It used to be called “executive compensation” and the FAR prescribed limits (at 31.205-6) on how much compensation government contractors could claim as being allowable for the top 5 most highly paid executives at each business segment. The rationale for those allowability limits being, of course, that the government didn’t want taxpayers to fund exorbitant executive salaries.

That notion was turned on its head a few years ago, when the limits on the top 5 executives were applied to all contractor employees. Now the “executive compensation cap” is simply called “contractor compensation cap.” The rationale for applying the limits to all contractor employees is less clear. To the extent there is a rationale, it appears to be along the lines of “nobody should ever think that they will get rich contracting with the Federal government.”

Of course, as defenders of the compensation cap are quick to point out, contractors are free to pay employees whatever amounts they choose; the rules simply limit the amount of such payments that are reimbursable by government customers. If you want to pay more, that’s on you. Which is fine—to some extent—because business owners often choose to reduce profits in order to win business. But we think legislating and regulating compensation limits flies in the face of free market principles—principles upon which this country was allegedly founded. (We don’t know for sure; we weren’t there.)

When a contracting officer determines that a proposed price is fair and reasonable, the “normal” expectation is that, somewhere along the line, that CO is comparing the proposed price to another price. Hopefully there was adequate price competition so multiple bidders’ (“offerors’”) prices can be compared. But that’s not the only price analysis technique; the FAR and agency guidance provides for other methods. The point is: who cares what the contractor is paying its employees if the bottom-line price is fair and reasonable? If the contractor is the low-bidder and wins a cost-type contract—and stays within the original contract price—then why should the government be permitted to force after-the-fact price reductions through a claim that certain elements of cost within that contract price were unallowable? But that’s the way it works.

The statutory and regulatory compensation caps also ignore the competition for top talent. We all know that STEM talent is in high demand. Believe it: contractors start hunting for talent early in a student’s undergraduate engineering career. Engineers and scientists who have the right clearances are in even more demand. The right individual can make or break a multi-billion-dollar development program; why would a contractor think twice about making a huge offer to that person? You’re right: it would be a smart investment.

The compensation caps also ignore the fact that government contractors are in competition with non-government contractors in private industry for that same talent. Google and Apple and Facebook (just to name three) do not have to deal with taking certain portions of compensation out of their profits. (Granted, their pricing isn't cost-based, but you get the point.) They can easily afford to pay the right person twice the current compensation cap amount—and they do. Reportedly, "Angela Ahrendts, Apple's senior vice-president of retail and online stores, … took home US$24.2 million in 2017, according to Apple company filings." *That's salary, not total compensation.* With stock thrown in, you can triple that amount. How can government contractors compete with that level of compensation? You're right; they can't.

And do not forget that simply paying employees less than the compensation caps is no guarantee that the compensation will be found to be allowable. Government auditors tend to examine compensation for "reasonableness." If they determine that your compensation—at whatever level—is unreasonable, then they will question it and ask the CO to disallow it. The audit methodology is often flawed and the results are often similarly flawed; but it frequently costs more to litigate than the issue is worth. Contractors that choose to litigate tend to win, but most choose to settle.

The Bipartisan Budget Act (BBA) established a compensation cap of $487,000—as applied to all employees. But that law didn't (and couldn't) retroactively apply the cap to contracts awarded before it went into effect. Thus, contractors have had to contend with implementing multiple caps on multiple groups of employees for some time. They have been calculating "blended" caps in an effort to have one set of rates for all government customers.

Critically, the BBA also required that the ceiling be escalated annually, based on changes in the Employment Cost Index for all workers as calculated by the Bureau of Labor Statistics (BLS). But the Federal government didn't follow the law's requirements: no escalated values were ever published. Savvy contractors have been escalating the cap on their own, using the appropriate BLS index. But many upon many contractors are not so savvy or well-informed, and they've been using the $487,000 cap for years—leaving money on the table.

Recently, the White House published escalated compensation caps. You can find the link **here** . Here's a summary of the cap to be applied to each calendar year. If your fiscal year is other than a calendar year, you will need to "blend" the caps appropriately.

CY 2015: $487,000

CY 2016: $500,000

CY 2017: $512,000

CY 2018: $525,000

If you want to know some of the historical caps (because you have contracts awarded before June, 2014) then follow **this link** .

In summary, the whole idea of hobbling government contractors by forcing them to choose between either underpaying employees when compared to the marketplace or paying the going rate but taking the difference from profit is a bad idea. It ignores free market principles and the power of competition to shape contract prices.

But until something changes, then this is the compensation compliance regime that government contractors have to live with. If you have to comply, you should know the details and be prepared to support your claimed compensation amounts in an audit.