

# Government Contracts Blog

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## FAR Councils Issue Interim Rule Limiting Excessive Pass-Through Charges

Based on their view that contractors who subcontract the majority of the work to subcontractors add little or no value, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (FAR Councils) issued an interim rule on October 14, 2009 that limits excessive pass-through charges by contractors and subcontractors. *See* 74 Fed. Reg. 52,853 (October 14, 2009). The rule not only makes excessive pass-through costs unallowable, but also provides for recoupment of pass-through charges later determined to be excessive.

This interim rule applies:

- Civilian Agencies: Cost-reimbursement contracts that exceed the \$100,000 simplified acquisition threshold.
- For DoD: cost reimbursement and certain fixed-price contracts that exceed \$650,000, the threshold for requiring cost or pricing data.

"Excessive pass-through charge" is defined as a charge by a contractor or higher-tiered subcontractor over their subcontractor's costs where the contractor/subcontractor "cannot demonstrate to the Contracting Officer that its effort added value to the contract or subcontract in accomplishing the work performed under the contract." Order processing, inventory management, schedule control, quality control, coordination, etc. are all considered to constitute "added value."

To prevent such excessive pass-through charges, the interim rule effects how contractors and subcontractors manage and report subcontracting arrangements in three important ways:

1. In their proposals, contractors must now disclose the total cost of work to be performed by the contractor and its subcontractors. Additionally, if a contractor proposes to subcontract more than 70 percent of the total cost of the work to be performed, then the contractor must disclose: a) the offeror's indirect cost and profit/fee applicable to subcontractor's work; and b) describe the value added by the work to be performed by the contractor.

2. After award, contractors must notify the Contracting Officer in writing if changes to their actual subcontracted effort make that effort exceed 70 percent. At that time, the contractor must also provide a "verification that the contractor will provide added value."
3. The rule equips the government with mechanisms to ensure that it does not pay excessive pass-through charges. For example, the interim rule changes FAR 31.203 to disallow indirect costs that meet the definition of "excessive pass-through charge" in 52.215-23. Likewise, the interim rule changes FAR 52-215-23(d) to entitle the government to a price reduction equivalent to any excessive pass-through charges included in the contract price for certain fixed-price DoD contracts. Additionally, interim FAR clause 52.215-23(e) permits the Contracting Officer to review subcontractor records to ensure the government is not paying excessive pass-through charges.

As a result of this rule, contractors and subcontractors must now affirmatively prove that their management efforts over subcontracted effort benefit the government and provide "added value," just one more way in which the Government can micromanage contractor performance.

Interested parties must submit comments no later than December 14, 2009.

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