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CREATE A WINNING TEAM.

Part III — How to negotiate a successful
subcontract.

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Important Note

The contents of this presentation are intended for general information only and should not be construed or relied upon as legal advice nor as a legal opinion on any specific facts or circumstances. If you need legal advice concerning your specific circumstances, please consider contacting Kaufman & Canoles, P.C.

Subcontract

- FAR 44.101 defines the term “Subcontract”
 - Subcontract: Means any contract as defined in Subpart 2.1 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 from a prime contractor or another subcontractor.

Subcontract Negotiation Objectives

- Minimize risk
- Profitable subcontract
- Positive past performance evaluation

Practical Issues

- **Prime Contractor:**
 - Reduce risk with a “reasonable” subcontract that is “fair” (a subcontract that a subcontractor will sign)
 - Balance reducing risk with the need for a particular subcontractor
- **Subcontractor:**
 - Balance risk with the need for work

Due Diligence

- **Prime Contractor:**
 - Availability of other subcontractors
 - Need for a subcontract bond
- **Subcontractor:**
 - Reputation of prime contractor's relationships with other subcontractors
 - Review of solicitation and prime contract

1. National Defense Authorization Act (“NDAA”)

- Key Areas affecting Subcontractors
 - Subcontracting Plan Enforcement
 - Limitations on Subcontracting

NDAA

- Subcontracting Plan Enforcement
 - Notification: Sec. 1653 requires an offeror to notify any potential subcontractors that it intends to include in its subcontracting plan
 - Reporting: Sec. 1653 also requires the SBA to establish a reporting mechanism to allow a subcontractor or potential subcontractor to report “fraudulent activity or bad faith by a contractor with respect to a subcontracting plan”

NDAA

- Limitations on Subcontracting

- Service Contractors

- Sec. 1651 requires that small business prime contractors not expend on subcontractors more than 50 percent of the amount paid to the concern under the contract, with exceptions for subcontractors that qualify as a “similarly situated entity”

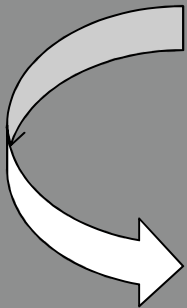
compliance with the limitations on subcontracting will be based on the total amount paid to the small business, not the “cost of the contract incurred for personnel” ([13 C.F.R. § 125.6\(a\)\(1\)](#))

NDAA

- Limitations on Subcontracting

- Supply Contracts

- Sec. 1651 also requires that small business prime contractors for supply contracts (other than from a regular dealer), that a small business “may not expend on subcontractors more than 50% of the amount, less the cost of materials, paid to the concern under the contract.”



compliance with the limitations on subcontracting is based on the total amount paid to the small business, not the “cost of manufacturing the supplies or products (not including the costs of materials.) ([13 C.F.R. § 125.6\(a\)\(2\)](#))

2. Enhanced Subcontract Management by the SBA

- Final rule expected March, 2013 to implement provisions of Small Business Jobs Act 2010 (Rule initially proposed in October, 2011) (76 Fed. Reg. 61626)
- For procurements >\$1.5 million for construction and \$650k for non-construction:
 - Rule specifically authorizes agencies to consider proposed small business subcontracting plans when evaluating offers

Enhanced Subcontract Management by the SBA (cont.)

- Large prime contractors must represent they will make good-faith efforts to award subcontracts to small businesses at the same percentage as set forth in the subcontracting plans in their proposal
- If a large prime does not meet the small business percentage the prime represented in its subcontracting plan, the large prime must provide a written justification and explanation to the CO

Enhanced Subcontract Management by the SBA (cont.)

- A prime must notify the CO in writing whenever the prime reduces payments to a sub or when payments to the sub are 90 days or more past due

Selected Subcontract Provisions for Negotiation

1. Scope of Work
2. Pricing and Payment
3. Performance Schedule
4. Indemnity
5. Warranty
6. Claims and Dispute Resolution
7. Insurance
8. Non-solicitation
9. Intellectual Property
10. Flow-down Clauses
11. Term
12. Termination

1. SCOPE OF WORK

Pro-Prime

- Flexibility
- Limitation on subcontracting

Pro-Sub

- Guaranteed percentage of work
- Restriction on other Subs

2. PRICING AND PAYMENT

Pro-Prime

- Sub to provide “Most Favored Nations” pricing
- Sub to be paid after Prime paid (“pay when paid” clause)

Pro-Sub

- Prompt payment provisions
- Limitations on pay when paid provisions
- Finance Charges
- Right to suspend performance pending payment
- Escrow/Lock-box
- Guaranty from/Indemnitys Prime’s shareholder(s)

Making it work

- BigRUs, Inc.: *“Notwithstanding any other provisions of this Agreement, Contractor shall be under no obligation to make any payment to the Subcontractor under any provision hereof except to the extent that the Contractor has received funds from Owner, payment by Owner being a **condition precedent** to payment of the Subcontractor”*
- SmallCorp: *“...If, however, payment is withheld due to the fault of the Contractor or other Subcontractors or Suppliers, then payment will be made to the Subcontractor within ___ days following the delivery of Subcontractor’s invoice”*

3. PERFORMANCE SCHEDULE

Pro-Prime

- No damages for delay clause
- Liquidated damages

Pro-Sub

- Delay damages recoverable
 - Unenforceable on Virginia state contracts under Virginia Public Procurement Act
- Limitation of liquidated damages
- Bonus for early completion
- Force Majeure excuses performance

Making it work

For delays for which the Government is or may be liable, Subcontractor shall be entitled to damages to the extent that the Contractor recovers such delay damages from the Government which shall be a condition precedent to any recovery by Subcontractor from the Contractor for delays. For any delays for which the Contractor is or may be liable, the Subcontractor shall be entitled to recover job site delay costs only.

4. INDEMNITY

Pro-Prime

- Indemnification for all losses or claims arising out of subcontractor performance including attorney, consultant and expert witness fees
- Attorneys fees for enforcing indemnity obligation

Pro-Sub

- Limit indemnity to third-party claims for personal injury and property damage only as a result of sub's negligence

Making it work

To the fullest extent permitted by law the parties shall indemnify and hold each other harmless from and against claims, damages, losses and expenses, including but not limited to, reasonable attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, death or disease, or injury or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the other party, a subcontractor, or any one directly or indirectly employed by them or any one for whose acts they may be liable, regardless of whether or not such claim, damage, or loss or expenses caused in part by a party indemnified hereunder.

5. WARRANTY

Pro-Prime

- Warranty period begins upon final delivery by Prime and final acceptance by the Government
- FAR Warranty
- Implied warranties of merchantability and fitness for a particular purpose (UCC)
- Liability for consequential damages
- Warranty that Sub expert in this line of business

Pro-Sub

- Limited warranty period starts when Subcontractor's work substantially completed
- FAR Warranty
- Disclaimer of implied warranties

Making it work

- Warranty of Supplies of a Noncomplex Nature.
 - (....)
 - (b) Subcontractor's obligations.
 - (1) Notwithstanding inspection and acceptance by the Government of supplies furnished under this contract, or any condition of this contract concerning the conclusiveness thereof, the Subcontractor warrants that for [__ months after acceptance by the Government] —
 - (i) All supplies furnished under this contract will be free from defects in material or workmanship and will conform with all requirements of this contract; and
 - (ii) The preservation, packaging, packing, and marking, and the preparation for, and method of, shipment of such supplies will conform with the requirements of this contract.

6. CLAIMS AND DISPUTE RESOLUTION

Pro-Prime

- Owner-caused disputes
 - Sub bound by determination in Owner-Prime dispute resolution
- Prime-Sub disputes
 - Conciliation Measures
 - Mediation
 - Arbitration or litigation in Prime's discretion
- Prompt notice of claims or claims waived
- Choice of law and venue

Pro-Sub

- Protection from being bound by Owner-Prime dispute resolution
- Indirect Appeals
- Mediation/Arbitration
- Qualifications of mediator/arbitrator
- Law of place of the project controls
- Venue (Virginia statute barring venue outside of Virginia for construction projects in Virginia)

Making it work

- BigRUs, Inc.: *“If the Subcontractor shall make any claim against the Contractor...and such claim is presented by the Contractor to the Owner, the Owner’s decision shall be final and binding upon the Subcontractor to the same extent and purpose that is final and binding on the Contractor.”*
- SmallCorp: *“...whether the claim is caused by the Government or the Contractor will be subject to the dispute resolution agreement as stated in this Subcontract.”*

Making it work

“With respect to any claim that may arise between the Contractor and Subcontractor for which the government is or may be liable, Subcontractor agrees that it will prepare its claim and will timely present it to Contractor for submission to the government under the Contract Disputes Act of 1978, the Disputes Clause of the Prime Contract, or any other disputes resolution provisions of the Prime Contract. ~~Contractor agrees that this remedy shall be the Subcontractor’s sole and exclusive remedy in lieu of any claim directly against Contractor or its bonding company pursuant to the Miller Act, 40 U.S.C. §3131.~~

7. INSURANCE

Pro-Prime

- Additional insured
- Indemnity coverage
- Coverage term

Pro-Sub

- Limit additional insureds
- Limit indemnity coverage
- Limit coverage term
- Completed operations coverage
- Waiver of Subrogation

8. NON-SOLICITATION

Pro-Prime

- No solicitation or hiring of Prime's employees
- Non-solicitation of Customer

Pro-Sub

- No solicitation or hiring of Sub's employees

9. INTELLECTUAL PROPERTY

Pro-Prime

- Flow-down of Prime Contract Clauses

Pro-Sub

- No flow-down to benefit Prime

10. Subcontract Flow-Down Provisions

Mandatory v. Recommended Clauses

Mandatory Clauses

Subcontracts for Commercial Items

See FAR 52.244-6 Subcontracts for Commercial Items (Dec 2009)

- Code of Business Ethics and Conduct, FAR 52.203-13 (Apr 2010)
- Whistleblower Protections Under American Recovery and Reinvestment Act of 2009, FAR 52.203-15 (June 2010)
- Utilization of Small Business Concerns, FAR 52.219-8 (Jan 2011)
- Equal Opportunity, FAR 52.222-26 (Jan 2011)
- Equal Opportunity for Veterans, FAR 52.222-35 (Mar 2007)
- Affirmative Action for Workers with Disabilities, FAR 52.222-36 (Oct 2010)
- Notification of Employee Rights Under the National Labor Relations Act, FAR 52.222-40 (Dec 2010)
- Combat Trafficking in Persons, FAR 52.222-50 (Feb 2009)
- Preference for Privately Owned U.S.-Flag Commercial Vessels, FAR 52.247-64 (Feb 2006)

Mandatory Clauses (cont.)

Subcontracts for Noncommercial Items

- Same 9 clauses for Commercial Items
- Anti-Kickback Procedures, FAR 52.203-7 (Oct 2010)
- Limitation on Payments to Influence Certain Federal Transactions, FAR 52.203-12 (Oct 2010)
- Audit and Records—Negotiations, FAR 52.215-2 (Oct 2010)
- Patent Rights—Ownership by the Contractor, FAR 52.227-11 (Dec 2007)

Mandatory Clauses (cont.)

Construction Subcontracts

See FAR 52.222-11, Subcontracts (Labor Standards) (July 2005)

- Davis-Bacon Act, FAR 52.222-6 (July 2005)
- Contract Work Hours and Safety Standards Act—Overtime Compensation, FAR 52.222-4 (July 2005)
- Apprentices and Trainees, FAR 52.222-9 (July 2005)
- Payroll and Basic Records, FAR 52.222-8 (June 2010)
- Certification of Eligibility, FAR 52.222-15 (Feb 1988)
- Compliance with Copeland Act Requirements, FAR 52.222-10 (Feb 1988)
- Withholding of Funds, FAR 52.222-7 (Feb 1988)
- Disputes Concerning Labor Standards, FAR 52.222-14 (Feb 1988)
- Contract Termination—Debarment, FAR 52.222-12 (Feb 1988)
- Accident Prevention, FAR 52.236-13 (Nov 1991)
- Service Contract Act of 1965, FAR 52.222-41 (Nov 2007)

Mandatory Clauses (cont.)

Conflict of Interest Clauses

Preventing Personal Conflicts of Interest, FAR 52.203-16 (Dec 2011)

(...)

“Acquisition function closely associated with inherently governmental functions” means supporting or providing advice or recommendations with regard to the following activities of a Federal agency:

- (1) Planning acquisitions.
- (2) Determining what supplies or services are to be acquired by the Government, including developing statements of work.
- (3) Developing or approving any contractual documents, to include documents defining requirements, incentive plans, and evaluation criteria.
- (4) Evaluating contract proposals.
- (5) Awarding Government contracts.
- (6) Administering contracts (including ordering changes or giving technical direction in contract performance or contract quantities, evaluating contractor performance, and accepting or rejecting contractor products or services).
- (7) Terminating contracts.
- (8) Determining whether contract costs are reasonable, allocable, and allowable.

Making it work

“Incorporation of Mandatory FAR/DFAR Clauses. This Subcontract is subject to certain clauses as set forth in the FAR, DFAR and/or other applicable government regulations (collectively, the "Mandatory Clauses"), which are set forth below and hereby incorporated by reference to the extent that the Prime Contract incorporates such Mandatory Clauses by reference, statement in the text or otherwise, provided, however, such incorporated FAR/DFAR Clauses shall, as between the Contractor and the Subcontractor, be subject to any revisions set forth herein. The Subcontractor hereby represents and warrants that it has reviewed the Prime Contract and all documents incorporated therein, and shall fulfill all obligations of the Contractor set forth in such incorporated Mandatory Clauses as obligations of the Subcontractor hereunder, giving effect to any provisions thereof relating to applicability of such Mandatory Clauses to subcontracts (or requiring modifications thereof in their application to subcontracts). As appropriate, the language of such incorporated Mandatory Clauses shall be construed to express the Contractor/Subcontractor relationship rather than the Government/Contractor relationship indicated in the incorporated Mandatory Clauses.”

Recommended Clauses

- Termination for Convenience Clause (FAR Part 49)
- Changes Clause (FAR Part 43)
- Disputes Clause (FAR Part 33)
- Definitions Clause (FAR Part 2)
- Protest After Award Clause (FAR Part 33)
- Reporting Executive Compensation and First-Tier Subcontract Awards (FAR 52.204-10)
- Organizational and Consultant Conflicts of Interest (FAR Subpart 9.5)

11. TERM

Pro-Prime

- Options at Prime's discretion

Pro-Sub

- Base year and all options

12. TERMINATION

Pro-Prime

- Termination for default
- Termination for convenience
- Sub's cure rights strictly limited to timeframe less than the timeframe Prime has to cure based on notice from Government

Pro-Sub

- No termination for convenience unless prime contract terminated by Government for convenience
- Notice and cure provisions