

(c) If the Contractor is unable to submit a payment request in electronic form, or DoD is unable to receive a payment request in electronic form, the Contractor shall submit the payment request using a method mutually agreed to by the Contractor, the Contracting Officer, the contract administration office, and the payment office.

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DEPARTMENT OF DEFENSE

48 CFR Parts 232 and 252

[DFARS Case 2002-D017]

Defense Federal Acquisition Regulation Supplement; Payment Withholding

AGENCY: Department of Defense (DoD).

ACTION: Final rule.

SUMMARY: DoD has issued a final rule amending the Defense Federal Acquisition Regulation Supplement (DFARS) to provide additional flexibility when determining the need to withhold payments under time-and-materials and labor-hour contracts. The rule clarifies that normally there should be no need to withhold payment for a contractor with a record of timely submittal of a release discharging the Government from all liabilities, obligations, and claims under a contract.

EFFECTIVE DATE: December 15, 2003.

FOR FURTHER INFORMATION CONTACT: Mr. Thaddeus Godlewski, Defense Acquisition Regulations Council, OUSD(AT&L)DPAP(DAR), IMD 3C132, 3062 Defense Pentagon, Washington, DC 20301-3062. Telephone (703) 602-2022; facsimile (703) 602-0350. Please cite DFARS Case 2002-D017.

SUPPLEMENTARY INFORMATION:

A. Background

Federal Acquisition Regulation (FAR) 52.232-7, Payments under Time-and-Materials and Labor-Hour Contracts, requires the contracting officer to withhold 5 percent of the amounts due, up to a maximum of \$50,000, unless otherwise specified in the contract Schedule. The Government retains the withheld amount until the contractor executes and delivers, at the time of final payment, a release discharging the Government from all liabilities, obligations, and claims arising under the contract. This rule adds DFARS 232.111(b) and DFARS 252.232-7006, Alternate A, to specify that, normally, there should be no need to withhold payment for a contractor with a record of timely submittal of such a release.

DoD published a proposed rule at 68 FR 9627 on February 28, 2003. Five sources submitted comments on the proposed rule. A discussion of the comments is provided below. Differences between the proposed and final rules are addressed in the DoD Response to Comments 5, 6, 7, and 8 below.

1. *Comment:* The rule should specify whether the clause applies retroactively or from a specific date forward to all time-and-materials and labor-hour contracts.

DoD Response: Do not concur. Policy on the applicability of DFARS changes is provided in DFARS 201.304(6), which states, “* * * Unless guidance accompanying a change states otherwise, contracting officers must include any new or revised clauses, provisions, or forms in solicitations issued on or after the effective date of the change.” This rule does not deviate from the policy in DFARS 201.304(6) and, therefore, requires no additional instructions regarding applicability.

2. *Comment:* FAR 52.232-7(a)(2) should be eliminated. If it is not eliminated, there should be a graduated scale for the rate of withholding and the total to be withheld. For instance, the ceiling amount for very small businesses should be reduced to \$5,000 and the withholding rate should be reduced to 2 percent so that the effects are spread over a longer time.

DoD Response: Do not concur. DoD believes the withhold is an important tool for the Government to use when the contractor does not have a record of timely submittal of the release discharging the Government from all liabilities, obligations, and claims. The withhold protects the Government in these circumstances while also providing the contractor with an incentive to submit the discharges in a timely manner.

3. *Comment:* In addition to continuing forward with this DFARS revision, the FAR should be revised at the earliest possible date to make withholding optional.

DoD Response: The Defense Acquisition Regulations Council is presently working with the Civilian Agency Acquisition Council to incorporate similar policy into the FAR.

4. *Comment:* The language at 232.111(b)(ii) should be revised to indicate that timely submittal of release is only one example where there is no need to withhold payment. There are other circumstances when the withholding may not be necessary, such as when the contractor has demonstrated a satisfactory accounting and billing system and is determined to

be eligible for direct billings by the Defense Contract Audit Agency.

DoD Response: Do not concur. A satisfactory accounting and billing system and eligibility for direct billings indicate that the contractor has the necessary internal controls to address periodic billings during contract performance. However, they are not determinative as to whether the contractor submits timely releases discharging the Government from all liabilities, obligations, and claims upon completion of the contract. If the contractor does not have a record of submitting these discharge documents in a timely manner, the fact that the accounting and billing systems are adequate is not sufficient to warrant removing the withhold requirement.

5. *Comment:* The language at 232.111(b)(iii) should be revised to refer to the withholding as “five percent up to a maximum of \$50,000” of the amounts due until a sufficient reserve is established. This maximum amount of coverage is addressed properly in the contract clause. In addition, 232.111(b)(iii) should be amended to authorize the ACO to establish an administrative mechanism for holding contractor funds that does not require the withholding of funds on each invoice so as to reduce the administrative burden on both the Government and the contractor.

DoD Response: Partially concur. DoD agrees that the \$50,000 maximum withhold amount should be stated in 232.111(b)(iii) and, accordingly, has replaced “until a sufficient reserve is set aside” with “up to a maximum of \$50,000.”

As to the suggestion to provide for alternative mechanisms, DoD believes that determining whether alternative administrative mechanisms are feasible and/or practical is beyond the scope of this case.

6. *Comment:* The rule should instruct the contractor to forward all vouchers to the Defense Finance and Accounting Service (DFAS) through the ACO for approval, until such time that the ACO considers sufficient reserves to be set aside to adequately protect the Government interests. The ACO must inform DFAS when funds will be withheld from a contract, and there must be a process to link the modification with the vouchers being submitted to DFAS for payment. The modification should specify the percentage of the amounts due up to a maximum dollar amount.

DoD Response: Partially concur. DoD recognizes the need for coordination among all parties in the payment process to ensure that withholds are