VENABLE LLP

government contracts update
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President Obama and Congress Take Dramatic Steps to Increase Oversight of Government Contracts

President Obama and the 111th Congress, now just weeks in office, are taking an aggressive approach with federal contractors and increasing oversight of government contracting. During the past few weeks, the President signed several executive orders mandating new employment policies for government contractors. From an oversight perspective, the Senate created an ad hoc subcommittee with the sole purpose of overseeing federal contracting and the recent American Recovery and Reinvestment Act of 2009 ("ARRA") includes a requirement for the creation of a Recovery Act Accountability and Transparency Board.

ARRA includes several provisions of significance for government contractors, including a further delay to the proposed withholding tax for government contractors and a "Buy American" provision.

President Obama Issues Four Employment-Related Executive Orders

On January 30, 2009, President Obama signed three executive orders relating to: 1) the displacement of workers under service contracts; 2) the notification of employees' rights under federal labor law; and 3) the unallowability of costs for certain activities related to the prevention of unionization; which significantly change the employment landscape for federal contractors. For a detailed analysis of each of these executive orders, please see Venable's Labor & Employment News E-lert at http://www.venable.com/docs/pubs/2086.pdf.

More recently, on February 6, 2009, President Obama signed Executive Order 13502 that encourages executive agencies to consider requiring the use of "project labor agreements" in the awarding of construction projects that will cost the federal government $25 million or more. Under this Order, a project labor agreement is "a pre-hire collective bargaining agreement with one or more labor organizations that establishes the terms and conditions of employment for a specific construction project…." Any project labor agreement pursuant to this Order shall:

(a) bind all contractors and subcontractors on the construction project through the inclusion of appropriate specifications in all relevant solicitation provisions and contract documents;

(b) allow all contractors and subcontractors to compete for contracts and subcontractors without regard to whether they are otherwise parties to collective

bargaining agreements;

(c) contain guarantees against strikes, lockouts, and similar job disruptions;

(d) set forth effective, prompt, and mutually binding procedures for resolving labor disputes arising during the project labor agreement;

(e) provide other mechanisms for labor-management cooperation on matters of mutual interest and concern, including productivity, quality of work, safety, and health; and

(f) fully conform to all statutes, regulations, and Executive Orders.

The FAR Council shall issue any necessary implementing regulations within 120 days of the date of the Order, and the Director of Office of Management and Budget is expected to provide the President, within 180 days of the date of the Order, with recommendations about whether broader use of labor agreements will promote economical, efficient, and timely completion of such projects.

Senate Forms Subcommittee to Oversee Federal Contracting

On January 29, 2009, Senator Joseph Lieberman (I-Conn.) announced that he was creating an ad hoc subcommittee within the Homeland Security and Government Affairs Committee, the committee he chairs. This subcommittee will be chaired by Senator Claire McCaskill (D-Mo.).

In a statement regarding the new subcommittee, Senator Lieberman referred to government contracting as a high-risk area for waste, fraud, abuse, mismanagement, and in need of reform. He also added that he was "certain that [Senator McCaskill] will approach her new responsibilities with unmatched vigor to improve the value of all the taxpayer dollars devoted to federal contracting."

Senator McCaskill is a former prosecutor and state auditor and has sponsored bills to strengthen the power of federal agencies' Inspectors General. Senator McCaskill's web site states that she "believes that one way to reduce government spending is to target government contractors." Senator McCaskill, in accepting the new position, stated "we all know that outrageous contracting abuses occur in every facet of government. I can't wait to get to work…" Undoubtedly, government contractors will face increased scrutiny from the 111th Congress.

Notable ARRA Provisions

"Recovery Act Accountability and Transparency Board"

ARRA includes the creation of a Recovery Act Accountability and Transparency Board ("Board") that will "coordinate and conduct oversight of covered funds to prevent fraud, waste, and abuse." This Board will be composed of a chairperson, and the Inspectors General of the Departments of Agriculture, Commerce, Education, Energy, Health and Human Services, Homeland Security, Justice, Transportation, Treasury, and the Treasury Inspector General for Tax Administration, as well as any other Inspector General designated by the President from an agency that obligates ARRA funds.

Generally, "[t]he Board shall conduct audits and reviews of spending of covered funds and coordinate on such activities with the inspectors general of the relevant agency to avoid duplication and overlap of work." However, the ability of the Board to "request[] that an inspector general conduct or *refrain from conducting* an

audit or investigation" (emphasis added) has raised some concern for the Board's detractors that believe it restricts the independence of inspectors general. On the other hand, proponents argue that the Board is composed of at least 10 Inspectors General, which assures the autonomy of inspectors general from the Board.

Regardless of the concerns relating to independence of Inspectors General on the Board, contractors accepting stimulus funds should remain mindful that such contracts and funds will come with significant strings and oversight.

Postponement of Implementation of the Government Contractor 3% Tax Withholding Requirement

The final version of the ARRA, which President Obama signed on February 17, delays by one year the implementation of the 3% tax withholding requirement applicable to payments made to government contractors. The new effective date of the withholding requirement will begin on January 1, 2012. The final version of the "stimulus bill" negotiated in conference last week comes as a disappointment to industry because Section 1541 of the original House bill, H.R. 1, included language repealing the 3% tax withholding requirement in its entirety. Instead, Congress adopted the Senate version, which only delays implementation by another year.

Under current law, Federal, State, and local governments "making any payment to any person providing any property or services . . . shall deduct and withhold from such payment a tax in an amount equal to 3 percent of such payment." 26 U.S.C. § 3402(t). The automatic withholding could prove to be a considerable burden on government contractors, especially those that operate on very low-margins and rely on prompt and complete government payments to meet their short-term cash needs. A House bill in the 110th Congress sought to repeal the 3% withholding law, but did not gain much traction. On December 5, 2008, the Internal Revenue Service issued a proposed rule to implement the withholding requirement, with comments due by March 5, 2009. *See* 73 FR 74082. Although not the repeal hoped for by contractors, the one-year delay suggests Congress may be willing to reconsider the withholding requirement before it is implemented.

Controversial "Buy American" Provision

The ARRA includes a "Buy American" provision that despite being watered down from an earlier Senate version is proving controversial and angering numerous U.S. trading partners.

This provision provides that any "iron, steel, and manufactured goods used" in any project with funds appropriated by ARRA shall be produced in the U.S. Department heads may waive the application of the provision if it is: a) "inconsistent with the public interest;" b) the iron, steel and manufactured goods at issue are not "in sufficient and reasonably available quantities and of a satisfactory quality;" or c) the use of domestically produced iron, steel or manufactured goods "will increase the cost of the overall project by more than 25 percent."

Interestingly, however, the provision includes a requirement that it "shall be applied in a manner consistent with United States obligations under international agreements." Therefore, although the provision alarms many U.S. trading partners, it is unclear whether it will be implemented in a manner so as to allow the procurement of iron, steel and manufactured goods from some or all U.S. trading partners.

E-Verify Update

On January 30, 2009, President Obama postponed the implementation of the E-Verify Rule until May of this year. This rule requires federal contractors to check if newly-hired employees are not undocumented immigrants. For more information on this rule, please visit: http://www.venable.com/docs/pubs/2071.pdf

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