FLOW-DOWN CLAUSES IN FEDERAL GOVERNMENT SUBCONTRACTS

Current Issues and Cases
McMahon, Welch and Learned, PLLC represents many small and mid-sized federal services contractors in Northern Virginia, DC and Maryland, including small-disadvantaged firms, veteran-owned firms, women-owned firms and Hub Zone qualified firms. We also have a strong corporate and acquisitions-support practice which focuses on general business legal matters of significant interest to the broader business community.
J. Patrick McMahon, Partner

Mr. McMahon has nearly thirty years of experience with a primary focus on representation of companies that offer information technology products and services to the federal government. Mr. McMahon advises corporations and other business entities in connection with all aspects of their federal procurement business including contract award and terminations, claims, contract disputes, bid protests, and prime contractor/subcontractor relationships.
William T. Welch, Partner

Mr. Welch has twenty-two years of experience providing legal counsel for the entire lifecycle of a government contractor from contract negotiation, award, and litigating protests and contract claims. Mr. Welch also has experience in teaming agreements, subcontractor agreements (from the prospective of the prime and subcontractor), and related issues. In addition, Mr. Welch advises contractors who qualify for small business set-aside awards, 8(a) competitive and non-competitive contracts, and HUBZone and Service-Disabled, Veteran Owned contracts.
Why Do Flow-Downs Matter?

- If you are the prime contractor and you do not have proper flow-down clauses, then your subcontractor can force you into a default situation with your Government customer.
Federal Government Contracts differ in many respects from a commercial contract.

Federal Government Contracts are governed by federal law (most prominently the Federal Acquisition Regulations, FAR, 48 C.F.R.) not state law, which will govern the subcontract.

Federal Government Contracts are subject to a completely different set of Courts and Boards for dispute resolution.
Your Subcontract should capture these unique characteristics

- Your subcontractor should respond to you in sync (or better) with how you have to respond to your prime contractor.
- If your subcontract is inconsistent with your prime contract, your subcontractor can force you as the prime into a potential default situation with your Government customer.
How to make your Subcontract Compatible with your Prime Contract

- Use both mandatory and discretionary flow-down clauses.

- A flow-down clause is a clause taken from your prime contract and inserted into the subcontract with some minor modifications.
Are there any Automatic Flow-Down Clauses?

- 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” flow-down clauses.
- There are “mandatory” flow-down clauses and “discretionary” flow-down clauses.
Mandatory vs. Discretionary Flow-Down Clauses

- A mandatory flow-down clause is a contract clause in the prime contract that requires the prime to insert the substance of the clause into a subcontract.

- A discretionary flow-down clause is one that the prime chooses to insert into the subcontract but is not required to do so.
Why not just flow-down the entire prime contract or at least all the 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.
- You should not be flowing down the prime clauses exactly, but only their “substance.”
- In order for the flow-down to be enforceable, it needs to be modified to fit the subcontract.
- Also, no subcontractor legal counsel would or should ever accept a complete flow-down of the prime contract.
How to flow-down your prime contract clauses

- Cannot simply flow-down by reference to the clause number.
- Must flow-down with modifications for the subcontract.
- For the important flow-down clauses, they should be stated in full in your subcontract.
Which is most important: Mandatory or Discretionary Flow-Downs?

- Surprisingly, the most important flow-downs are the discretionary ones.

- Best examples are: Changes clause, termination for convenience clause, and the disputes clause.
Changes Clause

☐ Most federal prime contracts contain a unilateral changes clause: the government can modify the contract unilaterally and you must perform the change if within the general scope of the contract.

☐ If the Government can modify your prime contract unilaterally, then you need to be able to modify your subcontract unilaterally, at least to match the scope of the Government change.

☐ If not, the subcontractor can refuse the change.
Termination for Convenience

- Under the Termination for Convenience clause, the Government can unilaterally terminate your contract completely or partially.
- This is not a right that a prime contractor has with its subcontractor unless the subcontract contains a termination for convenience clause.
- If your prime contract is terminated and you have no right to terminate the subcontract, then it could be a costly breach of contract.
Disputes Clause

☐ Your prime contract has a unique Disputes clause. Contract disputes with the Government that can’t be resolved at the CO level are resolved in special courts that a subcontractor cannot use.

☐ It also prohibits the prime from stopping work in the event of a dispute.

☐ Your subcontract must contain a provision that fits with the prime’s Disputes clause and requires the subcontractor to continue working even if there is a dispute.
Other Important Flow-Down Clauses

- Default clause (discretionary)
- Option exercise clause (discretionary)
- Rights in Technical Data (discretionary)
- Limitation of Funds/Limitation of Costs (discretionary)
- Service Contract Act Requirements (mandatory)
- Davis-Bacon Act Requirements (mandatory)
- Audit and Records – Sealed Bidding and Negotiated Contracts (mandatory)
- Cost and Pricing Data (mandatory)
- Subcontracts for Commercial Items (mandatory)
Questions?

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