be dated for payment and mailed 5 days before the due date, which would accord with industry norms.<sup>214</sup>

The Circular, however, imposed a very strict payment "window." It considered payments made 5 days or more before the due date as "early," and required agencies to annually report to OMB the number of early payments.<sup>215</sup> In addition to the stick of this reporting requirement, the Circular (1) emphasized in three separate sections that agencies were to make payments (i.e., date the checks) "as close as possible to, but not later than, the due date";<sup>216</sup> and (2) instructed agencies to mail the checks "on or about the same day" the checks were dated.<sup>217</sup> Reading the two directions together, it might be argued OMB was at least sanctioning, and possibly even encouraging, agencies to mail the checks after the due date. If so, such regulatory implementation would conflict with the PPA. The Comptroller General found, however, that such a conflict did not

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<sup>214</sup> S. REP. No. 97-302, *supra* note 61, at 11.

<sup>215</sup> Circular (1982), *supra* note 74, § 11.

<sup>216</sup> *Id.* §§ 3, 6, 7. No doubt OMB was reacting to, among other things, GAO's 1978 report, *The Federal Government's Bill Payment Performance is Good But Should Be Better*, GAO/FGMSD 78-16 (Feb. 1987). The report pointed out that too many bills were paid early, thus causing federal borrowing and interest costs. Consequently, the report recommended paying the bills "when due, or as close thereto as possible without being late."

<sup>217</sup> Circular (1982), *supra* note 74, § 6d (emphasis added).

exist.<sup>218</sup> He noted that the Circular also said in Section 6 that payment was to be consistent with Treasury Regulation 6-8040.20, which in turn stated an agency's payment system must provide for receipt of any checks by a payee to be "as close as administratively possible to but no later than the due date." Therefore, he opined, the Circular's very narrow payment window did not authorize the Government routinely to date and mail its checks on or after the due date (since normal mail time would cause every payment to be late). Nevertheless, the Comptroller General acknowledged the apparent discrepancy and several months later wrote to OMB suggesting it reconsider its position.<sup>219</sup> OMB reconsidered its position, but in such a way as to exacerbate, rather than eliminate, the problem. Two years later, OMB narrowed the permissible payment window even further by requiring agencies to report payments made even 3 days before the due date as "early."<sup>220</sup>

The legislative history of the 1988 Amendments reveals Congress was concerned that such a restrictive payment window was causing too many late payments.<sup>221</sup> Balanced against this concern was the continued recognition that payments made too early would also cost the Government money.<sup>222</sup> In a compromise move, the Amendments, and implementing regulations, allow

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<sup>218</sup> Assessment of Interest by or Against Federal Agencies on Past Due Debts, Comp. Gen. B-212976, 84-2 CPD ¶ 46.

<sup>219</sup> Comp. Gen. B-212976, Feb. 27, 1985.

<sup>220</sup> OMB Circular A-125, § 11, 52 Fed. Reg. 21926 (1987).

<sup>221</sup> H.R. REP. NO. 100-784, *supra* note 62, at 30-31.

<sup>222</sup> *Id.* See also H.R. REP. NO. 927, 99th Cong. 2d Sess. 14 (1986), wherein it was recognized that decreasing the number of early payments through implementation of OMB Circular A-125 saved hundreds of millions of dollars over 42 months.

agencies to pay as early as 7 days prior to the due date without having to notify OMB.<sup>223</sup> The Circular is still more restrictive than the act, however, for while the statute allows payments more than 7 days early on a case-by-case basis, the Circular prohibits such payments.<sup>224</sup> On the other hand, while the Circular still encourages payment to be made as close as possible to the due date without exceeding it,<sup>225</sup> it now requires checks to be mailed "on," rather than "on or about," the same day the check is dated.<sup>226</sup> On this latter point, the FAR needs revision, for it still reads "on or about."<sup>227</sup>

## **II. THE INTEREST PENALTY**

Once it has been determined payment is late, the inquiry turns next to an examination of the interest penalty. This section discusses how the penalty is calculated, whether it is automatic, and which Government funds are to pay the penalty.

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<sup>223</sup> 31 U.S.C. § 3903(a)(8) (1988); Circular (Rev.), *supra* note 76, § 14d-e. The FAR drafters elected not to address this regulatory flexibility in the FAR for fear that otherwise some contractors might "then think that they are in some way entitled to be paid 7 days earlier than stated in the contract." FAR Case 88-69, Comment 32.

<sup>224</sup> Circular (Rev.), *supra* note 76, § 41.

<sup>225</sup> *Id.* § 41.

<sup>226</sup> *Id.* § 4n.

<sup>227</sup> FAR 32.903.

## **A. Calculating The Standard Interest Penalty**

### **1. Same Daily Rate as the Contract Disputes Act**

Interest accrues at the same daily rate as that established for interest payments under section 12 of the Contract Disputes Act.<sup>228</sup> FAR 32.907-1(d) states this rule, but makes an exception for interest penalties "prescribed by other Governmental authority (e.g., tariffs)." The FAR erroneously still reflects the 1987 OMB Circular. It should be corrected, not only to conform to the most recent Circular, which makes no such exception, but also to eliminate internal error. Since FAR 32.901 correctly excludes from PPA coverage contracts where the late payment penalty has been "established by other Governmental authority (e.g., tariffs)," the "exception" in FAR 32.907-1(d) is really a misstatement. It is incorrect to state at one place that tariffs are excluded from PPA coverage and then at another to maintain that tariffs can provide an alternative PPA penalty.

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<sup>228</sup> 31 U.S.C. § 3902(a) (1988); Circular (Rev.), *supra* note 76, § 7a(10). The Circular states at subsection 7a(11) that interest calculations are based on a 360-day year. Interest cannot be computed according to any other rate. W.M.F. Security Service, Co., Comp. Gen. B-238542, 90-1 CPD ¶ 553 (overseas interest rate rejected for overseas contract because PPA interest is a statutory requirement); Delfour, Inc., VABCA Nos. 2049 et al., 89-1 BCA ¶ 21,394 at 107,860 (Eichlay-type formula rejected for interest rate).

The rate, known as the "Renegotiation Board Interest Rate," is published semiannually in the Federal Register on or about January 1 and July 1 by the Finance & Funding Branch, Dept. of the Treasury (tel: 202-566-5651). A complete listing of all rates since they were first published in 1971 appears in GOVERNMENT CONTRACTS REPORTER (CCH) ¶ 26,630.

## 2. Rate Established the Day After the Due Date

The PPA as amended and current regulations provide that the applicable rate is the one in effect on the day after the due date and that it remains fixed throughout the entire period interest accrues.<sup>229</sup> This superseded the previous OMB and FAR guidance, which applied the rate in effect on the payment date. By remaining fixed, the late payment interest rate differs from the CDA interest rate; the latter is a variable rate established at 6-month intervals.<sup>230</sup>

According to testimony in support of the Amendments, the previous OMB and FAR guidance permitted agencies to select the rate most advantageous for them by either paying the rate in effect when the amount owed first became overdue or by waiting to pay until the rates dropped.<sup>231</sup> Since interest rates can change every 6 months, and in fact fell more than 4 percentage points during one change, the regulations actually encouraged agencies to delay payments when falling rates were anticipated. Proponents of the Amendments argued that "the Government's goal should be 'promptness' regardless of the prevailing interest rate, and vendors' invoices should not be held hostage to biannual interest rate fluctuations."<sup>232</sup> Congress obviously agreed and so modified the act.

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<sup>229</sup> 31 U.S.C. § 3902(a) (1988); Circular (Rev.), *supra* note 76, § 7a(1); FAR 32.907-1(d).

<sup>230</sup> 41 U.S.C. § 611 (Supp. V 1981). See Joseph Penner, Penner Financial Group, GSBGA No. 6820, 83-1 BCA ¶ 16,282.

<sup>231</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 592-94 (1988).*

<sup>232</sup> *Id.* at 594.

### 3. Compound Interest

Unlike Contract Disputes Act interest, which is simple interest,<sup>233</sup> late payment interest compounds every 30 days.<sup>234</sup> A literal reading of the statute ("an amount of an interest penalty unpaid after any 30-day period shall be added to the principal amount") and FAR ("interest accrued at the end of any 30-day period will be added to the approved invoice payment amount") leads to the conclusion that interest will not compound if payment is made on or before the 29th day after payment is late. No boards have yet squarely held this, but such an interpretation is consistent with construing waivers of sovereign immunity narrowly.

A decision in which the board apparently overlooked the effects of compounding is Sol Flores Construction.<sup>235</sup> The Government received a proper invoice on 15 April. When it paid the invoiced amount on 20 June, it did not include an interest penalty. The following December, the

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<sup>233</sup> FAR 33.208; see Brookfield Constr. Co. v. United States, 228 Ct. Cl. 551, 661 F.2d 159 (1981); Professional Design Constructors, GSBICA No. 8554 (Sept. 28, 1990); EMS, Inc., GSBICA Nos. 9588, 9771, 90-2 BCA ¶ 22,876; Central Mechanical, Inc., ASBCA No. 29193, 85-2 BCA ¶ 18,005.

<sup>234</sup> 31 U.S.C. § 3902(e) (1988); Circular (Rev.), *supra* note 76, § 7a(4); FAR 32.907-1(d). Professional Design Constructors, GSBICA No. 8554 (Sept. 28, 1990); EMS, Inc., GSBICA Nos. 9588, 9771, 90-2 BCA ¶ 22,876; Southland Constr. Co., VABCA No. 2543, 89-1 BCA ¶ 21,548; Professional Window and House Cleaning, Inc., GSBICA No. 7603 (Apr. 2, 1985) (Board Rule 13 so no precedential value) (interest compounded on an improperly taken prompt payment discount); Prompt Payment Act Interest on Utility Bills, 65 Comp Gen. 842 (1986). Note that CDA interest accrues on the combined total of both principal and PPA interest that remain unpaid on the date of the CDA claim. See Columbia Eng'g Corp., IBCA Nos. 2351, 2352, 88-2 BCA ¶ 20,595.

<sup>235</sup> ASBCA No. 32608, 90-1 BCA ¶ 22,365.

contractor filed a claim for the interest under the CDA. The board awarded PPA interest, but only the amount that accrued from 15 May until 20 June. Without explanation, it shortchanged the contractor the amount of interest that should have compounded through the December date on which the CDA claim was filed.

#### 4. Length of Accrual

Interest begins accruing the day after the required due date and continues until (1) the payment date, (2) a contractor files a claim for the interest under the CDA, or (3) 1 year passes, whichever occurs earliest.<sup>236</sup> Congress specifically intended there to be no duplication of interest under the PPA and CDA.<sup>237</sup>

#### 5. Information to Accompany Payment

Whenever an agency pays an interest penalty, it must enclose a notice which discloses the amount of the penalty as well as the interest rate and period for which the penalty was calculated.<sup>238</sup> The legislature believed contractors should be provided the necessary information in order to enable them to determine for themselves the accuracy of any penalty

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<sup>236</sup> 31 U.S.C. § 3907(b)(1) (1988); Circular (Rev.), *supra* note 76, § 7a(5); FAR 32.907-1(e). But see Sol Flores Construction, discussed in the preceding section of text.

<sup>237</sup> H.R. REP. NO. 97-461, *supra* note 61, at 10.

<sup>238</sup> 31 U.S.C. § 3902(c)(2) (1988). The effective date of this provision is discussed in the text accompanying notes 344 and 345, *infra*.

calculation.<sup>239</sup> Congress also recognized that it might be appropriate to include, along with the required data, additional information to assist contractors. Contract and invoice numbers would be especially helpful where a contractor has multiple contracts or multiple invoices under the same contract. The Circular reflects this suggestion, but to date the FAR only mandates the statutorily required information.<sup>240</sup>

#### ***B. Is The Penalty Automatic?***

There are two aspects to the question of whether the interest penalty is automatic: accrual and payment. Once the interest clock has started ticking as discussed above, a contractor need do nothing to ensure the accrual of interest. In contrast, a contractor may have to take positive steps to actually obtain the interest, even though Congress intended agencies to pay the penalty automatically. The next sections discuss both of these points.

##### *1. Automatic Accrual*

"The Committee intends . . . that interest penalties resulting from provisions of the Prompt Payment Act will accrue automatically . . . ." <sup>241</sup> This legislative pronouncement, together with the act's declaration that an agency "shall pay an interest penalty" when it fails to pay by the

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<sup>239</sup> H.R. REP. NO. 100-784, *supra* note 62, at 17-18.

<sup>240</sup> Circular (Rev.), *supra* note 76, § 6; FAR 32.907-1(d).

<sup>241</sup> H.R. REP. NO. 97-461, *supra* note 61, at 11.



required payment date,<sup>242</sup> provided the basis for a decision by the Armed Services board that interest accrues automatically.<sup>243</sup> It rejected a Government argument that a contractor was ineligible for the penalty unless it first filed a "claim" under the FPA and then, upon denial of that claim by the contracting officer, filed a second claim under the CDA.

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<sup>242</sup> 31 U.S.C. § 3902(a) (1988).

<sup>243</sup> General Elec. Co., ASBCA No. 33227, 87-1 BCA ¶ 19,484. See also Toombs & Co., ASBCA Nos. 35085, 35086, 89-1 BCA ¶ 21,402; Dombrowski & Holmes, GSBCA No. 6328, 83-1 BCA ¶ 16,300; Safeguard Maint. Corp., GSBCA No. 6054, 83-1 BCA ¶ 16,276.

The Comptroller General has issued several opinions indicating there are no excuses which will prevent interest from automatically accruing: National Park Service--Late Payment Charges for Utility Services, Comp. Gen. B-222944, Oct. 23, 1987 (agency "generally unable" to pay within prescribed time due to administrative requirements); accord Social Sec'y Admin.--Late Payment Charges for Utility Services, 63 Comp. Gen. 517 (1984); Hon. Glenn English, Chairman, Subcomm. on Govt. Information, Justice, and Agriculture, Comm. on Government Operations, House of Representatives, Comp. Gen. B-223857, Feb. 27, 1987 (agency temporarily out of funds with which to pay invoice); National Park Service--Physical Fitness Program, Comp. Gen. B-218840, 85-2 CPD ¶ 275 (certifying officer awaiting advance decision from Comptroller General as to the propriety of the voucher).

## 2. Not-So-Automatic Payment

Agencies are supposed to pay any penalties which exceed \$1.00<sup>244</sup> automatically. In the words of the drafters, "The Committee intends that Government agencies will automatically be obligated to pay interest penalties without the necessity for business concerns to take action to collect such payments."<sup>245</sup> The regulatory guidance has faithfully implemented this clear statement of legislative intent.<sup>246</sup>

### a. collection of PPA interest under the Contract Disputes Act

Despite such unequivocal language requiring automatic payment, Congress knew agencies would not always pay without being forced to do so;<sup>247</sup> consequently, it advised vendors in the statute<sup>248</sup> that they could collect by filing a claim "under" Section 6 the Contract Disputes Act. Filing such a claim involves an understanding of how to "convert" PPA

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<sup>244</sup> 31 U.S.C. § 3902(c)(1) (1988); Circular (Rev.), *supra* note 76, § 7a(8); FAR 32.907-1(e). This minimum dollar threshold was missing from the PPA as originally enacted; however, it was included in section 9 of the original Circular. The legislative history makes clear that agencies need not pay amounts below the threshold even if payment is specifically requested by a contractor. *Amendments to the Prompt Payment Act: Hearings on H.P. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations*, 100th Cong., 2d Sess. 73-74 (1988).

<sup>245</sup> H.R. REP. NO. 97-461, *supra* note 61, at 8.

<sup>246</sup> Circular (Rev.), *supra* note 76, Policy, § 4p; Circular (1982), *supra* note 74, §§ 3, 8a; FAR 32.903, 32.907-1(a), (c).

<sup>247</sup> H.R. REP. NO. 97-461, *supra* note 61, at 8-9.

<sup>248</sup> 31 U.S.C. § 3907 (1988). The Circular also contains this notice; however, the FAR does not. Circular (Rev.), *supra* note 76, § 13.

entitlement into a Contract Disputes Act claim, as well as an appreciation of what constitutes a proper filing under the Contract Disputes Act.

i. "converting" PPA entitlement into a claim

Vouchers, invoices, or other routine requests for payment that are not in dispute when submitted are not claims.<sup>249</sup> For example, proposals for change order pricing or contract modifications do not constitute claims.<sup>250</sup> Nor can such routine requests spontaneously be converted into claims after the due date has passed.<sup>251</sup> However, they may be "converted" into proper claims under the Contract Disputes Act if the contractor makes a written demand in the form of a claim after an unreasonable delay by the Government in making payment.<sup>252</sup>

The same procedure is used to convert PPA interest entitlement into a Contract Disputes Act claim for eventual collection. While this technique of converting an invoice into a claim is a creature of the Contract Disputes Act rather than of the PPA, the latter statute has

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<sup>249</sup> FAR 33.201; Placeway Constr. Corp. v. United States, No. 90-5017 (Fed. Cir. Aug. 7, 1990), 36 CCF 75,914; Granite Constr. Co., ASBCA Nos. 26023, 26776, 83-2 BCA ¶ 16,843.

<sup>250</sup> Ricway, Inc., ASBCA No. 30205, 86-1 BCA ¶ 18,539.

<sup>251</sup> Professional Carpet Service, GSBGA Nos. 7162 et al. (Aug. 8, 1984) (Board Rule 13 so no precedential value); Dombrowski & Holmes, GSBGA No. 6328, 83-1 BCA ¶ 16,300; Safeguard Maint. Corp., GSBGA No. 6054, 83-1 BCA ¶ 16,276.

<sup>252</sup> FAR 33.201. They may also be converted in the same manner once an "undisputed" payment request becomes disputed as to liability or amount. Soi Flores Constr., ASBCA Nos. 32278, 32726, 89-3 BCA ¶ 22,154.

expanded the meaning of this process<sup>253</sup> to encompass the recovery of claims for interest (albeit PPA only) without any other underlying claim.<sup>254</sup> The mechanics of the operation, as well as the interplay between the Contract Disputes Act and PPA, were succinctly spelled out in TEM Associates, Inc., wherein the board stated,

TEM's invoices were elevated to claim status when appellant filed its formal claim on May 9, 1988. This letter converted the matter into a dispute within the meaning of the Contract Disputes Act, and triggered the running of interest under that act, while terminating the running of any interest which might be payable under the Prompt Payment Act.<sup>255</sup>

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<sup>253</sup> Absent its PPA applicability, the phrase "converting a claim" generally refers to the situation where a Government claim is converted into a contractor claim. By way of illustration, suppose the Government withholds a sum of money in excess of \$50,000, establishing a Government claim. The contractor can appeal the withhold to a Board or Claims Court without certification. If the appeal is successful, the contractor receives the sum but no interest. If, on the other hand, the contractor submits a written, certified claim for the withheld amount which the contracting officer rejects, the contractor may appeal both the Government withhold claim and the contracting officer's adverse decision on the contractor's claim. Success on appeal would garner both a return of the sum and Contract Disputes Act interest from the date of filing the claim. American Fed. Contractors, Inc., PSBCA No. 1359, 87-2 BCA ¶ 19,848. For a general discussion of this process and the nuances of the differences between Government and contractor claims, see Blue Cross Ass'n & Blue Shield Ass'n, ASBCA No. 25778, 89-2 BCA ¶ 21,840.

<sup>254</sup> The Contract Disputes Act does not permit interest absent an underlying claim other than for the interest itself. Radcliffe Constr. Co., ASBCA Nos. 39252, 39253, 90-2 BCA ¶ 22,651, citing A.L.M. Contractors, Inc., ASBCA No. 23792, 79-2 BCA ¶ 14,099.

<sup>255</sup> DOT BCA No. 2024, 89-1 BCA ¶ 21,266 at 107,223. See also Tera Advanced Sys. Corp., GSBGA No. 7109-NRC, 85-2 BCA ¶ 17,341 at 89,902.

*ii. proper filing of claim*

Because the PPA provides that collection procedures will be governed under Section 6 of the Contract Disputes Act,<sup>256</sup> a contractor cannot simply demand to be paid the interest which an agency was supposed to pay automatically. To the contrary, a contractor must adhere to all Contract Disputes Act requirements or else face denial of PPA interest.<sup>257</sup> For example, if a contractor does not present an interest claim to the contracting officer prior to raising it on appeal,<sup>258</sup> fails to certify a claim when the interest owed exceeds \$50,000,<sup>259</sup> or neglects to appeal a

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<sup>256</sup> The legislative history reveals this provision was intended to preclude a contractor from filing a PPA claim directly with a court of law. H.R. REP. No. 97-461, *supra* note 61, at 11. That prohibition was challenged by a contractor seeking interest payments for late Medicare payments in National Ass'n of Rehabilitation Facilities, Inc. v. Otis R. Bowen, Secretary, Dept. of Health & Human Services, 840 F.2d 931 (D.C. Cir. 1988). The Government argued all disputes related to the PPA are subject to the process established by the Contract Disputes Act. The court dismissed the suit on other grounds, saying it would leave the issue for another day. The Comptroller General has ruled that a contractor seeking to collect an interest penalty must appeal to the appropriate board of contract appeals rather than to the GAO. J & M Lumber, Inc.-- Claim for Interest on Late Payment, Comp. Gen. B-213383, 88-2 CPD ¶ 536.

<sup>257</sup> The Court of Appeals for the Federal Circuit recently requested the parties to file briefs on the question of whether compliance with the Contract Disputes Act was a jurisdictional prerequisite to a suit in the Claims Court for PPA interest. The court did not reach the issue since it found the PPA inapplicable on other grounds. See New York Guardian Mortgagee Corp. v. United States, No. 90-5043 (Fed. Cir. Oct. 11, 1990).

<sup>258</sup> Walsky Constr. Co., ASBCA No. 37753, 90-3 BCA ¶ 23,092; Sol Flores Constr., ASBCA Nos. 32278, 32726, 89-3 BCA ¶ 22,154; HSQ Technology, ASBCA No. 36083, 88-3 BCA ¶ 20,852; Decker & Co., GmbH, ASBCA No. 33285, 88-3 BCA ¶ 20,925; George Shadie Elec. Assocs., Inc., GSBCEA No. 7627, 88-2 BCA ¶ 20,720. JDIC, Inc., ASBCA No. 31196, 86-3 BCA ¶ 19,037; Green Planting Co., ASBCA Nos. 85-195-3, 85-288-3, 86-2 BCA ¶ 18,808; Universal Contracting, DOT CAB No. 1565, 85-2 BCA ¶ 18,071.

<sup>259</sup> Sociedade De Construcoes Soares Da Costa, ASBCA No. 37875, 90-2 BCA ¶ 22,691.

contracting officer's adverse decision within the statutory time,<sup>260</sup> the board is deprived of jurisdiction. Similar consequences are suffered if the "claim" is not an unequivocal demand for payment. Where a contractor merely made a statement in one of its letters to the Government to the effect that a court would award interest for the late payment, the board ruled this did not constitute a claim and thus dismissed the appeal for lack of jurisdiction.<sup>261</sup>

Even if the demand is manifest, a claim is insufficient if it fails to specify that PPA interest is the type of interest sought. In HSQ Technology,<sup>262</sup> the Government delayed paying Contract Disputes Act interest which had been awarded to the contractor by a previous board judgment. The contractor then filed a claim for interest on that delayed interest payment. Although the claim did not mention the PPA, it did demand compound interest. In its appeal to the board, the contractor reiterated that it did not seek simple interest; in addition, it stated it wanted PPA interest. The board dismissed the appeal without prejudice, reasoning it lacked jurisdiction because the contractor never mentioned the PPA in its claim to the contracting officer.

The result in HSQ Technology seems unduly technical, given the Contract Disputes Act explicitly forbids compound interest and the PPA expressly allows it. A holding that the PPA was implicitly invoked would have been more in keeping with the Congressional intent that payment be automatic, and it would have done no violence to the maxim that waivers

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<sup>260</sup> AAAA Enters., Inc. v. United States, 10 Cl. Ct. 191 (1986).

<sup>261</sup> Ricway, Inc., ASBCA No. 29983, 86-2 BCA ¶ 18,841.

<sup>262</sup> ASBCA No. 36083, 88-3 BCA ¶ 20,852.

of sovereign immunity must be construed narrowly. Nevertheless, the warning has been sounded: contractors must spell out they want PPA interest when they file their claims. They do not, however, need to mention that they are filing their claims pursuant to the Contract Disputes Act. The board has ruled that submitting a claim to the contracting officer that invokes only the PPA is sufficient to grant the board jurisdiction.<sup>263</sup>

*b. Statutory reinforcement of automatic payment*

*i. background*

The fact that agencies often did not pay interest penalties without a demand did not go unnoticed during the Amendments hearings. According to one industry witness, "Not only do Government agencies fail to pay interest automatically on overdue accounts, some Federal agencies will not pay interest when interest is requested by the vendor or even when the vendor bills the agency for the amount."<sup>264</sup> While GAO conceded some payments may have been intentionally withheld, it explained that lack of payment was "more often the result of poor management and administrative controls rather than any purposeful withholding."<sup>265</sup>

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<sup>263</sup> General Elec. Co., ASBCA No. 33227, 87-1 BCA ¶ 19,484.

<sup>264</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 573 (1988).*

<sup>265</sup> H.R. REP. NO. 100-784, *supra* note 62, at 18.

Whatever the rationale for the omission of the penalty, it occurred frequently. A 1986 GAO report found that interest penalties were included in only 10 of the 66 late payments it identified that should have included the penalties.<sup>266</sup> Despite these recurring failures, vendors often did not demand the penalty, either because they were reluctant to "'rock the boat' and risk opportunities for future contracts"<sup>267</sup> or because the costs of collection equalled or exceeded the penalty due.<sup>268</sup>

In order to deal with this problem, Congress adopted three measures in the Amendments to reinforce its mandate that payment be automatic. First, it added a new section to the already imperative language of the original act. In addition to the original statement that agencies "shall pay an interest penalty,"<sup>269</sup> the new section emphasizes such a penalty "shall be paid without regard to whether the business concern has requested payment of such penalty."<sup>270</sup> Second, Congress made explicit that an agency which is unable to make timely payment due to the temporary unavailability of funds is nevertheless required to pay the interest penalty when funds become available.<sup>271</sup> Third, and most important,

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<sup>266</sup> General Accounting Office, *Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits*, GAO/AFMD-86-69 (Aug. 1986).

<sup>267</sup> 135 CONG. REC. S903 (daily ed. Jan. 20, 1987) (testimony of Christopher R. Brewster).

<sup>268</sup> H.R. REP. NO. 100-784, *supra* note 62, at 18.

<sup>269</sup> 31 U.S.C. § 3902(a) (1982).

<sup>270</sup> 31 U.S.C. § 3902(c)(1) (1988); Circular (Rev.), *supra* note 76, § 7b(2); FAR 32.903.

<sup>271</sup> 31 U.S.C. § 3902(d) (1988); Circular (Rev.), *supra* note 76, § 7b(3); FAR 32.903. This codifies an opinion rendered by the Comptroller General when the Commodity Credit Corporation "suspended" the PPA after it reached the ceiling of its borrowing authority. Hon. Glenn English,



Congress added an extra penalty if four conditions are met. This additional penalty, for "double interest," is treated in the next section. Given these three additional signals by Congress that interest is to be paid automatically, any contractor who must resort to the boards or Claims Court for collection should have a legitimate argument that it should be awarded legal fees and expenses pursuant to the Equal Access to Justice Act, if it otherwise qualifies.<sup>272</sup>

*ii. the "double interest" penalty*

A contractor is entitled to "double interest" if (a) it is already owed the standard interest penalty, (b) the agency pays part or all of the principal but includes no interest, (c) the agency does not correct its failure to pay the interest within 10 days of paying the principal, and (d) the contractor makes a written demand for the interest not later than 40 days after the incomplete payment.<sup>273</sup> The OMB Circular, but not the FAR, has expanded on the fourth condition, requiring the contractor to attach to the demand a copy of the specific invoice under which the interest is due and to certify both that an incomplete payment was

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Chairman, Subcomm. on Govt. Information, Justice, and Agriculture, Comm. on Govt. Operations, House of Representatives, Comp. Gen. B-223857, Feb. 27, 1987.

<sup>272</sup> 28 U.S.C. § 2412(d) and 5 U.S.C. § 504 (award appropriate unless agency position is substantially justified or special circumstances make award unjust). No forum has yet awarded EAJA fees for failure to pay PPA interest. Such fees were requested but denied due to the unsettled state of the law in Zinger Constr. Co., ASBCA No. 31858, 88-2 BCA ¶ 20,661, *aff'd*, 88-3 BCA ¶ 20,978.

<sup>273</sup> 31 U.S.C. § 3902(c)(3)(D) (1988); Circular (Rev.), *supra* note 76, § 8a; FAR 32.907-1(g).

received and the date of such receipt. Furthermore, the Circular provides the request must generally be postmarked by the 40th day, unless it is received and date-stamped by the agency within that time.<sup>274</sup>

Both the Amendments and the FAR state that the amount of the additional penalty is to be set by OMB.<sup>275</sup> The Circular provides that after January 21, 1990, the additional penalty is 100 percent of the standard interest penalty.<sup>276</sup> The Circular also sets maximum and minimum limits. During the 2-year period between January 22, 1990, and January 21, 1992, the additional penalty is capped at \$2500. After that time, the cap will increase to \$5000. Moreover, at no time will the extra penalty be less than \$25. For purposes of determining the maximum and minimum penalty, "the test shall be the interest due on each separate contract. The penalty shall not be based on individual invoices unless the invoices are paid by separate payment." In addition to these boundaries, divergence from a purely double penalty can be caused by the method of calculation. Whereas the standard penalty must cease to accrue

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<sup>274</sup> Circular (Rev.), *supra* note 76, § 8a(4).

<sup>275</sup> 31 U.S.C. § 3902(c)(3)(D) (1988); FAR 32.907-1(g).

<sup>276</sup> Circular (Rev.), *supra* note 76, § 8b. The Senate version of the Amendments, S. 328, would have imposed a penalty of 200 percent of the standard penalty. The House deemed this amount excessive. Instead, it stated it expected OMB to set a rate which balanced both the need for a rate high enough to get the attention of the agencies as well as the need for good stewardship of the taxpayers' monies. H.R. REP. NO. 100-784, *supra* note 62, at 18-19. OMB had already opposed the 200 percent penalty, arguing the "provision could increase the incentive for agencies to improperly deny that penalties are due, increase the incidence of contract disputes, and otherwise strain the business relationship between the Government buyer and commercial vendor." *Prompt Payment Act Amendments of 1987: Hearing on S. 328 Before the Senate Comm. on Govt. Affairs*, 100th Cong., 1st Sess. 433 (1987). Why this would be true for a 200 percent penalty but not a 100 percent penalty is not discussed in the legislative history.

after 1 year, the additional penalty may continue accruing and compounding until either the cap is reached or a claim is filed pursuant to the CDA.<sup>277</sup>

According to the OMB Circular, the additional penalty does not apply to the payment of utility bills because late payment penalties for such bills are determined through the rate-setting process.<sup>278</sup> The FAR has not carved out this exception and, it would seem, is justified in declining to do so. The Amendments themselves indicate no such exception, and since they pose no ambiguity on their face, they do not require a foray into legislative history.<sup>279</sup> However, even if such a venture is undertaken, the history does not support an exception. True, the House committee stated it did not intend the additional penalty to apply to utility bills for the same reason reflected by the Circular.<sup>280</sup> The Senate committee, however, did not discuss the issue.<sup>281</sup> Thus, the conclusion to be drawn is not that both houses intended to exempt utility bills from the additional payment. Rather, it is that, although one house considered such an exclusion, the resulting statute, which requires concurrence of both chambers, rejected the exemption. Congress knew how to pen such an amendment if, upon

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<sup>277</sup> Circular (Rev.), *supra* note 76, § 8c.

<sup>278</sup> *Id.* § 8d.

<sup>279</sup> Howe v. Smith, 452 U.S. 473 (1981) (when the terms of a statute are unambiguous, the inquiry of a court as to the meaning comes to an end except in rare and exceptional circumstances).

<sup>280</sup> H.R. REP. NO. 100-784, *supra* note 62, at 19.

<sup>281</sup> S. REP. NO. 100-78, *supra* note 65.

consideration, it had considered one appropriate, but it did not. The Circular's exclusion of utility bills, then, is of doubtful validity.<sup>282</sup>

*c. waiver of the penalty*

Although the interest penalty accrues and is to be paid automatically, a contractor may waive it. The Comptroller General has ruled that waiver is permissible since no public policy would be violated and it would be impossible to compel the contractor to accept the money anyway.<sup>283</sup> Waiver may be either by express written statement or by acts and conduct which indicate an intent to waive. The party alleging the waiver has the burden of proof. The ruling cautions that mere failure to cash or deposit the check, as opposed to returning it, does not imply waiver since Treasury checks are payable without limitation of time.<sup>284</sup> The opinion further states that waiver cannot be accomplished prospectively by means of a

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<sup>282</sup> The rationale for exempting utility bills from the additional penalty does not hold water either. To say utility bills are exempt from the extra penalty because late payment penalties are determined through the rate-setting process begs the question of why the standard penalty should not also be exempt. The statute and regulations should be consistent: they should either totally exempt utility bills from the PPA on the grounds that rate-setting already establishes the late payment costs to the utility, or they should make utility bills subject to both the standard and additional penalty on the grounds that such penalties are required to give agencies the incentive to pay on time.

<sup>283</sup> Central Intelligence Agency--Waiver of Interest under Prompt Payment Act, Comp. Gen. B-211737, 83-2 CPD ¶ 475.

<sup>284</sup> This prong of the reasoning was superseded by Pub. L. No. 100-86, 101 Stat. 552 (1987), codified at 31 U.S.C. § 3328 (1988), which provides that Government checks are void if not negotiated within one year.

contract clause. However, if entitlement has already arisen, a contractor may waive such interest in a settlement agreement.<sup>285</sup>

### **C. Which Funds Pay The Penalty?**

When an agency is obligated to pay an interest penalty, it must pay from the funds appropriated for the program for which the penalty is incurred.<sup>286</sup> By including this provision, the House Committee sought to eliminate inefficient management "within specific programs."<sup>287</sup> The degree to which such an incentive can be effectively applied to a specific program is questionable, given that many late payment problems may be attributable to a consolidated payment office rather than to a particular program office. The Senate Committee appears to have had a more realistic view, in that it thought the motivation would be at the agency rather than program level.<sup>288</sup> In any event, the incentive to pay on time is increased by the fact that appropriation of additional amounts to pay the penalty is not authorized.<sup>289</sup>

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<sup>285</sup> E.g., Baker Material Handling Corp., GSBGA No. 9510-TD (Sept. 2, 1988). Of course, the right to such interest may also be retained in a settlement agreement. E.g., Amperif Corp., GSBGA No. 8942-COM (May 3, 1988).

<sup>286</sup> 31 U.S.C. § 3902(f) (1988); 31 U.S.C. § 3902(d) (1982); Circular (Rev.), *supra* note 76, § 7b(5) (this provision explicitly applies to both the standard and additional penalties); FAR 32.903.

<sup>287</sup> H.R. REP. NO. 97-461, *supra* note 61, at 9.

<sup>288</sup> S. REP. NO. 97-302, *supra* note 61, at 6-7.

<sup>289</sup> 31 U.S.C. § 3902(f) (1988); 31 U.S.C. § 3902(d) (1982); Circular (Rev.), *supra* note 76, § 7b(5).

Despite the statutory requirement to pay the penalty out of program funds, it might be permissible for an agency to enter into an agreement whereby another agency would be liable for the penalty. The Comptroller General has apparently left open that possibility. In the relevant decision,<sup>290</sup> the Federal Emergency Management Agency (FEMA) and the General Services Administration (GSA) entered into an agreement whereby the latter would execute procurement contracts on FEMA's behalf and FEMA would reimburse GSA for its expenses. When GSA failed to make timely payment, both agencies claimed the other was responsible for the penalty. GSA and OMB both pointed to the statutory language and reasoned FEMA must pay because its programs were being implemented. FEMA argued GSA should pay because only GSA had privity with the contractor. The Comptroller General ruled FEMA must pay, but based his decision solely on the grounds that the interagency agreement required FEMA to reimburse GSA's expenses. If such an agreement is controlling, presumably an agreement that would have provided reimbursement except in the case of GSA fault would have shifted liability for the penalty to GSA.

A final issue is what year funds are to be used for the penalty. The Comptroller General has ruled that payment should come from the fiscal year funds in which the obligation arose.<sup>291</sup>

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<sup>290</sup> Liability for Prompt Payment Interest Penalties Under Interagency Agreement, 65 Comp. Gen. 81 (1986).

<sup>291</sup> Social Security Administration--Late Payment Charges for Utility Services, 63 Comp. Gen. 517 (1984).

### III. APPLICATION OF THE PPA TO CONSTRUCTION CONTRACTS

In implementing the 1982 PPA, the original OMB Circular declared that payments made "solely for financing purposes" were excluded from PPA coverage.<sup>292</sup> Since the Circular did not distinguish construction progress payments from other types of progress payments, most agencies specified in their regulations that all progress payments were made solely for financing purposes and thus refused to pay interest penalties on all untimely progress payments.<sup>293</sup> The Armed Services board eventually corrected this view, holding that progress payments on construction contracts were not solely for financing and therefore were subject to the PPA.<sup>294</sup> The 1988 Amendments removed any potential ambiguities among other agencies by explicitly stating interest must be paid on late construction progress payments.<sup>295</sup> Two of the distinctive rules which apply to

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<sup>292</sup> Circular (1982), *supra* note 74, § 8c.

<sup>293</sup> H.R. Rep. No. 100-784, *supra* note 62, at 22.

<sup>294</sup> Zinger Constr. Co., ASBCA No. 31858, 87-3 BCA ¶ 20,013; Batteast Constr. Co., ASBCA No. 34420, 87-3 BCA ¶ 20,044. See also Steven E. Jawitz, 86-1 BCA ¶ 18,564 at 93,233 (although board did not directly confront the issue of progress payments, its reference to legislative history foreshadowed Zinger).

<sup>295</sup> 31 U.S.C. § 3903(a)(6)(A) (1988); Circular (Rev.), *supra* note 76, § 10a(1); FAR 32.905(c)(1). The statute, which is mirrored by the Circular, defines a construction progress payment to include "a monthly percentage of completion progress payment or milestone payments for completed phases, increments, or segments of any project."

The legislative history indicates Congress believed construction progress payments already fell "squarely within the [1982] act's protection" at section 3903(4) since they are payments for partial executions. H.R. Rep. No. 100-784, *supra* note 62, at 22. Nevertheless, Congress created the new section 3903(a)(6)(A) to add to section 3903(a)(5), the latter of which revised the original section 3903(4).

For further discussion, see the text beginning at page 143, *infra*.

construction progress payments have been treated previously. Special documentation is required to constitute a proper request for a progress payment, namely, certain substantiation and a certificate.<sup>296</sup> Second, the time allowed for payment of a progress payment request is shortened to 14 days unless a longer time is specified in the solicitation.<sup>297</sup>

The Amendments also extended PPA coverage to retainage, which is a percentage of a progress payment otherwise due a contractor but retained by the Government.<sup>298</sup> A more dramatic revision was the application of the PPA to subcontractors through their contracts with higher tier contractors.<sup>299</sup>

The following two sections address the statutory changes not yet covered in this chapter. Discussion is brief since neither provision involves interest payments by the Government, which is the focus of this thesis.

#### **A. Interest Payments By Contractors For Deficient Work**

If, after submitting a substantiated and certified request for progress payments, a contractor discovers that a portion or all of the request covers work which fails to conform to the specifications, terms, or conditions of its contract, the contractor must notify the Government

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<sup>296</sup> See notes 146-49 *supra* and accompanying text.

<sup>297</sup> See notes 183-85 *supra* and accompanying text.

<sup>298</sup> 31 U.S.C. § 3203(a)(6)(B) (1988); Circular (Rev.), *supra* note 76, § 10a(2); FAR 32.905(c)(2). FAR 52.232-5(e) allows a contracting officer to retain a maximum of 10 percent for cause.

<sup>299</sup> 31 U.S.C. § 3905 (1988).



of the deficient performance and pay the Government interest on the "unearned amount" of the progress payment it received.<sup>300</sup>

According to the statute and the FAR, interest is computed from the date the contractor receives the unearned amount.<sup>301</sup> In contrast, the Circular does not impose a penalty until the 8th day after receipt of payment.<sup>302</sup> The Circular apparently relies on what can only be construed as an error in one portion of the legislative history, where it mistakenly refers to unearned amounts caused by subcontractors.<sup>303</sup> Other portions clearly distinguish between unearned amounts caused by primes and those caused by subcontractors.<sup>304</sup> To avoid potential litigation, the Circular should be revised to reflect the clear statutory language and presumed legislative intent.

No ambiguity exists over how long interest can accrue. The penalty accumulates until either the contractor notifies the Government that the performance deficiency is corrected or until the contractor reduces a subsequent progress payment request by the unearned amount in its

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<sup>300</sup> 31 U.S.C. § 3905(a) (1988); Circular (Rev.), *supra* note 76, § 10e; FAR 52.232-5(d) (1).

<sup>301</sup> 31 U.S.C. § 3905(a) (2) (1988); FAR 52.232-5(d) (2). Although the FAR drafters were urged to compute interest from the date of discovery of the deficient work rather than from the date of payment, they declined to do so since they perceived no such flexibility in the statute. FAR Case 88-69, Comment 24.

<sup>302</sup> Circular (Rev.), *supra* note 76, § 10e(1).

<sup>303</sup> H.R. REP. NO. 100-784, *supra* note 62, at 25 (interest "from the eighth day after receipt").

<sup>304</sup> H.R. REP. NO. 100-784, *supra* note 62, at 37 (for primes, interest "from the day of their receipt") and 39 (for subcontractors, interest "from the eighth day after receipt"). The Senate Report sheds no light since the provision was added by the House.

possession.<sup>305</sup> Interestingly, the statute as originally enacted only requires the subsequent request to be reduced by the unearned amount and not by the accrued interest as well. However, the Amendments and the revised Circular have plugged this gap by requiring agencies to deduct such interest from their next payments.<sup>306</sup> The FAR does not yet mirror this mandate; however, agencies may nevertheless recover the interest through administrative offset.

Finally, the applicable interest rate is the average bond equivalent rate of 91-day Treasury bills.<sup>307</sup>

## **B. Construction Subcontracts**

### **1. Background**

During the hearings on the Amendments, one group voiced its support for the provisions extending the PPA to subcontractors in the following manner:

The proposed legislation corrects a problem we had hoped would be solved by the 1982 Act, but wasn't. Because subcontractors were complaining about late pay, we felt they would get paid faster if Congress ensured that the general contractors got paid faster. But it didn't work that way. Prime or general contractors, because of the Act, got paid faster, but did not speed up their

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<sup>305</sup> 31 U.S.C. § 3905(a)(2) (1988); Circular (Rev.), *supra* note 76, § 10e; FAR 52.232-5(d)(2).

<sup>306</sup> 31 U.S.C. § 3903(c)(1) (1988); Circular (Rev.), *supra* note 76, § 10f.

<sup>307</sup> *Id.* § 10f.

payments to subcontractors. This section of the proposed legislation resolves a problem of unfairness.<sup>308</sup>

Congress enacted the new provision not only for equitable reasons but also to prevent the exact same deleterious effects of late payment on subcontractors and the Government as the original act sought to preclude from happening to primes and the Government. Such concern was warranted because as much as 80 percent of federal construction work is performed by subcontractors.<sup>309</sup>

## *2. Flowdown of Payment and Interest Penalty Clauses*

The Amendments require contractors to flow down to all tiers payment and interest penalty clauses in their contracts.<sup>310</sup> A contractor must pay the standard interest penalty ("double interest" provisions are not included) if it fails to pay a lower tier contractor within 7 days after it receives payment from the Government or a higher tier, provided no dispute as to performance exists.<sup>311</sup> These provisions are not intended to apply to routine, over-the-counter cash or credit purchases from

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<sup>308</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 578 (1988).*

<sup>309</sup> S. REP. NO. 100-78, *supra* note 65, at 23-24.

<sup>310</sup> 31 U.S.C. § 3905 (1988). A standard form prepared by the Associated General Contractors of America (Document No. 601) to assist compliance with the flowdown requirements is reproduced in Briefing Papers #90-4 (Rosen, McGrath and Davis, *Prompt Payment Act Amendments of 1988*), 9 BPC \_\_\_\_.

<sup>311</sup> 31 U.S.C. §§ 3905(b), (c) (1988).

suppliers, such as when a subcontractor runs to the local hardware store for a few items.<sup>312</sup>

### *3. Administration of Subcontractor Performance by Primes*

The Amendments also require prime contractors to manage certain facets of subcontractor performance for the Government; primes need not flow down these obligations. If a prime has requested payment from the Government but discovers some money should be withheld from a subcontractor prior to paying it, the prime shall reduce its next progress payment to the subcontractor by the appropriate amount. Once the deficiency has been corrected, the prime must pay the withheld amount within 7 days or pay both the standard interest penalty to the subcontractor and the average bond equivalent rate of 91-day Treasury bills to the Government.<sup>313</sup> If a prime pays its subcontractor and then is notified under the Miller Act<sup>314</sup> that its subcontractor failed to pay lower tier subcontractors, the prime is permitted to withhold the appropriate amount without incurring an interest penalty. Once the defect has been cured, the prime must pay the withheld amount within 7 days or incur the standard interest penalty.<sup>315</sup>

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<sup>312</sup> H.R. REP. NO. 100-784, *supra* note 62, at 28.

<sup>313</sup> 31 U.S.C. § 3905(e) (1988).

<sup>314</sup> 40 U.S.C. § 270b.

<sup>315</sup> 31 U.S.C. § 3905(f) (1988).

#### 4. Privity of Contract not Otherwise Impaired

This subsection of the Amendments does not otherwise impair the principle of privity of contract between a prime contractor and its subcontractors or subcontractors of any tier. Parties are free to negotiate other parts of their contracts, such as the amount of retainage that can be withheld without cause and the right to withhold all or part of payments for cause.<sup>316</sup> Consistent with preserving the concept of privity are provisions which protect the Government from being made a party to any disputes between contractors<sup>317</sup> and from having to reimburse a contractor for any interest penalties.<sup>318</sup>

#### IV. REPORTING REQUIREMENTS

To enable Congress to monitor agency compliance with the new law and to identify trouble spots,<sup>319</sup> the PPA as originally enacted required two annual reports.<sup>320</sup> The first report was to be submitted by the agencies to OMB within 60 days after the end of the fiscal year and had to include the number, amounts and frequency of the penalty payments and the reasons

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<sup>316</sup> *Id.* § 3905(d). However, primes may not request payment from an agency for any amount withheld or retained until they certify to the agency that the subcontractor is entitled to the amount. *Id.* § 3905(h).

<sup>317</sup> *Id.* § 3905(i).

<sup>318</sup> *Id.* § 3905(k).

<sup>319</sup> H.R. REP. NO. 97-461, *supra* note 61, at 10; S. REP. NO. 97-302, *supra* note 61, at 8-9.

<sup>320</sup> 31 U.S.C. § 3905 (1982); Circular (1984), *supra* note 74, § 11.

why the payments were late. The second report, filed within 120 days after the end of the fiscal year, was to be submitted by OMB to Congress.

During the course of the Amendments hearings, it became clear that the reports were inadequate and even misleading. The primary source for this conclusion was a study by GAO in 1986.<sup>321</sup> Because the PPA and Circular only required reports on "interest penalty payments," the reports did not include instances where payments were made during the grace period or even after the grace period if the agency never paid the penalty. Furthermore, although one payment might include several late invoices, the report would show only one problem rather than the true number. Finally, the reports did not reflect late payment penalties other than interest, such as flat fees prescribed by certain utility tariffs.<sup>322</sup>

The Amendments seek to correct the reporting deficiencies. Agencies<sup>323</sup> must now report interest penalties on an invoice rather than payment basis and must report standard penalties separately from any additional penalties. In addition, they must report not only "interest" penalties but "other late payment penalties" as well.<sup>324</sup> OMB has also tightened up

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<sup>321</sup> General Accounting Office, *Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits*, GAO/AFMD-86-69 (Aug. 1986).

<sup>322</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations*, 100th Cong., 2d Sess. 63 (1988).

<sup>323</sup> The Amendments subject the U.S. Postal Service to the PPA but exempt the agency from the reporting requirements. 31 U.S.C. § 3901(c) (1988).

<sup>324</sup> 31 U.S.C. § 3906(a) (1988).

the Circular, requiring much more detailed reporting.<sup>325</sup> The timing of the agency and OMB reports remains unchanged.

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<sup>325</sup> Circular (Rev.), *supra* note 76, § 14.

## CHAPTER 3

### SCOPE OF COVERAGE

This chapter discusses the breadth of coverage of the PPA. Part I addresses the effective dates of the 1982 Act and 1988 Amendments. Part II examines the nature of the parties affected and what types of their contractual arrangements are covered. Withholding is considered in Part III, as the PPA does not apply to payments which are withheld because of a dispute or in accordance with the contract. Finally, Part IV explores the types of payments covered by the PPA, since the OMB Circular has decreed that most payments made solely for financing are not subject to the statute.



## **I. EFFECTIVE DATES**

### **A. The 1982 Act**

#### *1. Contracts Awarded On or After October 1, 1982*

##### *a. statute and regulations*

Section 7(a) of Public Law No. 97-177 states that the PPA "applies to the acquisition of property or services on or after [October 1, 1982]." Although Congress did not define what it meant by "acquisition," the drafters delegated to OMB the necessary rulemaking authority to clarify the term. OMB interpreted "acquisition" to mean contract award, as evidenced by paragraph 13 of the 1982 Circular. That paragraph reads, "Interest penalties will apply to payments made under contracts issued on or after October 1, 1982."<sup>326</sup> After its proposed Circular was published for comment, OMB explicitly rejected the suggestions of several commentators that the act should apply to all "payments made" after October 1, 1982. It reasoned that, because the statute as enacted reflected the House version, rather than the Senate version (which would have applied to payments made after the October date regardless of when the contract was entered into), an interpretation that contract award is

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<sup>326</sup> Contrast this definition for PPA purposes with FAR 2.101, which states acquisition begins at the much earlier stage of establishing an agency's needs.

the dispositive event for application of the act was more consistent with the legislative intent.<sup>327</sup>

*b. majority view: contract award date dispositive*

The majority view concurs with the OMB Circular. Four agency boards of contract appeals<sup>328</sup> and the Claims Court<sup>329</sup> subscribe to OMB's position that the contract award date is dispositive for PPA applicability. Similarly, the Comptroller General apparently defers to OMB's interpretation.<sup>330</sup> Although no court of appeals has expressed its assessment of this issue for attribution, the Court of Appeals for the Federal Circuit and the Sixth Circuit have indicated their positions in unpublished opinions.<sup>331</sup> Both align themselves with OMB.

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<sup>327</sup> 47 Fed. Reg. 37321 (1982).

<sup>328</sup> Massman Constr. Co., ENG BCA No. 4961, 89-1 BCA ¶ 21,304; Consolidated Techs., Inc., ASBCA No. 33580, 88-1 BCA ¶ 20,470; Chartwell Assocs., AGBCA No. 75-111-4, 86-3 BCA ¶ 19,335; JC Edwards Contracting and Eng'g Inc., VABCA No. 1947, 85-2 BCA ¶ 18,068.

<sup>329</sup> International Business Investments, Inc. v. United States, 21 Cl. Ct. 79 (1990); Ocean Tech. v. United States, 19 Cl. Ct. 288 (1990).

<sup>330</sup> City of Aberdeen, Comp. Gen. B-226231, Oct. 23, 1987; Home State Bank--Payment under Assignment of Claims Act, Comp. Gen. B-214273, June 21, 1984.

<sup>331</sup> Hettich & Co. v. United States, No. 88-1390 (Fed. Cir. April 12, 1989), *affirming in part* ASBCA No. 35239, 88-2 BCA ¶ 20,699; Kentucky Carbon Corp. v. Tennessee Valley Auth., No. 88-5708 (6th Cir. May 8, 1989).

c. *minority view: ambiguous*

The "minority" view is not so much one of opposition as it is of ambiguity. Three boards of contract appeals have missed opportunities to express their solidarity with the majority. The GSA Board had the most recent chance to align itself in Elden-Rider, Inc.<sup>332</sup> The board acknowledged both the majority rule and that a single GSA judge had previously issued a decision<sup>333</sup> under small claims procedures (such decisions having no precedential value) which flatly rejected the OMB interpretation of "acquisition." That earlier ruling applied the PPA to services performed after October 1982 -- and thus "acquired" by the agency -- pursuant to a contract awarded in June 1982. Because the acquisition at issue in Elden-Rider occurred prior to October 1982 and thus precluded coverage of the act, any "reversal" of the prior decision would have been dicta. Nevertheless, the board could have indicated a change in sentiments, but did not.

One of the four boards in the majority, the Corps of Engineers Board, apparently counts the Transportation Board among its numbers based on its reading<sup>334</sup> of A.T. Kearney, Inc.<sup>335</sup> However, such a conclusion is perhaps presumptuous. The Transportation Board's statements were only dicta. Moreover, that dicta, after citing the "acquisition" language of Public

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<sup>332</sup> GSBICA No. 8643, 90-2 BCA ¶ 22,878.

<sup>333</sup> Professional Window & House Cleaning, Inc., GSBICA No. 7603 (Apr. 2, 1985).

<sup>334</sup> Massman Constr. Co., ENG BCA No. 4961, 89-1 BCA ¶ 21,304 at 107,428.

<sup>335</sup> DOTBCA No. 1263, 83-2 BCA ¶ 16,835.

Law No. 97-177 rather than the Circular, declared that the PPA waived sovereign immunity "for payments due after October 1, 1982."<sup>336</sup> Such dicta is more at odds than in consonance with the Circular.

Finally, the HUD Board's position is also unclear. When a contractor sought PPA interest on a contract entered into during July 1982, the board spent considerable energy analyzing the statute and facts before eventually concluding no penalty was due because the invoice was not proper and because the parties disagreed as to contract compliance.<sup>337</sup> The board could have denied interest based on the far simpler rationale of the early award date or, alternatively, have cited the award date as a third basis for disapproving the claim. It did neither.

## *2. Do Options/Modifications Equate to Contract Award?*

Although there is near unanimity that the PPA only applies to contracts awarded on or after October 1, 1982, there is a deep rift between the ASBCA and the Claims Court as to whether an option is the equivalent of a new contract award. The question arises when a contract executed prior to the effective date of the PPA contains an option clause and the Government exercises that clause after October 1, 1982.

The ASBCA is the only board to have dealt with this issue. It got first crack at the problem, holding in Honeywell Federal Systems, Inc.,<sup>338</sup>

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<sup>336</sup> *Id.* at 93,496.

<sup>337</sup> Ross Plumbing and Heating, HUD BCA No. 85-932-C7, 85-3 BCA ¶ 18,478.

<sup>338</sup> ASBCA No. 36227, 89-1 BCA ¶ 21,258.

that an option to extend the contract for one year did constitute the equivalent of a contract award. Thus, it awarded PPA interest for late payments made during the option period even though the initial contract began in June 1982. The board relied heavily on Professor Corbin's treatment of option contracts.

The Claims Court has subsequently issued two opinions. In the first, Ocean Technology v. United States,<sup>339</sup> Judge Nettesheim took the view opposite that of the ASBCA. Reading Professor Corbin differently, the court said an option should only be considered a new contract if the option is the only, or at least the principal, part of the bargain. The facts of the case were unusual in that the option in question was not part of the contract prior to October 1982; rather, it was created and exercised during 1984. Applying Corbin to these facts, the court concluded the PPA did apply. However, the court parted with the board when it also declared that the PPA would not have applied to the exercise of an option that had been part of the original contract.<sup>340</sup>

The second case had two rounds. In International Business Investments, Inc. v. United States,<sup>341</sup> the option clause was included in the original contract. In round one, Judge Smith was persuaded by the Honeywell logic and granted late payment interest. On reconsideration, however, he vacated his earlier decision and, aligning himself with Judge Nettesheim, ruled the PPA does not apply to such options.<sup>342</sup>

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<sup>339</sup> 19 Cl. Ct. 288 (1990).

<sup>340</sup> *Id.* at 293.

<sup>341</sup> 19 Cl. Ct. 715 (1990).

<sup>342</sup> 21 Cl. Ct. 79 (1990).

The only decisions concerning other types of modifications have come from the ASBCA. The Honeywell decision dealt not only with options, but also with delivery orders placed after October 1982 under a requirements contract executed prior to that date. The board held the PPA did not apply to such modifications. In Cieszko Construction Co., Inc.,<sup>343</sup> change orders issued subsequent to the effective date of the act were determined not to be subject to its provisions.

#### ***B. The 1988 Amendments***

Unlike the 1982 Act, which took effect in its entirety on one date, portions of the 1988 Amendments take effect at various times. As of this writing at least, there has been no litigation over the latter's effective dates. Thus, the entire guidance is presently contained at Section 14 of Public Law No. 100-496, Sections 8 and 15 of the latest Circular, and the relevant FAR provisions. The overall scheme provides for the bulk of the Amendments to take effect on one date, with four exceptions.

##### ***1. General Rule: April 1, 1989***

The Amendments, Circular and FAR all declare that, unless otherwise specified, the sections of the updated act apply to payments made under contracts awarded, contracts renewed, and contract options exercised on

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<sup>343</sup> ASBCA No. 34199, 88-2 BCA ¶ 20,652.

or after April 1, 1989.<sup>344</sup> Most sections of the new law therefore become effective on that date.

## 2. Exceptions

### a. notice accompanying late payment

According to the Amendments and the Revised Circular, the notice agencies are required to provide to contractors along with an interest penalty only applies to contracts awarded on or after October 1, 1989.<sup>345</sup> Common rules of statutory construction preclude requiring the notice for contract renewals and options. Since the portion of the FAR concerned with the notice<sup>346</sup> carves out no special date for application, the general FAR effective date applies, namely, April 1, 1989. Since failure to provide such notice appears to confer no substantive rights on contractors and thus does not invoke waiver of sovereign immunity implications, the FAR is free to impose stricter requirements on the agencies than those mandated by the act and Circular.

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<sup>344</sup> PPA Amendments § 14(a), Pub. L. No. 100-496, 102 Stat. 2455 (1988) (not codified); Circular (Rev.), *supra* note 76, § 15c (listing thirteen portions of the Amendments which take effect beginning April 1, 1989; if not otherwise specified, provisions take effect beginning January 20, 1990); FAC 84-45. Note that FAR Part 32 does not contain this language; it is found in the FAC at 54 Fed. Reg. 13332 (March 31, 1989).

<sup>345</sup> PPA Amendments § 14(b), Pub. L. No. 100-496, 102 Stat. 2455 (1988) (not codified); Circular (Rev.), *supra* note 76, § 15b. The notice provision is discussed in the text accompanying notes 238-40, *supra*.

<sup>346</sup> FAR 32.907-1(d).

*b. Postal Service and CCC*

Only the Amendments and the Revised Circular spell out when the U.S. Postal Service and the Commodity Credit Corporation become subject to the PPA since those two entities' procurement practices are not governed by the FAR. All of their "obligations incurred" on or after January 1, 1989, are covered by the PPA.<sup>347</sup> The "obligations incurred" terminology appears much broader than the "contracts awarded, contracts renewed, and options exercised" language, thus indicating, for example, that a delivery order placed against a pre-1989 Postal contract would be subject to the late payment provisions.

*c. reporting requirements*

The new reporting requirements levied on OMB and the agencies are required for each fiscal year beginning with fiscal 1989.<sup>348</sup>

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<sup>347</sup> PPA Amendments § 14(c), Pub. L. No. 100-496, 102 Stat. 2455 (1988) (not codified); Circular (Rev.), *supra* note 76, § 15a. BRAK-HARD Concrete Co., PSBCA No. 2762, 90-3 BCA ¶ 23,067 (act is inapplicable to Postal Service obligations incurred prior to January 1, 1989). Reporting requirements are not, however, levied on the Postal Service.

<sup>348</sup> PPA Amendments § 14(d), Pub. L. No. 100-496, 102 Stat. 2455 (1988) (not codified); Circular (Rev.), *supra* note 76, § 15 (since reporting requirements are given no special effective date, the new requirements became mandatory on January 20, 1990).



d. the additional penalty

Section 14 of the Amendments specifies an effective date for every section of the updated act except for that part dealing with the additional penalty.<sup>349</sup> Consequently, Congress has left it to OMB to decide the effective date pursuant to its general delegation in the Amendments to implement the PPA.<sup>350</sup> The Circular stipulates the additional interest provisions take effect on January 22, 1990.<sup>351</sup> However, given the case law stemming from the 1982 Act regarding options, whether an agency which awarded a contract prior to January 22, 1990 and then exercises an option after that date will have to pay the additional penalty will depend on whether the contractor appeals to the Claims Court or to the ASBCA or, if to another board, which precedent that board follows.

The FAR subjects "contracts awarded on or after October 1, 1989," to the additional penalty provisions.<sup>352</sup> Thus, agencies are subject to the additional penalty earlier than OMB would allow. It remains to be seen what influence, if any, the contract "award" language will have on the options issue.

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<sup>349</sup> PPA Amendments § 14, Pub. L. No. 100-496, 102 Stat. 2455 (1988) (not codified).

<sup>350</sup> 31 U.S.C. § 3903(a) (1988).

<sup>351</sup> Circular (Rev.), *supra* note 76, § 8b. It is curious why OMB chose a date only two days later than the catch-all date provided for at § 15.

<sup>352</sup> FAR 32.907-1(g).

## **II. AFFECTED PARTIES AND THEIR CONTRACTS**

The Prompt Payment Act applies to a federal "agency acquiring property or service from a business concern."<sup>353</sup> This section examines all three components of that relationship: an agency, a business concern, and their contract.

### **A. Covered Agencies**

The PPA and OMB Circular basically apply to agencies as they are defined in Section 551(1) of the Administrative Procedure Act, 5 U.S.C. § 551(1).<sup>354</sup> The Circular elaborates on what the term "agency" means.<sup>355</sup> Included are military posts, base exchanges and commissaries, and other entities operated exclusively as an agency instrumentality for the purpose of administering an agency program if the agency head so designates. Excluded are federal courts; the Congress;<sup>356</sup> governments of territories, possessions, and the District of Columbia; courts martial; military commissions; and certain military authority exercised in the field. A

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<sup>353</sup> 31 U.S.C. § 3902(a) (1988).

<sup>354</sup> 31 U.S.C. § 3901(a)(1) (1988); Circular (Rev.), *supra* note 76, § 1b.

<sup>355</sup> *Id.*

<sup>356</sup> Hon. Stuart F. Balderson, Financial Clerk of the Senate, Comp. Gen. B-225123, May 1, 1987 (PPA does not apply to the Senate).

board of contract appeals has recently held that nonappropriated fund instrumentalities are not subject to the PPA.<sup>357</sup>

In addition to the preceding general rule governing the PPA's coverage, three entities are given special consideration by the statute. The Tennessee Valley Authority is subject to the PPA; however, it is not subject to the OMB Circular.<sup>358</sup> The Amendments specify that the United States Postal Service is now subject to the PPA except for reporting requirements. The Postmaster General is responsible for issuing procurement regulations as well as solicitation and contract clauses.<sup>359</sup> The Amendments also clarify that the PPA applies to certain contracts of the Commodity Credit Corporation,<sup>360</sup> thereby codifying the opinion of the Comptroller General<sup>361</sup> over the objection of OMB.<sup>362</sup>

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<sup>357</sup> Royal Services, Inc., ASBCA No. 38580, 89-3 BCA ¶ 22,233. In National Ass'n of Rehabilitation Facilities, Inc. v. Bowen, 840 F.2d 931 (D.C. Cir. 1988), the court was asked to decide whether Medicare payments administered by the Department of Health and Human Services are subject to the PPA; however, the court ruled it lacked jurisdiction to hear the case since no factual controversy was before it. The Bureau of Indian Affairs must abide by the PPA. Harvey C. Jones, Inc., IBCA Nos. 2070 et al., 90-2 BCA ¶ 22,762.

<sup>358</sup> 31 U.S.C. § 3901(b) (1988); Circular (Rev.), *supra* note 76, §§ 1b, 2a(1). Although two contractors have sought late payment interest from the TVA, neither were successful since their contracts preceded the effective date of the PPA. Kentucky Carbon Corp. v. TVA, No. 88-5708 (6th Cir. May 8, 1989); Sigmon Fuel Co. v. TVA, 754 F.2d 162 (6th Cir. 1985).

<sup>359</sup> 31 U.S.C. § 3901(c) (1988); Circular (Rev.), *supra* note 76, §§ 1b, 2a(2).

<sup>360</sup> 31 U.S.C. § 3902(h) (1988); Circular (Rev.), *supra* note 76, § 2a(3).

<sup>361</sup> See Hon. Glenn English, Chairman, Subcomm. on Govt. Information, Justice, and Agriculture, Comm. on Govt. Operations, House of Representatives, Comp. Gen. B-223857, Feb. 27, 1987.

## **B. Covered Business Concerns**

Although the statute uses the term "business concern" and defines it to include persons carrying on a trade or business and nonprofit entities operating as contractors,<sup>363</sup> the Circular now uses the term "contractor" to describe the other party to the acquisition contract.<sup>364</sup> The definition of "contractor" is not, however, substantively different from the PPA's definition of "business concern."

The FAR carves out an exception for foreign vendors that has no counterpart in the statute or Circular. According to FAR 32.901, PPA interest does "not apply to contracts awarded to foreign vendors outside the United States for work performed outside the United States." The FAR Council was urged to remove this exception from the final rule on grounds the PPA did not authorize it.<sup>365</sup> Rejecting such a suggestion, the FAR drafters reasoned the rule was permitted because it believed OMB had determined that the PPA was not intended to apply to payments to non-U.S. vendors.<sup>366</sup> However, such a belief was misplaced. Although the OMB

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<sup>362</sup> See *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 117 (1988).*

<sup>363</sup> 31 U.S.C. § 3901(a)(2) (1988).

<sup>364</sup> Circular (Rev.), *supra* note 76, § 1g. The original Circular used the term "business concern." Circular (1982), *supra* note 74, § 4c. The revision did not change the meaning.

<sup>365</sup> FAR Case 88-69, Comment 29.

<sup>366</sup> *Id.* It was thought the legislative history indicated an intention to protect U.S. businesses and to accord with "'industry practice' (obviously U.S. industry practice)."

Circular as originally proposed<sup>367</sup> would have excluded from PPA coverage any payments made outside the United States, OMB removed this exclusion upon receipt of comments which argued the PPA itself did not provide for such a restriction.<sup>368</sup>

An alternative argument for finding the exception for non-U.S. vendors permissible, but which was not made by the FAR Council, could be based on the legislative history of the Amendments. An earlier version of the FAR language<sup>369</sup> was published one month before the House hearings on the Amendments took place. Despite the existence of the FAR provision, and despite the recommendation during the hearings to forbid "this discriminatory practice,"<sup>370</sup> the Amendments ignored the issue. Thus, Congressional inaction might be viewed as acquiescence.<sup>371</sup> In any event, unless the FAR deletes this questionable exclusion, it seems a likely candidate for litigation.

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<sup>367</sup> 47 Fed. Reg. 29620 (1982).

<sup>368</sup> 47 Fed. Reg. 37322 (1982).

<sup>369</sup> FAC 84-33, 53 Fed. Reg. 3688 (1988).

<sup>370</sup> *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 597-98 (1988).*

<sup>371</sup> Apparently the Comptroller General does not believe Congress intended to adopt the FAR interpretation. Regarding an RFP issued December 15, 1989, for guard services at the United States embassy in Costa Rica, the Comptroller General declared that inclusion of the PPA in the solicitation was a statutory requirement. W.P.M. Security Service Co., Comp. Gen. B-238542, 90-1 CPD ¶ 553. If indeed Congress acquiesced to anything, perhaps the Amendments reflect its affirmation of the interpretation afforded by the boards. See Sol Flores Constr., ASBCA Nos. 31557, 32608, 90-1 BCA ¶ 22,365 (PPA interest awarded to Philippine contractor for work done in that country).

The Comptroller General has rendered several opinions that certain entities are not business concerns. Neither other Government agencies<sup>372</sup> nor Government employees<sup>373</sup> are business concerns, and, thus, they cannot receive PPA interest for late payments. Furthermore, where the Government acted as a supplier of water and then erroneously overbilled the purchaser, the PPA did not apply.<sup>374</sup>

### C. Covered Contracts

The PPA elaborates only slightly on the meaning of "acquiring property or service" from a contractor. It deems a contract to rent property the equivalent of a contract to acquire property.<sup>375</sup> It does not apply to contracts awarded by recipients of various forms of federal assistance.<sup>376</sup>

The Circular fleshes out the concept of acquisition, defining a contract as "any enforceable agreement, including rental and lease agreements, purchase orders, delivery orders, . . . requirements-type (open ended) service contracts, and blanket purchase agreements [which

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<sup>372</sup> Authority to Pay Interest to the Western Area Power Administration, Comp. Gen. B-226008, May 27, 1988.

<sup>373</sup> David W. Eubank -- Relocation Income Tax Allowance -- Delayed Payment Interest, Comp. Gen. B-219526, May 25, 1988; Harold R. Fine -- Relocation and Travel Expenses, Comp. Gen. B-224628, Jan. 12, 1988.

<sup>374</sup> City of Aberdeen, Comp. Gen. B-226231, Oct. 23, 1987.

<sup>375</sup> 31 U.S.C. § 3901(a) (6) (1988). The May 1989 and 1990 pocket parts for 31 USCS § 3901 omitted reference to this section, thereby erroneously implying the Amendments deleted this provision. In contrast, the 1990 pocket part for 31 USCA § 3901 correctly reflects that rental contracts are still subject to the PPA.

<sup>376</sup> 31 U.S.C. § 3902(g) (1988); Circular (Rev.), *supra* note 76, § 11.

involve the Commodity Credit Corporation]."<sup>377</sup> Presumably, even oral contracts would subject the Government to PPA interest.<sup>378</sup> Since FAR Part 32 does not provide special definitions for the terms "contract" or "acquisition," those terms are ascribed the general meanings spelled out in FAR 2.101.

The Comptroller General has ruled that the Government is subject to PPA interest when it purchases utility services pursuant to a tariff which does not specify a late payment charge.<sup>379</sup> Conversely, the Comptroller General has also determined that the Government is not subject to PPA interest when a tariff does contain its own late penalty provision.<sup>380</sup> The Circular does not appear to differentiate between these two decisions, for it states it does not apply "where agencies acquire utility services under terms required by other Governmental authorities not subject to the Act (e.g., tariffs)."<sup>381</sup> Obviously not all tariffs contain late penalty provisions; where they do not, the Circular should apply. OMB should

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<sup>377</sup> Circular (Rev.), *supra* note 76, § 1e.

<sup>378</sup> See generally Elkhorn Constr. Co., VABCA Nos. 1493 et al., 84-2 BCA ¶ 17,435 (general discussion of binding nature of oral contracts).

<sup>379</sup> Prompt Payment Act Interest on Utility Bills, 65 Comp. Gen. 842 (1986). Note also the Comments of the Federal Executive Agencies filed with the State Corporation Commission of the State of Kansas in Docket No. 88-SWBT-50-TAR, Proposal by Southwestern Bell Telephone Company for Late Payment Charges, wherein the FEA urged the Commission to exempt the FEA from the late payment tariff since the PPA already provided the FEA an incentive to pay on time. See also Arkansas Best Freight Sys., Inc. v. United States, 20 Cl. Ct. 776 (1990) (PPA interest granted for late payment of trucking tariff).

<sup>380</sup> National Park Service--Late Payment Charges for Utility Services, Comp. Gen. B-222944, Oct. 23, 1987; Social Security Administration--Late Payment Charges for Utility Services, 63 Comp. Gen. 517 (1984).

<sup>381</sup> Circular (Rev.), *supra* note 76, § 2b.

correct this oversight.<sup>382</sup> In contrast, the FAR correctly reflects the distinction drawn by the Comptroller. The FAR only exempts from PPA coverage those contracts "where payment terms and late payment penalties have been established by other Governmental authority (e.g., tariffs)."<sup>383</sup>

The Court of Appeals for the Federal Circuit recently held that the procedure under which the Veteran's Administration reimburses lenders for defaulted loans which the VA has guaranteed is not a federal contract within the meaning of the PPA.<sup>384</sup> A lending institution acquired 76 mortgages guaranteed by the VA which were in default. The institution then conveyed the properties to the VA in return for payment, all in accordance with governing statutory procedures. The VA paid, but took about 6 months to do so. The court held that the PPA only applies to the Government's contractual obligations for the purchase of goods and services and not to those obligations which are purely statutory.

The ASBCA employed similar logic to an unusual situation.<sup>385</sup> A contractor entered into a contract with the Syrian Arab Republic to improve the water supply in Damascus. Not long afterward, a truck loaded with explosives crashed into the United States Marine barracks in Beirut, Lebanon. Because of Syria's role in the attack, Congress passed

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<sup>382</sup> The GAO brought its two cited decisions to the attention of Congress during the Amendments hearings. *Amendments to the Prompt Payment Act: Hearings on H.R. 1663 and S. 328 Before a Subcomm. of the House Comm. on Govt. Operations, 100th Cong., 2d Sess. 77-78, 88-89 (1988)*. Since Congress did not modify the act when presented the opportunity, it can be argued that the lawmakers agreed with the Comptroller.

<sup>383</sup> FAR 32.901.

<sup>384</sup> New York Guardian Mortgage Corp. v. United States, No. 90-5043 (Fed. Cir. Oct. 11, 1990).

<sup>385</sup> G.E. Boggs & Assocs., Inc., ASBCA No. 36792 (Oct. 31, 1990).



legislation authorizing a Government agency to adopt certain contracts with Syria as contracts of the United States and to terminate them for convenience. The board denied a request for PPA interest for late payments of invoices submitted to Syria because it reasoned the agency was acting to mitigate the effects of the termination legislation rather than "acquiring property or service from a business concern."

### III. WITHHOLDING

The term "withholding" is often used in its generic sense to include all offset situations where the Government withholds monies from a contract for whatever reason. When used in this manner, the term fails to distinguish between (a) situations where money is withheld from a contract because the Government believes the contractor has not performed its contractual obligations on that particular contract and (b) situations where the money is withheld from one contract to satisfy a Government claim that arose from a totally different contract. This section of the thesis will refer to the offset first described as "withholding" and to the latter as "setoff."<sup>386</sup>

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<sup>386</sup> Others have employed the same terminology to describe this distinction. Thrasher, *Application of the Debt Collection Act of 1982 to Government Contracts*, 29 A.F.L. REV. 133 (1988); J. Cibinic and R. Nash, *ADMINISTRATION OF GOVERNMENT CONTRACTS* 909 (2d ed. 1986).

The term "withholding" is chosen over the closely related, but more restrictive, term "recoupment," since the latter more precisely describes an offset by a defendant to an action. The similarity is noted in BLACK'S LAW DICTIONARY 1147 (5th ed. (1979), which distinguishes the terms "set-off" and "recoupment" in the following manner:

A "set-off" is a demand which the defendant has against the plaintiff, arising out of a transaction extrinsic to the plaintiff's cause of action, whereas a "recoupment" is a reduction or rebate by the defendant of part of the plaintiff's claim

That the Government has both withholding and setoff rights is well established. Its common law right as a creditor to offset debts owed it has been confirmed by the courts and boards as well as the Comptroller General.<sup>387</sup> Going beyond its common law offset rights,<sup>388</sup> the Government has spelled out additional offset authority in numerous FAR provisions to protect itself from damages incurred under a contract. The rights appear both in payment<sup>389</sup> and other clauses.<sup>390</sup>

The following two sections discuss which offsets will trigger contractor entitlement to PPA interest. The first addresses the possible contention that offsets, by their very nature, always trigger PPA interest. The second section takes up the question of whether PPA interest is due when an offset is deemed improper, either because of a procedural defect or because the offset was unreasonably taken. The starting point for both sections is the statute and regulations. As mentioned previously, the PPA does not apply to payments made late or not at all "because of a dispute . . . over the amount of payment or

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because of a right in the defendant arising out of the same transaction. Zweck v. D. P. Way Corp., 70 Wis.2d 426, 234 N.W.2d 921, 924.

<sup>387</sup> United States v. Munsey Trust Co., 332 U.S. 234 (1947) ("the Government has the same right 'which belongs to every creditor, to apply the unappropriated moneys of his debtor, in his hands, in extinguishment of the debts due him'"); Project Map, Inc. v. United States, 203 Ct. Cl. 52, 486 F.2d 1375 (1973); Cotyvan Co., ASBCA No. 24599, 89-3 BCA ¶ 22,129; Gesford P. Wright, Comp. Gen. B-176791, Sept. 8, 1972.

<sup>388</sup> See also U.C.C. § 2-717 (withholding right).

<sup>389</sup> E.g., FAR 52.232-1; 52.232-5; 52.232-7; 52.232-9; and 52.232-16, Progress Payments clause, § (c).

<sup>390</sup> E.g., FAR 52.216-13, Alt I(g); 52.222-7; 52.223-6(d); and 52.227-21(d).

compliance with the contract."<sup>391</sup> Nor does the act apply to amounts temporarily withheld or retained in accordance with the contract.<sup>392</sup>

**A. No Automatic Trigger For Proper Offsets**

Contractors might conceivably argue that setoffs, by their very nature, trigger PPA interest. They would begin by pointing out that the only enumerated exceptions to the PPA for a properly submitted invoice are if the invoice is disputed or is one solely for financing. From that sound foundation, they would argue that if there is no dispute over the dollar amount or contract compliance on construction contract XX, then PPA interest must be paid if a payment on contract XX is set off by a debt the contractor owes on contract YY, since the statute makes no exceptions for setoff.

Some might also argue that the fact that the statute uses the words "the contract" rather than "a contract" in the phrase "dispute . . . over the amount of payment or compliance with the contract" implies an intent to limit the exception to disputes over "the" contract. They might further claim that the legislative history supports this theory.<sup>393</sup>

Taking up the latter argument first, an agency might contend that the more likely reason Congress did not mention disputes arising from any, rather than from a particular, contract was because the lawmakers simply

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<sup>391</sup> See note 163 *supra* and accompanying text.

<sup>392</sup> Circular (Rev.), *supra* note 76, § 7c(3); FAR 32.907-1(f). Only the FAR mentions retainage; however, this difference is insignificant.

<sup>393</sup> S. REP. NO. 97-302, *supra* note 61, at 8 (interest not required if performance not in accordance "with terms of the contract").

did not think about the issue. Having answered the legislative history challenge, an agency might then insist that the proper statutory construction is to view the words "the contract" as only modifying the disjunctive phrase ". . . or compliance with the contract." Had Congress intended "the contract" to modify disputes over "the amount of payment" as well, it would have done so by insertion of commas after the words "payment" and "compliance" so that the phrase would have read, "disputes . . . over the amount of payment, or compliance, with the contract. Such an awkward wording is further evidence Congress could not have intended such an interpretation. Moreover, an agency would point out that the drafters of the Circular and FAR evidently did not interpret the statute as the contractors would, for the Circular uses the words "a contract" rather than "the contract" and the FAR omits an article entirely, stating simply that interest is not due when the dispute is over "issues of contract compliance."<sup>394</sup> In short, an agency could take the position that the PPA exempts from its coverage all disputes over the amount of payment and any setoff is such a dispute.

An agency might also argue that, should the contractor's argument prevail, the current utility of the Government's setoff rights, whether they be common law rights or rights under the Debt Collection Act of 1982,<sup>395</sup> would be severely hampered. Such a result was not intended by the PPA drafters. The Government's setoff rights operate as an efficient mechanism for making the sovereign whole. As an example of what the consequences would be if the PPA automatically applied, assume an

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<sup>394</sup> Circular (Rev.), *supra* note 76, § 7c(1); FAR 32.907-1(f).

<sup>395</sup> 31 U.S.C. §§ 3701 et seq. (1982).

uncontested invoice is for \$100, the debt owed the Government is \$90, and the PPA interest rate is 10 percent. The Government would retain \$90 for the debt owed, thereby creating an interest penalty of \$9. The penalty should then presumably be subtracted from the retained amount, leaving the Government with only \$81 collected on a \$90 debt. Congress certainly did not contemplate such repercussions from the PPA, judging from the absence of any such consideration in the act's legislative history. Moreover, the Thayer<sup>396</sup> doctrine of strictly construing any exceptions to the no-interest rule would undoubtedly be invoked to prevent undermining the Government's long standing common law and recently created statutory rights in the absence of a clear Congressional mandate.<sup>397</sup>

Although this issue has not yet been litigated, the arguments militate against applying PPA interest to routine setoffs. A similar analysis need not be applied to proper withholds, because the retained amounts are necessarily either disputed or are withheld in accordance with the terms of the contract. In either case, they are specifically exempted from PPA coverage.

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<sup>396</sup> *supra* note 24.

<sup>397</sup> An agency could not prevail upon an alternative argument that, in setting off a contractor's debt owed from contract YY against an invoice on contract XX, it is in fact paying the entire XX invoice. To view the setoff transaction as one in which all funds are paid out against invoice XX, thus discharging the Government's obligation, and an instant later sufficient funds to satisfy YY are recaptured, is precluded by the logic in Isthmian Steamship Co., 359 U.S. 314 (1959). Although the suit arose in admiralty, the court considered other contexts before concluding that "withholding and applying" is traditionally considered setoff and not the equivalent of payment.

## **B. Improper Offsets**

While the preceding section suggests setoffs and withholds do not automatically trigger late payment interest, improperly taken offsets require further analysis. Since an improper offset deprives a contractor of a payment which is otherwise uncontested and due, the PPA should arguably apply because the statute requires late payment interest for such invoices.<sup>398</sup> The following discussion separately treats the two broad categories of improper offsets: those which are procedurally defective and those which are unreasonably taken.

### **1. Procedural Defects: Debt Collection Act and FAR 32.6**

Despite the fact that the Government has common law, contractual and statutory rights of offset, the rights are not completely unfettered. The Debt Collection Act (DCA) imposes strict procedural requirements on statutory offsets, on common law offsets, and perhaps on procurement setoffs as well. FAR 32.6 (formerly in DAR Appendix E) also specifies procedural steps for setoffs, but does not implement the DCA.<sup>399</sup> Neither the DCA nor FAR 32.6 apply to withholding. Consequently, the possibility of obtaining PPA interest for violating the procedural requirements of either the DCA or FAR depends on whether the offset is a withhold or a

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<sup>398</sup> See generally Cibinic, *Debt Collection by Offset: What's Wrong*, 1 NASH & CIBINIC REPORT 1, ¶ 5 (1987).

<sup>399</sup> Some of the differences are discussed in Thrasher, *Application of the Debt Collection Act of 1982 to Government Contracts*, 29 A.F.L. REV. 133 (1988), and Fenster & Levy, *New Restrictions on the Government's Right of Administrative Offset*, 17 NAT. CONT. MGT. J. 1 (Winter 1984).

setoff. Before turning to examine the rationale for this difference in treatment, a threshold question regarding the DCA must be addressed -- does the DCA apply to federal procurement contracts?<sup>400</sup>

a. *DCA applicability to procurement contracts*

If the DCA does not apply to procurement contracts, then the Government's failure to follow DCA procedures cannot trigger PPA interest since the offset will not be deemed improper. Writers who have probed the legislative history for an answer have reached opposite conclusions.<sup>401</sup> The district courts are unable to decide the matter because the Tucker Act<sup>402</sup> deprives them of jurisdiction to hear claims founded either on an express or implied contract with the Government.<sup>403</sup> Department of Justice attorneys have urged at the Claims Court that the DCA does not apply, but so far that body has been able to skirt the issue, most recently stating

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<sup>400</sup> FAR 32.6 applicability is obviously not an issue.

<sup>401</sup> Compare Thrasher, *supra* note 399, ("Nothing in the language of the Act or its legislative history indicates it was intended to apply to government contracts. . . . [The DCA was] adopted primarily to facilitate recovery of outstanding amounts due under federal student loan programs"); with Fenster & Levy, *supra* note 399, ("[N]othing in the [DCA] evidences an intent to exclude Government contracts from the act's coverage"); and Cibinic, *Debt Collection by Offset: What's Wrong*, 1 NASH & CIBINIC REPORT 1, ¶ 5 (1987) ("Although the Act was not targeted at procurement contracts and there is no record of their mention in the legislative history, it does not exclude debts owed by contractors from its coverage and there is no reason to treat a contractor differently from any other person from whom the Government is seeking to offset a claim").

<sup>402</sup> 28 U.S.C. § 1346 (1986).

<sup>403</sup> *Id.* § 1346(a)(2). U.S. Trading Corp. v. United States, No. 90-1779-LFO (D.D.C. Sept. 10, 1990), 36 CCF 75,941; Spectrum Leasing Corp. v. United States, 764 F.2d 891 (D.C. Cir. 1985).

that the question is a "novel" one.<sup>404</sup> The GSBICA position is also uncertain, since the issue was avoided in the two cases it heard by findings that the DCA was inapplicable for other reasons.<sup>405</sup> The ASBCA is the only tribunal to have ruled on the question. The board has held that the DCA does apply to procurement contracts;<sup>406</sup> however, as discussed below, it might be moving away from that view.

*b. withholding: PPA interest unavailable*

Even assuming the DCA applies to procurement contracts, it only applies to the collection of debts.<sup>407</sup> The Claims Court has flatly ruled that the DCA does not pertain to withholding, stating, "The kind of debts targeted by the Debt Collection Act are not intra-contractual disputes."<sup>408</sup> The court reasoned withholding was more in the nature of contract administration than collection of a debt. Furthermore, the court did not distinguish withholdings which are pursuant to a specific contract clause from those which are based upon inadequate performance, such as the case it adjudicated.

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<sup>404</sup> Cecile Indus. v. United States, 18 Cl. Ct. 730 (1989).

<sup>405</sup> See Sam's Elec. Co., GSBICA Nos. 9359, 10044, 90-3 BCA ¶ 23,128; Information Consultants, Inc., GSBICA Nos. 8130-COM, 8528-COM, 86-3 BCA ¶ 19,198.

<sup>406</sup> The seminal case is DMJM/Norman Eng'g Co., ASBCA No. 28154, 84-1 BCA ¶ 17,226.

<sup>407</sup> Administrative offsets as defined by the DCA apply only to offsets by the Government "to satisfy a debt." 31 U.S.C. § 3701(a)(1).

<sup>408</sup> Avco Corp. v. United States, 10 Cl. Ct. 665 (1986), cited with approval in Cecile Indus. v. United States, 18 Cl. Ct. 730 (1989).



In contrast, the boards have not made such a sweeping exclusion. In all the cases to date, the boards have declined to apply the DCA to intra-contractual offsets, but in each case the withholding was under a specific clause.<sup>409</sup> Since the ASBCA cases have focused on the importance of the contract clause allowing the withholding, that body has not foreclosed a ruling that the DCA applies if there is no clause. However, even if the DCA did apply in this situation, the withholding would presumably be because of a contractor's deficient performance -- a cause for which the PPA expressly does not apply.

FAR Subpart 32.6 is similar to the DCA in the sense that it, too, applies only to the collection of debts. This limited scope is indicated by the provision's title, "Contract Debts." Because the provision does not pertain to withholding, failure to abide by it cannot trigger PPA interest.

*c. setoff: PPA interest perhaps available*

As indicated above, the ASBCA might be retreating from its position that the DCA applies to procurement contracts. Although the board ruled in its three earliest decisions involving the DCA that the statute applied

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<sup>409</sup> Sam's Elec. Co., GSBGA Nos. 9359, 10044, 90-3 BCA ¶ 23,128; Allied-Signal Aerospace Co., ASBCA No. 37248, 90-1 BCA ¶ 22,448; Information Consultants, Inc., GSBGA Nos. 8130-COM, 8528-COM, 86-3 BCA ¶ 19,198; A.L. Fowler Corp., ASBCA No. 28965, 86-2 BCA ¶ 18,970; Fairchild Republic Co., ASBCA No. 29385, 85-2 BCA ¶ 18,047, *aff'd on reconsid.*, 86-1 BCA ¶ 18,608, *dismissed for lack of jurisdiction*, 810 F.2d 1123 (Fed. Cir. 1987).

to setoff,<sup>410</sup> it subsequently took the opposite view in the withholding cases.<sup>411</sup> Moreover, the board has also ruled that a setoff on contract XX was not subject to the DCA because the debt on contract YY was pursuant to a contract clause.<sup>412</sup>

If the DCA is ultimately held to apply, PPA interest should be due when DCA procedures are ignored. The previously described contention, that an award of PPA interest for proper offsets would undercut the utility of the DCA to an agency, loses persuasiveness when the agency fails to comply with the statute.

Perhaps a tribunal will award PPA interest for a failure to follow the FAR 32.6 procedures. However, it seems far more likely that PPA interest would be disallowed. Waivers of sovereign immunity are construed narrowly. Enlargement of the PPA waiver by a regulation -- which is not based on a specific statute -- is improbable.

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<sup>410</sup> IBM Corp., ASBCA No. 28821, 84-3 BCA ¶ 17,689; Pat's Janitorial Service, Inc., ASBCA No. 29129, 84-3 BCA ¶ 17,549; DMJM/Norman Eng'g Co., ASBCA No. 28154, 84-1 BCA ¶ 17,226.

<sup>411</sup> Allied-Signal Aerospace Co., ASBCA No. 37248, 90-1 BCA ¶ 22,448; A.J. Fowler Corp., ASBCA No. 28965, 86-2 BCA ¶ 18,970; Fairchild Republic Co., ASBCA No. 29385, 85-2 BCA ¶ 18,047, *aff'd on reconsid.*, 86-1 BCA ¶ 18,608, dismissed for lack of jurisdiction, 810 F.2d 1123 (Fed. Cir. 1987).

<sup>412</sup> B&A Elec. Co., ASBCA No. 33667, 88-2 BCA ¶ 20,533 (contract clause implemented the Davis-Bacon Act).

## 2. Unreasonably Taken Offsets

Aside from any procedural concerns, an offset is unreasonable for PPA purposes if it does not fall within one of the exemptions from payment spelled out in the PPA and its regulations. To reiterate, the PPA does not apply to (a) "dispute[s] . . . over the amount of payment or compliance with the contract"<sup>413</sup> or to (b) amounts temporarily withheld or retained in accordance with the contract.<sup>414</sup>

The issues in this area can be clustered into three broad categories. The initial question is whether a dispute for PPA purposes actually exists. Second, the cases dealing with withholding that are not authorized by the terms of the contract are covered. Finally, the manner in which the boards treat excessive withholding is examined.

### a. withholding not based on true disputes

Various boards have explicitly invoked the "disputes" exemption to deny late payment interest.<sup>415</sup> In addition, at least one decision implicitly applied the exemption to reject a claim for the penalty. On

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<sup>413</sup> 31 U.S.C. § 3907(c) (1988); Circular (Rev.), *supra* note 76, §§ 7c(1), 13a(3); FAR 32.905(a)(1)(ii), 32.907-1(f).

<sup>414</sup> Circular (Rev.), *supra* note 76, § 7c(3); FAR 32.907-1(f).

<sup>415</sup> *E.g.*, Toombs & Co., ASBCA Nos. 35085, 35086 (Sept. 18, 1990); EMS, Inc., GSBICA Nos. 9588, 9971, 90-2 BCA ¶ 22,876; Singleton Contracting Corp., GSBICA No. 7429, 85-2 BCA ¶ 18,124; Jen-Beck Assocs., VABCA Nos. 2107 *et al.*, 87-2 BCA ¶ 19,831 (only noted the rule); Green Planting Co., AGBICA Nos. 85-195-3, 85-288-3, 86-2 BCA ¶ 18,808; Ross Plumbing and Heating Co., Inc., HUDBCA No. 85-932-C7, 85-3 BCA ¶ 18,478; Lemar Constr. Co., ASBCA No. 28880, 84-2 BCA ¶ 17,373.

a construction contract, the contracting officer withheld a portion of the progress payments because he believed the paving aggregate supplied did not meet specifications. Although the board found that the aggregate did satisfy specifications, it rejected without discussion the contractor's clear demand for PPA interest.<sup>416</sup>

Where a contracting officer's decision to withhold because of a disagreement is sustained on appeal, the existence of a true dispute is obvious. However, where a tribunal sides with the contractor and grants CDA interest, the case law is not altogether clear as to whether PPA interest is due as well.

The Claims Court has perhaps done the best job of expressing the rationale for granting or denying PPA interest when the Government loses on appeal. In Arkansas Best Freight System, Inc. v. United States,<sup>417</sup> the agency questioned the validity of some invoices and asked the GAO for a decision. After the GAO opined that they were valid, the agency began examining the invoices to determine whether each one came within the bounds of the opinion. It did not pay the invoices during the review period and argued to the court that reviewing the invoices to determine whether there was a basis for rejection amounted to a dispute within the meaning of the PPA. The court rejected that argument, stating, "If the [PPA] penalty provisions mean anything, they must mean that there has to be a present basis for delaying payment which is related to an objectively discernable dispute."<sup>418</sup> In reaching this judgment, the court relied in

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<sup>416</sup> Alaska Unlimited Co., ASBCA No. 32593, 89-2 BCA ¶ 21,814.

<sup>417</sup> 20 Cl. Ct. 776 (1990).

<sup>418</sup> *Id.* at 779 (emphasis added).

part on the legislative history wherein the Committee stated that it intended "any questions concerning the amount of an invoice or the performance of a contract [to] be raised in *good faith*, in order to establish a *bona fide* dispute."<sup>419</sup>

Three conclusions can be drawn from the Claims Court's language in Arkansas Best Freight System. First, a true, bona fide dispute must be based on an objective standard. Second, although the dispute must be objectively discernable, the contracting officer need not win the dispute. He or she need only satisfy the subjective standard of good faith. Third, both the objective and subjective standards are measured at the time the contracting officer decides to withhold. Thus, the award of PPA interest for an offset which is eventually adjudicated improper is not a foregone conclusion; it should only be awarded when there is no colorable basis for the contracting officer's decision. The focus shifts now to the extent to which five of the boards have complied with this rationale.

The ASBCA's only case was the one already mentioned dealing with potentially noncompliant paving aggregate. The board reached the right result since there was significant evidence supporting the Government's position, even though it lost.<sup>420</sup>

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<sup>419</sup> H.R. REP. No. 97-461, *supra* note 61, at 15 (emphasis added).

<sup>420</sup> Despite the paucity of case law, however, there is some evidence that the ASBCA might agree with the Claims Court's "good faith" standard. In Toombs & Co., ASBCA Nos. 35085, 35086 (Sept. 18, 1990), the contracting officer withheld a portion of a progress payment because he disagreed with the contractor's estimated percentage of completion achieved. The contractor did not claim the decision was incorrect but it did claim PPA interest on the withheld amount. The board denied PPA interest, noting there was a "good faith dispute" as to the percentage of completion.

The same cannot be said of the GSBGA, which has recently faced the issue three times. In Al-Henco Enterprises,<sup>421</sup> the agency held up payment on a \$8200 invoice dated June 10 because two individuals appeared underpaid by about 45 cents an hour and a wage determination was missing for a third individual. The payroll discrepancies were corrected on June 22 but the invoice went unpaid until August 6. The board acknowledged the disputes exemption in the PPA but characterized the payroll problem as a "minor discrepancy" and awarded PPA interest from the 10th of June.<sup>422</sup> Nothing in the statute or regulations distinguishes between major and minor disputes. No doubt the Agency should have paid the majority of the invoice that was not in dispute, but it should not have been penalized for withholding a small amount commensurate with the contractor's error.

In EMS, Inc.,<sup>423</sup> the Government withheld \$4000 from the final invoice because the Government believed the contractor had failed to submit the proper documentation as required by the PPA and the terms of the contract. The board ruled the documentation was proper, placing great weight on the fact that the Government never notified the contractor, as required by the act, that it considered the invoice defective. The board granted the PPA interest claim; it did not mention why the documentation disagreement was not a dispute. Perhaps the case stands for the proposition that failure

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<sup>421</sup> GSBGA No. 9673 (Sept. 17, 1990).

<sup>422</sup> Even if the Government were unjustified in delaying payment the board should not have granted PPA interest from June 10; interest should not have begun accruing until the payment was late, i.e., 30 days after receipt of the invoice. In addition to this error, the board awarded PPA interest until the date of payment, when in fact PPA interest should have ceased and been replaced by CDA interest four days previously when the claim was filed.

<sup>423</sup> GSBGA Nos. 9588, 9971, 90-2 BCA ¶ 22,876.

to give notice of a defective invoice is proof the contracting officer's position was totally without merit. If so, the decision is defensible. But if the decision reflects a belief that there cannot be a true dispute over whether an invoice is proper, the case is wrong. Not only would such a view be at odds with the statute, it would ignore the rule stated even in a non-PPA context that the Government is entitled to adequate invoice documentation.<sup>424</sup>

The third GSBICA case is Atlas Construction Co.<sup>425</sup> The contracting officer withheld payments based on a failure to make progress. The contractor argued the delay was excusable, citing multiple change orders and differing site conditions. After weighing the evidence, the board sided with the contractor and held the withholding to be "unreasonable;" it also granted PPA interest. This decision sets clearly bad policy. The facts show the contracting officer had at least a colorable reason for taking the withholding. A board which characterizes every wrong contracting officer decision as *unreasonable* effectively negates the statutory disputes exemption. The focus should not be on whether the final decision is ultimately adjudicated wrong, but rather on whether the contracting officer had a good faith basis for the decision at the time the decision was made.

The position taken by the VABCA in Monarch Enterprises, Inc.<sup>426</sup> is not totally clear. After the agency paid all but \$5.24 of an invoice for

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<sup>424</sup> See Building Maint. Specialists, ASBCA No. 29814, 86-3 BCA ¶ 19,236.

<sup>425</sup> GSBICA Nos. 7903 et al., 90-2 BCA ¶ 22,812.

<sup>426</sup> VABCA Nos. 2239, 2296, 86-3 BCA ¶ 19,281.

December 1984 work, the contractor submitted a claim the following April for various disputes, including the \$5.24. At first the agency responded that its records showed the sum had been paid, but later during litigation conceded it had not been. The board granted interest on the \$5.24, but calculated it from January 1985. It did not specify whether it was PPA or CDA interest. Arguably, it was the former, since CDA interest can only run from the time a claim is submitted -- in this case April. To have been PPA interest, one must assume, since there is no mention in the case, that the contractor demanded PPA interest in his claim to the contracting officer, else the board would have lacked jurisdiction.<sup>427</sup> If it were PPA interest, perhaps the VABCA took a position similar to that of the GSEBCA in Al-Henco Enterprises,<sup>428</sup> namely, that small amounts in dispute are not true PPA disputes. Or perhaps it saw evidence which showed the agency frivolously made its initial assertion that it had already paid. Only the latter rationale would be correct.

The HUD Board has also promulgated a questionable decision, but this one works to the prejudice of contractors. The contractor in Ross Plumbing and Heating Co.<sup>429</sup> requested a final decision from the contracting officer regarding the withheld amount. The contracting officer then failed to issue the decision within the 60 days required by the CDA. The board reasoned no PPA interest was due because the failure to issue a timely decision was an implicit denial which of itself "established the

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<sup>427</sup> See note 258 *supra* and accompanying text.

<sup>428</sup> GSEBCA No. 9673 (Sept. 17, 1990).

<sup>429</sup> HUDBCA No. 85-932-C7, 95-3 BCA ¶ 18,478.



disputed status of those claims."<sup>430</sup> It reached this conclusion even though the Government eventually conceded on some of the claims!<sup>431</sup> Beyond the fact that the board's reasoning completely fails to assess the reasonableness of the contracting officer's decision at the time it was made, the board's logic is flawed because it could totally gut the PPA. Merely by waiting at least 61 days to issue a final decision, contracting officers could in every case invoke the disputes exemption to avoid interest. For example, suppose an agency withholds payment for no reason and 4 months later a contractor requests a final decision. According to Ross, a "smart" contracting officer who issues the decision 61 days later would only have to pay 61 days of CDA interest. A "not-so-smart" colleague who issues the decision only 50 days after the request would have to pay 50 days of CDA interest plus approximately 3 months of PPA interest if the contractor prevails upon the ground that the withholding was meritless. No other decisions have followed the Ross rationale.

The AGBCA correctly decided the two cases it heard. In Green Planting Co.,<sup>432</sup> it denied PPA interest even though it ruled the contracting officer's decision to withhold was improper; there was sufficient evidence to show there was some merit to the initial decision. In contrast, the board granted PPA interest in W. Huffman<sup>433</sup> because even the contracting officer admitted his initial decision to withhold was unreasonable.

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<sup>430</sup> *Id.* at 92,819.

<sup>431</sup> *Id.*

<sup>432</sup> AGBCA Nos. 85-195-3, 85-288-3, 86-2 BCA ¶ 18,808.

<sup>433</sup> AGBCA No. 84-203-1, 87-1 BCA ¶ 97,861.

*b. withholds not in accordance with the contract*

Two ASBCA cases have held PPA interest is payable when no contract provision authorizes the withhold (and assuming there is no dispute). In the first case,<sup>434</sup> the Government withheld \$100 from an invoice after the contractor had already completed the work in order "to keep the contract open pending finalization" of a change order. The agency contended the "Payments to Contractor" clause authorized its action. The board disagreed, stating that neither that clause nor any other authorized withholding money to keep a contract open.

In the more instructive Steven E. Jawitz,<sup>435</sup> the Department of Labor (DOL) investigated the contractor for a possible \$1188 underpayment to a subcontractor and other labor standard irregularities. The contract contained a Withholding of Funds clause which permitted temporary withholding while the DOL conducted the Davis-Bacon Act investigation. Based on that clause, the contracting officer withheld \$4500. After the DOL determined there had been neither an underpayment nor any other violation, the agency paid the \$1188 but inexplicably continued to withhold the remaining \$3312 for more than 45 days. The board granted PPA interest on the \$3312 since the agency no longer had a contractual basis for withholding the funds.<sup>436</sup> In contrast, it did not award interest on the \$1188 because it was part of the originally withheld amount, which was not "excessive or unreasonable in view of the then known

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<sup>434</sup> Ricway, Inc., ASBCA No. 30205, 86-1 BCA ¶ 18,539.

<sup>435</sup> ASBCA No. 33610, 87-3 BCA ¶ 20,011.

<sup>436</sup> *Id.* at 101,333.

circumstances."<sup>437</sup> The focus on the circumstances known at the time of the decision is the correct test.

It is not certain whether the Transportation Board agrees with the ASBCA. In TEM Associates, Inc.,<sup>438</sup> the contracting officer did not pay an invoice after completion of a cost reimbursement contract because he was awaiting a post-performance audit to determine the final overhead rates. The board ruled the withholding a material breach, reasoning there was "no applicable contractual authority for the contracting officer to withhold payments under the specific terms of the contract." Whether the board granted PPA interest is unclear, but presumably it did not since it explicitly granted CDA interest. Moreover, in so doing it noted that the CDA terminates "the running of any interest which *might* be payable under the Prompt Payment Act."<sup>439</sup> Why PPA interest was not given was not explained. Perhaps the invoice was for interim payments, which under cost reimbursement contracts are financing and not subject to the PPA.<sup>440</sup> However, if the invoice was for final payment, then PPA interest should have been paid. If the Transportation board has parted from the ASBCA, it should rejoin at the next opportunity.<sup>441</sup>

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<sup>437</sup> *Id.* at 101,329.

<sup>438</sup> DOT BCA No. 2024, 89-1 BCA ¶ 21,266.

<sup>439</sup> *Id.* at 107,223 (emphasis added).

<sup>440</sup> See the discussion beginning at page 139, *infra*.

<sup>441</sup> No indication of the board's inclination can be gleaned from its only other case involving a withholding not authorized by a contract clause. In footnote 3 of Security Associates International, Inc., DOT CAB Nos. 1340, 1432, 84-2 BCA ¶ 17,444, the board asked whether the PPA would apply to funds improperly withheld for possible Service Contract Act violations. The question was purely theoretical, for the contract was awarded prior to 1982.

c. *excessive withholding*

Even assuming there exists a valid dispute over the amount of money due or contract compliance or that a withhold is clearly permitted by the contract, the amount withheld should be reasonable. Moreover, reasonableness for PPA purposes rather than CDA purposes should be determined as the Claims Court and ASBCA have indicated, i.e., in view of the circumstances known at the time of the contracting officer's decision.<sup>442</sup> Under this standard, an excessive withholding should trigger PPA interest. In effect, an invoice should be treated as a severable document. For example, if an invoice is for \$50,000 and the disputed amount is only \$10,000 or the contract clause only allows withholds up to \$10,000, then the PPA should apply to any amounts withheld in excess of \$10,000. The following discussion examines how three different boards, the VA, Interior, and Armed Services Boards, have dealt with this issue.<sup>443</sup>

In Southland Construction Co.,<sup>444</sup> the contracting officer paid no portion of a progress payment because she feared the contractor's surety might have a competing claim for the money. At the time of the invoice

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In a case where the withholding was clearly allowed by the contract and the amount retained was less than the clause permitted, the board rejected a claim for PPA interest. Mark Smith Constr. Co., Inc., DOT BCA No. 2044, 90-1 BCA ¶ 22,445.

<sup>442</sup> See Arkansas Best Freight System, Inc. v. United States, 20 Cl. Ct. 776 (1990); Steven E. Jawitz, ASBCA No. 33610, 87-3 BCA ¶ 20,011.

<sup>443</sup> A fourth board, the AGBCA, has not confronted the issue but did query "whether the Prompt Payment Act applies to a portion of an invoice." Green Planting Co., AGBCA Nos. 85-195-3, 85-288-3, 86-2 BCA ¶ 18,808.

<sup>444</sup> VABCA No. 2543, 89-1 BCA ¶ 21,548.

denial, she was withholding approximately \$30,000, of which \$16,000 was retainage and \$4000 represented liquidated damages. The VA Board focused on the Payments to Contractor and Defaults clauses, as both permit withholding to protect the Government's interest. It concluded these clauses allow the contracting officer to withhold only a reasonable amount. Since the contracting officer (1) gave no explanation of why she withheld \$30,000 rather than \$20,000, (2) took none of the steps set forth in the Defaults clause prior to deciding not to pay anything, and (3) had not been informed by the surety or any other creditor that Southland had outstanding obligations, the board found the contracting officer's decision unreasonable. It then awarded PPA interest on the \$10,000.<sup>445</sup>

While the board reached the correct conclusion, it did not explain its leap from finding the contracting officer's decision unreasonable to deciding the PPA applied. A defensible rationale is that a limitation of reasonableness, measured at the time of the decision (which the board did), properly balances the interests of both contractors and the Government. Without such a limitation, an agency could withhold any amount, no matter how patently excessive, and frivolously claim the amount was in dispute and thus thwart the PPA's purpose. On the other hand, without the protection of a reasonableness standard, every contracting officer decision which might ultimately be deemed erroneous (even if by a 51-49 preponderance) would trigger PPA interest. Such a result could perhaps lead contracting officers to withhold amounts inadequate to

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<sup>445</sup> *Id.* at 108,457-58.

protect the Government's interest in their zeal to avoid overwithholding penalties. The compromise struck in Southland is decidedly correct.

In Columbia Engineering Corp.,<sup>446</sup> the contracting officer withheld \$50,000 for potential labor violations while it referred the matter to the Department of Labor (DOL) for a determination. A little more than a year later, the DOL determined the contractor owed additional Davis-Bacon Act wages of only \$5,965.34. The Interior Board ruled PPA interest was due because the withholding was "so excessive as to have been arbitrary and capricious." It considered the fact that the labor specialist on whom the contracting officer relied was relatively inexperienced and had made only one site visit to the contractor.

While the board cannot be faulted for finding the withholding excessive, it should be criticized for not trying to determine *how much* was unreasonably excessive. Instead, it awarded PPA interest on every dollar withheld over the DOL determination. In its words,

[W]e have specifically found that the amount withheld by the CO was unreasonable. That being the case, we decline to speculate on how much the CO *might* reasonably have withheld in this case; rather, we find that, of the \$50,000 withheld, only the \$5,965.34 that was ultimately determined to be owed should be considered reasonable, and that therefore only that amount was in dispute.<sup>447</sup>

Why did the board specifically refuse to determine the amount that could have been reasonably withheld, an amount which it implicitly recognized could be greater than the \$5,965.34? If the board will not decide, who will? By this abdication, the Interior Board holds contracting officers

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<sup>446</sup> IBCA Nos. 2351, 2352, 88-2 BCA ¶ 20,595.

<sup>447</sup> *Id.* at 104,091 (emphasis original).

to "speculate" in advance to the same degree of precision that can only be determined by hindsight.

Although the Interior Board should have determined the amount that the agency could have reasonably withheld, at least it recognized the principle that excessive withholding can trigger PPA interest. The ASBCA apparently does not share that view. Until recently, the ASBCA's position was uncertain,<sup>448</sup> but now the board has tipped its hand and has indicated in dicta that it will not award PPA interest for excessive withholds. In Walsky Construction Co.,<sup>449</sup> the facts are similar to those of other cases: the agency withheld the entire amount from an invoice. The contractor then sought PPA interest on the excessive withholding and cited Columbia Engineering for authority. Although the board agreed that only a portion of the withhold was reasonable, it saw "no merit" to the PPA claim.<sup>450</sup> The board could not make that ruling, however, since the contractor raised the PPA claim for the first time on appeal and the board was thus deprived of jurisdiction.<sup>451</sup> When the ASBCA does get the opportunity to decide this issue in a concrete case, it ought to reverse the stance it has forecast.

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<sup>448</sup> There are several cases in which PPA interest arguably could have been granted; however, there is no indication the contractors asked for it. E.g., Santa Fe Eng'rs, Inc., ASBCA No. 31686, 90-1 BCA ¶ 22,490; DeKonty Corp., ASBCA No. 32,140, 89-2 BCA ¶ 21,586; Martin Marietta Corp., ASBCA No. 31248, 87-2 BCA ¶ 19,975.

<sup>449</sup> ASBCA No. 37753, 90-3 BCA ¶ 23,092.

<sup>450</sup> *Id.* at 115,954.

<sup>451</sup> *Id.*

#### IV. TYPES OF PAYMENTS COVERED BY THE ACT

##### A. Overview

Not all types of payments are covered by the PPA. The statute only applies to payments for "complete delivered items of property or service."<sup>452</sup> Such language has elicited the comment that, "ostensibly, the act has no application to late progress payments based on incurred costs. The applicability to other types of progress payments or to payments under cost reimbursement contracts is less certain."<sup>453</sup> Although more than eight years have passed since the PPA first took effect, some uncertainty regarding the extent of statutory coverage still exists. This is due partly because the regulations have decreed that payments made for "financing" are not subject to the PPA<sup>454</sup> without adequately defining that term and partly because of the paucity of decisional law. To explain the "financing runaround," as it has been called, requires an "expedition into

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<sup>452</sup> 31 U.S.C. § 3902(a) (1988) (emphasis added).

<sup>453</sup> J. Cibinic and R. Nash, *ADMINISTRATION OF GOVERNMENT CONTRACTS* 895 (2d ed. 1986).

<sup>454</sup> Circular (Rev.), *supra* note 76, §§ 2a, 7c(2); FAR 32.907-2. However, section 7c(2) of the Circular does allow interest for late financing payments made pursuant to 31 U.S.C. §§ 3902(h)(1) and (h)(2), which concern payments to farmers pursuant to an agreement entered into under the Agricultural Act of 1949.

The "complete delivered" language of the statute, on which the PPA regulatory concept of financing is based, carries with it the idea that the goods or services must be first accepted by the Government before the penalty can apply. Both regulations highlight the crucial importance of acceptance. The Circular states, "Interest may only be paid after acceptance has occurred." Circular (Rev.), *supra* note 76, § 7b(1). Similarly, FAR 32.902 defines payments made prior to acceptance as financing payments and those made after acceptance as invoice payments; only the latter are subject to the PPA.



the land beyond the looking glass."<sup>455</sup> To assist the journey, a bottom-line summary of which payments are covered by the PPA and which are not is tabulated here.

TABLE OF COVERED VS. NON-COVERED PAYMENTS

- \* Advance Payments -- no
- \* Progress Payments
  - \*\* based on a percentage or stage of completion
    - \*\*\* construction contracts -- yes
    - \*\*\* architect-engineer contracts -- yes
    - \*\*\* shipbuilding contracts -- perhaps
    - \*\*\* other contracts -- no
  - \*\* based on costs -- no
- \* Payments on Cost Reimbursement Contracts
  - \*\* final payment -- yes
  - \*\* interim payment -- no
- \* Payments for Partial Deliveries Accepted by the Govt. -- yes

**B. Financing**

The term "financing" has been generally thought to include advance payments, guaranteed loans, and progress payments based both on a percentage of incurred costs and on a percentage of completion.<sup>456</sup> It has

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<sup>455</sup> Cibinic, Prompt Payment Act: The "Financing" Runaround, 2 NASH & CIBINIC REPORT 3, ¶ 15 (1988). For a companion article, see Nash, Prompt Payment of Progress Payments, 1 NASH & CIBINIC REPORT 8, ¶ 65 (1987).

<sup>456</sup> FAR 32.102; SF 1411, Block 11B, FAR 53.301-1411; J. Cibinic and R. Nash, ADMINISTRATION OF GOVERNMENT CONTRACTS 884-893 (2d ed. 1986); GOVERNMENT CONTRACTS REPORTER (CCH) ¶ 26,000; Chierichella, Oliver, Everhart, and Villet,

even been applied to certain partial payments, although such payments are usually treated as a method of payment rather than as a method of contract financing.<sup>457</sup> Despite this general understanding, however, the term takes on specialized meaning within the PPA context. This variance between the common and special usage has caused considerable confusion.

#### 1. Progress Payments

The original Circular did nothing to remove the uncertainty regarding PPA applicability to progress payments since it did not explicitly differentiate between progress payments based on costs and those based on a percentage or stage of completion. In its draft form it instead equated all types of progress payments with *financing* and proposed to exclude from PPA coverage *progress payments that were made solely for financing*.<sup>458</sup>

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*Financing Government Contracts*, 7 BPC 311 (Briefing Papers #86-7) (cited hereinafter as 7 BPC 311); Defense Financial and Investment Review, at IV-1 (1985); General Accounting Office, *The Federal Government's Bill Payment Performance Is Good But Should be Better*, GAO/FGMSD 78-16, at 9 (Feb. 1978). Sources which do not discuss all three aspects but which support the general understanding that all progress payments are considered financing include: 10 U.S.C. § 2330, Integrated Financing Policy (Section 2330(a)(2)(A) applies to "policies relating to progress payments or other financing by the [DoD]. . . "); DAC 76-42, 48 Fed. Reg. 28826-01 (1983) (memo dated January 4, 1983, from the Deputy Under Secretary of Defense (Acquisition Management) stating, "All existing and new contracts which contain financing provisions (advance payments, progress payments or cost reimbursement provisions . . . ").

<sup>457</sup> FAR 32.102(d); 7 BPC 311, *supra* note 456, at 312; Baker and Davis, *Government Contract Financing -- Balancing Contractor Need Against Government Cost*, 17 NAT. CONT. MGT. J. 7 (1984).

For a discussion of the confusion that exists between progress payments and partial payments, see Meador, *Financing Government Contracts with Progress Payments*, 18 A.F.L. REV. 1 (Winter 1976).

<sup>458</sup> 47 Fed. Reg. 29620 (1982).

However, the final version dropped the reference to progress payments and instead said only "payments . . . made solely for financing purposes" cannot trigger an interest penalty.<sup>459</sup> The retreat from *progress payments* to simply *payments* left the implication that OMB intended for progress payments to be treated differently from payments that were "solely for financing." Of course no light was shed on *which* progress payments were to be treated differently -- were all progress payments to be subject to the PPA or only those which were not "solely for financing"?

OMB later attempted to dispel the confusion with an attachment to the Circular. That attempt was unsuccessful for two reasons. On the one hand, again no explicit differentiation was made between progress payments based on costs and those based on a percentage or stage of completion. The proposed attachment continued to equate all progress payments with financing, stating that payments made before the receipt of goods or services may be "referred to as progress payments, contract financing, advances, or prepayments."<sup>460</sup> The final edition of the attachment did the same.<sup>461</sup> On the other hand, the attachment carried the conflicting signal that progress payments were subject to interest payments under the PPA, as it stated that a progress payment request "shall be considered receipt of an invoice."<sup>462</sup>

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<sup>459</sup> Circular (1982), *supra* note 74, § 8C.

<sup>460</sup> 48 Fed. Reg. 40582-01 (1983).

<sup>461</sup> Attachment to Circular No. A-125, 49 Fed. Reg. 28140 (1984) ("Questions were raised, however, regarding the applicability of the Circular to *progress payments and other types of contract financing* that are provided before receipt of goods and services" (emphasis added)).

<sup>462</sup> *Id.* at 28141.

Most agencies read such muddled "guidance" and focused on the language equating progress payments with financing; they elected to specify in their implementing regulations that all progress payments were made solely for financing and thus were not subject to late payment penalties. In contrast, some commentators concentrated on the language stating receipt of a progress payment request is considered receipt of an invoice and concluded no progress payments were made solely for financing and instead were all subject to the PPA.<sup>463</sup>

a. *progress payments on construction contracts*

A portion of the puzzle was finally sorted out by the Armed Services Board in Zinger Construction Co.<sup>464</sup> The US Army Corps of Engineers argued that its failure to pay two progress payment requests on time on a construction contract that was not yet completed did not trigger a penalty because the payments were made for financing purposes. It reasoned that, since the contractor had not yet finished the work, the payments were not for "complete delivered" items of property or services as required by the statute and therefore must be solely for financing.<sup>465</sup>

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<sup>463</sup> 7 BPC 311, *supra* note 456, at 322.

<sup>464</sup> ASBCA No. 31858, 87-3 BCA ¶ 20,043. Accord Batteast Constr. Co., ASBCA No. 34420, 87-3 BCA ¶ 20,044.

<sup>465</sup> The position taken by the Corps at the board had not always been its viewpoint. Initially, the Corps had considered progress payments under construction contracts to be payments for completed work since the payment amounts were based on estimates of project completion and the corresponding dollar value. However, by the time of Zinger's claim, the Corps had changed its position to be consistent with DoD-wide policy. DoD regulations had categorized construction progress payments, along with all other progress payments, as those made "solely" for financing. A

The contractor countered by pointing to a different part of the statute. The PPA allowed interest for late payments when property or services were provided "in a series of partial executions."<sup>466</sup> It argued that construction progress payments cannot be financing since they are received at least 60 days after a portion of the work has been completed and so they must be payments for partial execution of work. The Corps responded by arguing that even partial executions must be for completed work and that, as the whole construction job was not yet completed, the periodic payments were purely a form of financing.

The board sided with the contractor and held that the PPA applies to late progress payments in construction contracts. Three factors accounted for this conclusion. First, the board opined that the Circular's attachment would be rendered "superfluous and meaningless" if no progress payments were subject to the PPA.<sup>467</sup>

Second, if some progress payments were subject to the PPA, the obvious next query was to determine what type of progress payments could trigger the interest penalty. For an answer, the board looked to the acquisition regulations. Although the FAR had not yet implemented the PPA, the board noted that FAR Part 32 on contract financing distinguished progress payments based on costs from those based on percentage of completion. Those payments based on percentage of completion, such as construction contracts, were specifically not covered by the financing provisions. The

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summary of the DoD policy letters and instructions is set out in the Zinger decision. See 87-3 BCA ¶ 20,043 at 101,474.

<sup>466</sup> 31 U.S.C. § 3903(4) (1982); revised at 31 U.S.C. § 3903(5) (1988) ("periodic" payments).

<sup>467</sup> 87-3 BCA ¶ 20,043 at 101,477.

board reasoned that, since the latter type of payments represent compensation for work "that has been performed and is in place as in construction projects and shipbuilding," they are not "solely" for financing.<sup>468</sup>

Third, and most important, the board's rationale rested on Congressional intent. It looked primarily to the then-pending legislative proposals which later became the 1988 Amendments. Pertinent language from the analysis accompanying Senate Bill 328, on which the board relied, is set out below:

*Section 5. Interest Penalties on Progress Payments and Retained Amounts Under Construction Contracts*

This section makes explicit the intent of the Prompt Payment Act that progress payments under construction contracts are subject to the Act's requirements and protections. Despite explicit legislative history in the reports accompanying [the 1982 Act] that progress payments fall within reach of the Act's provision affording coverage for partial executions if authorized by the contract (31 U.S.C. 3903(4)), most agencies have determined by regulations that construction progress payments are "payments . . . made solely for financing purposes", which are exempt from coverage under OMB Circular A-125 (Para.8(c)).<sup>469</sup>

Zinger makes clear that progress payments on construction contracts are subject to the PPA -- they are periodic payments for partial executions or delivery rather than financing payments.<sup>470</sup> The GSBICA recently concurred with the ASBCA's decision based on the following reasoning:

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<sup>468</sup> *Id.*

<sup>469</sup> *Id.* at 101,476-77, quoting S. 328, 133 CONG. REC. S895, 898 (daily ed. Jan. 20, 1987).

<sup>470</sup> The ASBCA in Steven E. Jawitz, ASBCA No. 31173, 86-1 BCA ¶ 18,546, had previously clarified that payments on completed construction contracts were subject to the PPA as periodic payments for partial executions or delivery.

As in Zinger, payment is to be made thirty calendar days after approval of the work by the contracting officer, thus indicating that payment is conditioned upon completion and is not given in advance of the work, as might be expected in the case of financing.<sup>471</sup>

Of course, there is no longer any need to rely solely on case law for construction contracts which are subject to the 1988 Amendments. For such contracts, interest penalties can be imposed for delinquent progress payments either on the periodic payments rationale of Zinger or on the basis of the explicit provision in the Amendments.<sup>472</sup>

*b. other progress payments*

Neither the ASBCA nor any other tribunal has had an opportunity to decide whether other types of progress payments are "financing" for PPA purposes. However, there are three reasons for believing that only progress payments under construction contracts and architect-engineer contracts are covered by the PPA. First, the present regulatory scheme still treats the other types of progress payments as financing. The Circular defines financing as follows:

[Contract financing payments are an] authorized disbursement of monies prior to acceptance of supplies or services including advance payments, *progress payments based on cost*, *progress payments* (other than under construction contracts or architect-engineer contracts) *based on a percentage or stage of completion*, and interim payments on cost-type contracts. Contract financing payments do not include invoice payments or payments for partial deliveries.<sup>473</sup>

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<sup>471</sup> Professional Design Constructors, GSBGA No. 8554 (Sept. 28, 1990).

<sup>472</sup> See notes 294 and 295 *supra* and accompanying text.

<sup>473</sup> Circular (Rev.), *supra* note 76, § 1f (emphasis added).

The FAR prescribes a similar definition of financing at FAR 32.902.<sup>474</sup>

The second reason for presuming only construction and architect-engineer progress payments are subject to the PPA is the apparent Congressional acquiescence. Congress was well aware of the position taken by OMB and the agencies prior to and during its deliberations on the 1988 Amendments and chose only to alter the treatment of construction progress payments.<sup>475</sup> Finally, such a conclusion is consistent with the Thayer<sup>476</sup> maxim that waivers of sovereign immunity must be narrowly construed.

While this deduction is assuredly sound for progress payments based on costs,<sup>477</sup> the conclusion that progress payments under shipbuilding contracts are financing is not as certain. Like progress payments under construction and architect-engineer contracts, progress payments under shipbuilding or ship conversion, alteration, or repair contracts are based

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<sup>474</sup> The FAR definition for PPA purposes is not wholly consistent with the general definition of financing at FAR 32.102.

<sup>475</sup> This argument was made even before the Amendments were passed: "[I]n seeking to remedy the administrative implementation abuses by expressly including progress payments for construction contracts, the 1987 [sic] amendments, by negative implication, may arguably provide a basis for construing that all other types of progress payments are excluded from coverage." Donnally and Stone, *The Prompt Payment Act in 1987: Collecting from Uncle Sam*, 21 NAT. CONT. MGT. J. 45 (1987). This reasoning was also articulated by the FAR drafters. FAR Case 88-69, Comment 5.

Not only was Congress generally aware of the OMB position, the House was specifically asked during the Amendments hearings to consider a progress payment "the same as a partial payment for a partial delivery." *Prompt Payment Act Amendments of 1987: Hearing on S. 328 Before the Senate Comm. on Govt. Affairs*, 100th Cong., 1st Sess. 10 (1987).

<sup>476</sup> *supra* note 24.

<sup>477</sup> Although the deduction is correct, the result is that most progress payments are probably excluded from statutory coverage since progress payments based on costs account for most of the progress payments furnished by DoD. See *Defense Financial and Investment Review*, at IV-1 (1985).



on a percentage or stage of completion.<sup>478</sup> An argument could be made that such progress payments should be treated no differently than those under construction and architect-engineer contracts. Based on the dicta in the Zinger decision, the ASBCA might agree. The board stated that progress payments based on a percentage of completion

represent compensation for work that has been performed and is in place as in construction projects and shipbuilding. As the [Corp's] initial position pointed out, such payments are not made 'solely' for financing purposes and were thus not required to be exempted from the PPA coverage by Circular A-125.<sup>479</sup>

Although the logic of equating construction projects to shipbuilding is appealing, it remains to be seen whether it can overcome the trio of reasons set forth above which weigh against extending PPA coverage to shipbuilding. In the meantime, the Navy will not pay late payment interest on shipbuilding contracts.<sup>480</sup>

## 2. Cost Reimbursement Contracts

For the same three reasons outlined in the preceding section, PPA coverage should not be regarded as extending to interim payments on cost reimbursement contracts. Both the Circular and FAR classify such payments

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<sup>478</sup> FAR 32.500(b).

<sup>479</sup> 87-3 BCA ¶ 20,043 at 101,477 (emphasis added).

<sup>480</sup> Navy Comptroller Manual, NAVSO P-1000, Vol. 4, ¶ 04090307-4 (1990).

as financing, the Amendments show Congress concurred with that treatment,<sup>481</sup> and waivers of sovereign immunity must be narrowly construed.

### 3. Periodic Payments for Partial Deliveries

As indicated previously, periodic payments for partial deliveries are definitely not considered financing and are subject to the PPA.<sup>482</sup> It might be enticing for contractors to stretch a point and interpret the reach of such periodic payments as encompassing both progress payments made on other than construction contracts and cost reimbursement payments. However, not only is it "unlikely the 'money managers' in the Office of Management & Budget will do so,"<sup>483</sup> it would be inappropriate. The trilogy of reasons put forth in the prior two subsections are again dispositive.

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<sup>481</sup> In addition to the general awareness of Congress of the position taken by OMB and the agencies, the following passage appears in the legislative history: "This provision [on periodic payments] is not intended to alter the prompt payment of certain progress payments due under various cost reimbursement type contracts." H.R. REP. NO. 100-784, *supra* note 62, at 21. This statement was cited by the FAR Council as authority for not extending PPA coverage to cost type contracts. FAR Case 88-69, Comment 19.

<sup>482</sup> 31 U.S.C. § 3903(a)(5) (1988); Circular (Rev.), *supra* note 76, § 1f; FAR 32.902. See also note 470 *supra*, and accompanying text.

<sup>483</sup> Cibinic, *Prompt Payment Act Amendments of 1988: Construction Subcontractor Coverage and More*, 3 NASH & CIBINIC REPORT 2, ¶ 12 (1989).

*C. Remedy: Convert Into A Claim*

Although PPA interest is not available for delayed financing payments, contractors can still obtain Contract Disputes Act interest if they make the late payment the subject of a claim. This process of "converting" a claim was discussed previously;<sup>484</sup> however, the question of how long a contractor must wait before claiming the delay in payment is "unreasonable" was not covered. While the boards grappled with that issue many times in the past,<sup>485</sup> the FAR has now put it to rest. FAR 32.906 states that financing payments are generally due 30 days after receipt of a proper payment request. If the costs (administrative and potential damage to the contractor-agency relationship) of filing the claim are outweighed by the interest to be recovered, contractors should consider submitting a claim on the 31st day.

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<sup>484</sup> See notes 249-55 *supra* and accompanying text.

<sup>485</sup> E.g., Consumer's Oil Co., ASBCA No. 24172, 86-1 BCA ¶ 18,647 (37 days reasonable); LTD Builders, ASBCA Nos. 28005, 28662, 85-3 BCA ¶ 18,302 ("by no stretch of the imagination" can 14 days be unreasonable); General Ry. Signal Co., ENGBCA Nos. 4283, 4284, 84-2 BCA ¶ 17,452 (60 days unreasonable); Globe Eng'g, ASBCA No. 23934, 83-1 BCA ¶ 16,370 (25 days reasonable); C.S. Smith Training, Inc., DOT CAB No. 1273, 83-1 BCA ¶ 16,304 (31 days unreasonable since PPA, even though not applicable to the case at bar, establishes "what is reasonable as a matter of law in absence of specific provision to the contrary"); BHT Thinning, AGBCA No. 81-191-1, 82 BCA ¶ 16,116 ("reasonable time depends on the facts and circumstances of the particular case at hand"; 34 days not unreasonable).

## CONCLUSION

This thesis has sought to provide a comprehensive and current<sup>486</sup> analysis of the Prompt Payment Act. It placed the act in its historical context, scrutinized the statute's major provisions, and examined its scope of coverage. In doing so, this study uncovered some conflict and confusion in the regulations, questionable regulatory and court and board interpretations of the statute, and inconsistencies between the tribunals on certain issues. For a number of these problems, specific recommendations were proffered.

No suggestions were directed towards the agencies since the GAO has audited their performance and made recommendations three times since 1978.<sup>487</sup> According to the GAO reports, agencies improved from their "good" record of paying 30 percent of their invoices late to 24 percent by the third audit. More recently, OMB related in its 1989 report to Congress that agencies had slashed the percentage of late payments to 3.3 percent.<sup>488</sup> However, that figure was up from 2.7 percent in 1988. In

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<sup>486</sup> Research is current through December 10, 1990.

<sup>487</sup> General Accounting Office, *Prompt Payment Act: Agencies Have Not Fully Achieved Available Benefits*, GAO/AFMD 86-69 (Aug. 1986); General Accounting Office, *Actions to Improve the Timeliness of Bill Paying by the Federal Government Could Save Hundreds of Millions of Dollars*, GAO/AFMD-82-1 (Oct. 1981); General Accounting Office, *The Federal Government's Bill Payment Performance Is Good But Should be Better*, GAO/FGMSD 78-16 (Feb. 1978).

<sup>488</sup> Office of Management and Budget, *Prompt Payment: 1989 Report to Congress* (Mar. 22, 1990).

terms of dollars paid late, the Department of Justice had the worst record: 16.2 percent were late compared to only 8.2 percent in 1983.<sup>489</sup> Moreover, the Department of Defense, whose performance record was better than most, saw its number of late payments in 1989 increase by 23 percent from 1988 to a total of 1.35 percent and told OMB it expected the percentage to increase even more in 1990.<sup>490</sup>

In comparison to the 1978 GAO assessment of "good," agencies' performance is now excellent. However, the upswing in late payments in 1989 warrants some advice. During the hearings on the Amendments, the following story was told:

[M]y final observation is of a late payment case and how it was handled during the reign of Kubla Khan. The case was witnessed and reported by Marco Polo. In reporting on the excellence of the Grand Khan's government and its administration, Polo witnessed a case where an administrator in charge of maintaining the roads of the kingdom failed to make a payment to a local townsman for his services. The Khan ordered that the administrator to be taken into the street, benaded and his body left in the dirt for the dogs to devour.<sup>491</sup>

Congress has already acted once to remedy late payment and a second time to close some of the original enactment's loopholes. Agencies should be leery of letting their performance slide, lest Khangress be called upon a third time.

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<sup>489</sup> Id. at Table 6.

<sup>490</sup> Id. at 6.

<sup>491</sup> *Prompt Payment Act Amendments of 1987: Hearing on S. 328 Before the Senate Comm. on Govt. Affairs, 100th Cong., 1st Sess. 26 (1987).*