

APTAC Body of Knowledge Competency Guide

C. Basics of Contracting with Government Entities

C.14.3 Subcontract Management Issues

Description

Payment Terms. Decisions about payment terms affect everybody's cash flow and cost of doing business. When the prime contract provides that the contractor will be paid upon satisfactory completion and acceptance of all work, the contractors frequently impose payment terms on their suppliers and subcontractors that require waiting until the contractor is paid, commonly called "pay when paid" (PWP). If the prime contractor's terms with the customer are "net 30", and each subcontractor has accepted "PWP", the lowest tier will wait to be paid for as many months as there are tiers. However, FAR now requires accelerated payment to small business subcontractors. Responsible contractors should have the financial resources to pay the subs upon completion of the subs' work, not upon the customer's acceptance of all of the contractor's work including subs. Some prime contracts permit the contractor to bill the government when the cost is incurred, in order to receive payment and pay the subcontractor without delay. A method the government can use to help subcontractors get paid on time is to reduce or suspend progress payments to the prime contractor. FAR 32.503-5 allows some discretion by the government when approving progress payments concerning work that has been accomplished.

Liens. Subcontractors and suppliers may try to file a "pre-lien notice" which would entitle them to place a lien on the owner if the owner's contractor fails to pay the subcontractor or supplier. This is common in the private sector, but government property is not subject liens, and lending services are reluctant to lien a government contract because of its "termination for convenience" clause, so subcontractors may be unable to mortgage their accounts receivable as is common in the private sector. Counselors must caution clients to be very vigilant about what payment terms they agree to.

Disputes. A subcontract document should always contain a tailored method of resolving disputes, either through state court (and the state must be specified) or through Alternative Dispute Resolution (ADR) such as arbitration or other mutually acceptable means. Prime contract provisions for resolving disputes between the prime and the government through the Board of Contract Appeals, or even through the Contracting Officer's own organization, do not apply to subcontracts. A subcontractor can ask the prime to carry a claim forward to the Government within the bounds of privity. A lower-tier subcontractor seeking this type of assistance would have to submit it up through the tiers because the prime contractor has no privity with the lower tiers. Disputes at any level should be referred to competent legal counsel, and PTACs are prohibited from helping clients sue the government.

Acceptance of work. In some cases, the government requires the right to inspect and accept the subcontractor's work; in other cases, the prime contractor is responsible for inspecting and accepting the subcontractor's work without government involvement. The subcontract must be clear on who inspects and accepts the subcontractor's work, and under what circumstances. The government's right to inspect and/or accept the subcontractor's work does not create a direct legal relationship between them or imply breach of privity; the contractor is still responsible for

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the subcontractor's work. The Prime's representative should always be present for any interaction between government and subcontractor, to protect privity.

Setasides. It is common in government contracting for a procurement to be restricted to only small businesses, and to certain socio-economic categories of small businesses. The solicitation will clearly specify whether and to what extent the procurement is set aside to any such category. The FAR citation under which the setaside is defined will specify whether it applies only to the prime contractor or to all tiers. It is very important for the prime contractor to determine which depth applies and to manage its subs accordingly. Penalties can be severe.

Source selection. Contractors must comply with their own company procedures, not the FAR, when selecting their vendors and subcontractors. The government may review those procedures and either approve or request revisions, and those requests can be discussed and negotiated separate from contract negotiations. The government's concern is that the public funds are spent efficiently for the best value for the project, especially on cost reimbursement-type contracts. Contractors must therefore maintain careful documentation on how all subcontracts (including purchase orders and other acquisition instruments) are entered into, how fair market value is established, and typical documentation justifying source, price, and methods. Company's past practice and industry standards are considered when government reviews a subcontract action. In addition,

Customer consent. Under FAR Part 44, the government may take an active role in the contractor's choice of subcontractors and method of contracting with them. If the contractor is a large business without an approved purchasing system, each subcontract over a certain amount, or within a specified scope, may have to be submitted to the government for consent prior to award of the subcontract, which can delay a small sub receiving an award. Consent does not mean approval, because approval implies that the government could be held responsible if the subcontractor fails. Consent only means they do not object, and they will not consent if they see flaws in the subcontracting process. Any subcontracts specified in the proposal and named in the award of the prime contract are not consented to and must be submitted under the consent requirements of the prime contract. Also, when the government approves the contractor's source of supply as a technical matter, it is neither consent nor "directed source", since contractors are generally required to have alternate sources of supply for critical items.

Reporting Subawards. The Federal Funding Accountability Transparency Act (FFATA) Subaward Reporting System (FSRS) is the reporting tool Federal prime awardees (i.e. prime contractors and prime grants recipients) use to capture and report subaward and executive compensation data regarding their first-tier subawards to meet the FFATA reporting requirements. The sub-award information entered in FSRS is displayed on www.USASpending.gov associated with the prime award to further Federal spending transparency.

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The subcontract document. The document may be as simple as the contractor's purchase order issued to the subcontractor, or a letter agreement specifying everything the two parties have agreed to. It should identify the prime contract number and the government customer, for reference only, but never to imply that the government is a party to the subcontract and never to incorporate the prime contract into the subcontract. This document is a commercial contract between two businesses, and absent specific provisions, is subject to Uniform Commercial Code, not the Federal Acquisition Regulation. The government sometimes requires a copy of the subcontract document, but usually only notification of its existence. Many resources provide advice on terms and conditions to include in subcontracts.

References

FAR 52.232-40 Accelerated payments to small subcontractors

Legal protections for subcontractors on federal prime contracts
<https://www.fas.org/sgp/crs/misc/R41230.pdf>

Reference materials posted at <http://www.onvia.com/business-resources/articles/subcontracting?page=1>

<https://www.fsr.gov/>

www.USASpending.Gov