

Contract & Subcontract Risk Management: Moving Beyond the General to Receive Maximum Results

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First Things First:

- What is a contract?
- What is a subcontract?
- Differences among: commercial, government and international contracting
- Contract types
- Battle of the forms
- Flowdowns
- Contract clauses
- P2P
- What's on the horizon

Types of Contracts

- Firm Fixed Price (FFP)
- Fixed-Price with Economic Price Adjustment (FP/EPA)
- Fixed Price Incentive (FPI)
- Cost Plus Incentive Fee (CPIF)
- Cost Plus Award Fee (CPAF)
- Cost
- Cost Sharing (CS)
- Time and Materials (T&M)

Battle of the Forms

- We include in our bid package our terms and conditions of purchase and we state that any terms and conditions contained in the supplier's proposal will not apply. In those cases where the supplier includes its terms of sale, whose terms and conditions reign supreme?
- What is a good example of language that should be on the buyer's form that takes exception to the terms in the seller's forms?
- We have a master agreement with a supplier. After we issue our PO release document, our supplier provides its acknowledgment form (with terms on the back) and its also submits an invoice with terms on the back. Are those terms binding and do they supersede the negotiated terms of the master agreement?

What is a flowdown clause?

- A Government prime contract clause incorporated into a subcontract/PO/consulting agreement/etc.
 - A flowdown transfers requirements from a prime contract into a subcontract in support of the prime contract
 - Subcontract clauses “flow down” responsibilities of the prime contractor to subcontractor
 - Can significantly impact obligations and risk of performing a subcontract

What is a flowdown clause?

- A Clause is generally flowed down in one of three ways:
 - By reference to a clause without including its full text in the subcontract
 - By incorporating the full text of the clause
 - By applying the “substantially as follows” or “substantially the same as” basis

Why do flowdown clauses matter?

○ PRIME CONTRACTOR:

- Ensure subcontractors/suppliers are required to comply with certain contract requirements
- Business system maintenance/approval
- Maximize cost recovery by ensuring cost reasonableness
- Manage/allocate performance uncertainties and risk

○ SUBCONTRACTOR:

- Ability to participate in huge Federal marketplace
- Ensures subcontractor understands contractual/compliance obligations

What if a required flowdown clause is omitted from a subcontract?

- CHRISTIAN DOCTRINE: Certain mandatory clauses are incorporated into prime contracts even if they are not included
- RECENT CASE APPLIED CHRISTIAN DOCTRINE TO A SUBCONTRACT: UPMC Braddock v. Seth D. Davis, Civ. 09-1210 (D.D.C. Mar. 30, 2013), which incorporated Department of Labor socio-economic regulations (EEO)

Mandatory Flowdowns: Commercial Items

- 20 mandatory flowdown clauses in subcontracts for commercial items (FAR Clause 52.244-6(c)(1))
- Most triggered at a specified value
- Prime contractor can flow down only a “minimal number of additional clauses” (FAR Clause 52.244-6(c)(2))

Mandatory Flowdowns: Non-commercial Items

- Per FAR 44.403, mandatory commercial item flowdowns (FAR Clause 52.244-6) are also mandatory for non-commercial item contracts
- Additional clauses must be flowed down in non-commercial item subcontracts
- Most are triggered based on certain subcontract values and/or subcontract types

Essential/Non-Mandatory Flowdowns

- The following prime clauses are not required to be flowed down:
 - Changes
 - Stop work
 - Termination
 - Organizational Conflict of Interest
- While these clauses are not required to be flowed down, the prime contractor should incorporate these clauses in the subcontract to ensure the agreement complies with these clauses as they relate to subcontracting.

Set of Clauses

- Companies typically use sets of clauses tailored to known variations in the procurement types
- This enables the development of flowdowns appropriate to the subcontract
- Prime Contractor can use the sets as a standalone or in combination with other sets
- This approach avoids the disadvantages of a 'one size fits all' approach in which each procurement action would require tailoring of clauses
- By using a 'building block' approach, the prime contractor can assemble the needed sets for a wide variety of subcontracts
- Example:
 - General Terms and Conditions Clause Set:
 - Liability and Indemnity
 - Termination and Default
 - Insurance
 - Disputes and Governing Law
 - Period of Performance
 - Type of Agreement
 - Place of Performance-
 - Inspection and Acceptance
 - Key Personnel

Caution!

- When using Sets of Clauses, be aware of the Date of the Clause to be flowed down!
- Dates Matter!
- Contents of a Federal Clause can Change!
- Make sure you are flowing down the Clause from your Prime Contract!

Negotiated Flowdowns

- Limitation of Liability
- Price/change/price changes
- Indemnification
- Service Level and Warranties
- Payment
- Termination
- Warranty
- Intellectual Property
- Performance/Guarantees/Undertakings
- Delivery/Acceptance
- Liquidated Damages
- Scope and Goals
- Change Management
- Data Protection/Security/Cybersecurity
- Responsibilities of the Parties

Flowdown Best Practices: Prime Contractor

- **READ YOUR CONTRACT!!!!!!!!!!!!!!!!!!!!**
- Create a flowdown matrix that identifies flowdown requirements specific to each contract that is based on subcontract value and type
- Determine which non-mandatory clauses are necessary to mitigate risk (termination, changes, etc.)

Flowdown Best Practices: Subcontractor

- Know which flowdowns are mandatory; don't waste time trying to negotiate those
- Potentially push back on essential/non-mandatory flowdowns
- Beware of onerous special clauses
- Beware of language incorporating all prime contract requirements
- Monitor the addition of new clauses in modifications

5 Seemingly Innocuous Contract Clauses

- “The entirety of this contract consists of an organization providing services or goods and an organization paying a total price for the services or goods provided...”

5 Seemingly Innocuous Contract Clauses

- “The parties are independent contractors with no employer-employee or agency relationship being established...all subcontractors must first be approved before being hired to perform work...”

5 Seemingly Innocuous Contract Clauses

- “A lawsuit, arbitrations, or any other method of dispute resolution cannot be commenced until after performance is completed...”

5 Seemingly Innocuous Contract Clauses

- “In a dispute, the parties agree that the party prevailing in litigation will be awarded attorney fees and other costs...”

5 Seemingly Innocuous Contract Clauses

- “Each party agrees to resolve any dispute through arbitration and waives their right to a review, a trial, or appeal...”

Private to Private (P2P) Compliance

- Embodied in contract clauses and codes of conduct, obligations now go beyond mere compliance and address the methods by which compliance IS ASSURED.
- Origins: flowdowns & the CSR movement
- Even where there is no formal contract, a party may impose P2P as a precondition for beginning or continuing the business relationship.
- Result: Dramatic evolution of internal corporate codes of conduct

Wrapping it All Up: the Pitfalls to Look for in Subcontracting

- Governing Law
- Flowdown Issues
- Scope Definition, Performance, Measurement, and Data Compatability
- Marketing and Customer Relationships
- Lack of Authority
- Increased Risk in Supply Chain Management
- Data Security

What's on the Horizon...

- Implementation of smart contracts or blockchain technology into supply chains...regulations increasingly requiring companies to be prepared for a blockchain financial future.
- Online dispute resolution: for example, automatically freeze disputed smart contracts and electronically solicit bids from online arbitrators.