



Government Contractors Forum: Doing Business with Small Business - Legal and Business Risks From the Perspectives of Large and Small Businesses

March 22, 2017

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Agenda

- Legal Issues: Large Business Subcontracting to Small Business
- Legal Issues: Small Business Subcontracting to Large Business
- Legal Issues: Joint Ventures with Small Businesses
- Legal Risk vs. Business Risk
- Negotiating with Large and Small Businesses
- Negotiating Nondisclosure Agreements
- Negotiating Teaming Agreements
- Negotiating Subcontracts
- Takeaways

Legal Issues: Large Business Subcontracting to Small Business

Subcontracting Policy/Regulations

- US policy to provide “maximum practicable opportunities” for small businesses to compete for and obtain award of federal prime contracts as well as subcontracts awarded in the performance of federal contracts (15 U.S.C. § 637(d)(1))
- Large businesses required to identify “maximum practicable subcontracting opportunities for small business concerns” in the performance of federal contracts (FAR 19.702)
- Large Business obligations set out in the FAR and SBA regulations
 - FAR Subpart 19.7
 - FAR 52.219-8, Utilization of Small Business Concerns
 - FAR 52.219-9, Small Business Subcontracting Plan
 - SBA Regulations, 13 C.F.R. § 125.3

Subcontracting Plan

- Applies to prime contracts or contract modifications that offer subcontracting possibilities valued greater than \$700,000 (or \$1.5 million for construction)(FAR 19.702(a)(1))
- Applicable only to large businesses (FAR 19.702(b)(1))
- Must be flowed to subcontracts meeting the same dollar thresholds (FAR 19.704(a)(9))
 - Exception for small business subcontracts and contracts for commercial items

Subcontracting Plan (cont'd)

- States subcontracting goals in percentage of total contract/subcontracting dollars (FAR 19.704(a)(2))
- Contractor must use “good faith attempts” to reach those goals and satisfy other elements of subcontracting plan (13 C.F.R. § 125.3(c)(1)(ii)) (FAR 19.702(c))
 - Failure is a material breach of the subcontract
 - Failure could lead to “liquidated damages”
- Contractor must report and provide an explanation to the Contracting Officer its failure to meet subcontracting goals in the plan (13 C.F.R. § 125.3(c)(6))
- CO must report contractor success in meeting subcontracting goals in past performance evaluation (FAR 42.1502(g)(1))

Lower-Tier Subcontracting

- SBA Final Rule issued December 23, 2016, 81 Fed. Reg. 94246
- Effective January 23, 2016
- Where prime contractor has an individual subcontracting plan for a specific contract, prime contractor shall receive credit towards its subcontracting goals for awards made to small business concerns at any tier under the contract

Lower-Tier Subcontracting (cont'd)

- Subcontractor must have its own individual subcontracting plan
- Prime contractor's subcontracting plan must include subcontractor's goals (prior to award)
- Extensive prime responsibilities which subcontractor may deem as intrusive

Subcontracting Obligations

- Contractor must assign to the subcontract/solicitation a NAICS code and accompanying size standard that reflects “principal purpose” of subcontract (13 C.F.R. § 125.3(c)(1)(5))
 - Prime contractor has discretion in selecting code/size standard
 - Prime contractor has to notify subcontractor of applicable size standard in advance of receiving subcontractor’s certification
- Contractor may rely on subcontractor’s **electronic** representations/certifications in SAM if subcontract contains a clause which provides that the subcontractor verifies by submission of the offer that the size or socioeconomic representations and certifications are current, accurate and complete as of the date of the offer for the subcontract (13 C.F.R. § 125.3(c)(1)(5)) (FAR 19.703(a)(2))
- Contractor can rely on the **written** representation of its subcontractor regarding subcontractor’s status as a “small business” and its socioeconomic status if subcontractor represents that size/status representation is “current, accurate and complete” as date of offer (FAR 19.703(b))(FAR 19.703(a)(2))

Subcontracting Obligations (cont'd)

- Must verify HUBZone certification/representation (FAR 19.703(d)(1))
- Contractor “acting in good faith” should not be held liable for misrepresentations made by subcontractors regarding size (13 C.F.R. § 121.108(d)) (19.703(a)(2)(iv))
- Subcontractor representations as to size may be protested (FAR 19.703(b)) (13 C.F.R. § 121.411)

Subcontracting Obligations (cont'd)

- Offeror must notify any small business that is included in Offeror proposal/subcontracting plan (13 C.F.R. § 125.3(c)(8))
- Offeror must represent to Contracting Officer in subcontracting plan that it will make a good faith effort to give work in the same “scope, amount and quality” to small business concerns it used in preparing its bid or proposal (13 C.F.R. § 125.3(c)(3))(FAR 19.704(a)(12))
- “Use”
 - The offeror references small business in bid or proposal or subcontracting plan
 - The offeror has a subcontract or “agreement in principle” with the specific small business
 - The small business drafted portion of the bid or proposal or offeror used small business’ pricing/technical expertise where there is a written intent or understanding that the subcontract would receive work if offeror awarded a prime contract
- If contractor fails to use small business, contractor must report and provide written explanation to Contracting Officer (FAR 19.704(a)(13))
- Contracting Officer will consider explanation in assessing contractor’s past performance (13 C.F.R. § 125.3(d)(4))

Subcontracting Obligations (cont'd)

- A prime contractor must notify the Contracting Officer if it makes a “reduced payment” to a small business subcontractor (13 C.F.R. § 125.3(c)(5))
- A prime contractor must notify the Contracting Officer if payment to subcontractor is 90 days past due (13 C.F.R. § 125.3(c)(5))
- Reporting obligations only if Government has paid prime contractor (13 C.F.R. § 125.3(c)(5))
- Contracting Officer will consider report of “unjustified” nonpayment in assessing a contractor’s past performance (13 C.F.R. § 125.3(d)) (FAR 42.1505(g)(2))
- If contractor has “history” of unjustified, untimely or reduced payments, CO will report history in FAPIIS (13 C.F.R. 125.3(d)(6))
 - “history” equals three reports within 12 month period (13 C.F. R. § 125(a)(3)) on a single contract (FAR 42.1502(g)(2)(ii))

Subcontracting Obligations (cont'd)

- Final FAR Rule issued December 20, 2016 regarding Payment of Subcontractors (81 Fed. Reg. 93481)
- Effective January 19, 2017
- FAR clause 52.242-5, Payments to Small Business Subcontractors (JAN 2017)
- Applies to commercial/COTS items
- Addresses “unjustified nonpayment”

Subcontracting Obligations (cont'd)

- Unjustified nonpayment does NOT include
 - Where there is a contract dispute
 - Partial payment is made for amounts not in dispute
 - Payment is reduced due to past overpayments
 - There is an administrative mistake
 - Late performance by the subcontractor leads to later payment by the prime contractor (FAR 42.1502(g)(2)(ii))

Subcontracting Obligations (cont'd)

- Contractor cannot prohibit a subcontractor from discussing any “material matter” pertaining to payment or utilization with Contracting Officer (13 C.F.R. § 125.3(c)(1)(iii))
- Subcontracting plan has to contain assurances that contractor will not prohibit such discussion (FAR 19.704(a)(14))
- Anyone who believes a contractor has made a false statement to the Government or a prime contractor with respect to a subcontracting plan must make a report to SBA OIG (13 C.F.R. § 125.3(c)(9))

Legal Issues: Small Business Subcontracting with Large Business

Limitations on Subcontracting

- SBA Final Rule issued May 31, 2016 (81 Fed. Reg. 34243)
- Effective June 30, 2016
- Conflicts with FAR 52.219-14, Limitations on Subcontracting
 - Services: at least 50% of the cost of contract incurred for personnel must be expended by small business prime
 - Only applied to small business and 8(a) set-asides
- Focus in SBA regulation on amount “paid” small business prime (13 C.F.R. 125.6)
 - Services: small business prime cannot pay subcontractor more than 50% of the amount paid small business prime
 - Now applies to all set-asides

Limitations on Subcontracting (cont'd)

- Does not apply to small business set-asides valued between \$3,500 and \$150,000
- Excludes “similarly situated entities”
 - Subcontractor has the same small business program status as the prime contractor that made prime contractor eligible for award
 - Already the case for the HUBZone and SDVOSB Programs
 - “Similarly Situated Entity” must be small under the NAICS code applicable to *subcontract*

Limitations on Subcontracting (cont'd)

- Period of time to determine compliance in set-aside contract is usually the base term and each subsequent option period
- For an order set aside under a full and open contract with a reserve, period of compliance is period of performance for each order
- CO has discretion under set-aside contract to make compliance correlate to task order period of performance
- Noncompliance could result in debarment or considerable fines

Limitations on Subcontracting (cont'd)

- GAO Cases (*Mare Solutions, Inc.* B-413328, Sept. 14, 2016)
 - Presumption that offeror will comply with rule
 - If proposal shows, on its face, that offeror will not comply, then proposal is considered nonresponsive/unacceptable
 - Agency's view as to whether offeror can comply with rule is a matter of responsibility
 - Whether offeror complies with the rule is a matter of contract administration

Ostensible Subcontractor Rule

- “Affiliation” concept (13 C.F.R. Subpart 121)
 - Focus on “control”
 - Aggregation of revenues/employees of affiliates
- 13 C.F.R. § 121.103(h)(4)
- Occurs where large subcontractor performs the “primary and vital” aspects of the prime contract or prime contractor is “unusually reliant” on subcontractor

Ostensible Subcontractor Rule (cont'd)

- Frequent basis for size protests to SBA
- SBA will look at “all aspects of the relationship” ; very fact specific
- SBA will look at proposal and teaming agreements
- Near presumption of affiliation if subcontractor was incumbent but grew out of small business size standard

Ostensible Subcontractor Rule (cont'd)

- Four factor test for “unusual reliance” Proposed sub was incumbent contractor but no longer small
 - Prime proposed to hire “en masse” incumbent/proposed subcontractor employees
 - But see NonDisplacement of Qualified Workers Rule
 - Prime proposed to use management personnel from incumbent contractor
 - Prime lacked relevant experience and relied on subs experience to win prime contract

See Size Appeal of Modus Operandi, Inc., SBA No. SIZ-5716 (February 19, 2016)
 - Recent case suggests subcontracting more than 40% of prime work may implicate the ostensible subcontractor rule
- See Size Appeal of Charitar Realty, SBA No. SIZ-5806 (January 25, 2017)*

Ostensible Subcontractor Rule (cont'd)

- Teaming Agreements
 - Prime in control of proposal preparation and submission
 - Prime will be only party interfacing with the government
 - Workshare complies with the limitations on subcontracting rule
 - Neither company will hire each other's employees
 - Workforce, including key personnel, employed by prime
 - Subcontractor assigned discrete tasks

See Size Appeal of CymSTAR Services, LLC, SBA No. SIZ-5329 (March 2, 2012)

Legal Issues: Joint Ventures with Small Businesses

Joint Ventures

- Large business access to small business set-aside work
- SBA affiliation rules presume that joint venturers are affiliated with one another (13 C.F.R. § 121.103(h)(2))
- An exception for joint ventures between a “Mentor” and its “Protégé” (13 C.F.R. § 121.103(b)(6))
 - SBA Section 8(a) Mentor-Protégé Program (13 C.F.R. §124.520)
 - All Small Business Mentor-Protégé Program (13 C.F.R. § 125.9)
 - effective August 24, 2016

Joint Ventures (cont'd)

- Mentor can have up to three Protégés
- Mentor required to provide various types of assistance to Protégé to meet goals in Protégé's business plan
 - Contracting Assistance
 - Business Development Assistance
 - Contract/Administrative Assistance
 - Financial/Accounting Assistance
 - Technical Assistance
- Documented in an SBA-approved Mentor-Protégé Agreement
- Significant application requirements and significant SBA monitoring obligations

Joint Ventures (cont'd)

- Joint venture requirements codified at 13 C.F.R. §§124.513 and 125.8
- Mentor may own up to 40% of Protégé
- Mentor may form joint ventures with Protégé without regard to affiliation concerns and, therefore, can compete for small business set-asides
 - Protégé only required to perform 40% of work performed by joint venture
- Mentor-Protégé Agreement must be approved by SBA before proposal can be submitted by a joint venture
- SBA must approve joint venture agreement if joint venture submitting proposal for 8(a) set-aside contract
 - SBA approval necessary *before award* of 8(a) contract

Joint Ventures (cont'd)

- JV Agreement must be in writing
- Usually a separate legal entity (LLC)
- Must be “unpopulated”
- JV may receive up to 3 contracts in two years
- Project Manager must be contingent hire/employee of Protégé, cannot be former employee of Mentor
- Joint bank account – dual signatures required
- Both members to joint venture must ensure contract performance (no re-entry option for withdrawal from JV)
- Mentor cannot exercise “negative control” over Protégé in the JV

Legal Risk vs. Business Risk

Business Risk

- Risk that proposed activity will result in lower profit or a loss
- Examples:
 - Negotiating unfavorable terms
 - Errors in pricing
 - Underestimating or misunderstanding costs
 - Performance risks
 - Legal risk

Legal Risk

- A sub-set of Business Risk – Many competing definitions
- Examples:
 - Defect in the Agreement
 - Exposure to claims or litigation
 - Acceptance of uninsured liability
 - Violation of laws/regulations

Large Business (“Big”) Approach to Risk

- Organizational approach, process-focused
- Legal Risk – sole responsibility of in-house counsel
 - Contract review is mainly a liability-shifting exercise
- Business Risk – Many potential departments involved
 - Pricing
 - Subcontracting/Purchasing
 - Compliance (frequently under Legal)
 - Accounting
 - Program Management
 - Program Control

Small Business (“SBs”) Approach to Risk

- Legal Risk and Business Risk are indistinguishable
 - Either could be an existential threat
 - May be far less averse to legal risk than Bigs as a result
- Few principals wearing many hats – no stovepipes for risk review/mitigation
- Near-term focused out of necessity
- Frequently take cues from large business teammates on how to mitigate risks, but may not have a comprehensive or consistent approach

Negotiating with Large and Small Businesses

Negotiating with Bigs

- Layered review processes – speed is not to be expected
- Tendency to overwhelm SBs with high volume of data calls, certification paperwork
- Business capture leads are usually your main point of contact, but typically:
 - Cannot legally bind their company – may unwittingly make oral promises their organization can't keep
 - May be several degrees removed from legal/contracts office drafting an agreement, creating a “telephone” effect
- While agreements may be fully vetted, the resulting document may not represent the original intent of the parties

Negotiating with SBs

- Typically no in-house counsel, and rarely represented by counsel in their dealings with Bigs – creates ethical challenges for attorneys who find themselves negotiating with non-attorneys
- Review, signature, and implementation agreements might be done by the same person
- SBs are nimble, usually have short turnaround times for doc review and signature, but...
- Agreements may not be fully vetted, or their terms fully understood
 - Alternatively, SBs who have been burned in the past may be slow to review, stalling progress for both parties

Foundational Agreements for Gov. Service Contracts

- Non-Disclosure Agreement (NDA)
- Teaming Agreement (TA)
- Subcontract

Nondisclosure Agreement (NDA)

- Purpose: Sets the rules for how parties handle and use each other's proprietary information
- Typically confined to a specific activity (e.g., pursuit of a government contract)
- Standard document with little variation in format from company to company within the industry

NDA's – How They Are Viewed

- Bigs' In-House Counsel View
 - A practical necessity, a prophylactic measure to put both companies on notice of need to protect each other's data
 - Difficult to enforce, poorly understood by business leads
 - Paperwork and tracking burden to in-house staff
- SB View
 - A document that Bigs make you sign
 - Example to copy and re-use when dealing with other companies
 - Forgotten long before it expires
- My View
 - First window into how the other party does business
 - How thorough and prompt is the review?
 - How easy are they to work with?

NDA Key Clauses

- Statement of Purpose: limit scope sufficiently so that both sides understand what information will be discussed
- Definition of Proprietary Information
 - Written/Non-written, oral disclosures, markings, types of information that are automatically included – be explicit
- Covered Individuals: Agents, subcontractors, consultants, and/or specific individuals by name
- Effective date
 - Get in place before discussions take place; backdating is not a sound approach

NDA Key Clauses (cont'd)

- Term: how long the agreement is in effect
 - 2 years is standard for most government business development efforts
 - Data disclosed during this period is protected
- Nondisclosure Period: how long you must “keep quiet”
 - Usually 3-5 years, depending on sensitivity of data.
 - Consider indefinite period if you’re discussing crown jewels
- Damages – typically excludes indirect/consequential/lost profits, etc.; always suggest a cap on damages

NDAAs – Post Agreement Considerations

- Training business points of contact on content of NDA and companies' obligations thereunder
- Storing transferred written info in a responsible/auditable way
- Tracking NDA periods of performance
- Requesting destruction/return of proprietary data at end of agreement

Teaming Agreements (TAs)

- Purpose: establish terms for collaboration between businesses in pursuit of a federal government contract
- Many industry-standard terms, but much more variance in language than NDAs, as much more is at stake
- Most common scenario: Large business prime contractor seeks small business subcontractor

Why Bigs Seek SB Teammates

- FAR 52.219-8, 52.219-9 establish U.S. Government policy to promote small business participation in contracts, and require offeror submission of a subcontracting plan
- USG Solicitations include small business subcontracting targets against which each offer is evaluated
- Excellent way to develop relationship with small businesses for future work:
 - Small business set-aside contracts on which large business can perform as a subcontractor
 - Opens door for mentor-protégé relationship
 - Potential for merger or acquisition

Why SBs Team With Big Primes

- Necessity – Bigs have access to large contracts and many opportunities
- Bigs have budgets and resources to do the heavy lifting on most proposals – subcontractor support is helpful but not expected
- Successful subcontract capture provides small business sub with past performance qualifications that improve chances of winning future work
- Relationship building

TA Clauses with High Potential Risk

- Defining the Program
- Award of Subcontract
- Exclusivity
- Termination
- IP Licensing (and related data rights)
- Workshare

TA Clauses: Defining the Program

- Parties must clearly define the scope of the effort on which the businesses will cooperate
- Sample Problem Clause: “Whereas the U.S. Army is known to have a requirement for support services in the area of ballistic missile defense (“The Program”)...”
 - Risk: Overly broad -- Future sections of the agreement (e.g., Exclusivity) will reference “The Program”, and could bind the companies to performance in a wider range of business than intended
- Better Clause: “Whereas the U.S. Army is known to have a requirement for support services defined in **Request for Proposal # HQ23563-2017B**, Army Missile Defense Training and Support (“The Program”)...”

TA Clauses: Award of Subcontract

- Obligates the prime to award a subcontract to prospective subcontractor under certain conditions. Typical clauses include:
 - Prime is awarded a prime contract that includes subcontractor's anticipated scope of work (usually outlined in an attachment)
 - Subcontractor agrees to terms consistent with the prime contract, including mandatory flow-downs, the Statement of Work, the cost proposal, etc.
 - Opt-out for Prime if it is unable to obtain approval of the subcontractor by the government customer (particularly for classified contracts)

Award of Subcontract: Sample Problem Clause

- “Subcontract shall include V-Corp’s standard Terms and Conditions (T&Cs), including any amendments made thereto from time to time at the sole discretion of V-Corp.”
- Risk to Sub:
 - Permits prime to unilaterally alter key negotiated points of the subcontract without the subcontractor’s knowledge
 - Accepting unanticipated legal risk from unknown indemnification or hold-harmless clauses
 - Confusion if standard T&Cs conflict with subcontract

Award of Subcontract: Sample Problem Clause

- Risk to Prime:
 - Amendments to standard terms rarely made by same attorneys who negotiate subcontracts – could add or reduce legal risk
 - Subcontractors rarely made aware of future changes to “outside” T&Cs
 - Change that harms subcontractor’s position can lead to frustration, involvement of customer, loss of reputation
- Suggested Approach
 - Explicitly include all necessary terms in the TA and Subcontract
 - If standard T&Cs are a must for the Big, limit it to those in effect at time of agreement, and include them as a static attachment for review by SB
 - Attach a copy of the draft subcontract to the TA for review

TA Clauses: Exclusivity

- Perhaps the most controversial clause in a TA
- Primes must ensure subcontractors can't negotiate with competitors & undermine Prime's pursuit of a contract
- Subcontractors must be sure not to overcommit to scope & time
 - Note that Big Subs may exclude parent or affiliate companies
- Typical problem clause:
 - “Subcontractor shall not participate in efforts competitive to this agreement, compete independently for work that may be covered by the Solicitation, or engage in negotiations with competitors of Prime.”

TA Clauses: Exclusivity (cont'd)

- Risks: Many – Sub may be in breach on day 1:
 - How do parties define “efforts competitive”?
 - Work that “may be covered by Solicitation” could include almost anything – even Subs’ existing contracts.
 - Who are Prime’s competitors, and where is the line for what can and can’t be negotiated with them?
- Better Approach:
 - “Subcontractor shall support Prime’s Proposal under the Solicitation on an exclusive basis, and shall not assist third parties in development of a proposal in response to the Solicitation, or engage in negotiations with third parties concerning the Solicitation.”
 - Ensure that “Solicitation” is narrowly defined to the specific RFP

TA Clauses: Termination

- Lists conditions for each party to get out of the agreement
- Most are standard: execution of a subcontract, decision by prime not to pursue, breach, suspension/debarment/bankruptcy, **mutual** (not unilateral) decision of the parties
- Typical Problem Clause:
 - “This Agreement will expire 36 months from the Effective Date of this Agreement”
 - Flaw: Too long a period increases risk – Much can change in 36 months

TA Clauses: Termination (cont'd)

- Big Prime risks:
 - Unknown changes to key assertions/representations made by subcontractor (e.g., change to small business status, organizational conflicts of interest)
 - Loss of key subcontractor employees
- Small Sub Risks:
 - Being “handcuffed” to one large prime contractor while other business opportunities pass by
 - Removal or loss of your portion of the work on the solicitation
- Suggestion: Limit commitment to 12-18 months and negotiate extensions as needed

TA Clauses: IP Licensing

- Key clause for technology companies – dictates how Intellectual Property (IP) rights will be handled on a resulting subcontract
- Mostly drafted to place risk on subcontractor, as prime's risk is inability to deliver required data/rights to government if subcontractor's IP rights conflict with terms of prime contract
 - Govt requires notice if prime/sub are not offering unlimited rights in data, or are including pre-existing IP as a deliverable
- Typical Problem Clause:
 - “Subcontractor grants Prime and Prime's teammates a perpetual, royalty-free license to all intellectual property necessary to the performance of a Prime Contract resulting from this Solicitation, including all option periods.”

TA Clauses: IP Licensing (cont'd)

- Risks to SB Sub:
 - **Perpetual** license limits Sub's right to control Prime's use of Sub IP on future contracts, or for internal business purposes
 - **Royalty-free** license is reasonable if IP is solely developed on the contract, but not if Sub offers pre-existing IP as deliverable
 - "All IP necessary" opens the door for Prime to later demand license for Sub's software not included in original bid
- Better clause: "Subcontractor grants Prime a royalty-free license to intellectual property developed exclusively in the performance of a Subcontract resulting from this Solicitation."
- Address delivery of pre-existing IP under separate license agreement

TA Clauses: Workshare

- Establishes what percentage of the contract (dollars, hours, etc.) will go to the subcontractor if Prime is successful in its bid
- Key issue for any subcontractor – failure to address it in the TA can undermine business purpose
- Primes wary of promising Subs minimum guaranteed revenue or profit, as many variables could prevent performance:
 - Gov. right to terminate portions of the contract for convenience
 - Changes to Prime business needs
 - Corporate purchasing policies and guidance

TA Clauses: Workshare (cont'd)

- Suggested Approach: Add a Workshare Exhibit to TA
 - One-page to clearly define what share of work goes to Sub, and what limitations apply
 - For labor, define workshare as percentage of positions on contract at time of award, or clearly indicate which positions from the statement of work will belong to Sub
 - Condition workshare on government's continued acceptance of portions of effort applicable to Sub, and continued satisfactory performance (at a minimum)

Subcontract

- Purpose: Sets the terms for performance and compensation of subcontractor in support of prime contractor's contract with a government customer
- Significantly more risk than NDAs and TAs, due to:
 - Larger number of significant issues that may arise
 - Shorter timeline for review – driven by contract start date
 - Greater variance in form and content
 - Proliferation of attachments requiring attention (flow-down clauses, security, property, reporting, funding, insurance)
 - Establishes rules to live with for up to five years

Structure of Subcontract

- Will vary in format and order, but will generally fit into the following categories:
 - The Schedule
 - Basic contract information
 - Subcontract type, term, points of contact, rates, key personnel, place of performance, invoicing, payment, reporting requirements
 - General Terms
 - Inspection/ Acceptance, Intellectual Property, warranties, indemnification, insurance, changes, termination, disputes, government property
 - May include key clauses from prime contract relating to compliance with federal law (Equal Opportunity, Service Contract Act, Trafficking in Persons, etc.)
 - Flow-downs from Prime Contract

Subcontract Relation to TA

- Tendency is for Sub to get caught up in the win, forget the TA
- Substance of several TA clauses must transfer to the subcontract to secure the hard-earned benefits of the TA:
 - Workshare
 - Sub can work this into subcontract in a number of ways
 - Prime can guarantee number of positions, carve out certain sections of a statement of work, and/or offer favorable termination language
 - Exclusivity
 - A must for Prime for IDIQ contract with task orders
 - Licenses/Intellectual Property
 - Watch for Prime attempt to add standard data rights flow-downs
 - If Sub brings pre-existing IP to the table, include Sub's license agreement

Subcontract Clauses Presenting Risk

Many potential problem areas, but a few highlights:

- Subcontract Type
- Termination for Convenience
- Invoice and Payment
- Suspension/Debarment/Security
- Non-Mandatory Flow-Downs

Subcontract Clauses: Subcontract Type

- Standard Rule: Must bid, book, and bill costs to the contract in a consistent way
 - If sub provided a fixed-price bid, prime should offer fixed-price contract
- Risks if prime requests post-award change in contract type:
 - Sub's pricing may ensure profitability under one model, but result in a loss under others – creates risk that sub (and, by proxy, prime) cannot meet performance objectives
 - If prime directs small business to move to a cost-type subcontract, must ensure that SB Sub has an approved accounting system
 - DCAA/DCMA may find deficiencies if rationale for change is improper

Subcontract Clauses: Termination for Convenience

- FAR 49.5 provides basis for government right to unilaterally terminate contracts for convenience of the customer
- Prime's risk exposure is high if gov. terminates Sub's work — instinct is to claim same termination rights as government within subcontract
 - Sometimes added through flow-downs section of the subcontract
- Risk to Sub: Prime can unilaterally terminate contract without reason
- Compromise: permit Prime to terminate for convenience to the extent government's termination has impacted Sub's effort

Subcontract Clauses: Invoice and Payment

- Significant potential risk to both Prime and Sub
- Prime Risks
 - Sub ability to produce proper, timely invoice
 - Cash flow if payment to subs due before payment from government
 - Variance in accounting periods and cost recognition create confusion
 - Managing many subcontractors in a consistent way to reduce back office staff workload
- Sub Risks
 - Unrealistic invoice terms (timekeeping periods, submission dates)
 - Cash flow risk due to delays in payment – can be existential issue if contract represents high percentage of company revenue

Subcontract Clauses: Invoice and Payment

- Approach for Prime
 - Analyze sub cost liability to determine pain threshold for advancing payments to subs before delivery of payment from government
 - How much and for how long?
 - Set clear but reasonable expectations with Subs
 - Consider payment “the sooner of net 45 days or 5 business days from receipt of corresponding payment from government”
 - Allow subs to use your timekeeping system for labor (in tandem with its own) to speed up invoicing, payment, and program management processes
- Approach for Sub
 - Communicate A/R aging and invoicing concerns promptly and directly – bad news does not get better with time
 - Secure revolving line of credit to ride out 2-3 months of invoicing issues, at a minimum (*See, e.g., Government Shutdown, 2013*).

Subcontract Clauses: Suspension/Debarment/Security

- Three “do not pass go” issues for Prime, always required flow-downs
 - Per FAR 52.209-6 Prime **must** require notice from sub of any suspension, debarment at the time of award over \$35K
 - Many large primes require subcontractor recertification with each bilateral contract modification, including funding allocations
 - For classified contracts, prime must report changes to facility security clearance, or mere awareness of adverse information regarding principals’ or performers’ security clearance
 - Annual certification for Subcontractors at a minimum
- Include as grounds for termination for default – gov agencies have little patience for Subs who fail these requirements
- Inquire early in the teaming process through Sub representations and certifications, rather than at the time of award

Subcontract Clauses: Non-Mandatory Flow-downs

- Prime contract includes many FAR, DFARs, and agency-specific clauses, both in text and by reference
- Subs rarely scrutinize flow-down clauses – high potential for risk
- Subs should know:
 - Primes may take the easy way out by reflexively attaching all prime contract clauses, then stating: “Insert ‘Prime’ in place of ‘government’ in all flow-down clauses”, but...
 - Not all clauses from the prime contract must flow down to the Sub
 - Example: FAR 52.215 – *Audit Records and Negotiation* grants the government extensive rights to review contractor's books, rights Subs should **never** grant to the Prime

Takeaways for Large Business In-house Counsel

- NDAs, TAs, and Subcontracts are legal agreements meant to support a business objective
- Duty is to your client, but mechanically passing legal risk on to your partners can result in a flawed transaction that harms both parties
- Draft agreements in a way that can be easily understood by both parties and reflects the negotiated business points
- Train your business development personnel on what can/cannot be promised at their level of authority
- Assign a relationship manager for small business subcontractors to:
 - Serve as liaison between SB and your organization
 - Shepherd TAs and subcontracts through your process tree
 - Ensure that negotiated business points survive the review process

Takeaways for SBs

- Get an attorney!
 - Many excellent government contracts attorneys in DC-MD-VA — can review most agreements very quickly and save you from problems down the road
 - Alternate fee structures (e.g., fixed price per review) are common for smaller clients — don't be afraid to ask
 - Build outside legal review into your annual indirect cost budgets
- Read the agreement
 - At least 2 key employees — do not go it alone
- Don't sign out of desperation
- Get familiar with typical “problem” clauses and how they can impact your business
- Make sure agreements match what you've negotiated

Questions ?

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Devon Hewitt, a partner at **Protorae Law PLLC**, has over 20 years' experience in the field of government contracts, representing small, mid-tier and large government contractors. She advises clients on a wide range of government contracting issues including FAR compliance; small business contracting programs; intellectual property and data rights; GSA Schedule; the Service Contract Act; noncompete, nonsolicitation and nondisclosure agreements; subcontracts and teaming arrangements; joint ventures; FOIA; due diligence and novations; contract claims; codes of ethics and business conduct; mandatory and voluntary disclosures; suspension and debarment; terminations; and government audits and investigations. Ms. Hewitt also is a litigator and has represented clients in nearly 100 protests before federal agencies, the U.S. Court of Federal Claims, and the Government Accountability Office. In addition, Ms. Hewitt represents clients in subcontract and other dispute matters in civil courts and in arbitrations. Prior to joining Protorae Law, Ms. Hewitt was a partner at Piliero Mazza in DC and a partner in the Government Contracts practice of Pillsbury, a large, multi-national law firm.



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