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Rule Raises Concerns About Adverse Competitive Impact on Small Firms that Contract with the Government

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On July 27, 2012, a final rule amending FAR 2.01, 52.204-7, and 52.204-10 was published, requiring contractors to report executive compensation and first-tier subcontractor awards for contracts of \$25,000 or more. The rule has raised concerns regarding a possible adverse competitive impact on small firms that contract with the government. A July 2010 interim rule also required this reporting on subcontracts over \$25,000. The final rule preserves most of the July 2010 interim rule, with additional revisions to the Transparency Act reporting requirements in FAR.

The final rule, which is effective August 27, 2012, implements a section of the Federal Funding Accountability and Transparency Act of 2006, as amended by the Government Funding Transparency Act of 2008. The latter Act requires the Office of Management and Budget to establish a free, public website containing full disclosure of all Federal contract award information (www.usaspending.gov).

Several exemptions and limitations to the reporting requirements are of note. While keeping much of the interim rule intact, the final rule now exempts "classified information" rather than "classified contracts" and deletes the interim rule's exception for contracts with individuals. The final rule preserves the interim rule's exemption for contractors and subcontractors whose gross income is under \$300,000. The rule requires annual reporting of the contractor's and first-tier subcontractors' five most highly compensated executives, and maintains the interim rule's provision that executive financial compensation is only required if a contractor or subcontractor receives at least 80 percent of its annual gross revenue and \$25 million from federal awards, and if senior executives do not already report compensation information (e.g., through SEC filings). Additionally, the final rule changes the definition of "first-tier subcontract" which will allow contractors greater

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flexibility to determine who their first-tier subcontractors are. Finally, the final rule does not require continued reporting, unless one of the reported data elements changes during the performance of a subcontract.

The final rule has elicited some concern, namely that small businesses risk becoming less competitive due to a higher cost of doing business with the government. Some factors that contribute to the risk are that large subcontractors are likely to also be prime contractors, so much of their top executive compensation is already reported, and compensation data of large contractor executives is already reported. One comment to the rule suggested that the compensation disclosure could cause companies to lose their key personnel to raiding by competitors, thus driving some contractors and subcontractors out of government contracting and limiting government access to key technologies and ideas while increasing its costs. Further, competitors who fell below the reporting threshold could gain an unfair advantage. A number of respondents to the rule suggested a flow-down provision, such that subcontractors may report executive compensation, thereby reducing the administrative burden on the prime contractors. The federal government is unlikely to implement such a change, however, because it has no privity with subcontractors and is reluctant to create additional contractual relationships. Another, perhaps more intuitive, risk, is noncompliance. Small businesses face a steeper learning curve and are generally less equipped to ensure compliance with multi-faceted reporting requirements. It remains to be seen whether the exceptions and limits described above will actually reduce the number of contractors required to report this information. The rule, and a summary of comments thereto, are located at www.gpo.gov/fdsys/pkg/FR-2012-07-26/html/2012-17724.htm.

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