

BEST PRACTICES FOR FEDERAL FLOWDOWN CLAUSES

A decorative graphic on the left side of the page, consisting of a vertical orange bar with a white diagonal line and a faint background image of a person's face and a document with a flowchart.

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AGENDA

- Introduction: What is a Flowdown Clause?
- The Importance of Flowdown Clauses
- Mandatory vs Non-Mandatory Clauses
- Discussion on Flowdown Clause Sets
- Negotiated Flowdown Clauses
- Flowdown Clauses to Cost Type and T&M Subcontracts
- Flowdown Best Practices



**INTRODUCTION:
WHAT IS A
FLOWDOWN
CLAUSE?**



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?

- Each FAR/DFARS/other agency clause is unique and can tell the prime contractor if the clause is to be *inserted, incorporated, will include the language, shall insert*, etc. (all these terms are used to indicate flowdown) into a subcontract
- It is the responsibility of the prime contractor to decide which of the flowdown clauses apply by matching the work effort to the description found in the clause
 - For example, a clause may only require flowdown if the subcontracted work is valued at greater than \$100,000 or in all subcontracts that involve access to classified material



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



THE IMPORTANCE OF FLOWDOWN CLAUSES



THE IMPORTANCE OF FLOWDOWN CLAUSES

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



THE IMPORTANCE OF FLOWDOWN CLAUSES

Why not flowdown all prime contract clauses?


- Some courts have found that attempting to flow down the entire prime contract is not enforceable because it will contradict other terms in the subcontract
- Also, no subcontractor legal counsel would or should ever accept a complete flowdown of all prime contract clauses
- It is bad contractual practice to include flowdown clauses in a subcontract that do not apply
 - Common mistake: Including small business, CAS and TINA clauses in subcontracts to non-large businesses



THE IMPORTANCE OF FLOWDOWN CLAUSES?

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
 - Clauses that implement core procurement policy
 - Has been applied to subcontracts
- RECENT CASE APPLIED CHRISTIAN DOCTRINE TO A SUBCONTRACT
 - UPMC Braddock v. Seth D. Davis, Civ. 09-1210 (D.D.C. Mar. 30, 2013)
 - Incorporated Department of Labor socio-economic regulations (EEO)



MANDATORY VS NON-MANDATORY CLAUSES



MANDATORY FLOWDOWNS



MANDATORY FLOWDOWNS

Key Things to Remember With Federal Subcontracts:

- A subcontract between the Prime and Subcontractor is a “Private” non-federal contract
- Adjudication of the terms of a Subcontract will be per the terms of the subcontract (think State Venue or State Law)
- Unless the subcontract states that Federal Law and Clauses take precedence over all other terms of the subcontract, State courts will apply State Law first

SO IS ANY CLAUSE TRULY A MANDATORY FLOWDOWN?



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))



COMMERCIAL FLOWDOWN

Prime Contractor FAR Clause	52.244-6 Subcontracts for Commercial items	52.212-5, Contract Terms and Conditions Required to Implement Statutes or Executive Order-commercial Items (Jan 2019)
Subcontract Flowdown	<p>(a)“Subcontract” includes a transfer of commercial items between divisions, subsidiaries, or affiliates of the Contractor or subcontractor at any tier.</p> <p>(b)To the maximum extent practicable, the contractor shall require its subcontractors at all tiers to incorporate commercial items or non-developmental items as components supplied under this contract.</p>	<p>(e)(1) Notwithstanding the requirements of the clauses in paragraphs (a), (b), (c), and (d) of this clause, the contractor is not required to flow down any FAR clause, other than those in Paragraph (e)(1) in a subcontract for commercial items. Unless otherwise indicated below, the extent of the flowdown shall be as required by the clause [22 clause follow</p> <p>(e)(2) While not required, the contractor may include in its subcontracts for commercial items a minimal number of additional clauses necessary to satisfy its contractual obligations.</p>



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/Pos
- Most are triggered based on certain subcontract values and/or subcontract types



MANDATORY FLOWDOWNS: NON-COMMERCIAL ITEMS

- If your prime contract says the prime “shall insert the substance of this clause into all subcontracts,” that’s not enough to put them in the subcontract automatically.
- There are no ‘automatic’ flowdown clauses - there are ‘mandatory’ and ‘discretionary’ flowdown clauses.



EXAMPLE MANDATORY FLOWDOWNS

FAR Clause 52.215-2, Audit and Records-Negotiation

- Trigger: Flexibly-priced subcontracts that exceed the Simplified Acquisition Threshold (SAT)
- Interpretation issue: Does the prime contractor have an audit right?
 - Typically “Government” is replaced by “Prime Contractor”
 - Clarify terminology usage in subcontract



EXAMPLE MANDATORY FLOWDOWNS

FAR Clause 52.222-41. Service Contract Act of 1965

- Subcontractor must pay prevailing wages and benefits in wage determination
- Prime contractor must process subcontractor Requests for Equitable Adjustments (REAs) based on increased wage determination
- Prime contractor liable for subcontractor violation



EXAMPLE MANDATORY FLOWDOWNS

- FAR Clause 52.222-6, Construction Wage Rate Requirements (Davis-Bacon Act requirements)
- FAR 15.403, Obtaining Certified Cost or Pricing Data (Truthful Cost or Pricing Data Act/TINA)
- FAR Clause 52.244-6, Subcontracts for Commercial Items



FLOWDOWN OF ETHICS REQUIREMENTS

Prime Contractor FAR Clause	52.203-6 Restrictions on Subcontractor Sales to the Government (September 2006)	52.203-14 Anti-Kickback Procedures (May 2014)	52.203-14 Display of Hotline Poster(s) (October 2015)
Subcontract Flowdown	Include in Subcontracts that exceed the Simplified Acquisition Threshold	Include the substance of this clause in all subcontracts over \$150,000	Include the substance of this clause in all subcontracts over \$5.5M except for: <ul style="list-style-type: none">- Acquisition of a Commercial Item; or- Subcontract is performed entirely outside the U.S.



NON-MANDATORY FLOWDOWNS



CLAUSES NOT REQUIRED TO BE FLOWED DOWN

- 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*

WHY?



EXAMPLE NON-MANDATORY FLOWDOWNS

- FAR Subpart 9.5, Organizational Conflicts of Interest
 - Subcontractor OCIs can disqualify prime contractor
 - There are no FAR OCI clauses - special clauses or prime contractors draft their own
 - OCI questionnaires/disclosures
 - Requires that the subcontractor maintain an OCI clearance process



EXAMPLE NON-MANDATORY FLOWDOWNS

- **FAR Clause 52.249-X, Termination**
 - Allows prime contractor to terminate the subcontract should the Government terminate the prime contract
- **FAR Clause 52.243-X, Changes**
 - Allows prime contractor to flow Government changes to the subcontractor



EXAMPLE NON-MANDATORY FLOWDOWNS

- FAR Clause 52.233-1, Disputes
 - Puts subcontractor on notice of disputes process
 - Requires subcontractor to keep working pending resolution of a dispute



**DISCUSSION ON
FLOWDOWN CLAUSE SETS**



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



TYPICAL SETS OF CLAUSES

Clause Set	Clause Description
General Terms and Conditions	<ul style="list-style-type: none">- Period of Performance- Type of Agreement- Place of Performance- Inspection and Acceptance- Key Personnel- Liability and Indemnity- Termination and Default- Insurance- Disputes and Governing Law
Non-Commercial FAR Clauses	<ul style="list-style-type: none">- Flowdowns Required by FAR- Flowdowns not required by FAR but Prime should flowdown (i.e. stop work, termination for convenience, etc.)
Commercial FAR Clauses	<ul style="list-style-type: none">- FAR Part 12 Acquisition of Commercial Items Clauses
DOD Contracts	<ul style="list-style-type: none">- Flowdowns from DFARS
Other Agency Supplements	<ul style="list-style-type: none">- Flowdowns from specific Federal Agency Supplement (i.e. GSAR, DEARS, EDAR, etc.)
IDIQ/GWAC Specific	<ul style="list-style-type: none">- Flowdowns specific to a large program award (i.e. OASIS, SPAWAR, SEWP, etc.)
Other	<ul style="list-style-type: none">- Contract type Clauses (FFP, CP, T&M, LH)- A/E and Construction subcontracts- Service type contracts



TOPIC-SPECIFIC SETS OF CLAUSES

- Contractor may also have standard sets based on certain contractual 'topics'
- These sets usually provide implementing details such as systems requirements, forms, formats, and instructions. There is no limit to these sets.
- A few of the more popular topics include:
 - Quality
 - Property
 - Insurance
 - Payment
 - Packaging and marking
 - Transportation and shipping



TOPIC-SPECIFIC SETS OF CLAUSES

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 FLOWDOWN CLAUSES



MOST NEGOTIATED CLAUSES

- It is not unusual for the same issues to be the most contentious as they carry high risk
- The International Association for Contract and Commercial Management (IACCM) conducts an annual survey of the top terms that are negotiated
- The next slide summarizes the top 10 negotiated terms for the years 2014 vs 2018 vs what IACCM finds to be the most important contract terms



MOST NEGOTIATED TERMS

TERM	2014 Rank	2018 Rank	Importance
Limitation of Liability	1	1	7
Price/change/price changes	2	3	3
Indemnification	3	2	
Service Level and Warranties	4		5
Payment	5	8	8
Termination	6	4	
Warranty	7	6	
Intellectual Property	8		
Performance/Guarantees/Undertakings	9	7	6
Delivery/Acceptance	10		4
Liquidated Damages	11	10	
Scope and Goals	12	5	1
Change Management			10
Data Protection/Security/Cybersecurity		9	9
Responsibilities of the Parties			2



NEGOTIATIONS AND RESOLUTION OF CONCERNS

- As noted earlier, terms and conditions are a risk-sharing mechanism
- It is natural for each party to want to assume the least risk
- However, the parties should understand the impacts to costs for their risk positions
- Patient and careful exchanges of views and concerns may be required to reach understandings that can lead to balanced agreements



CUSTOM TERMS AND CONDITIONS

- There are many award vehicles that do not lend themselves to standard or topic sets of terms and conditions
- Typical custom arrangements include:
 - Intellectual property and licenses
 - Agreements
 - Memoranda of understanding
 - Memoranda of agreement
 - Letters of intent
 - Other Transaction Agreements (OTA)
- The content of these arrangements depends on the customs of the market and the buyer
- These arrangements usually require legal advice because of their unique nature



**— FLOWDOWN CLAUSES TO
COST TYPE AND T&M
SUBCONTRACTS**



FLOWDOWN CLAUSES TO TYPE AND T&M SUBCONTRACTS

- FAR 52.216-7 Allowable Cost and Payment
- This is not a mandatory flow down clause
- However, not flowing this clause down to cost type or T&M (for other than commercial items) subcontractors, when the prime contract is cost type can place the prime contractor at risk.
- The subcontract could have unallowable costs but the prime contractor would have no recourse and potentially no audit rights.
- The government could hold the prime responsible, and could impose a number of negative consequences including withholding funds from the prime and providing a negative contractor rating.



FLOWDOWN CLAUSES TO TYPE AND T&M SUBCONTRACTS

- FAR 52.216-7 Allowable Cost and Payment
- Including this clause in cost type and T&M subcontracts does impose additional requirements on the prime, such as ensuring that indirect rates for cost type subcontracts and direct costs on T&M subcontracts are audited in a timely manner. However, the alternative is to place recovery of subcontract costs at risk.
- A number of government agencies, including DCMA have put out policy statements to indicate that it is the prime contractor's responsibility to ensure that audits are conducted of cost type and T&M subcontracts.



— FLOWDOWN BEST PRACTICES



FLOWDOWN BEST PRACTICES: PRIME CONTRACTOR

- Read your contract!
- Create a flowdown matrix that identifies flowdown requirements specific to each contract
 - Based on subcontract value and type
 - But Buyers and Subcontract Administrators still must think!
- Determine which non-mandatory clauses are necessary to mitigate risk (termination, changes, etc.)



FLOWDOWN BEST PRACTICES: PRIME CONTRACTOR

- When necessary, ensure that subcontractor is taking steps to comply with flowdowns (e.g., PCI, OCI, SCA)
- Monitor new clauses in contract modifications and modify subcontracts appropriately (e.g., counterfeit electronic parts, cyber-security, etc.)



PRIME CONTRACTOR PERSPECTIVE

- The prime contractor's tendency is to flow down as much as possible as a risk management strategy
- This is out of concern for being compliant to the prime contract's requirements. In many cases, the prime contractor does not see much latitude for negotiation.
- However, if overdone, this strategy can be costly in terms of time to negotiate and unnecessary added requirements. Instead of forcing subcontractors to take exceptions, a better strategy is for the prime contractor to ask the subcontractor to identify the terms and conditions that are increasing the proposed price.



SUBCONTRACTOR PERSPECTIVE

- The subcontractor's first concern is to understand what the prime contractor wants to flow down
- This requires the subcontractor to understand enough about the prime contract to determine if a flowdown applies
- The subcontractor should review the proposed clauses in the RFP and identify and relay any concerns or exceptions to the prime contractor as early as possible
- It is best to offer a rationale and alternatives so that the prime will understand the impact of the proposed flowdown and ways to possibly accomplish the same result at less cost



FLOWDOWN BEST PRACTICES: SUBCONTRACTOR

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



FLOWDOWN BEST PRACTICES: SUBCONTRACTOR

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REFERENCES AND RESOURCES

- FAR Subpart 52.3, Provisions and Clauses Matrix
- DAU Provision and Clause Matrix Tool
- Hill AFB FARSite
- Hill AFB FARSite Clause Logic Tool
- National Defense Industrial Association (NDIA): A Study of the Applicability of FAR Clauses to Subcontracts Under Prime Defense and NASA Contracts

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