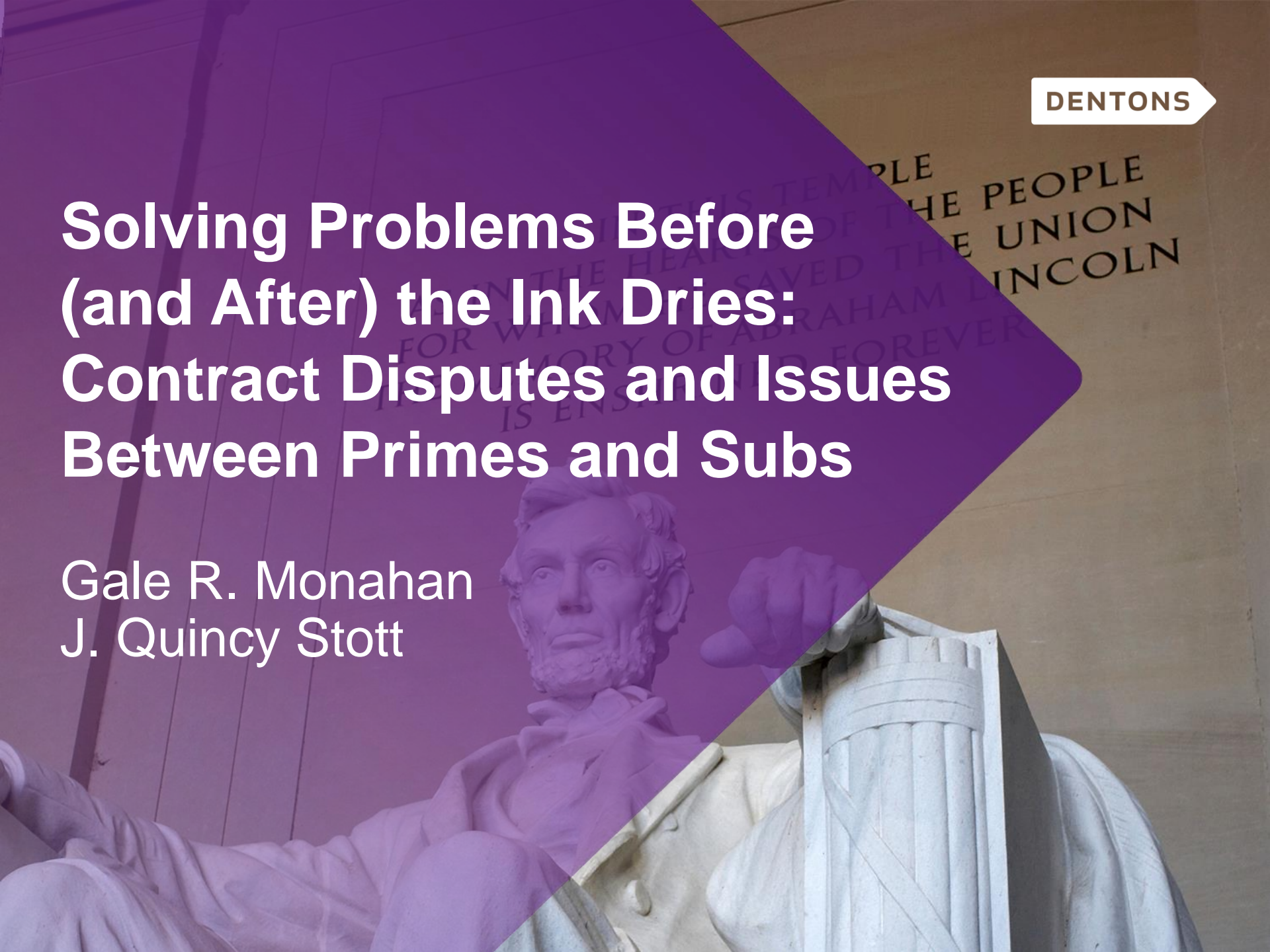


# Solving Problems Before (and After) the Ink Dries: Contract Disputes and Issues Between Primes and Subs

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# Overview

- Subcontracts and Common Areas of Dispute
- Flowdowns
- Negotiating Other Subcontract Clauses
- Primes and Subcontractors Working Together
- Litigation and Claims by Subcontractors
- Practice Tips

# Subcontracts and Common Areas of Dispute

# Subcontracts Generally

- What is a subcontract?
  - FAR 44.101: any contract entered into by a subcontractor to furnish supplies or services for performance of a prime contract or subcontract
- FAR treats intercompany transfers of commercial items as subcontracts
  - FAR 15.401 and 52.244-6
  - CAS: 48 C.F.R. 9903.201-1

# Common Areas of Prime/Sub Disputes

- Scope of work
- Changes
- Subcontractor performance issues
- Late or reduced payments
- Intellectual property and trade secrets

# Flowdowns

# Flowing Down FAR Clauses

- Factors that determine whether a clause must be flowed down
  - Contract type and payment method (fixed-price vs. flexibly priced)
  - Price threshold (SAT) or length of contract performance
  - Commercial items vs. non-commercial items
  - CAS applicability
  - Relevance to scope of work/specifications

# Mandatory Flowdowns

- Certain clauses must be flowed down to subcontractors
- May either require the exact clause or the "substance" of the clause to be included in the subcontract
- Look at "prescription" clause of FAR clause to determine where required
- Examples of common mandatory flowdowns:
  - FAR 52.203-13: Contractor Code of Business Ethics and Conduct
  - FAR 52.215-12: Subcontractor Certified Cost and Pricing Data



# Flowdowns to Commercial Item Subcontracts

- Limited flowdowns required in commercial item contracts
- Prime contractor may flow down a "minimal number" of additional clauses under FAR 52.212-5, Clauses Incorporated by Reference
- Examples
  - FAR 52.224-3: Privacy Training
  - FAR 52.222-26: Equal Opportunity
  - FAR 52.222-50: Combating Trafficking in Persons
- Certain exclusions for COTS (*but* see FAR 52.222-60 Paycheck Transparency Requirements)

# Differing Perspectives

## Prime Contractors

- Primes favor flowdowns to level playing field
- If subcontractor is resistant, determine which clauses most important to minimize risk
  - Termination for Default
  - Termination for Convenience
  - Changes
- Avoid flowing down standard terms without tailoring to contract at issue

## Subcontractors

- Subcontractors should resist wholesale flowdown of all prime contract terms
- Gain an understanding of which clauses are mandatory and which are negotiable
- Commercial items subcontractors should assert that certain clauses not necessary to administration of contract

# Industry-Specific Flowdown Provisions

## Cybersecurity

- DFARS 252.204-7012, Safeguarding Covered Defense Information and Cyber Incident Reporting
- Required flowdown in contracts for "operationally critical support, or for which subcontract performance will involve covered defense information"
  - Provide "adequate security" on all covered information systems
  - Implement NIST SP 800-171 by Dec. 31, 2017
  - Rapidly report cyber incidents to DOD with notice to prime

# Industry-Specific Flowdown Provisions

## Intellectual Property

- Various FAR and DFARS clauses address intellectual property rights between the government, primes, and subs
- FAR 52.227-11: Patent Rights - Ownership by the Contractor
  - Prime retains rights; government has broad license
  - Flowed down to certain subcontracts for research and development work
- Prime contractors should not use contracting power to leverage subcontractor intellectual property rights
  - FAR 52.227-11, DFARS 252.227-7013, 7014, 7038
  - *But see KDH Elec. Sys., Inc. v. Curtis Tech., Ltd.*, CA No. 08-2201, 2009 WL 564417 (E.D. Pa. 2009)
- Subcontractor trade secrets: marking rights and contractual protection (*Plainville Elec. Prods. Co. v. Bechtel Bettis, Inc.*, CA No. 3-06-920, 2009 WL 801639 (D. Conn. Mar. 26, 2009))

# Application of Christian Doctrine to Subcontracts

## Unsettled Issue

- *Christian* doctrine permits parties to read in mandatory clauses which express a significant or deeply ingrained strand of public procurement policy
- Unsettled whether this doctrine applies to subcontracts
  - *UPMC Braddock v. Harris*, 934 F.Supp.2d 238 (D.D.C. 2013), *vacated*, *UPMC Braddock v. Perez*, 584 Fed. App'x 1 (D.C. Cir. Nov. 14, 2014) (mooting the appeal on other grounds)
  - *Energy Labs, Inc. v. Edwards Eng'g, Inc.*, No. 14-C-7444, 2015 WL 3504974 (N.D. Ill. June 2, 2015)

# Negotiating Other Subcontract Clauses

# Negotiating Other Clauses

- Avoid using standard terms and conditions without tailoring to contract
- Ensure subcontracts address the following
  - Organizational conflicts of interest
  - Indemnification
  - Choice of law and choice of forum
    - Federal court typically preferred
    - Federal common law regarding government contracts-specific issues
    - State law likely to govern non-government contracts-specific issues
    - Remember, some judges lack familiarity with concepts unique to government contracts

# Choice of Law

## Pay-if-Paid and Pay-When-Paid

- Common provisions in subcontracts for construction work
- Jurisdictions take different approaches to enforcement of such clauses
  - California and New York
    - Wary of such clauses
    - Interplay with certain state laws may violate public policy
    - May only enforce in certain circumstances
    - Favorable stance for subcontractors
  - Virginia and New Jersey
    - Deference to terms of contract even where not equitable
    - Courts reluctant to invalidate
    - Favorable stance for prime contractors



# Prompt and Complete Subcontractor Payment

- Timeliness and amount of payment to subcontractor is frequently a source of disputes
- FAR provisions seeking to incentivize prompt and complete payments to certain subcontractors
  - Pay attention to prime contract payment clauses (FAR 52.216-7, 52.232-7, 52.232-16)
- New FAR 52.242-5, Payments to Small Business Subcontractors, provides 14-day reporting window for late or incomplete payment to small business contractors
  - Record of delinquent payments maintained in FAPIIS
  - May impact past performance assessment
  - Applies to commercial item contracts

# Primes and Subcontractors Working Together

# Subcontract Management Responsibilities

- FAR 42.202(e)(2): "prime contractor is responsible for managing its subcontracts"
- Differing views on what this entails
  - FAR 42.202(e)(2) does not require prime contractor to audit subcontractor costs
  - Rejects literal interpretation of clause by DCAA; must be read in context

*Lockheed Martin Integrated Sys., ASBCA No. 59508, 17-1 BCA ¶ 36,597*
- Not always practical/realistic for primes to obtain necessary information from subcontractors

# Best Practices for Prime/Sub Teams

## Teaming Agreements

- Separate agreement from subcontract, but must be enforceable
- Timing of subcontract should be considered
- Prime/sub teaming does not decrease prime contractor responsibility for overall contract performance

## Joint Ventures

- JV is in privity with Government
- Past performance considerations
- Populated vs. unpopulated
- SBA size standards implicated

# Litigation and Claims by Subcontractors

# Litigation or Arbitration

## Litigation

- Time-consuming and costly
- Potentially more predictable
- Appeals readily available

## Arbitration

- More efficient
- Less predictable
- Broad discovery standards
- Very limited appeal rights/options to overturn

## Considerations

- Arbitration clauses may include choice of law, arbitration rules (i.e., American Arbitration Association)
- Fee-shifting provisions to recover costs

# Privity and Pass-Through Claims

- Must be in "privity" with the government
  - Subcontractors may only recover directly from the government via "pass-through claims"
  - *B3 Solutions*, ASBCA No. 60654, 16-1 BCA ¶ 36,578
- Subcontractors should attempt to maximize recovery opportunities against primes
- Primes may generally maintain contractual relationships, but in some cases it may make sense to certify pass-through claims

# Practice Tips



# Practice Tips for Primes and Subs

- Carefully read your prime contracts and subcontracts and be aware of all terms
- Proactively assess risks and vulnerabilities
- Monitor version control of terms and conditions
- Beware of "standard" terms not tailored to subcontract
- Consider differences in jurisdictions when contemplating choice of law and choice of forum

# Questions?