

Key Concepts in Subcontracting

March 12, 2024

Agenda

- Introductions
- Presentation
- Q&A – Please use the Q&A feature to ask question

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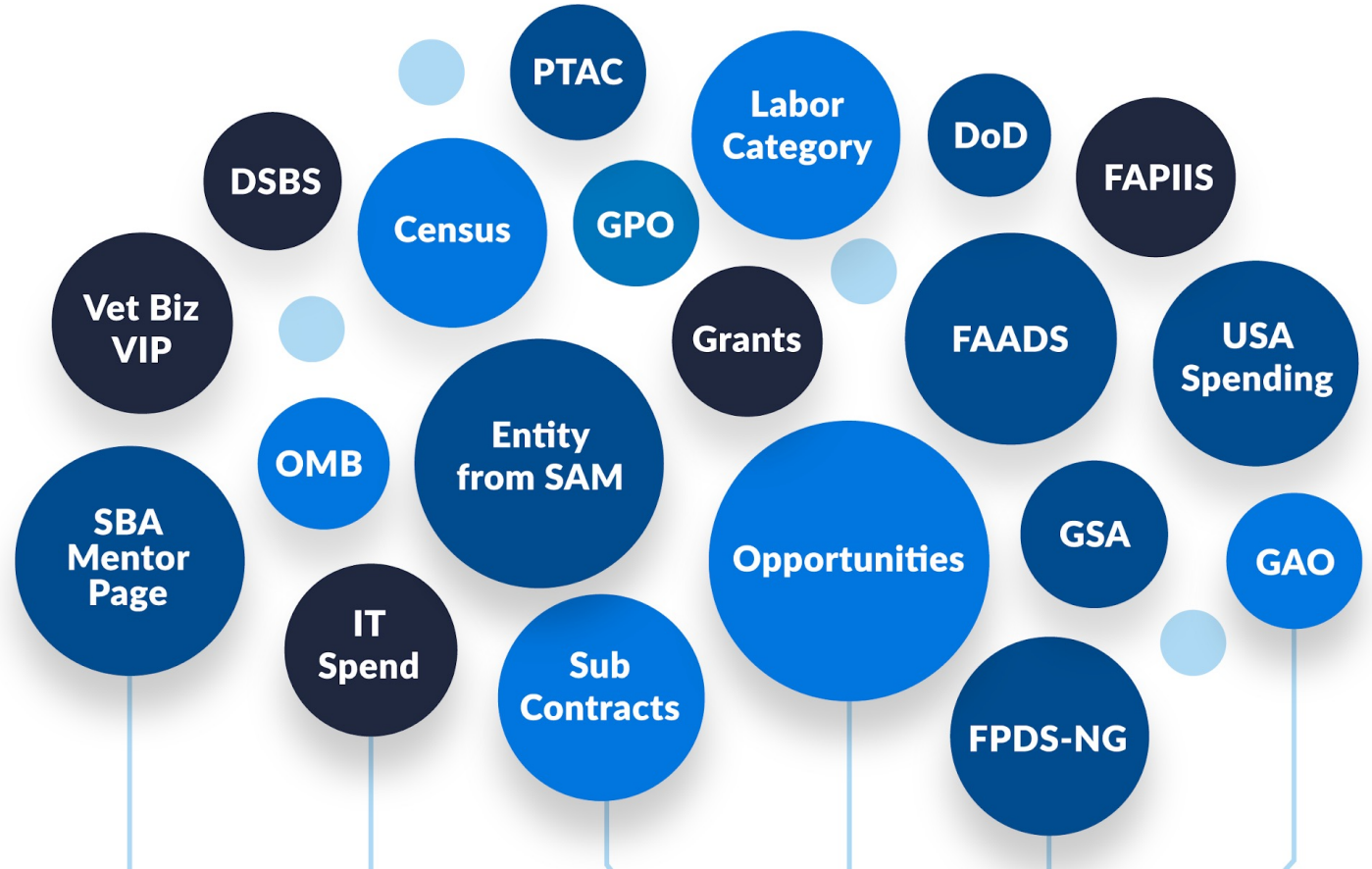
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Key Concepts in Federal Subcontracting

Meet the Presenter



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Agenda

- Primer: It's All About the Approach...
- Flow-Down Clauses and Risk-Shifting Provisions
- “Pass Through” Claims
- Claims Between Primes and Subs

How to Approach Your Subcontract

An Overall, Continuing Theme...

- Integrity and Willingness to Work (and Work Together)
- Communication
- Honesty
- Transparency
- Empathy and Understanding

A Quick Note About Terminology

Known Your Lingo

- Teaming v. Subcontracting
 - These are not the same!
 - Timing and Intention
- Subcontracting v. _____
 - CTAs
 - JVs
 - Mentor Protégé

Flow-Down Clauses and Risk-Shifting Provisions

Flow-down Clauses

Flow-down clauses are FAR clauses included in a contractor's prime contract with the Government, which the prime contractor is required to (or sometimes chooses to) **flow-down** to their subcontractors

Flow-down Clauses

Term is Sometimes Also Used to Refer to Other Risk-Shifting Provisions

- Protections for Prime

Drafting The Subcontract

The Unique World of Federal Government Contracting

- Federal Government Contracts differ in many respects from a commercial contract
- Federal Government Contracts are governed by federal law (FAR, Agency Supplemental Regs, Small Biz Regs)
- Subject to a completely different set of dispute resolution procedures / different adjudicatory forums (FAR and CDA / COFC and Boards of Contract Appeals), different theories of recovery and different legal bases for claims

Drafting The Subcontract

So, “Flow Downs” May Be a Little Different, and Potentially More Important, in the Federal Work Space

- Government does not bend or negotiate
- Prime Contractor has very little wiggle room
- Therefore, Prime Contractors are reluctant to negotiate with subs

UNLESS...

Drafting The Subcontract

Understanding Each Other

- Prime might be thinking:
 - I need to perform and complete the contract promptly and successfully; I cannot have my subcontractor put me in a position that endangers my contract/relationship with the client, or risks deficiency, delay, default or termination
 - I cannot afford to be stuck in the middle, fighting the government and my sub at the same time;
 - I can't be responsible for a subcontractor's (alleged) fraud or FCA violation

Drafting The Subcontract

Understanding Each Other

- Sub might be thinking:
 - I am less familiar with the FAR and this complicated Federal space, I need to know what I need to do to successful complete the contract;
 - I need to protect myself; I need access to remedies
 - I can't self-finance disputed work; I can't wait for recovery

Drafting The Subcontract

What Do I Flow Down/What do I Include?

- Mandatory Flow-Downs, No Brainer
- Suggested Clauses
- Other Risks, Considerations

Drafting The Subcontract

How Can You Tell Which Are the “Mandatory” Flow Downs

- Often, the FAR itself will state whether a clause must be flowed-down to a prime’s subcontractors
- BE CAREFUL! Mandatory does not equal Automatic – Vital Distinction
- Compliance Matrix?

Drafting The Subcontract

What other clauses *should* be flowed down?

What other issues should be addressed?

Well...

Drafting The Subcontract

Answering These Questions Starts with Understanding Why You Flow Down, Or Include, Clauses in Your Subcontract

Think Conceptually: What Is The Purpose?

- Prime Contractor is ultimately responsible for the completion of the contract and project, meaning they are ultimately responsible for the performance of their subcontractor(s)
- Federal Government does not mess around and is not going to accept finger-pointing. It is on the prime to get the work done. Period. A subcontractor issue can force a default, can cause notice failures, can cause delays, etc. Prime needs to be vigilant.

Problem Situations: Example 1

A Prime Gets Stuck!

Terminations for Convenience:

- FAR 52.249-1: The Contracting Officer, by written notice, may terminate this contract, in whole or in part, when it is in the Government's interest

In Example Case:

- Prime Contractor was terminated for convenience
- Nothing in the subcontract addressed Termination for Convenience, only for Default
- Termination of sub's contract was breach; Sub argued Prime Still had to pay sub
- \$\$ going out, while no more \$\$ coming in – It's a bad place to be!

Problem Situations: Example 1

A Prime Gets Stuck!

Take-Away Lessons for Primes:

- Always want to avoid battling on two fronts, or being stuck in the middle
- Carefully study your Prime contract and know all the possible scenarios. Prime contractors can find that their rights and obligations under the prime contract with the government are dramatically different from the rights and obligations of their subcontractors under standard subcontract boiler plate clauses found online or in commercial contracts prepared by non government-contracts attorneys
- Protect yourself! If you have an obligation that implicates the sub, flow it down! If the sub could impact your ability to fulfill a responsibility or perform, account for that!
- Make sure the subcontractor is accountable to at least the same extent you are; make sure that your rights vis a vis the sub mirror the Government's rights vis a vis you

Drafting The Subcontract

The Primary Objectives of Prime Contractors

- Don't Allow the Sub To Get You In Trouble Upstream
- Don't Get Stuck In the Middle

So:

- Make sure the obligations of the subcontractor to the Prime Contractor mirror the obligations of the Prime Contractor to the Government and to make sure the Subcontractor is bound by same procedures as the Prime Contractor
- Carefully Craft Dispute Resolution Provisions

What About Subcontractors?

Subs need to be thinking, too...

From a Subcontractor's Point of View

Biggest Subcontractor Mistake: Agreeing to a Non-Specific “Catch-All” Type Flow Down Clause, such as:

- *“The Subcontractor shall assume to the Contractor all the obligations and responsibilities that the Contractor has assumed towards the Owner”*
- *“The Subcontractor shall assume to the Contractor all obligations set forth in the Prime Contract”*
- *“All relevant and applicable provisions of the Prime Contract are incorporated by reference, except that “Owner” shall be changed to “Contractor” and “Contractor” shall be changed to Subcontractor”*

From a Subcontractor's Point of View

Why Is This a Mistake?

- Seems consistent with the advice given to Primes, no? Not Exactly.
 - Subcontractors need to understand their SPECIFIC obligations and responsibilities, scope of work, compliance requirements. Otherwise, you risk default, notice failures, and all the things you are hoping to avoid in the first place
 - Vague catch-all clauses do not put Subs on notice of their obligations! (Which is a problem for everyone)

Problem Situations: Example 2

A Sub's Ignorance is Not Bliss

- In many situations, NOTICE can be critical
 - Changes
 - Defective Specifications
 - Delays
 - Differing Site Conditions
- Notice failures cause HUGE problems

In Example Case

- Prime Contractor used vague catch all flow down clause
- Inexperienced sub had no idea about FAR notice requirements
- Subcontractor failed to give proper notice to Prime; Prime was unable to give requisite notice to Government
- Both subcontractor's ability to recover and Prime's ability to recover were hampered
- Poor drafting therefore hurt both Prime and Sub

Problem Situations: Example 2

A Sub's Ignorance is Not Bliss

Subcontractor's Primary Objectives:

- Subcontractors need to know what their obligations are, and what contractual procedures they must comply with
- Subcontractors also want to avoid assuming liability for compliance with clauses that are not mandatory and/or are not applicable to their subcontract work

Problem Situations: Example 2

A Sub's Ignorance is Not Bliss

Take-Away Lessons for Subs:

- **NEVER AGREE TO A CATCH-ALL FLOW DOWN CLAUSE IF YOU CAN HELP IT**
 - Make sure you understand your obligations and responsibilities in specific terms
 - If there is a reference to the Prime Contract Documents, get them! If you can't, don't sign – rework the language!
- Prime's obligations to you should mirror Government obligations to Prime

*(**Bonus Lesson for Primes:** Make sure your Subs understand their obligations and responsibilities in specific terms – It won't necessarily be only the sub that is harmed by the sub's ignorance or misunderstandings)*

Drafting The Subcontract

Critical Considerations:

- Mandatory Clauses
- Changes (Prosecution of Work)
- Dispute/Dispute Resolution
- Notice (Changes, Differing Site Conditions, etc.)
- Terminations/Default
- Delays/LDs
- Suspensions
- Costs and Pricing and Payment – VET IN ADVANCE (esp. when Teaming)
- Option Exercise
- L&E Issues
- Ethics Requirements
- Other Compliance Concerns
- IP Issues

Keep Up to Date; Plan For Contingencies!!!!

Problem Situations: Example 3

Don't Sleep On Potential Issues/New Developments

- **Cyber Security and “Scam” Developments**

- Address how to avoid
- And how to mitigate damages
- And how to Resolve

- **Cybersecurity and CMMC; CUI**

- **THINK AHEAD!** Don't just plan for good stuff, look out for bad.
KEEP UP TO DATE!

Subcontractor's “Pass Through” Claims

Subcontractor's "Pass Through" Claims

Subcontractors Cannot File Claims Directly Against the Federal Government

- Sovereign Immunity is general bar
- Tucker Act exception only covers prime contractors, who have "privity of contract" with the US
- So, to file a claim, a sub must rely on its Prime to "sponsor" or "pass through" its claim

Subcontractor's "Pass Through" Claims

- **Claims ruled by Contract Disputes Act ("CDA")**
 - Exhaustion of administrative remedies
 - Long and complicated legal process
- Prime litigates, Sub supports
- Unsurprisingly, can be a **HUGE source of Prime/Sub conflict**, and one of the most important things to account for in a subcontract

Subcontractor's "Pass Through" Claims

Why A Huge Source of Conflict?

Remember the Approach: Understanding Each Other

- **What is Prime scared of?**

- Two-fronted Battle; Being Stuck in the Middle
- Certification Issues → Forfeit/Fraud/FCA etc.

- **What is Subcontractor Scared of?**

- Lack of Remedies, Recourse for Problems
- Delay in Recovery

Subcontractor's "Pass Through" Claims

Draft Your Subcontract to Address These Concerns – But Understand there is No Magic Wand or "One Size Fits All" Answer

- Disputes clause that outlines cooperative requirements, addresses concerns
 - If sub does X, Prime will sponsor; sub will help in preparation, litigation, etc.
 - Addresses FCA/fraud issues; Disputes clause that provides for penalties for fraudulent certification
- Disputes clause that differentiates between sub disputes against owners and sub disputes against primes
- Disputes clause that explicitly refers to CDA remedies and process, and demands patience
 - Arbitration?

Subcontractor's "Pass Through" Claims

Sample clause:

14.1 Any dispute resolution procedure in the Prime Contract shall be deemed incorporated in this Agreement and shall apply to any disputes arising hereunder.

14.2 Any claims or disputes not covered by the dispute resolution procedure in the Prime Contract shall be submitted to arbitration in accordance with the Construction Industry Rules of the American Arbitration Association. In either case, the demand for arbitration shall be made within a reasonable time after written notice of the claim, but in no event shall it be made after the date when institution of legal or equitable proceedings based on such claim would be barred by the applicable statute of limitations. All proceedings in any such arbitration shall take place in [REDACTED]

Subcontractor's "Pass Through" Claims

Best practices for subcontract disputes clauses:

- The Disputes clause from the prime contract, FAR 52.233-1, should be flowed down *in full text*, verbatim, from the prime contract.
- An additional clause should be included requiring the subcontractor to proceed with the work during the pendency of the dispute, for example:
 - “**CONTINUATION OF WORK.** No claim, dispute or controversy shall interfere with the progress and performance of work required to be performed under this Subcontract and Subcontractor shall proceed as directed by Contractor in all instances with its work under this Subcontract.”

Subcontractor's "Pass Through" Claims

Best practices for subcontract disputes clauses (continued):

- The subcontract should set forth a method to determine if the subcontractor's claim is a claim against the government, or against the prime contractor, or some combination thereof.
- The subcontract should set forth explicitly what dispute resolution procedures must be exhausted before the subcontractor can demand arbitration.

Subcontractor's "Pass Through" Claims

Best practices for subcontract disputes clauses (continued):

- Every claim in excess of \$100,000 on a federal construction project must be certified -- A prime contractor passing through a subcontractor's claim to the Government must include the certification language
- So the subcontract should impose an obligation on the subcontractor to certify its claim and provide all necessary documentation and supporting data so that the prime contractor can certify it to the government.

Subcontractor's "Pass Through" Claims

Liquidating Agreements

- Agreements specifically governing the litigation of pass through claims
- Areas to discuss:
 - Relationship
 - Scope of litigation support responsibilities
 - Attorneys fees
 - Settlement/veto
 - Apportionment
 - Appeal decisions

Subcontractor v. Prime Contractor Claims

Sub/Prime Disputes

What if a prime breaches the subcontract?

If prime refuses to honor subcontract, the subcontractor can:

- Bring suit against the prime in the appropriate U.S. District Court/state court
- Proceed to arbitration if authorized in the subcontract
- Submit a claim to the prime's surety (a Miller Act claim, in construction/public works only)

Sub/Prime Disputes

What if a subcontractor breaches the subcontract?

If subcontractor breaches the prime can:

- Bring suit against the prime in the appropriate U.S. District Court/state court
- Proceed to arbitration if authorized in the subcontract

Sub/Prime Disputes

ADR Issues

- Mandatory mediation
- Arbitribility
- Location
- Attorneys fees

Sub/Prime Disputes

Other Issues in Sub v. Prime Litigation

- Damages for delay
- Pay if Paid v. Pay When Paid?
- Exhaustion of Administrative Remedies
- Jurisdiction/Venue

Questions?

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