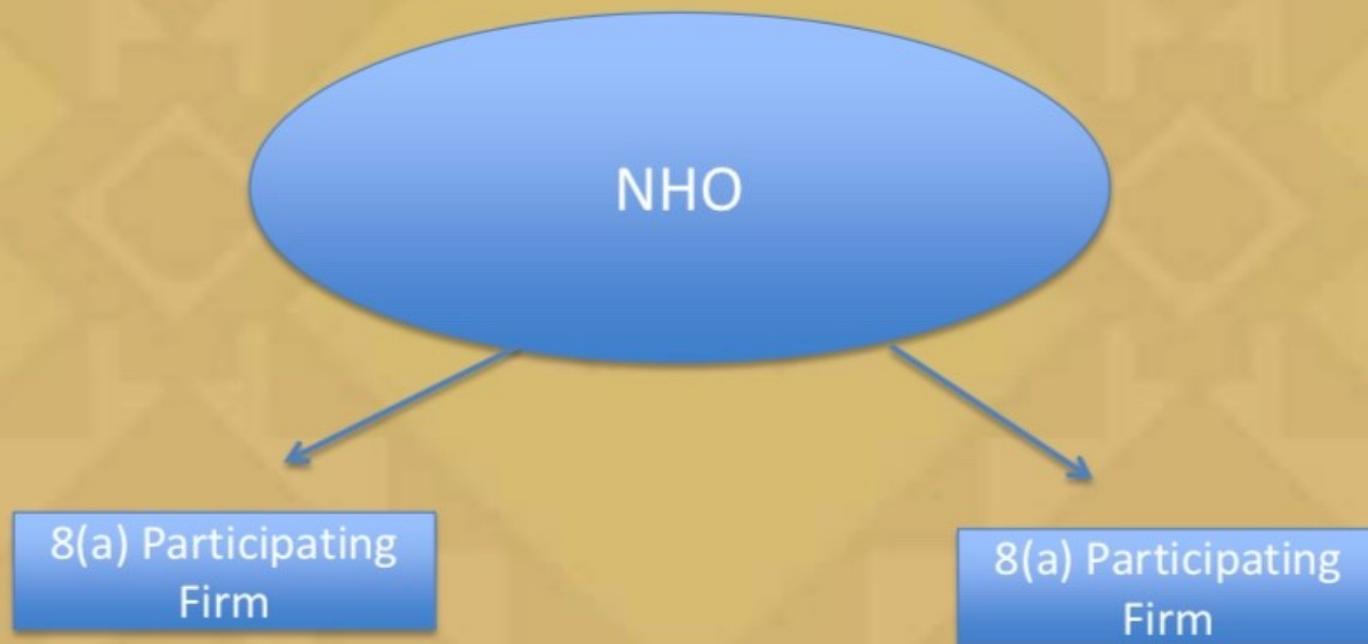


# BEST PRACTICES FOR MAINTAINING SUCCESSFUL PRIME-SUBCONTRACTOR RELATIONSHIPS

MICHAEL H. PAYNE  
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# Structural Options

## Native Hawaiian Organization (NHO)



*NHO Business Guide*

# 8(a) BUSINESS DEVELOPMENT PROGRAM

- The Small Business Administration's 8(a) program is designed to assist socially and economically disadvantaged small businesses, including NHO-owned firms.
- Through the award of sole-source and set-aside contracts, the 8(a) program provides market access and growth for qualified small businesses.



# PRIME CONTRACTOR PERSPECTIVE

- Subcontracting is often vital to be competitive
- Opens the door for participation in set-asides
- Critical to meeting performance requirements
- Good way to enhance a proposal
- Successful relationships are looked upon favorably



# SUBCONTRACTOR PERSPECTIVE

- Provides the ability to participate in larger projects
- Enhances the growth of small businesses
- Improves the possibility of set-aside awards
- Bid bond indemnification
- Successful relationships are looked upon favorably (provided they do not amount to affiliation with large business)



# HOW TO STRUCTURE THE RELATIONSHIP

## “Teaming” v. Joint Ventures

- **Teaming:** A special type of prime/subcontractor relationship
- **Joint Venturing:** Two or more separate companies coming together to compete as a newly formed entity
- **What about Mentor Protégé?**

# THE IMPORTANCE OF EVALUATION FACTORS

## What you Need to Know:

- Procurement Methods:
  - **FAR Part 14** – Sealed Bidding Invitation for Bids (IFB): Award is Made to the Lowest **Responsive** and **Responsible** Bidder
  - **FAR Part 15** – Contracting by Negotiation Request for Proposals (RFP): Award is made to the offeror who presents the “Best Value”

*\*Increased Importance on Non-Price Factors\**

# THE RISE OF SET-ASIDE CONTRACTS

- Federal procurement market has become more competitive
- An increasing number of contracts are set-aside contracts
- NDAA Section 809 Panel



# SELECTING THE BEST ARRANGEMENT

## Key Considerations:

- What are your company's goals?
- What are the requirements of *this* solicitation?
- What are your company's strengths and weaknesses?
  - Is the company capable of functioning as a Prime?
  - Would you be more competitive with a teammate or a joint venture partner?

# SELECTING THE BEST ARRANGEMENT

## Key Considerations:

- What are the sizes of your company and your partner?
- What's the relationship between the parties?
- **What effect will teaming/joint venturing have on small business status?**

# Teaming



# CRITICAL CONSIDERATIONS

## What Can Go Wrong?

- Destroying “small” size status or otherwise nullifying small business program eligibility, responsibility issues, etc.
- How? Most common ways:
  1. “Affiliation”
  2. “Control”
  3. Work Percentage Requirements

***Draft your Agreement to Address and Overcome these Concerns!***

# TEAMING

## **Why Does Affiliation Matter?**

What impact does it have on a company's size?

# COMMON AFFILIATION ISSUES

- **Ostensible Subcontractor:**
  - % of Work Requirements
  - Control on site
- **General affiliation:**
  - Shared Space, Employees, Resources, Equipment
  - Past Employee Relationship
  - Familial Relationship
  - Frequent Subcontracting
  - Financial Reliance/Control



# HOW TO COMBAT “AFFILIATION”

- Teaming partners can avoid “affiliation” determination by entering into arms-length transaction.

*(Note: Joint Ventures are presumed to be affiliated with each other, with certain exceptions...more on this later)*

# CONTROL

## Remember:

- “Unconditional Control”
- Two Components
  1. Long-Term Decision Making and
  2. Day-to-Day Management and Administration of Business Operations
- Watch out for negative control issues and economic reliance/duress issues

# SELF PERFORMANCE REQUIREMENTS

- In the case of **a contract for general construction**, it will not pay more than **85%** of the amount paid by the government to it to firms that are not similarly situated.
- In the case of **a contract for special trade contractors**, no more than **75%** of the amount paid by the government to the prime may be paid to firms that are not similarly situated.

# ESSENTIAL TERMS

- Relationship of the Parties (Roles and Responsibilities)
- Exclusivity
- Awarding a Subcontract/Flow Down Provisions
- Communications with Client
- Protection of Proprietary Information/Non-Disclosure Agreements
- Term and Termination
- Governing Law
- Limitation of Liability
- Disputes and Resolution Process
- Non Solicitation of Employees
- Protest Responsibilities?

# Joint Ventures



# JOINT VENTURES

- A new entity; the JV partners function as something like “co-primers” on the project
- **Regulatory Definition:** A joint venture is an association of individuals and/or concerns with interests in any degree or proportion consorting to engage in and carry out no more than three specific or limited-purpose business ventures for joint profit over a two year period, for which purpose they combine their efforts, property, money, skill, or knowledge, but not on a continuing or permanent basis for conducting business generally
- Joint Ventures should be formed before submitting offer/proposal/bid

# JOINT VENTURES REQUIREMENTS

- Must be in writing
- Must do business under its own name
- Must be identified as a JV in SAM
- May be in the form of a formal or informal partnership or exist as a separate LLC or other separate legal entity and,
- If it exists as a formal separate legal entity, may not be populated with individuals intended to perform contracts awarded to the joint venture (e.g., the joint venture may have its own separate employees to perform administrative functions, but may not have its own separate employees to perform contracts awarded to the joint venture)

# JV ADVANTAGES AND DISADVANTAGES

## Advantages/Disadvantages Compared to Teaming:

- Issues of Control (Advantage v. Disadvantage)
- Liability
- Termination can be complicated – know who you are getting involved with

# Mentor Protégé Programs

**MENTOR  
PROTÉGÉ**

# MENTOR PROTÉGÉ PROGRAMS

## Programs:

- 8(a) Program -13 C.F.R. 124.520
- “All Small” Business Program – 13 C.F.R. 125.9
- Agency-specific Mentor-Protégé programs

## General Rules:

- Protégé is the small concern / Mentor is large
- Have to be approved and admitted into these programs
  - Application process

# THE TERMS OF THE SUBCONTRACT

- Drafted by the prime or the sub?
- Is it a boilerplate form?
- Apportionment of risk
- Negotiability of terms
- Legal review
- Sometime the best subcontract is the one you do not accept

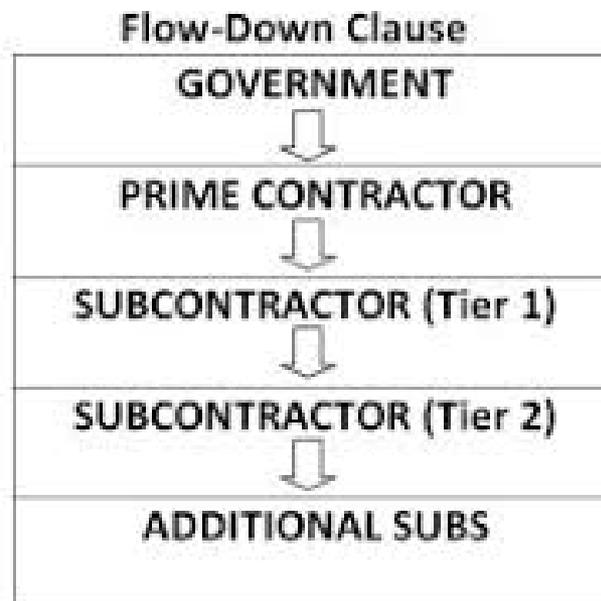
# FLOW-DOWN CLAUSES

- The unique world of federal government contracting...flow downs can be critical
- What are “Flow-Down” (aka “Flow-Through” or “Pass-Down”) Clauses?
  - Flow-down clauses are clauses included in a contractor’s prime contract with the Government, which the prime contractor is required to, or sometimes chooses to, flow-down, or incorporate into, the subcontract
  - Other risk-shifting or protectionary clauses

# FLOW-DOWN CLAUSES

## What is a flow-down clause?

- Designed to protect the interests of the prime contractor, but are important for the subcontractor, as well.



# TAKE-AWAY LESSONS FOR PRIMES

- It is critical to think about what obligations you will have to the Owner/Gov't, and how the sub could impact your ability to fulfill that obligation or assert your own
- Protect yourself by flowing down obligations, making sure that obligations are consistent, or accounting for potential risk in other ways
- Want to avoid being caught in the middle/battling on two fronts
- Carefully craft your subcontract to accomplish these goals

# WHAT DOES THIS MEAN FOR SUBCONTRACTORS?

- Subcontractors need to know what their obligations are, and what procedures they are bound to follow.
- In order to do so, they need to know **which** clauses have been flowed down, what obligations those clauses impose
- What other risks have been shifted?



# THE “CATCH-ALL” FLOW DOWN CLAUSE

“The Contractor shall assume toward the Subcontractor all obligations and responsibilities that the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities which the Contractor, under such documents, assumes toward the Owner and the Architect. The Contractor shall have the benefit of all rights, remedies and redress against the Subcontractor that the Owner, under such documents, has against the Contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor that the Contractor, under such documents, has against the Owner, insofar as applicable to this Subcontract.”

# TAKE-AWAY LESSONS FOR SUBS

- As a subcontractor, make sure you understand your obligations and the procedures you are bound by; never simply accept a vague flow down clause
- It is critical to obtain a copy of ALL the Prime contract documents, and to explicitly discuss what clauses are being incorporated
- Flip side: Advocate that the Prime's obligations to you mirror the Gov't obligations to the Prime
- Carefully craft subcontract to address these concerns or at least make sure you are clear on what your responsibilities are under the contract

# DETERMINING WHAT TO FLOW-DOWN

- Some clauses are mandatory, some are suggested, some should always be considered. ***No such thing as automatic!***
- Often, the FAR itself will state whether a clause must be flowed-down to a prime's subcontractors
- Should you flow down a clause, or the *substance* of clause?

# CRITICAL FLOW-DOWN ISSUES

- Changes
- Differing Site Conditions/Changes – NOTICE
- Dispute Resolution/Claims (and Certification)
- Payment Timing - Pay if Paid/Pay When Paid
- Terminations (for Convenience)
- Suspension

# SUBCONTRACTOR'S “PASS THROUGH” CLAIMS

- Disputes are not uncommon in federal contracting
- Sovereign Immunity – General rule is that lawsuits against the Federal Government are prohibited
- Privity of contract

SUBCONTRACTOR  
PASS-  
THROUGH CLAIM

# SPONSORSHIP OF “PASS-THROUGH” CLAIMS

- Commonly called a “pass-through” (“flow-through,” or “sponsored”) claim because the prime is “passing” the subcontractor’s claims through, upstream, to the owner
- Claims ruled by Contract Disputes Act (CDA)
- Prime must clearly and affirmatively agree to sponsor the claim – sometimes, they refuse
- Can be a **huge** source of Prime/Sub conflict

# ANTICIPATE DIFFERENCES OF OPINION

- **Prime's Concern:** Consequences of passing through problematic claims
  - Conditions on passing through claims
- **Sub's Concern:** Recourse if prime refuses to pass through a claim
  - Dispute/Case v. Prime
  - Remember, still no privity

***Appeal of Binghamton Simulator Company, ASBCA No. 59117 (2014)***

# TERMS OF THE SUBCONTRACT

- Consider a “Liquidating” or “Pass-Through Agreement”
- Prime contractor agrees to “sponsor” the subcontractor’s claim against the Government
- Sub agrees to release the prime in exchange for the prime’s promise to:
  - Prosecute the sub’s claim against the government; and
  - Pay the sub some or all of the money recovered from the Government in connection with that claim

# WHAT HAPPENS AFTER A CLAIM IS SUBMITTED?

- Remember an REA is not a Claim, the **Claim** is a prerequisite to litigation
- Contracting Officer issues a final decision on a claim, awarding money
  - Is it enough money? Do the Prime and Sub agree on that?
- Contracting Officer issues a final decision on a claim denying the claim (60 days/reasonable time)
  - Can take appeal as an appeal (90 days/1 year)
- Contracting officer does not issue a decision
  - Can take appeal as a “deemed denial” appeal

# WHAT HAPPENS AFTER A CLAIM IS SUBMITTED?

- Proceeds as any other litigation at COFC or Board of Contract Appeals:
  - Pretrial
  - Discovery
  - Written
  - Depositions
  - Motions
  - Trials
  - Decisions
  - Appeal to Federal Circuit

# CLAIMS APPEALS: COMMON GOVERNMENT DEFENSES

- The Government tends to rely on the same defenses over and over. Some of the favorites include:
  - Waiver, Release or Accord & Satisfaction
  - Notice
  - Lack of Governmental Authority

# SUB'S LAWSUITS AGAINST PRIME

## What if a prime breaches the subcontract?

- Many disputes center around Primes' refusal to pass-through claims, or subs' impatience in awaiting resolution of those claims
- If prime continues to refuse to honor subcontract, subcontractor can:
  - Bring suit against the prime in the appropriate U.S. District Court

# SUB'S LAWSUITS AGAINST PRIME

## Common Issues in Sub v. Prime Litigation

- Pay-if-Paid vs. Pay-when-Paid
- Exhaustion of Administrative Remedies
- ADR Clauses
- Jurisdictional Issues

# OTHER REMEDIES

- No liens on federal jobs
- Bonds
- If there is a nonpayment issue, subcontractor should serve timely notice of nonpayment upon prime and prime's surety
- Submit a claim to the prime's surety – called **Miller Act claims**

# Miller Act Claims



# THE MILLER ACT

40 USC 3131-3134

- Mandates the furnishing of payment bonds and performance by Federal prime contractors (in certain circumstances)
- Defines and limits where and when a bond claim may be brought
- Thus addresses two concerns that would otherwise exist in the performance of federal government construction projects . . .

# PAYMENT BONDS

- Sovereign immunity prevents the establishment of a lien against property owned by the government. As a result, subcontractors and material suppliers would be reluctant to work on Federal projects, knowing that they were not protected.
- Congress enacted the Miller Act to provide a substitute to guarantee payment to subcontractors and material suppliers working on government projects.

# PERFORMANCE BONDS

- The contractor's abandonment or other non-performance of a government job may cause critical delays and added expense in the government procurement process
- The bonding process helps weed out irresponsible contractors while the bond itself defrays the government's cost of substitute performance
- The subrogation right of the bond surety against the contractor (i.e., the right to sue for indemnification) is a deterrent to non-performance

# WHEN THE MILLER ACT APPLIES

- Applies to all projects for the construction, alteration or repair of any public building or public work of the federal government where the prime contract exceeds \$100,000
- Alternates allowed for contracts more than \$25,000 and less than \$100,000: (Bond, Letter of Credit, Escrow Agreement, CD, Cash)

# WHO IS A MILLER CLAIM AGAINST?

- A subcontractor Miller Act claim is not brought against the Prime Contractor
- A subcontractor Miller Act claim is brought against the Prime Contractor's surety/sureties

# PROCEDURAL REQUIREMENTS

## How does a First-Tier Subcontractor Bring a Miller Act Claim?

- No notice required
- Must wait 90 days from non-payment – waiting period to give bond principal a chance to make payments
- Must file suit within 1 year of last day of work performed or materials supplied
  - Contract work v. Punch list or warranty work

# SECOND-TIER SUBCONTRACTORS

## How does a Second-Tier Subcontractor Bring a Miller Act Claim?

- All requirements from previous slide

**PLUS**

- **MUST** provide notice within 90 days (**strictly construed!**) of supply of last labor or supplies

# NOTICE

- Notice **MUST** state:
  - Amount claimed with “substantial accuracy”
  - Name of party to whom labor or supplies provided
  - Claim is being made against bond principal
  
- Purpose of notice provision:
  - Allows prime to protect itself by withholding \$\$
  - Avoids double payment by prime

# LOWER-TIER

## How does a lower-tier subcontractor or supplier bring a Miller Act Claim?

- They don't
- Courts have strictly interpreted the word "subcontractor" when defining a second-tier claimant, and parties having a direct contractual relationship with a supplier to the contractor furnishing the bond have been denied a Miller Act remedy
- Subcontractors to a second-tier claimant, and any other parties farther down the line, are not covered by the Miller Act and are not able to prosecute a claim on the payment bond

# COMMON DEFENSES

- Surety can assert all defenses of its principal (or the sub if a second-tier subcontractor claimant), unless precluded by bond language:
  - Breach of contract
  - Recoupment/setoff
  - Failure to mitigate

# QUESTIONS?



# CONTACT INFORMATION

**Michael H. Payne** | **Chair, Government Contracting Group**  
Cohen Seglias Pallas Greenhall & Furman PC

30 South 17th Street  
19th Floor  
Philadelphia, PA 19103

(D) 267.238.4756

[mhpayne@cohenseglia.com](mailto:mhpayne@cohenseglia.com)