



Subcontract Management From A to Z:

Session 7: Subcontract Negotiations

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Introduction



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Overview of the Series

- January 12: Federal Subcontracting 101 (An Overview)
- February 9: Joint Ventures and Teaming Agreements
- March 9: Small Business Programs
- April 13: Small Business Subcontracting
- May 11: Contractor Purchasing Systems
- June 15: Selecting Subcontractors
- September 14: Subcontract Negotiations
- October 12: Subcontract Pricing
- November 9: Subcontract Management and Administration

Subcontract Negotiations



“Builder shall design and build a house...”

Subcontract Negotiations A-Z



TERMS

&



CONDITIONS

3 Phases of Subcontract Management



Agenda

- Subcontract Negotiations
- Subcontract Flowdowns
 - Mandatory flowdowns
 - Necessary flowdowns
- Other Terms & Conditions

1. SUBCONTRACT NEGOTIATIONS

Negotiating Subcontracts

- Preliminary philosophical issues
 - "Tough" vs. "Fair" terms
 - Who has the leverage?
 - Do you want to use your leverage?
 - Contracting history of the subcontractor?
 - Expected life of the program?
 - What is the relative "contribution" of the subcontractor?
 - Can the subcontractor be replaced at reasonable cost?
 - Can the subcontractor be replaced with a reasonable schedule?
 - Can the subcontractor financially handle a "loss" contract?
 - Impact of a "hurting" subcontractor on schedule and performance?



Negotiating Subcontracts (cont'd)

- The Uniform Commercial Code (UCC) places limits on "tough" provisions in contracts for sales of goods

§ 2-302, Unconscionable Contract or Clause.

- (1) If the court as a matter of law finds the contract or any clause of the contract to have been **unconscionable** at the time it was made the court **may refuse to enforce the contract**, or it may enforce the remainder of the contract without the unconscionable clause, or it may so **limit the application of any unconscionable clause** as to avoid any unconscionable result.
- (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be **afforded a reasonable opportunity to present evidence** as to its commercial setting, purpose and effect to aid the court in making the determination.



Negotiating Subcontracts (cont'd)

Ten Tips for Negotiating Subcontracts

1. Start the process early
 - As early as possible while “honeymoon” atmosphere exists
 - Possibly even as part of a teaming agreement
2. Complete the negotiation prior to initiating work
 - Leverage is significantly altered once work begins
 - UCC "Battle of the Forms" and initiation of work
 - You could end up (accidentally) with an enforceable contract with different terms and conditions than you expected

Negotiating Subcontracts (cont'd)

3. Know when to take exception

- Evaluate the practical importance to the particular contract of the issues presented by a clause
- Try to argue only over important issues
 - “Keep your powder dry...”

4. Can you prevail if you object?

- Are you willing to walk away?
- Is the clause a "deal breaker" for the other side?
- Is the language "boilerplate" or specially drafted for your subcontract?
- Has the clause been proposed to and accepted by other Subcontractors?
- Are the objectionable terms susceptible to differing interpretations?



Negotiating Subcontracts (cont'd)

5. *"It is sometimes better not to have fought, than to have fought and lost."*
6. Object only to clauses that can be deleted or changed
 - Know the FAR System mandatory flowdown clauses – *i.e.*, socioeconomic; environmental; enforcement; ethics; technical data; etc.
 - Know which clauses the prime needs based on clauses in the prime contract – Changes, Inspection, Default, Progress Payments, Government Property, Warranty, etc.
 - Consider carefully before taking exception to these "mandatory" or "necessary" clauses, but do not hesitate to take exception to contractor alterations to the standard clauses

Flowdowns

Negotiating Subcontracts (cont'd)

7. Take exception using professional, tempered statements of your objection and the reason
8. If possible, propose alternative language rather than simply rejecting the clause (at least after initial objection)
9. Propose language or clauses that are "given up" in exchange for other concessions
10. "Keeping Score" Negotiations



Negotiating Subcontracts (cont'd)

- Internal negotiation controls
 - Who is authorized to change or accept proposed clauses?
 - Counsel?
 - VP/Director?
 - Supervisor?
 - Required approval of someone other than negotiator helps because:
 - Standardizes clauses
 - Protects against unknowing assumption of risks
 - Provides negotiator with obstacle to resist pressure to change language
 - These controls should be specified in your written procedures
 - May also be included in a Negotiation Manual

Negotiating Subcontracts (cont'd)

- Who maintains **records of negotiation**, where, and for how long?
 - **Contemporaneous records** are generally heavily persuasive in litigation
 - People leave, memories become obscured – records are invaluable
 - **All drafts, memoranda, and teleconference notes regarding terms/language** should be maintained
 - Consider the importance of **e-mails & voicemail** – maintain hard copies
 - Even if the records ultimately undermine your case, it is better to know you have a bad case early before you incur costs of litigation based on faulty memories
 - Keep one set of the records in one place and allow no document to be removed from that set; custodian should make copies as needed
 - Keep records where they can be reasonably retrieved
 - Keep records for **at least 6 years** after subcontract closeout
 - State law statute of limitations is generally 3-4 years
 - U.S. statute of limitations (including FCA liability) is generally 6 years

Negotiating Subcontracts (cont'd)

- Format of terms and conditions
 - Best practice: Standard templates
 - List of clauses to be checked when applicable?
 - Multiple forms based on nature of contract
 - This is easier to do if you have a limited number of subcontract types with which you typically work
 - Criteria for choosing
 - Breadth of your company's product lines and types of contracts
 - Experience and knowledge of contracting personnel
 - Size of procurement/subcontract

Negotiating Subcontracts (cont'd)

- Common approaches to:
 - Self-incorporating clauses
 - Self-deleting clauses
- **Remember: Your people need to have the tools so they can know what they are doing!**
 - Make sure that you are following your Purchasing System [policies and procedures](#)



Negotiating Subcontracts (cont'd)

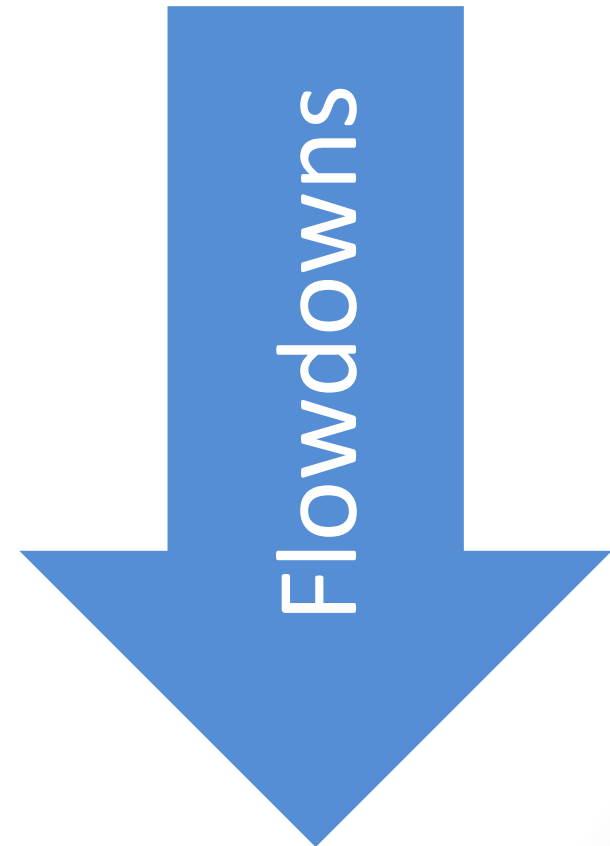
- Where do you find subcontract terms and conditions to be used?
 - **Start with the Prime Contract involved**
 - Review for flowdown requirements
 - Professional/trade association publications
 - **NDIA** (www.ndia.org)
“A Study of the Applicability of FAR Clauses to Subcontracts Under Prime Defense and NASA Contracts”
 - **ABA**/Public Contract Law Division (www.abanet.org/contract/pubs.html)
 - **NCMA** (www.ncma.org)
 - Major prime contractor websites (Lockheed Martin, Boeing, Northrop Grumman, Raytheon, General Dynamics, BAE Systems, etc.)
 - FAR System – See FAR 52.301
 - Mandatory clauses for commercial products and services – (FAR 52.244-6; 52.212-5(e))



2. SUBCONTRACT FLOWDOWNS

Flowdowns

- Most government contracts include terms and conditions that need to be “flowed down” to subcontractors/suppliers
 - How far?
 - *“All the way down...” [if you can believe it]*
- Types of flowdowns
 - Mandatory
 - Necessary
 - Other
- At the subcontract level, most FAR clauses must be invoked to apply



Flowdowns (cont'd)

- “Mandatory” vs. “Necessary” flowdowns
 - Clauses mandated by law (examples)
 - Contractor Code of Business Ethics and Conduct
 - Small Business
 - Socioeconomic/Equal Opportunity
 - Human Trafficking
 - Prohibitions on use of Chinese telecommunications equipment
 - **NEW: TikTok ban** (June 2023)

Flowdowns (cont'd)

- **Mandatory flowdowns** in commercial subcontracts

- FAR 52.244-6 (noncommercial prime) & FAR 52.212-5(e) (commercial prime)

1. FAR 52.203-13, Contractor Code of Business Ethics and Conduct
2. ~~FAR 52.203-15, Whistleblower Protections Under the American Recovery and Reinvestment Act of 2009~~
3. FAR 52.203-19, Prohibition on Requiring Certain Internal Confidentiality Agreements or Statements
4. FAR 52.204-21, Basic Safeguarding of Covered Contractor Information Systems
5. FAR 52.204-23, Prohibition of Contracting for Hardware, Software, and Services Developed by Kaspersky Lab and Other Covered Entities
6. FAR 52.204-25, Prohibition on Contracting for Certain Telecommunications and Video Surveillance Services or Equipment
7. **FAR 52.204-27, Prohibition on a ByteDance Covered Application**
8. FAR 52.219-8, Utilization of Small Business Concerns
9. FAR 52.222-21, Prohibition of Segregated Facilities
10. FAR 52.222-26, Equal Opportunity
11. FAR 52.222-35, Equal Opportunity for Veterans
12. FAR 52.222-36, Equal Opportunity for Workers with Disabilities
13. FAR 52.222-37, Employment Reports on Veterans
14. FAR 52.222-40, Notification of Employee Rights Under the National Labor Relations Act
15. FAR 52.222-41, Service Contract Labor Standards
16. FAR 52.222-50, Combating Trafficking in Persons
17. FAR 52.222-51, Exemption from Application of the Service Contract Labor Standards to Contracts for Maintenance, Calibration, or Repair of Certain Equipment—Requirements
18. FAR 52.222-53, Exemption from Application of the Service Contract Labor Standards to Contracts for Certain Services—Requirements
19. FAR 52.222-54, Employment Eligibility Verification (“E-Verify”)
20. FAR 52.222-55, Minimum Wages under E.O. 13658
21. FAR 52.222-62, Paid Sick Leave under E.O. 13706
22. FAR 52.224-3, Privacy Training
23. FAR 52.225-26, Contractors Performing Private Security Functions Outside the United States
24. FAR 52.226-6, Promoting Excess Food Donation to Nonprofit Organizations
25. FAR 52.232-40, Providing Accelerated Payments to Small Business Subcontractors
26. FAR 52.247-64, Preference for Privately Owned U.S.-Flag Commercial Vessels

Flowdowns (cont'd)

- Why two different lists: 52.244-6 and 52.212-5(e)?
 - Because commercial item contracting has evolved separately under the FAR
 - Most companies simply combine the two lists
 - Easier to have one process in place



Flowdowns (cont'd)

- Necessary flowdowns

- Clauses that, as a practical matter, the prime needs to include to meet prime contract requirements
- Examples:
 - Cybersecurity (especially DFARS 252.204-7012)
 - Buy American/Country of Origin
 - Sourcing restrictions (including DFARS 252.246-7008, Sources of Electronic Parts)
 - Technical data rights/computer software rights
 - Cost or pricing data
 - Background check/facility access
 - Organizational Conflicts of Interest (OCIs)
 - H-Clauses

Flowdowns (cont'd)

- Alterations/Limitations to Flowdowns
 - Some clauses, if flowed down, should be altered appropriately
 - Incorporation without modification can create confusion
 - *Performance Contracting, Inc. v. Seaboard Sur. Co.*, 163 F.3d 366 (6th Cir. 1998) – Unnecessary litigation over disputes procedures when low-level subcontractor refused to present claim to CO before suing in court
 - Some clauses sometimes found in subcontracts that should not be there
 - (Altered) DOD Data Rights, DFARS 227.7103-15 & 227.7203-15
 - Limitations on a Subcontractor's right to sell directly to the Government, FAR 3.503-1
 - Limitations on small business contacts with the contracting officer, FAR 32.112-2
 - Subcontractors cannot be precluded from contacting CO on payment delays on noncommercial contracts

Flowdowns (cont'd)

- Be aware of the *Christian Doctrine*
 - *G.L. Christian & Assocs. v. United States*, 312 F.2d 418, 160 Ct. Cl. 1 (1963)
 - Certain rules and contract clauses have the force and effect of law even though not expressly incorporated in a prime contract
 - “Deeply ingrained strand of public procurement policy”
 - Such as, for example, the Termination for Convenience clause
 - Open debate as to whether the *Christian* doctrine applies at the subcontractor level
 - BUT...

Flowdowns (cont'd)

- The Office of Federal Procurement Policy (OFCCP) has issued at least two decisions extending *Christian* to subcontractors in the healthcare field
 - **Radically expansive view** of *Christian* doctrine
 - *OFCCP v. UPMC-Braddock*, ARB Case No. 08-048 (May 29, 2009)
 - Relates to Federal Employee Health Benefits Program (administered by Office of Personnel Management)
 - “Equal Rights” clauses under jurisdiction of Department of Labor and OFCCP may be subject to the *Christian* doctrine or incorporated into subcontracts by operation of language of authorizing statute or Executive Order
 - In 2013, the D.C. District Court **affirmed** OFCCP’s ruling by granting the Government’s motion for summary judgment
 - The case was appealed to the D.C. Circuit and was **dismissed** as moot in 2014 because the Secretary of Labor issued a five-year moratorium on the enforcement of the socioeconomic requirements for TRICARE subcontractors
 - *OFCCP v. Fla. Hosp.*, DOL OALJ No. 2009-OFC-00002 (Oct. 18, 2010)
 - Relates to TRICARE (administered by the Department of Defense)
 - Complaint **dismissed** on appeal

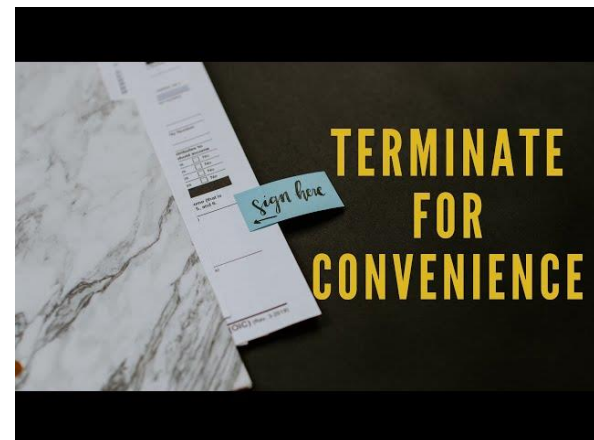
3. OTHER TERMS & CONDITIONS

Other Terms & Conditions

- “Standard” terms & conditions
- Examples:
 - Termination (incl. Termination for Convenience)
 - Default
 - Excusable Delay
 - Liquidated Damages
 - Delivery/Shipping
 - Inspection/Warranty
 - Limitations on Liability
 - Payments
 - Changes
 - Audit
 - Disputes
 - Choice of Law

Other Terms & Conditions (cont'd)

- Termination for Convenience (“T4C”)
 - Under what circumstances is a T4C appropriate in a subcontract?
 - Same as Government T4C clause, or something different?
 - Timing for submittal of termination proposal
 - Commercial restocking charges
 - Audit rights?
 - Who gets to audit – government or prime?
 - Any clause at all?
 - Maybe you choose not to include a T4C clause at all...



Other Terms & Conditions (cont'd)

- Termination for Default (“T4D”)
 - List causes for default
 - Suspension/debarment
 - Bankruptcy
 - Failure to make progress
 - Failure to respond to “cure” letters
 - Others
 - "Cover" v. "reprocurement"
 - What remedies are available for recovery of excess costs?
 - Incidental and consequential damages?
 - Normally these are disclaimed, but maybe not



Other Terms & Conditions (cont'd)

FAR 52.249-8 Default (Fixed-Price Supply and Service)

(a)(1) The Government may, subject to paragraphs (c) and (d) below, by written notice of default to the Contractor, terminate this contract in whole or in part **if the Contractor fails to—**

- (i) **Deliver the supplies or to perform the services within the time specified in this contract** or any extension;
- (ii) **Make progress**, so as to endanger performance of this contract (but see paragraph (a)(2) below); or
- (iii) **Perform any of the other provisions** of this contract (but see paragraph (a)(2) below).

(2) The Government's right to terminate this contract under subdivisions (1)(ii) and (1)(iii) above, may be exercised if the Contractor **does not cure such failure within 10 days** (or more if authorized in writing by the Contracting Officer) after receipt of the notice from the Contracting Officer specifying the failure.

(b) If the Government terminates this contract in whole or in part, it may acquire, under the terms and in the manner the Contracting Officer considers appropriate, supplies or services similar to those terminated, and the **Contractor will be liable to the Government for any excess costs** for those supplies or services. However, the Contractor shall continue the work not terminated.

(c) **Except for defaults of subcontractors at any tier, the Contractor shall not be liable for any excess costs if the failure to perform the contract arises from causes beyond the control and without the fault or negligence of the Contractor.** Examples of such causes include (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) epidemics, (6) quarantine restrictions, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance the failure to perform must be beyond the control and without the fault or negligence of the Contractor.

Other Terms & Conditions (cont'd)

FAR 52.249-8 Default (Fixed-Price Supply and Service) (cont'd)

(d) If the failure to perform is **caused by the default of a subcontractor at any tier**, and if the cause of the default is beyond the control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be liable for any excess costs for failure to perform, unless the subcontracted supplies or services were obtainable from other sources in sufficient time for the Contractor to meet the required delivery schedule.

(e) If this contract is terminated for default, the Government may require the Contractor to transfer title and deliver to the Government, as directed by the Contracting Officer, any (1) completed supplies, and (2) partially completed supplies and materials, parts, tools, dies, jigs, fixtures, plans, drawings, information, and contract rights (collectively referred to as manufacturing materials in this clause) that the Contractor has specifically produced or acquired for the terminated portion of this contract. Upon direction of the Contracting Officer, the Contractor shall also protect and preserve property in its possession in which the Government has an interest.

(f) The Government shall pay contract price for completed supplies delivered and accepted. The Contractor and Contracting Officer shall agree on the amount of payment for manufacturing materials delivered and accepted and for the protection and preservation of the property. Failure to agree will be a dispute under the Disputes clause. The Government may withhold from these amounts any sum the Contracting Officer determines to be necessary to protect the Government against loss because of outstanding liens or claims of former lien holders.

(g) If, after termination, it is determined that the Contractor was not in default, or that the default was excusable, the rights and obligations of the parties shall be the same as if the termination had been issued for the convenience of the Government.

(h) The rights and remedies of the Government in this clause are in addition to any other rights and remedies provided by law or under this contract.

Other Terms & Conditions (cont'd)

- **52.212-4 Contract Terms and Conditions – Commercial Products and Commercial Services.**

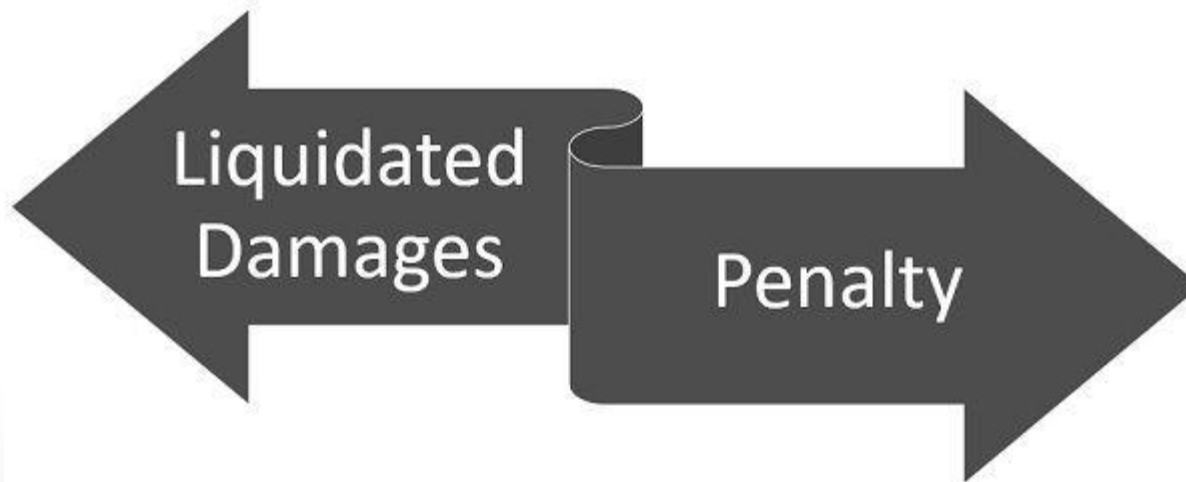
(f) *Excusable delays.* The Contractor shall be liable for default **unless nonperformance is caused by an occurrence beyond the reasonable control of the Contractor and without its fault or negligence** such as, acts of God or the public enemy, acts of the Government in either its sovereign or contractual capacity, fires, floods, epidemics, quarantine restrictions, strikes, unusually severe weather, and delays of common carriers. The Contractor shall notify the Contracting Officer in writing as soon as it is reasonably possible after the commencement of any excusable delay, setting forth the full particulars in connection therewith, shall remedy such occurrence with all reasonable dispatch, and shall promptly give written notice to the Contracting Officer of the cessation of such occurrence.

- No mention of subcontractors as cause of default (as is the case in 52.249-8)
- Why are subcontractors not addressed?



Other Terms & Conditions (cont'd)

- Liquidated Damages
 - Should you specify liquidated damages?
 - Common in construction contracts and situations where time is of the essence
 - Do the rights survive the contract default?
 - In order to be enforceable, damages/remedies must have been reasonable when the contract was signed



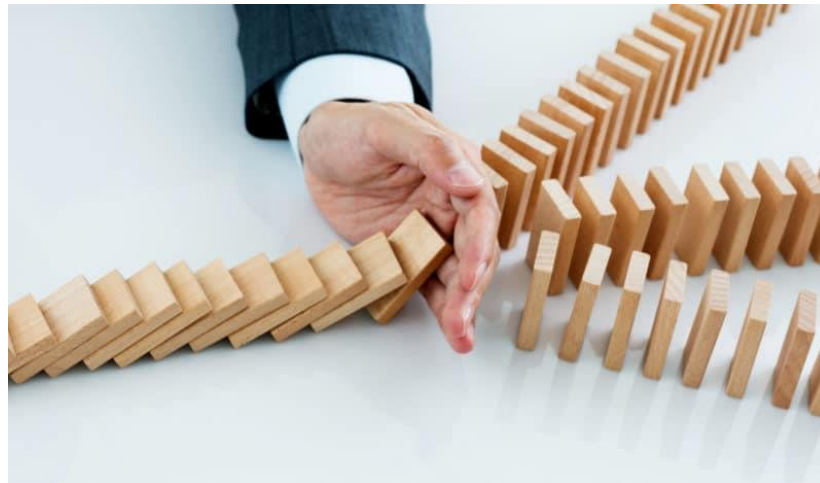
Other Terms & Conditions (cont'd)

- Delivery/Shipping
 - FOB Destination vs. FOB Origin
 - This clause may need to be flowed down from the prime contract if the subcontractor is going to be direct-shipping to the government customer
- Inspection/Warranty
 - Latent defects vs. UCC revocation of acceptance
 - Latent defects = Ongoing liability
 - Revocation of acceptance = Within a reasonable time
 - UCC Implied Warranties
 - Parties may disclaim all warranties not expressly made



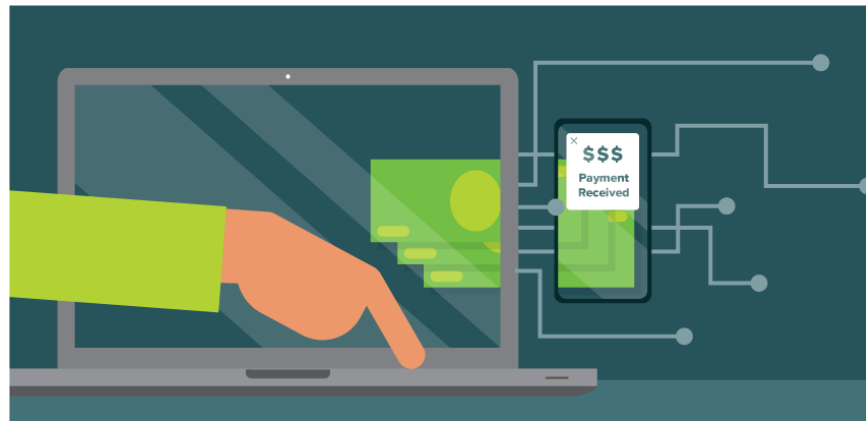
Other Terms & Conditions (cont'd)

- Limitation on Liability
 - Damages may be limited to “direct damages” tied to contract breach
 - Consequential or Incidental damages flow collaterally
 - These are commonly disclaimed/waived
 - MANY JURISDICTIONS REQUIRE LIMITATIONS ON LIABILITY AND WAIVERS TO BE **CONSPICUOUSLY DISCLOSED** – [ALL-CAPS]



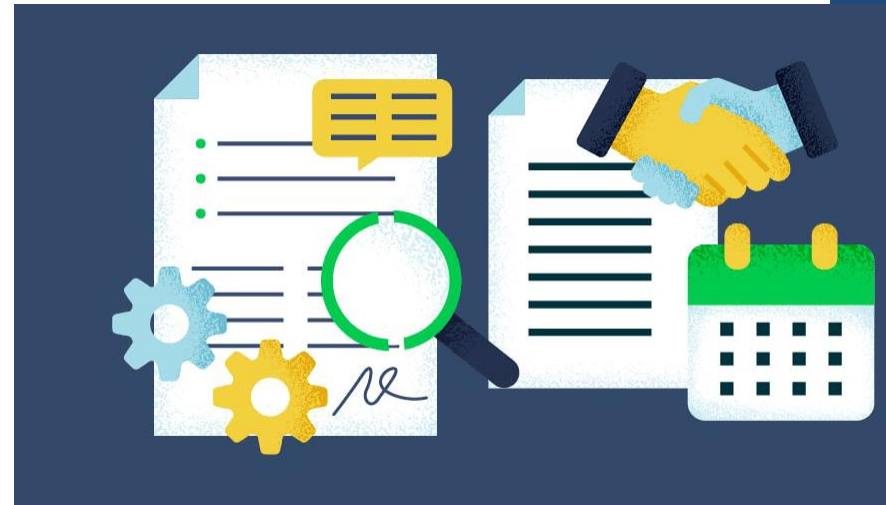
Other Terms & Conditions (cont'd)

- Payments
 - Electronic funds transfer (probably) = Details
 - You will not be flowing down the government's payment instructions...
 - Other Administrative considerations?
 - Prompt Payment Interest?
 - Sometimes makes sense to specify a low interest rate when the Federal interest rate may rise higher than desired
 - Potential bankruptcy considerations?



Other Terms & Conditions (cont'd)

- Changes
 - Key issue of subcontract management relates to controlling change orders
 - Is it appropriate to have a Changes clause in a commercial products or commercial services subcontract?
 - 52.212-4(c) = Bilateral changes only
 - Pricing for changes?
 - Audit?
 - Notice/timing?
 - "No damages" for changes?
 - Liquidated damages for delay?
 - "No damages for delay"
 - This is a good clause to think about



Other Terms & Conditions (cont'd)

- Audit
 - Flowdown the prime contract audit requirement?
 - Custom requirement?
- Disputes
 - Alternatives to work stoppage
 - Administrative procedures for resolving disputes
 - Alternative Dispute Resolution/Arbitration vs. Courts
 - Remedies



Other Terms & Conditions (cont'd)

- Choice of Law
 - Typically considered boilerplate
 - But choice of law may have an impact on the rights/remedies under the agreement
 - For example, Virginia law is very pro-prime contractor on teaming agreements
 - Needs to have some causal connection to contract performance



CONCLUSION

Key Take-Aways

- Negotiation is an art, not a science
 - Follow your processes and procedures
 - Maintain your files
- Be aware of what clauses are mandatory flowdowns
- Be aware of what clauses are necessary flowdowns
- Customize your “other” clauses as appropriate for your business
 - Utilize templates/standard terms
- Remember that the *Christian* doctrine does **not** apply at the subcontract level
- If you want a clause in your subcontract, you need to make sure you include it!



uestions?

Next Session on October 12, 2023

- Session 8: Subcontract Pricing