

# Subcontract Management From A to Z:

## Session 1: Federal Subcontracting 101

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**David S. Gallacher, Kutak Rock LLP**

[David.Gallacher@KutakRock.com](mailto:David.Gallacher@KutakRock.com)

(202) 828-2437

# Introductions

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**David Gallacher**

+1 202.828.2437 | Washington, D.C.

[David.Gallacher@KutakRock.com](mailto:David.Gallacher@KutakRock.com)

# Overview of the Series

- January 16: Federal Subcontracting 101 (An Overview)
- February 20: Joint Ventures and Teaming Agreements
- March 19: Small Business Programs
- April 16: Small Business Subcontracting
- May 21: Contractor Purchasing Systems
- June 18: Selecting Subcontracts
- September 17: Subcontract Negotiations and Flowdowns
- October 15: Subcontract Pricing
- November 19: Subcontract Management and Administration



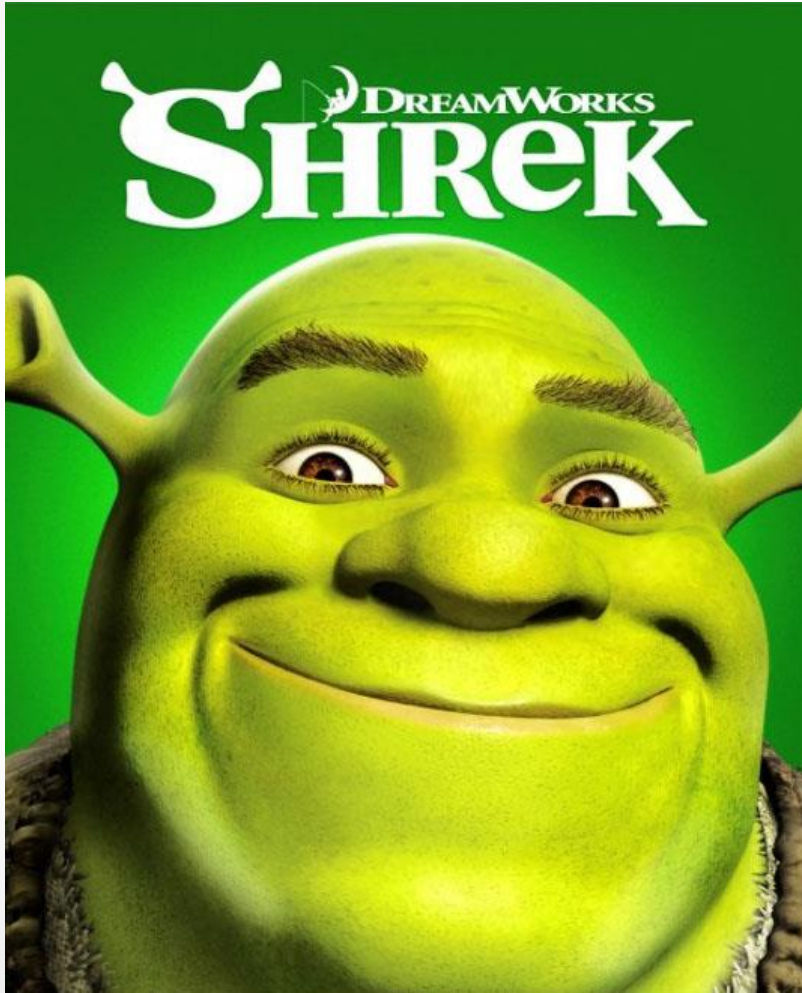
is for **S**ubcontractor  
or **S**upplier\*

\*But what's the difference?



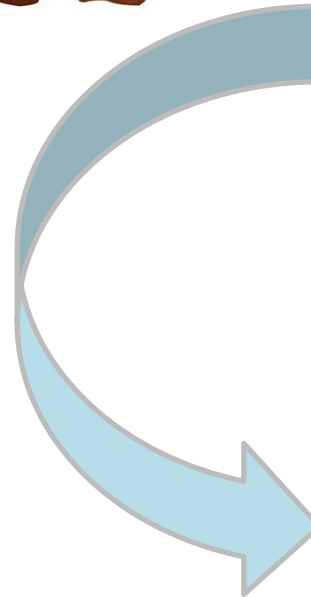
is for **P**rivity  
and **P**olicies  
and **P**rocedures

# Once Upon a Time...





# Once Upon a Time... (cont'd)



# Once Upon a Time... (cont'd)



# Once Upon a Time... (cont'd)





# Once Upon a Time... (cont'd)



# Today's Agenda: Subcontracting 101

- What is a “Federal Subcontractor”?
- Privity of (Sub)contract
- Subcontractor Policies and Procedures (FAR Part 44) – A Brief Introduction

# 1. What is a “Federal Subcontractor”?

# What Is a “Subcontractor”?

- The terms "Subcontract" and "Subcontractor" appear frequently in the FAR
  - But there are **seven or eight distinct definitions**
- As a definitional matter, there is no real distinction between a “supplier” and a “subcontractor”

# What Is a “Subcontractor”? (cont’d)

- Beware of the variety of definitions
- Also be aware that FAR 2.101 – the overall FAR definitional provision – does **not** define "Subcontract" or "Subcontractor"
- But FAR 2.101 does define the term "Contract" – so let's start there...



# What Is a “Subcontractor”? (cont’d)

- FAR 2.101, Definitions

**Contract** means a mutually binding legal relationship obligating the seller to furnish the supplies or services (including construction) and the buyer to pay for them. It includes all types of commitments that obligate the Government to an expenditure of appropriated funds and that, except as otherwise authorized, are in writing. In addition to bilateral instruments, contracts include (but are not limited to) awards and notices of awards; job orders or task letters issued under basic ordering agreements, letter contracts; orders, such as purchase orders, under which the contract becomes effective by written acceptance or performance; and bilateral contract modifications. Contracts do not include grants and cooperative agreements covered by 31 U.S.C. 6301, et. seq. For discussion of various types of contracts, see [FAR] part 16.

# What Is a “Subcontractor”? (cont’d)

- FAR 44.101, Subcontracting Policies and Procedures; Definitions

**Subcontract** means **any contract** as defined in [FAR 2.101] entered into by a subcontractor **to furnish supplies or services for performance of a prime contract or a subcontract**. It includes but is not limited to **purchase orders**, and changes and modifications to purchase orders.

**Subcontractor** means **any supplier, distributor, vendor, or firm that furnishes supplies or services** to or for a prime contractor or another subcontractor.

# What Is a “Subcontractor”? (cont’d)

- Similar definitions at:
  - FAR 3.901, Whistleblower Protections for Contractor Employees
    - Also included at 52.203-18, Prohibition on Contracting with Entities that Require Certain Internal Confidentiality Agreements or Statements – Representation and 52.203-19, Prohibition on Requiring Certain Internal Confidentiality Agreements or Statements
  - FAR 3.1001, Contractor Code of Business Ethics and Conduct
    - Also included at 52.203-13, Contractor Code of Business Ethics and Conduct
  - FAR 22.1702, Combatting Trafficking in Persons
    - Also included at 52.222-50, Combatting Trafficking in Persons
  - FAR 22.1801, E-Verify
    - Also included at 52.222-54, Employment Eligibility Verification
  - FAR 46.101, Quality Assurance

# What Is a “Subcontractor”? (cont’d)

- FAR 19.701, Small Business Subcontracting; Definitions

***Subcontract*** means any agreement (other than one involving an employer-employee relationship) entered into by a Government prime contractor or subcontractor calling for supplies and/or services **required for performance of the contract**, contract modification, or subcontract.

# What Is a “Subcontractor”? (cont’d)

- FAR 3.502-1, Subcontractor Kickback; Definitions

## ***Subcontractor*** –

(1) means any person, other than the prime contractor, who offers to furnish or furnishes any supplies, materials, equipment, or services of any kind under a prime contract or a subcontract entered into in connection with such prime contract, and

(2) includes any person who offers to furnish or furnishes general supplies to the prime contractor or a higher tier subcontractor.



# What Is a “Subcontractor”? (cont’d)

- Is a transfer between divisions, subsidiaries, affiliates a “subcontract”?

- FAR 12.001, Commercial Products and Commercial Services; Definitions

**Subcontract**, as used in this part, includes, but is not limited to, a transfer of commercial products or commercial services between divisions, subsidiaries, or affiliates of a contractor or subcontractor.

- FAR 15.401, Contract Pricing; Definitions

**Subcontract** ... also includes a transfer of commercial products or commercial services between divisions, subsidiaries, or affiliates of a contractor or a subcontractor.

- *But note that these are not true “definitions”; they relate to access to cost or pricing data...*

# What Is a “Subcontractor”? (cont’d)

- FAR 22.801, Equal Employment Opportunity; Definitions

**Subcontract** means **any agreement** or arrangement between a contractor and any person (in which the parties do not stand in the relationship of an employer and an employee)

- (1) **For the purchase, sale, or use of personal property or nonpersonal services that, in whole or in part, are necessary to the performance of any one or more contracts;** or
- (2) Under which any portion of the contractor's obligation under any one or more contracts is performed, undertaken, or assumed.

**Subcontractor** means any person who holds, or has held, a subcontract subject to E.O. 11246. The term **first-tier subcontractor** means a subcontractor holding a subcontract with a prime contractor.

# What Is a “Subcontractor”? (cont’d)

- FAR 52.204-10, Reporting Executive Compensation and First-Tier Subcontract Awards

**First-tier subcontract** means a subcontract awarded directly by the Contractor for the purpose of acquiring supplies or services (including construction) for performance of a prime contract. It does not include the Contractor's supplier agreements with vendors, such as long-term arrangements for materials or supplies that benefit multiple contracts and/or the costs of which are normally applied to a Contractor's general and administrative expenses or indirect costs.

*Note: FAR 4.1701, Service Contracts Inventory, uses this same definition (as does 52.204-14 and 52.204-15).*

# What Is a “Subcontractor”? (cont’d)

- No uniform statutory rule, either
- 41 U.S.C. § 1906(c)(1) includes language relating to flowdowns under commercial subcontracts:
  - “... **includes** a transfer of commercial products or commercial services **between divisions, subsidiaries, or affiliates** of a contractor or subcontractor.”
  - “... **does not include** agreements entered into by a contractor for the supply of commodities that are **intended for use in the performance of multiple contracts** with the Federal Government and other parties and are not identifiable to any particular contract.”
- FAR Case 2018-0006 is supposed to give a more uniform definition of “subcontract,” hopefully streamlining the list of mandatory flowdown clauses
  - *We will discuss flowdowns in greater detail in Session 7 (in September 2024)*

# What Is a “Subcontractor”? (cont’d)

- Note that the FY 2019 NDAA (H.R. 5515) *proposed* the following statutory definition of “Subcontract” to be added at 41 U.S.C. § 115.
  - **But this was omitted from the final law.**

(a) IN GENERAL.—In this subtitle, the term ‘subcontract’ means a contract entered into by a prime contractor or subcontractor **for the purpose of obtaining** supplies, materials, equipment, or services of any kind under a prime contract. The term **includes a transfer of a commercial product or commercial service between divisions**, subsidiaries, or affiliates of a contractor or subcontractor.

- (b) MATTERS NOT INCLUDED.—In this subtitle, the term ‘subcontract’ **does not include**—
- (1) a contract the costs of which are applied to **general and administrative expenses or indirect costs**; or
  - (2) an agreement entered into by a contractor or subcontractor for the supply of a commodity, a commercial product, or a commercial service that is intended for use in the **performance of multiple contracts**.



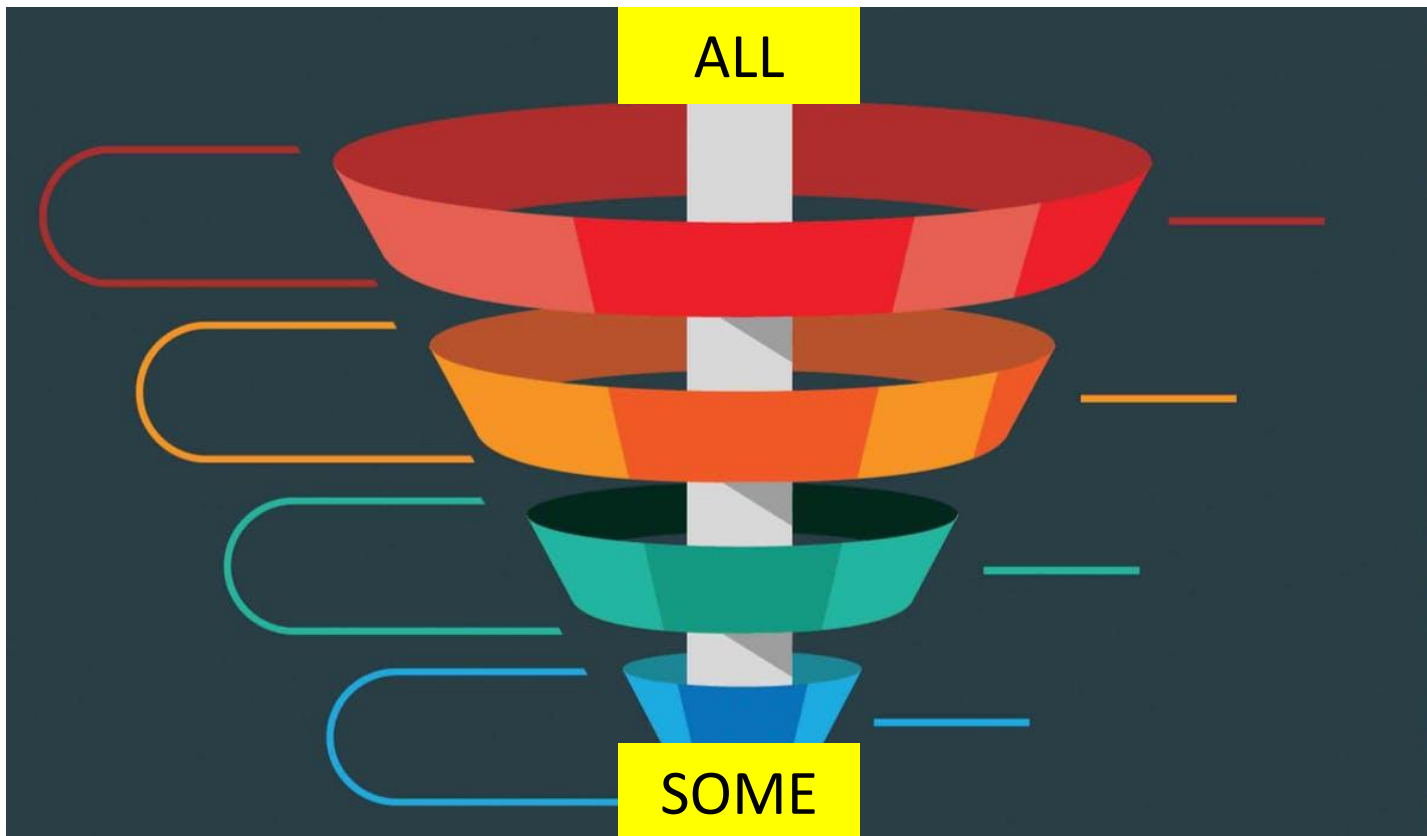
# What Is a “Subcontractor”? (cont’d)

- Practically speaking, a “subcontractor” is **likely** to include any vendor providing supplies or services that are used in a Government prime contract
  - This includes vendors that are far removed in the supply chain
- “A **rose** by any other name...”
  - [Subcontractor vs. Supplier vs. Vendor?](#)
  - [Subcontract vs. Purchase Order?](#)
  - There may be no difference legally
    - However, there may be a difference within your organization for:
      - Subcontracts under a certain dollar threshold
      - Commercial subcontracts
      - Routine supplier agreements
      - Long-term arrangements for materials or supplies that would normally be applied to a Contractor's general and administrative expenses or indirect cost.
      - Bottom line: use terms precisely to avoid confusion and misinterpretation.
- There are no reported cases of the government prosecuting companies for drawing such distinctions



# What Is a “Subcontractor”? (cont’d)

- Two paradigms:



# What Is a “Subcontractor”? (cont’d)

- **Why does the definition matter?**
  - Flowdowns + Terms & Conditions
    - Failing to flow down = breach of prime contract
  - Certifications
  - Reporting obligations
  - Internal procedures for award/administration
  - Small Business Subcontracting Plan
  - Risk mitigation/oversight
  - Increased government demands of its **deputies**...



# Common Practices to Distinguish “Subcontractors” from “Suppliers”

- **What is the supplier’s role on the program?**
  - Are they required to comply with prime contract SOW requirements?
  - Will access be required to customer facility?
  - Will supplier be interacting with the government customer?
  - What is the nature of the subcontract award – new award vs. existing relationship?
- **What is the dollar value of the subcontract?**
  - < \$10,000 (micro-purchase threshold)
  - < \$250,000 (simplified acquisition threshold)
  - < \$2 million (certified cost or pricing data threshold)



# Common Practices to Distinguish “Subcontractors” from “Suppliers” (cont’d)

- **What is being purchased?**
  - Commercial vs. non-commercial?
  - Products vs. services?
- **How is the purchase structured?**
  - Straight subcontract?
  - Master Purchase Agreement?
  - Purchase Order?



## 2. Subcontractor Privity

# Subcontractor Privity

- Legal doctrine of "privity"
  - Only a person who shares a contracting relationship with another person may claim rights
    - Doctrine derives from common law
    - Prevented people from entertaining lawsuits brought by people with no direct contractual interest
- Government subcontractors lack privity to deal directly with the Government
  - No direct access to BCAs/Court of Federal Claims
  - No direct claim against Government
  - In many instances, subcontractors cannot even talk directly with the Government
- **Subcontractors only have privity with the Prime Contractor**

# Subcontractor Privity (cont'd)

- Cost contracts/subcontracts make no difference
- Parallel terms in Prime/Subcontract that are largely dictated by Government does not affect privity
- Source of funding (e.g., grant from the Federal Government; flow-through payments) does not affect privity



# Subcontractor Privity (cont'd)

- Direct dealings by Government with Subcontractor could affect privity
- Third party beneficiary theories can also substitute for privity
  - For example, Data Rights (DFARS 227.7103-7, "Use and non-disclosure agreement").
- There are several regulatory exceptions to lack of privity between a subcontractor and the Government
  - But these are generally all one-way exceptions, working in favor of the Government, and not giving subcontractors extra rights

# Main Exceptions to Doctrine of Privity Between Government and Subcontractors

1. Government "liens" under Progress Payments provisions
2. Government rights under Intellectual Property clauses
3. Government audit rights
4. Rights granted by socioeconomic clauses
5. Suspension and debarment proceedings
6. Ethics and mandatory disclosures
7. Industrial Security regulations
8. Small business subcontractors' right to payment

# Exceptions to Doctrine of Privity

## 1. Government "liens" under Progress Payments provisions

- FAR 52.232-16(d), Progress Payments; Title
  - (1) Title to the property described in this paragraph (d) shall vest in the Government. Vestiture shall be immediately upon the date of this contract, for properly acquired or produced before that date. Otherwise, vestiture shall occur when the property is or should have been allocable or properly chargeable to this contract.
  - (2) *Property*, as used in this clause, includes all of the below-described items acquired or produced by the Contractor that are or should be allocable or properly chargeable to this contract under sound and generally accepted accounting principles and practices.
    - (i) Parts, materials, inventories, and work in process;
    - (ii) Special tooling and special test equipment to which the Government is to acquire title;
    - (iii) Nondurable (i.e., noncapital) tools, jigs, dies, fixtures, molds, patterns, taps, gauges, test equipment, and other similar manufacturing aids, title to which would not be obtained as special tooling under subparagraph (ii) above; and
    - (iv) Drawings and technical data, to the extent the Contractor or subcontractors are required to deliver them to the Government by other clauses of this contract.

# Exceptions to Doctrine of Privity (cont'd)

## 2. Government rights under Intellectual Property clauses

- DFARS 252.227-7013, Rights in Technical Data — Noncommercial Items

(k) Applicability to subcontractors or suppliers.

(1) The Contractor shall ensure that the rights afforded its subcontractors and suppliers under 10 U.S.C. 3771–3775, 10 U.S.C. 3781–3786, and the identification, assertion, and delivery processes of paragraph (e) of this clause are recognized and protected.

(2) Whenever any technical data for other than commercial products or commercial services, or for commercial products or commercial services developed in any part at Government expense, is to be obtained from a subcontractor or supplier for delivery to the Government under this contract, the Contractor shall use this same clause in the subcontract or other contractual instrument, including subcontracts or other contractual instruments for commercial products or commercial services, and require its subcontractors or suppliers to do so, without alteration, except to identify the parties. This clause will govern the technical data pertaining to noncommercial items or to any portion of a commercial product or commercial service that was developed in any part at Government expense, and the clause at 252.227–7015 will govern the technical data pertaining to any portion of a commercial item that was developed exclusively at private expense. No other clause shall be used to enlarge or diminish the Government's, the Contractor's, or a higher-tier subcontractor's or supplier's rights in a subcontractor's or supplier's technical data.

(3) Technical data required to be delivered by a subcontractor or supplier shall normally be delivered to the next higher-tier contractor, subcontractor, or supplier. However, when there is a requirement in the prime contract for data which may be submitted with other than unlimited rights by a subcontractor or supplier, then said subcontractor or supplier may fulfill its requirement by submitting such data directly to the Government, rather than through a higher-tier contractor, subcontractor, or supplier.

# Exceptions to Doctrine of Privity (cont'd)

- DFARS 252.227-7037, Validation of Restrictive Markings on Technical Data
  - (k) Privity of contract. The Contractor or subcontractor agrees that the Contracting Officer may transact matters under this clause directly with subcontractors at any tier that assert restrictive markings. However, this clause neither creates nor implies privity of contract between the Government and subcontractors.
  - (l) Flowdown. The Contractor or subcontractor agrees to insert this clause in contractual instruments, including subcontracts and other contractual instruments for commercial products or commercial services, with its subcontractors or suppliers at any tier requiring the delivery of technical data.

# Exceptions to Doctrine of Privity (cont'd)

## 3. Government audit rights

- For example
  - FAR 52.214-26(e), Audit and Records – Sealed Bidding
  - FAR 52.215-2(g), Audit and Records – Negotiation
  - FAR 15.404-3, Subcontract Pricing Considerations
- Government audit rights may be limited in commercial contracts
  - But what about commercial subcontractors under non-commercial prime contracts?

# Exceptions to Doctrine of Privity (cont'd)

## 4. Rights granted by socioeconomic laws (labor, civil rights, environmental)

- Government can sue to enforce
  - Government audit rights
  - Penalties
- Be aware of the Office of Federal Contract Compliance Programs (“OFCCP”)
  - Audit division of the Department of Labor
  - Charged with monitoring contractor compliance with socioeconomic requirements



# Exceptions to Doctrine of Privity (cont'd)

## 5. Suspension and debarment proceedings

- Continual push in Congress to use suspension and debarment remedy more aggressively



# Exceptions to Doctrine of Privity (cont'd)

## 6. Mandatory Ethics Plans/Mandatory Disclosures

- FAR 52.203-13 requires disclosure of contractor wrongdoing
- Mandatory flowdown
- Agency Inspectors General insist that subcontractors report wrongdoing directly to the Government

# Exceptions to Doctrine of Privity (cont'd)

## 7. Industrial Security regulations

- Relates to handling of classified materials
- Government rights are tied to a subcontractor's facility clearance agreements with the Government (DD254)

# Exceptions to Doctrine of Privity (cont'd)

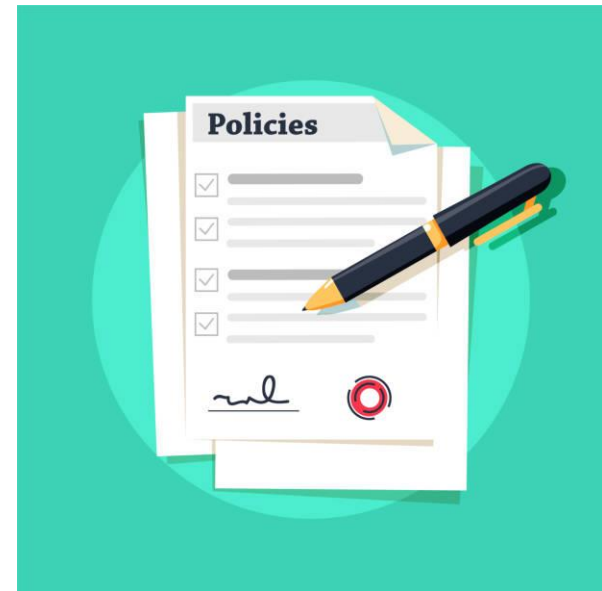
## 8. Small business subcontractors' right to contact CO regarding payments

- FAR 32.112-1 authorizes a small business to contact CO regarding large business's failure to pay in a timely manner
- Making timely payments to small business subcontractors is part of a prime contractor's performance evaluation (FAR 42.1502(g)(2) and 52.242-5)

# 3. Subcontractor Policies and Procedures (FAR Part 44) – A Brief Introduction

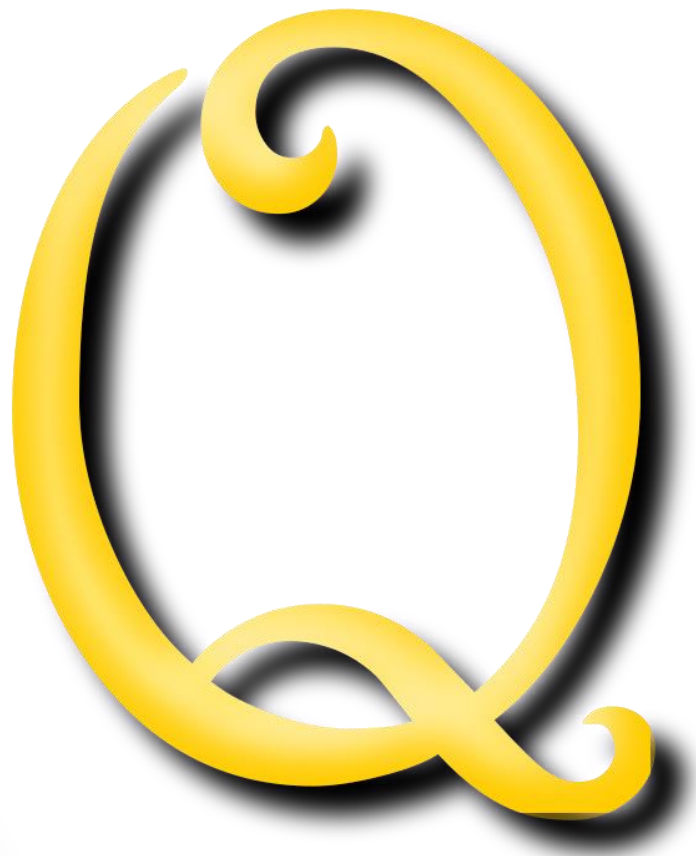
# Subcontracting Policies and Procedures

- Companies should implement policies and procedures to manage their subcontract administration
- Key Features
  - Written policies/manuals
  - Subcontract Management Plan
  - Contractor Procurement System
  - Small Business Subcontracting Plan
  - Training on Subcontract Administration
- **Have a system in place... and follow it!**



# Subcontracting Policies and Procedures (cont'd)

- Internal policies and procedures should derive from the FAR requirements
  - FAR subpart 44.2 – Consent to Subcontracts
  - FAR subpart 44.3 – Contractors' Purchasing Systems Reviews
  - FAR subpart 44.4 – Subcontracts for Commercial Products and Commercial Services
- We will be discussing these FAR requirements (and more) in subsequent sessions...



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# Next Session on February 20, 2023

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- Session 2: Joint Ventures and Teaming Agreements