

# BRIEFING PAPERS<sup>®</sup>

## SECOND SERIES



PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

### PRACTICAL TIPS & CONSIDERATIONS FOR SUBCONTRACT NEGOTIATIONS: A SUBCONTRACTOR'S PERSPECTIVE

By Douglas E. Perry and Louis D. Victorino

**D**uring the negotiation of subcontracts, the prime contractor typically provides a prospective subcontractor with a form agreement containing standard clauses and requests the subcontractor's authorized representative to sign the document. The standard form agreements normally leave little room for negotiation, the parties are anxious to sign the paperwork and, in any event, because the parties are still in the "honeymoon" stage, the subcontractor frequently will sign the standard form agreement with little real negotiation and without a full appreciation for the implications of the standard form terms.

The purpose of this BRIEFING PAPER is to address this everyday reality and to focus on some of the key issues that arise (or should arise)—from the perspective of the subcontractor under a Federal Government contract—during the subcontract negotiations with the prime contractor. The PAPER does not attempt to address every single common subcontract term; instead, it highlights some of the key issues that all subcontract negotiators face. Specifically, this Paper discusses (a) mandatory and necessary flow-down clauses, (b) issues and concerns that arise in connection with the negotiation of subcontract intellectual property and disputes provisions, (c) the "battle of the forms" problem, (d) matters related to subcontract warranty and most

favored customer provisions, and (e) steps subcontractors can take to ensure their continued participation throughout the life of a long-term federal acquisition effort such as a major defense program. For simplicity and clarity, the PAPER is written from the perspective of the prospective subcontractor's interests; for their part, prospective prime contractors may take away many of the converse points outlined below to meet their needs and interests.<sup>1</sup>

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## Mandatory & Necessary Flow-Down Clauses

Most subcontracts include a section that flows down standard Federal Acquisition Regulation and Defense FAR Supplement (or other agency FAR supplement) clauses from the prime contract to the subcontract.<sup>2</sup> The “flow down” of the rights and responsibilities of the prime contractor under these clauses to the subcontractor frequently is accomplished with standard language reading something like this:

The following clauses are incorporated in the Prime Contract. These clauses are incorporated by reference in this subcontract with the same force and effect as if presented in full. The text of these clauses is subject to the following definitions and to the modifications indicated. Specifically, “Contractor” means subcontractor except where the term “prime contractor” is used. “Contract” means this subcontract except where the term “prime contract” is used.

Some standard prime contract clauses must be flowed down to subcontracts under statute, regulation, or the terms of the clause itself. These so-called “mandatory” flow-down clauses should not be subject to any significant negotiations between the prime contractor and the subcontractor; after all, if the prime and subcontractor wish to do business with the U.S. Government, they have no choice in the matter. In addition to the mandatory flow-down clauses, many other standard clauses, while not, strictly speaking, required under the applicable regulations, are necessary if the parties wish to conduct business with the Government. These necessary flow-down clauses generally are accepted—in some form—by subcontractors.

### ■ Mandatory Flow-Down Clauses

Under the terms and conditions of the prime contract, the prime contractor must flow down certain standard FAR and DFARS clauses. For noncommercial items, these so-called “mandatory” flow-down clauses include, for example, the socioeconomic clauses,<sup>3</sup> the “Anti-Kickback Procedures” clause,<sup>4</sup> and the “Audit and Records—Negotiation” clause.<sup>5</sup> An illustrative, nonexhaustive list of mandatory flow-down clauses is set forth in Table 1 at the end of this PAPER (p.18).

At the outset of negotiations, the parties should identify the clauses that must be flowed down to the subcontract. The prospective subcontractor should insist initially on receiving a copy of the prime contract or the solicitation to identify the clauses that are actually incorporated into the prime contract. The prospective subcontractor should then identify which of these clauses are mandatory flow-down clauses. In addition, the prospective subcontractor should identify those clauses that must be flowed down only under certain conditions<sup>6</sup> or above certain dollar thresholds.<sup>7</sup> Although the process of identifying mandatory flow-down clauses is intended to be straightforward, in practice it can be tedious because the text of each clause and the clause prescription provisions must each be reviewed to determine if the clause is required to be incorporated in the subcontract. To help contractors identify mandatory flow-down clauses, a number of professional and trade associations have published guides. Although these guides frequently are outdated almost as soon as they are published due to the frequent modifications to the FAR and the DFARS, they are nonetheless a useful tool for subcontract negotiations.<sup>8</sup>



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### ■ Necessary Flow-Down Clauses

In addition to mandatory flow downs, many standard form FAR and DFARS clauses are “necessary” flow downs—at least in some modified fashion—as the price of doing business with the U.S. Government. An illustrative list of necessary flow-down clauses that should be tailored for each subcontract is set forth in Table II at the end of this PAPER (p.19). The task of differentiating necessary flow downs from the other clauses the prime would like to flow down for its own benefit and protection is neither simple nor straightforward—especially for prospective subcontractors that may be new to Government contracting. Indeed, this is an area where subcontractors are well advised to consult with counsel before signing the subcontract. Some of the key clauses that may be deemed necessary as a cost of doing business with the U.S. Government—even though the prime may not be expressly required to flow them down under the terms of the prime contract—and suggested areas for possible negotiation over their scope are discussed below.

(1) “Changes” clause<sup>9</sup>—Under this clause, the Government reserves the right to make changes in the work “within the general scope” of the prime contract. By implication, the “Changes” clause also allows the Government to change work within the general scope of the subcontractor’s area of responsibility. The clause provides for an equitable adjustment to the contract price and schedule to compensate for the change. The prime typically will wish to flow down this clause to the subcontractor. Although it is reasonable for the prime to flow down a variant of the “Changes” clause, prospective subcontractors should read the clause carefully.

Two areas are most likely to be objectionable. First, *time limits* for change notices and submission of change proposals may be too short under the clause the prime seeks to flow down. For example, the FAR “Notification of Changes” clause<sup>10</sup> requires the prime to provide notice to the Government of any changes within a specified time period as prerequisite to recovery of an equitable ad-

justment under the clause. In Federal Government contracts cases, however, strict compliance with a contract’s written notice requirements generally is not required. If the contractor provided oral notification, if the Government otherwise knew of the changes, or if the Government was not prejudiced by the contractor’s failure to comply strictly with the notice requirements, the Government generally will not be able to avoid its obligation to provide an equitable adjustment under the “Changes” clause.<sup>11</sup> State courts applying common-law principles to a subcontract, however, may interpret the “Notification of Changes” clause more strictly, which could result in the forfeiture of a claim in the event the contractor does not comply strictly with the notice provisions. If the prime is to meet its notification deadline, it is reasonable to demand that the subcontractor submit its notice of changes and its change proposals sometime before the prime’s submission due date. In general, however, any shortening greater than five calendar days may well be too great.

Second, some prime contractors attempt to *limit the equitable adjustment* to which the subcontractor is entitled under the “Changes” clause. These limitations range from (a) “no damages for delay,” to (b) restrictions on recovery of overhead or general and administrative expenses applicable to the direct cost of the changed work, to (c) imposition of fixed, below-cost labor rates on the changed work, to (d) limitations on recovery of profit on the changed work. Prospective subcontractors should resist these limits. Indeed, such attempted limits on the subcontractor’s equitable adjustment *may* be an indication that the prime expects to be responsible for costs that it believes cannot be passed on to the Government. If true, the subcontractor may not want to participate in the program.

(2) “Termination for Convenience of the Government” clause<sup>12</sup>—Under this clause, the Government reserves the right to terminate the prime contract at its convenience. This clause provides the Government broad termination rights and significantly restricts recovery of

damages. Anticipatory profits, for example, are not recoverable under this clause.<sup>13</sup> Although the prime contractor has a reasonable expectation that some variant of this clause will be incorporated into its subcontracts, prospective subcontractors are well advised to negotiate special “Termination” clauses that limit the prime’s termination discretion. For example, subcontractors should not accept the boilerplate flow-down language noted previously if that boilerplate substitutes the “prime” for the “Government.” Instead, the subcontract “Termination for Convenience” clause should authorize the prime to terminate the subcontract for its convenience only in the event and to the extent the Government terminates the subcontractor’s area of responsibility from the prime contract effort. Without this protection, the prime could terminate the subcontract for convenience and assume the work (and profits) promised to the subcontractor under the subcontract agreement. The subcontract “Termination” clause also should include favorable terms for resolution of the termination claim and payment that is not dependent on the outcome and timing of the prime’s termination claim against the Government. The parties could agree, for example, that the award of termination costs by an arbitrator should be deemed *prima facie* evidence of the allowability of the costs on the prime’s termination claim.

(3) “Default” clause<sup>14</sup>—Under the “Default” clause, the Government is entitled to terminate the contract for cause and to recover, among other things, excess procurement cost. The prime contractor has a reasonable right to insist on some kind of default termination provision in the subcontract. In some cases, however, the prime contractor will seek to include a “Default” clause that is broader than the clause incorporated in the prime contract. During negotiations, the subcontractor should seek a “Default” clause that is no broader than the clause found at the prime contract level.

(4) “Inspection of Supplies” clause<sup>15</sup>—Under this clause, the contractor must maintain an inspection system acceptable to the Govern-

ment, prepare and maintain inspection records, and allow the Government to perform inspections and conduct tests of supplies on the contractor’s premises. As a practical matter, the prime contractor will need to flow down this clause to its subcontractors because the Government will insist on the right (along with the prime) to inspect at the subcontractor’s facilities. In some cases, the prime will attempt to negotiate an “Inspection” clause that is more onerous than the Government’s “Inspection” clause. The subcontractor should bear in mind that, while the prime has the right to insist on inspection and testing of the supplies to assure the quality of the end product, the prime does not have the right to inspect the subcontractor’s proprietary processes and know-how for obtaining the end result.

(5) “Warranty” clause<sup>16</sup>—The FAR “Warranty” clauses give the Government the right to assert claims against the prime for deficiencies in the furnished supplies or services.<sup>17</sup> The FAR does not mandate the flow down of “Warranty” clauses to subcontractors, but primes typically will want to flow down some variant of the “Warranty” clauses included in the prime contract. Negotiation approaches for dealing with “Warranty” clauses are discussed in more detail below. Two key issues, however, bear noting at this juncture.

The first issue is the warranty *period*. The prime contractor’s warranty generally begins upon delivery and acceptance of the end item. A subcontractor product may be delivered to the prime and incorporated with the end item early in the production cycle, long before final delivery and acceptance of the end item. Thus, for a one-year end item warranty, a prime might propose a much longer warranty for the subcontractor’s product. The prospective subcontractor may (a) object to the extended warranty (at the risk of not getting the work), (b) attempt to price the risk as part of its quotation (and risk not getting the work), or (c) accept the risk. A fourth alternative is to propose a “cap” on total warranty liability (for example, at an amount reflecting the subcontractor’s expected profit).

The second issue concerns the *scope* of the warranty. Some prime contractors seek to impose standard warranties that are broader than those justified by the subcontractor's role or by the prime contract. For example, prime contractors sometimes use "Warranty" clauses in their subcontracts that require the subcontractor to warrant the design of the product even though the subcontractor does not control the product design. In addition, some primes use subcontract "Warranty" clauses that go beyond the standard FAR warranty of material, workmanship, and contract compliance<sup>18</sup> to include the Uniform Commercial Code warranties of merchantability and fitness for a particular purpose as well as liability for consequential damages. Prospective subcontractors should object to these broader provisions. In general, the subcontractor's warranty should be no broader than the prime's and narrower if the subcontractor is not responsible for the design contract. The bottom line is that, while it may be appropriate for the prime to flow down a "Warranty" clause, the terms of the flow-down clause should be carefully reviewed and negotiated.

(6) "*Price Reduction for Defective Cost Or Pricing Data*" clause<sup>19</sup>— The Truth in Negotiations Act (TINA) requires contractors and subcontractors to provide the Government with cost or pricing data when negotiating contracts or contract modifications over a specified threshold (currently \$550,000) unless one of several stated exceptions applies.<sup>20</sup> "Cost or pricing data" are broadly defined to include "all facts that...a prudent buyer and seller would reasonably expect to affect price negotiations significantly."<sup>21</sup> While the term "does not include information that is judgmental," it does include "the factual information from which a judgment was derived."<sup>22</sup> The data submitted must be "accurate, complete, and current" as of the date on which the parties agreed upon a price.<sup>23</sup> If the Government later determines that the contractor's data were *not* accurate, complete, and current, it may assert a defective pricing claim against the contractor by demanding a reduction in the contract's price to compensate for the effect of the undisclosed or in-

accurate data, as provided for under the contract's "Price Reduction for Defective Cost or Pricing Data" clause.<sup>24</sup> By obtaining cost or pricing data, the Government seeks to place its negotiators on equal footing with the contractor and thus ensure that the price negotiated by the parties is fair and reasonable.<sup>25</sup>

Although the prime contractor is responsible for any defective pricing caused by its subcontractors,<sup>26</sup> the regulations do not mandate the flow down of the TINA "Price Reduction for Defective Cost Or Pricing Data" clauses to subcontractors. Prime contractors, therefore, insist that any applicable TINA clauses be flowed down to the subcontractors so that they are not saddled with sole responsibility for the failure of their subcontractors to provide accurate, complete, and current cost or pricing data. Before agreeing to the flow down of any TINA clauses, potential subcontractors first should determine whether any of the TINA exceptions may apply to their subcontract.<sup>27</sup> Commercial item subcontracts, for example, are not subject to the TINA cost or pricing data submission requirements.<sup>28</sup> Assuming the subcontractor cannot avail itself of any of the TINA exceptions, the subcontractor should not execute any subcontract agreement with defective pricing provisions unless and until it has put into place a strong compliance program that, among other things, educates negotiators and other key employees about the provisions of TINA and provides for "sweeps" of data prior to the agreement on price to ensure compliance with the law.

(7) "*Progress Payments*" clause<sup>29</sup>—This clause authorizes the prime contractor to receive financing from the Government during the course of performance of a fixed-price contract on the basis of costs incurred. The customary progress payment rate for large businesses is 80%,<sup>30</sup> which means the prime is authorized to submit invoices on a monthly basis in an amount up to 80% of the contractor's allowable, allocable, and reasonable costs during the period covered by the invoice. The inclusion of the "Progress Payments" clause, therefore, requires the contractor to estab-

lish an accounting system that excludes unallowable costs and otherwise complies with Government contracting accounting rules and regulations.<sup>31</sup>

Until recently, prime contractors were not authorized to bill the Government for subcontractor costs that had been billed but not yet paid. On November 22, 2002, the regulators eliminated the so-called “paid cost rule.”<sup>32</sup> The “paid cost rule” protected subcontractors because it required large contractors actually to pay (not just incur on their books) costs for supplies and services purchased from suppliers and subcontractors before including the costs in their billings to the Government. Under the current rules, all primes (both large and small) are authorized to invoice the Government for unpaid subcontractor costs as long as the contractor ordinarily pays the subcontractor within 30 days of the submission of the contractor’s payment request to the Government.<sup>33</sup>

Before agreeing to a “Progress Payments” clause, subcontractors should determine whether other forms of contract financing are available. For example, is *performance-based financing* available? Under performance-based financing, the contractor is paid based on the attainment of certain milestones or accomplishments—i.e., not on the basis of costs incurred.<sup>34</sup> This could improve the contractor’s cash flow; it would also eliminate the need for the contractor to worry about unallowable costs with the submission of progress payment invoices under a firm-fixed-price contract. In addition to performance-based financing, *advance payments* may be authorized—particularly if the contract is a commercial item contract. Advanced payment financing is customary for commercial items.<sup>35</sup> The bottom line is that progress payments contain traps for the unwary and other, preferable financing vehicles may be available to subcontractors.

If no other financing is available, subcontractors should review the prime’s proposed “Progress Payments” flow-down clause. Among other things, subcontractors should determine whether (a) they are receiving the highest progress payment rate available (small busi-

nesses can receive a progress payment rate up to 85%),<sup>36</sup> (b) the prime’s proposed clause attempts to exclude otherwise allowable costs from the calculation of the progress payment rate (some primes attempt to exclude general and administrative expenses from the base of costs used to calculate the allowable progress payment amount), and (c) the proposed clause incorporates a provision requiring the prime to pay the subcontractor within a date certain from receipt of a proper invoice (typically, subcontractors will want to insist on payment within 30 days of submission of a proper invoice, with provision for interest penalties in the event payment is not received within that window of time). Finally, before submitting progress payment invoices, subcontractors should ensure that their accounting system excludes unallowable and unallocable costs from the base used to calculate the progress payments.

## Intellectual Property Clauses

No set of contract clauses pose a greater threat to a subcontractor than the subcontract intellectual property clauses. At the same time, no set of clauses provides a greater opportunity to ensure future business. Many standard form agreements, however, simply flow down or incorporate intellectual property clauses without regard to the implications of those clauses on the parties’ relationship or their respective contributions. To protect their interests, the parties should identify the relevant prime contract intellectual property clauses, determine the source of funding for various activities and, as appropriate, negotiate special intellectual property clauses suitable for the transaction at hand.

That said, most prime Government contractors simply flow down FAR or DFARS standard patent rights, technical data rights, and computer software rights clauses to subcontracts.<sup>37</sup> If unaltered by the prime contractor, these clauses provide a by and large fair allocation of rights. In general, these clauses provide that (1) all rights to preexisting intellectual property privately developed by the subcontractor, outside of a Government contract, remain the

sole property of the subcontractor (assuming that the administrative requirements of the clauses are met) and (2) rights in new patentable inventions made under the contract and nonpatentable intellectual property developed and paid for by the Government (via contract direct cost payments) are allocated with title vesting in the subcontractor and a license to practice the intellectual property allocated to the Government.<sup>38</sup> Difficulties arise if the prime attempts to modify the standard coverage or if non-Government-funded development work is anticipated as part of the subcontract effort. In addition, in implementing both standard clauses and specially negotiated clauses, the subcontractor should give consideration to provisions that better protect its intellectual property and help ensure its continued participation in the program.

#### ■ Prime Contract Clause Alternative

Prime contractors sometimes attempt to incorporate subtle, but significant, changes to the standard intellectual property clauses. As noted above, boilerplate FAR/DFARS clauses are often incorporated by reference into the subcontract with a lead-in paragraph directing that the word “Prime” or “Buyer” be substituted for “Government” and the word “Sub” or “Seller” be substituted for the word “Contractor.” Literal application of this change, in the case of the intellectual property clauses, results in the prime contractor allocating to itself licenses and other rights normally flowing to the Government. A subcontractor should not accept such modifications to the standard clauses.

Less subtly, the prime contractor sometimes clearly demands that rights in intellectual property developed under the subcontract fully vest in the prime. In large measure, the fairness of this demand depends on the source of funds paying for the development effort. Allocation of rights in federal procurement is, generally, based on a “follow-the-funds” test. For example, if the developmental work is performed by personnel charging directly to a Government contract, the Government will be allocated some form of license to practice

and perhaps disclose the intellectual property. On the other hand, if the development is achieved by personnel properly charging to an overhead or indirect cost account (such as an independent research and development account), the Government is allocated only a “limited rights” license—a license that does not permit disclosure or use to manufacture or develop other products.<sup>39</sup>

It is also the custom in the Government contracting industry that the company that “pays the bill” for the intellectual property development is entitled to control the intellectual property. Thus, if the prime contractor is paying the subcontractor, not out of direct Government funds, but out of its own IR&D budget or other noncontractual funds, the prime would be entitled to request that all rights in the intellectual property vest in it. If, on the other hand, the development effort is financed by the subcontractor’s IR&D funds or other noncontractual sources, an attempt by the prime to demand control of the intellectual property (perhaps as a condition of being a subcontractor or “team member”) is overreaching. Indeed, applicable regulations admonish Contracting Officers to avoid such situations and demand that the standard clauses be flowed down unaltered.<sup>40</sup>

#### ■ Nondisclosure Agreement

Most subcontractors know that, before exchanging proprietary information with another company, it is important to have a so-called nondisclosure agreement in place. Such an agreement can be brief (in the case of an initial exchange of information to determine the merits of going forward) or more complex (if a long-term relationship is contemplated and the parties anticipate exchanging highly sensitive data).

More astute subcontractors include express “use” limitations in their nondisclosure agreements. “Use” limitations state that the recipient *may* use the intellectual property for certain stated purposes and *may not* use the intellectual property for other stated purposes. For example, it is often stated in prime/subcontractor

tor use and nondisclosure agreements that intellectual property is exchanged for the purpose of preparing a joint proposal and for the performance of any contract that may be awarded as a result of the proposal. Unfortunately, many such agreements do not explicitly state that the exchanged intellectual property may not be used for manufacture. Indeed, many agreements state that the intellectual property may be used “only in connection with the Program” without further defining permitted and prohibited activity. A more specific definition of permitted uses must be set forth in the nondisclosure agreement to spell out the parties’ respective rights and responsibilities in this regard.

If the size, term, and nature of the proposed relationship merits the time investment, a safer approach to protecting the subcontractor’s intellectual property is to combine a nondisclosure agreement with express license language licensing the intellectual property for only identified purposes and no other. Specifically, the license might extend to the use of the intellectual property in developing a proposal, to interface designs, and for other such common prime/subcontractor coordination efforts. But the license should explicitly state that the intellectual property is not licensed to (a) manufacture, (b) design follow-on or derivative products, or (c) disassemble or otherwise enable back-engineered products. In addition, the license should have a finite duration as well as a termination provision. A subcontractor armed with such an agreement makes it more difficult for the prime to cut the subcontractor out of the program and to go to a competitor for the subcontractor’s product or to do the work itself. If such an attempt is made, the license is violated and the subcontractor can terminate the license, thereby further complicating the prime’s ability to perform the work.

### **“Disputes” Clause**

Most standard form agreements incorporate some type of “Disputes” clause, often specifying that disputes be resolved through an alternative dispute resolution procedure. An ADR clause, however, may not be appropriate in

all cases. Moreover, in those cases where an ADR clause is appropriate, the standard form clause that is proposed may not be in the best interests of the prospective subcontractor.

Before agreeing to the prime’s standard disputes resolution clause, the prospective subcontractor should consider carefully (1) whether a disputes provision is desirable and (2) if so, what type of disputes resolution clause is most appropriate given (a) the parties’ relationship, culture, and past history, (b) the nature and duration of the subcontract, and (c) the types of issues or problems that may reasonably be anticipated.

#### **■ No Clause Option**

As a preliminary matter, the parties should consider whether a “Disputes” clause is even desirable. In the absence of a disputes provision, the parties will be left to resolve disputes under the rights afforded them by common law. This means that disputes between the parties will be adjudicated in a court of law, either federal court or state court, depending on well-established legal principles of relating to jurisdiction.

#### **■ ADR vs. Court Litigation**

Assuming the parties desire to incorporate a “Disputes” clause, the parties should consider what type of disputes provision is most desirable. Such clauses can run the gamut from various ADR techniques such as mediation, arbitration, or minitrial proceedings, to court litigation, or to a combination of these. In some cases, litigation in court may be preferable to ADR. Courts must apply the law and follow a full due process procedure. Thus, parties seeking a more formal reading and application of the subcontract terms may prefer to bring their disputes in court. Moreover, court proceedings have well-established, formal discovery procedures that may prove beneficial. In addition, the law affords parties the right to appeal a court decision. ADR proceedings, on the other hand, generally provide for little or no discovery, are summary in nature, often result in a compromised application of the law, and are



final and cannot be appealed in the absence of allegations of fraud or other gross procedural irregularity.<sup>41</sup> On the other hand, court proceedings tend to take longer and cost more money. Indeed, these are the two most important reasons given for turning to ADR.<sup>42</sup>

### ■ Good-Faith Negotiations

Whichever type of proceeding the parties elect, a well-drafted disputes resolution clause should include a provision that requires the parties' management to attempt to negotiate and resolve any simmering disputes before initiating formal proceedings. For example, the clause could specify that, with the exception of disputes relating to intellectual property and other specified exceptions, disputes would be handled as follows:

Good-Faith Negotiations. If any dispute arises under this agreement that is not settled promptly in the ordinary course of business, the parties shall seek to resolve any such dispute between them, first, by negotiating promptly with each other in good faith in face-to-face negotiations involving management personnel not previously and significantly involved in contract performance. If the parties are unable to resolve the dispute within 20 business days (or such period as the parties shall otherwise agree) through these face-to-face negotiations, then any such dispute shall be resolved [through litigation or the ADR procedures enumerated below].

Although this provision technically should not be necessary (because parties are always free to talk to each other), it does at least require the decisionmakers for the parties to meet with each other try to resolve disputes before calling in the lawyers. If management cannot resolve the dispute, the next step typically is arbitration or some other type of ADR procedure.

### ■ ADR Provisions

If the prime proposes an ADR provision, the subcontractor should consider the following questions before accepting it:

(1) *What type of ADR proceeding is most appropriate?* Should the parties agree to arbitration, mediation, a "minitrial" or some variant of these techniques?

(2) *What procedural rules will govern the proceedings?* For example, will discovery be authorized? How will the arbitrator or mediator be selected? Does the agreement specify that the rules of the American Arbitration Association will apply?<sup>43</sup> If the AAA or some other recognized set of rules apply, the parties nonetheless may agree to carve out modifications or exceptions to the rules. For example, the parties could agree on different mechanisms for selecting the arbitrator or neutral; the parties could specify the location for the ADR; and the parties could specify special discovery rules for the proceedings.

(3) *What law will apply?* Arbitrators typically are not required to base their decisions on law.<sup>44</sup> Indeed, the arbitrator may not be a lawyer. The parties should consider, therefore, a provision in the subcontract that requires the application of law and specifies which law will govern the dispute. As a general rule, federal common law provides greater predictability with respect to disputes arising under Government contracts provisions; state law, on the other hand, tends to be more formalistic in its approach and reading of contract clauses.

(4) *Where will the proceedings take place?* Arbitration clauses often provide for (or result in) arbitration proceedings held in the prime contractor's city, which means that the subcontractor is subjected to both travel expenses and a potential "home court" advantage.<sup>45</sup> The parties, however, could agree in the subcontract to a neutral location.

(5) *What is the authority of the arbitrator or neutral?* For example, will the parties authorize the arbitrator or neutral to (a) decide price or other terms of a subcontract,<sup>46</sup> (b) award attorney fees to the prevailing party,<sup>47</sup> or (c) award punitive damages?<sup>48</sup>

(6) *What is the schedule for the ADR proceeding?* Do the parties wish to specify an ADR schedule, with specific provision for the issuance of a decision within a set time period?<sup>49</sup>

(7) *Will the parties receive a written decision, including findings of fact and conclusions of law?* Arbitrations typically do not result in formal

written decisions; the subcontractor, however, can require a written decision as part of the ADR process.<sup>50</sup>

(8) *Are any types of disputes excluded from ADR?* Prospective subcontractors should exclude from any ADR agreement disputes related to disclosure or misuse of intellectual property. ADR is too slow and imprecise to obtain an effective remedy for threats to the subcontractor's intellectual property. For disputes relating to disclosure or misuse of intellectual property, the subcontractor should reserve the right to march into court immediately to seek a temporary restraining order and injunction.

#### ■ Right Of Indirect Appeal

Finally, the subcontractor may wish to seek authorization for a so-called right of "indirect appeal." The right of "indirect appeal" permits the subcontractor to seek resolution of disputes arising from Government action at agency boards of contract appeals or the Court of Federal Claims. In effect, the "indirect appeal" is achieved by the prime agreeing to "sponsor" the subcontractor's appeal in its name. The FAR specifically recognizes the right of the subcontractor to pursue an indirect appeal. It directs COs not to refuse consent to a subcontract merely because the subcontract contains a clause giving the subcontractor the right of indirect appeal to an agency board if the subcontractor is affected by a dispute between the Government and the prime.<sup>51</sup>

Without a right of indirect appeal, the subcontractor will be left to pursue its claims against the prime, which ordinarily delays resolution and payment of the subcontractor's claims.<sup>52</sup> Most standard prime contractor forms do not include a clause granting the subcontractor the right to an indirect appeal; the subcontractor, thus, should consider proposing one during negotiations.

#### "Battle Of The Forms" Problem

A common problem that arises during subcontract negotiations relates to what is referred to as the "battle of the forms." Under com-

mon law, a proposed contract (made by an "offeror") could be acted upon by the recipient (the "offeree") in essentially three ways. The offeree could accept the proposed contract, in which case the parties would create a binding, enforceable contract. Alternatively, the offeree could reject the proposed contract. Finally, the offeree could respond with a counteroffer suggesting different or modified terms. Under the common law's "mirror image" rule, a counteroffer is treated as an implicit rejection and terminates the offeree's right to accept the contract terms and create a binding contract.<sup>53</sup> If one party conditions its acceptance to the other party's offer in any way, a formal contract comes into existence under common law only upon acceptance of the counteroffer terms by the original offeror.

#### ■ UCC § 2-207

The problem with this common-law rule is that, in today's commercial world, parties typically exchange forms, with different boilerplate language, and proceed to perform the work. Under the common law, the courts would find that no contract existed, and the parties would be left to resolve disputes under other, often unsatisfactory equitable principles, such as estoppel and unjust enrichment. The UCC recognizes the realities of the modern commercial world and has replaced the "mirror image" rule with a new rule, commonly referred to as the "battle of the forms" provision. UCC § 2-207 provides as follows:<sup>54</sup>

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an *acceptance* even though it states terms additional to or different from those offered or agreed upon, *unless* acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants *such terms become part of the contract unless*:

(a) the offer expressly limits acceptance to the terms of the offer;

(b) they materially alter it; or

(c) notification of objection to them has already been given or is given within a

reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provision of this Act.

Thus, under the UCC's approach, a contract may be found to exist even if the seller conditions its acceptance. Parties that are engaged in the "battle of the forms" need to address and understand several key issues, however.

*First*, the UCC does not apply to all transactions. The UCC applies only to *merchants* engaged in the sale of *goods*.<sup>55</sup> Most subcontractors engaged in sales of goods and services to prime contractors under Government contracts will qualify as merchants. The real issue for most subcontractors is whether they are engaged in the sale of goods or the sale of services. If the contemplated subcontract calls for the sale of services, UCC § 2-207 does not apply. For services contracts, thus, the parties will be left to the common-law "mirror image" rule and the traditional "battle of the forms" rules outlined below will not apply.

*Second*, assuming the contemplated subcontract is for the sale of goods, does the exchange of conflicting and unresolved "boilerplate" language in the standard form purchase orders create a binding subcontract? As quoted above, UCC § 2-207 states that, as a general rule, a binding contract will be found even though the acceptance contains additional or different terms and conditions "unless acceptance is expressly made conditional on assent to the additional or different terms." Does this mean that standard boilerplate language stating that the subcontractor's consent is "subject to" the standard terms and conditions of the subcontractor's form agreement constitutes an express condition on the creation of a contract? As a general rule, such boilerplate language does *not* prevent the formation of

a contract under the UCC; instead, the party taking exception to the standard language must clearly state that its agreement to enter into a contract is expressly conditioned on the other party's acceptance of its terms.<sup>56</sup> Under this view, therefore, if the parties wish to condition acceptance and prevent the formation of a contract under the UCC, their conditional acceptance must be clear and explicit, not buried in the boilerplate.

*Third*, assuming that the parties have entered into a subcontract under the UCC, what are the terms of the subcontract? Additional terms proposed in a reply to the offeror are construed as proposals for additions to the contract. They become part of the contract unless, as noted above, (a) the offer expressly conditions acceptance to the terms of the offer (in which case no contract comes into being), (b) the additional terms materially alter the contract, or (c) the other party has objected to the additional terms or provides notice of such objection within a reasonable period of time after the party becomes aware of the additional terms.

A key question, therefore, is what constitutes a "material" alteration or modification under the UCC. Terms that are contrary to industry practice or trade usage generally will be considered material alterations or additions.<sup>57</sup> The drafters of the UCC noted that an added clause would "materially alter" the contract if it would "result in surprise or hardship if incorporated without express awareness by the other party."<sup>58</sup> Common examples of clauses that could be construed as *material* alterations or modifications include (1) indemnification clauses, (2) limitation of liability clauses, (3) clauses negating a seller's standard warranties of merchantability and fitness, (4) disputes clauses (e.g., provisions for arbitration), (5) choice of law/choice of venue clauses different from those proposed by the offeror, (6) notice requirements that would require complaints to be made in a materially shorter time than reasonable or customary in the industry, and (7) clauses authorizing contract cancellation for untimely payment of invoices.<sup>59</sup>

On the other hand, the following clauses might be considered *nonmaterial*, provided they are consistent with industry custom and practice and would not otherwise unduly surprise the buyer or impose undue hardship: (a) clauses imposing reasonable and customary interest and finance charges for late payment of invoices, (b) choice of law clauses (provided the seller's form does not have a contrary choice of law provision), (c) clauses requiring the seller to provide notice of complaints within a reasonable and customary period of time, and (d) force majeure clauses.<sup>60</sup>

#### ■ Practical Effect

What does this mean in practice? Suppose that the parties exchange forms with boilerplate terms. One form includes a "Disputes" clause and a "Choice of Law" clause. The other form does not include these provisions. Pursuant to UCC § 2-207, the "Disputes" clause likely would be considered a material alteration and likely would "drop out" of the contract; the "Choice of Law" clause, however, probably would not be considered material and likely would be considered to be part of the contract.

On the other hand, if both parties' form agreements included different "Disputes" and "Choice of Law" clauses, the likely result is that the "Disputes" clause would "drop out" of the agreement because it would be considered a "material alteration." The "Choice of Law" clause also would likely drop out—even though it might not be considered a "material alteration"—under the prevailing "knockout" rule. As one leading treatise on the subject describes it, if two proposed provisions are in conflict, they knock each other out of the agreement.<sup>61</sup>

When a confirmation states a term different from the original oral or other informal agreement, the different term falls out. The benchmark for determining additionalness or differentness is the prior agreement, not the other confirmation form. Thus if a supplier of metal and a purchaser orally agree to the sale of a set quantity of brass at a firm price of \$1.17 per pound, that will be the contract price notwithstanding a different price in one of the two confirming forms. If the seller responds with a confirmation of a term not in the informal

agreement and the buyer's confirmation states a conflicting term, the two knock each other out. Comment 6 [to UCC § 2-207], however, provides that if [UCC] Article 2's gap fillers then supply a term, it is binding.

Thus, under the prevailing "knockout" rule, the conflicting terms would knock each other out from the contract.

The foregoing analysis assumes that the UCC's "battle of the forms" governs the transaction. If the subcontract involves the sale of services (or the UCC does not otherwise apply), the common law's "last shot" doctrine would determine the terms and conditions of the parties' agreement. Under this doctrine, each new form is considered to be a counteroffer until the last form is accepted by the conduct of one of the parties. The last party to send a form before payment would, under these circumstances, generally dictate the terms of the boilerplate language.<sup>62</sup>

## Other Issues

#### ■ Warranty Clauses

Parties often spend a great deal of effort negotiating and worrying over warranty provisions. Their concerns relate to the duration and scope of the warranties (as discussed above), liability for breach of warranty, and the effect and enforceability of disclaimer provisions. The statute of limitation for latent defects, for example, may not even begin to run until some undefined point in the future long after acceptance when the buyer discovers (or should have discovered) the defect. This prospect creates headaches for legal departments attempting to advise management on the potential scope and value of the warranties.

To limit the uncertainties associated with warranty provisions, subcontractors should review the subcontract language with the following questions in mind:

(1) *What law applies?* First, does the UCC or common law govern the warranties? Second, does the subcontract also flow down a Government contracts warranty clause? If so,

which clause is preferable? The Government contracts clause, for example, may state that acceptance occurs when the system is accepted; the prime contractor's boilerplate clause, however, may state that acceptance is deemed to have occurred at an earlier point in time—i.e., when the part is delivered to the prime. If the Government contracts clause is preferable, the subcontractor may wish to insist on the Government contracts clause and seek to strike the other conflicting warranty provisions. On the other hand, if the subcontractor regards the prime's standard boilerplate clause as more advantageous, the subcontractor may wish to negotiate an order of precedence clause or some other clarifying language to enhance its position. Third, when does the statute of limitation begin to run under the applicable clause?

(2) *What is the customary industry practice with respect to warranties of the goods or services to be provided under the subcontract? Is the buyer asking for warranty rights greater than those typically provided in the industry for the items to be delivered under the subcontract? If so, does the sales price reflect these warranties?*

(3) *Does the subcontract disclaim warranties?* First, what is the industry practice for warranty disclaimers for the items to be delivered under the subcontract? Second, will the buyer accept a disclaimer of fitness for a particular purpose? Third, what effect does the disclaimer have on the statute of limitation period? As a general rule, disclaimers that negate warranties for future performance operate to limit the statute of limitation period; warranties that cover future performance, however, have the general effect of providing the buyer more time to "discover" any latent defects before the statute of limitation begins to run.

Many parties spend disproportionately greater time negotiation over and worrying about warranty provisions because of the fear of potentially significant liabilities that may not ripen for some period long into the future. Pro-

spective subcontractors faced with recalcitrant prime contractors that insist on acceptance of their warranty provisions should attempt to negotiate a higher price or to secure disclaimer provisions and "Choice of Law" clauses that operate to limit the potential liability of the warranty clauses. Alternatively, the subcontractor might attempt to negotiate a "cap" on potential warranty liability.

#### ■ "Most Favored Customer" Clauses

Some primes will insist on a "Most Favored Customer" clause to help ensure favorable pricing terms. In some cases, the primes will secure a "Most Favored Customer" clause in the teaming agreement leading up to the subcontract. Before agreeing to these and similar clauses, the prospective subcontractor should, at a minimum, (a) examine its existing contracts to ensure that agreement on this clause does not create pricing issues on other contracts, particularly with respect to any General Services Administration Multiple Award Schedule contracts the subcontractor may hold, (b) review the subcontract pricing terms to assure consistency with the clause, and (c) insist, as a quid pro quo, that the prime agree to favorable financing terms (see discussion above) and structure the subcontract to guarantee longer term work by, for example, giving the subcontractor the exclusive right to meet the prime's requirements in certain specified areas of work throughout the duration of the production contract, including options and foreign direct sales and foreign military sales.

#### Ensuring Subcontractor's Long-Term Role

It is the nature of major defense programs that they normally have a long life—typically characterized by a phased development, initial low-rate production, full-scale production, option quantities, follow-on procurements, derivative products, and international sales. At the inception of such a program, it is not unusual for the prime contractor to insist that a subcontractor make an "investment"—i.e., absorb some developmental costs or early pro-

duction costs to capture the work. The promise of long-range profits makes such investments reasonable. The investment is reasonable, however, only if the subcontractor is assured of future participation in the program. The subcontractor needs to ensure that the prime will not, after enjoying the benefit of its company's investment, seek to transfer in-house or to some other low-cost competitor the work the subcontractor helped develop. There are several actions a subcontractor should consider to ensure its future role in a program.

#### ■ Intellectual Property

As discussed above, a subcontractor must maintain control of its intellectual property. To accomplish this, a subcontractor should negotiate a nondisclosure agreement/use license that makes it difficult for the prime to use the subcontractor's intellectual property either in-house or with another vendor.

#### ■ Teaming Agreements

It is common to have in place a teaming agreement covering long-term programs. These teaming agreements can transcend single, individual contracts for development, initial low-rate production, and full-scale production, to cover the entire program. In negotiating a teaming agreement to ensure a future role, a subcontractor should consider the following:

(a) *Coverage*—The subcontractor should make certain that the "Program" covered by the teaming agreement is broadly defined. It should include civilian agency and foreign sales as well as military sales. In addition, the subcontractor should attempt to define the product broadly to cover derivative products as well as the product currently under development.

(b) *Termination*—Some teaming agreements are written to terminate upon the award of a subcontract, or the subcontract is stated to "supersede" or "take precedence over" the teaming agreement. These terms provide a major loophole enabling a prime to avoid a long-term arrangement. Most subcontracts con-

tain termination for convenience and termination for default provisions. By terminating the subcontract, the prime can argue that the teaming agreement is also terminated, freeing it from using the subcontractor on future phases of the program.

(c) *Exclusivity*—The subcontractor should have counsel to review all exclusive teaming agreements and all noncompete agreements. These agreements can be enforced to prevent the prime contractor from cutting the subcontractor out of the program. At the same time, however, these provisions can raise significant antitrust and other anticompetitive law issues.<sup>63</sup> If the teaming agreement exclusivity provisions are found to run afoul of such laws they will, at a minimum, be unenforceable and will potentially create significant liability for the subcontractor's company. Moreover, the fact that a company may be small is not determinative of antitrust issues. Even a small company can be found to dominate a particular market if the company's product is unique and superior. By entering into an exclusive arrangement with the prime, the subcontractor may be violating the law.

(d) *Enforcement*—Teaming agreements are often difficult to enforce. Courts sometimes find the agreements to be vague "agreements to agreements." To reduce the chances of such a result, the subcontractor first should research the enforceability of teaming agreements in the jurisdiction that might be called upon to decide the issue and specify that the teaming agreement will be construed and enforced in accordance with the law of a favorable jurisdiction, if possible. Second, the subcontractor should obtain agreement on as many terms of future subcontracts as possible. The subcontractor could include as an attachment to the teaming agreement, for example, negotiated standard terms and conditions with a provision that alterations will be made based on the final terms of the prime contract. In negotiations, the subcontractor should try to reach agreement on price or components of the price, if possible. For example, the subcontractor should seek the same profit margin as accepted by the prime (adequately demonstrated). The

subcontractor should also seek agreement to a cap on overhead, general and administrative expenses, or labor costs. The more definitive the teaming agreement, the more likely it will be enforced.

#### ■ Customer Relationship

A subcontractor should seek to maintain its relationship with the Government customer. Many prime contractors attempt to limit a subcontractor's contact with the Government. While these are often reasonable restrictions as they relate to contract issues, a subcontractor should make clear that its company has independent relationships that it intends to make it more difficult for the prime to cut that subcontractor out of the program.

#### ■ Employee Restrictions

A subcontractor should obtain an agreement with the prime that key employees of each company will not be recruited by the other. The subcontractor may also wish to enter into employment agreements with its key employees that restrict their options on future employers or include financial penalties for leaving. Such provisions need to be reviewed by labor attorneys who are knowledgeable about the applicable jurisdiction's labor laws. Many such restrictions are highly regulated or unenforceable in some states. If enforceable, however, these employee restrictions provide another obstacle to any potential attempts by the prime contractor to cut the subcontractor out of the program.

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## GUIDELINES

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These *Guidelines* are intended to assist subcontractors in understanding some of the key issues that arise during subcontract negotiations with Government prime contractors. They are not, however, a substitute for professional representation in any specific situation.

1. Determine whether a *commercial item* subcontract is available. If so, most "mandatory" clauses disappear and many of the traditional administrative burdens and risks of Government contracting are *eliminated*. Even if the prime contract is not a commercial item contract, you may be able to obtain agreement to treat your product or service as a commercial item.

2. Identify which clauses are *mandatory flow-down clauses*, which are *necessary*, and which ones are *open for meaningful negotiation*. Focus your efforts in negotiations on the last category of clauses.

3. Understand that as a general rule, the *standard FAR and DFARS clauses* regarding *intellectual property* may be preferable from the subcontractor's perspective to specially tailored clauses proposed by the prime. Review any

*deviation* from the standard *FAR* and *DFARS* clauses carefully with counsel.

4. Consider whether the prime contractor's standard form agreement contains an acceptable "*Disputes*" clause. Although parties frequently do not seek to change the boilerplate disputes resolution language, this is a subcontract term that should be subject to *reasonable negotiation*.

5. Try to ensure that the subcontract provides you with *at least as many* rights and protections as the prime enjoys under its prime contract. For example, compare the subcontract and the prime contract terms with respect to *notice of changes*, *inspections*, the *scope* and *period* of the *warranty*, and *contract financing*.

6. Be aware of the "*battle of the forms*" doctrine. Frequently, contract performance begins before any subcontract is signed, the parties engage in numerous rounds of boilerplate contract exchanges, and then payment is made. If you are involved in contentious subcontract negotiation issues, you should pay attention to the *common-law* and *UCC rules* governing this situation so that you do not unintentionally and adversely prejudice your interests.

## ★ REFERENCES ★

- 1/ See generally Steven W. Feldman, "Subcontractors in Federal Procurement: Roles, Rights & Responsibilities," Briefing Papers No. 03-3 (Feb. 2003).
- 2/ See generally E. Sanderson Hoe, Richard B. Oliver & Thomas M. Abbott, "Flow-Down Clauses in Subcontracts," Briefing Papers No. 85-5 (May 1985).
- 3/ See, e.g., FAR 52.219-8 ("Utilization of Small Business Concerns" clause); FAR 52.222-26 ("Equal Opportunity" clause); FAR 52.222-35 ("Equal Opportunity for Special Disabled Veterans, Veterans of the Vietnam Era, and Other Eligible Veterans" clause); FAR 52.222-36 ("Affirmative Action for Workers With Disabilities" clause); FAR 52.222-37 ("Employment Reports on Special Disabled Veterans, Veterans of the Vietnam Era, and Other Eligible Veterans" clause).
- 4/ FAR 52.203-7.
- 5/ FAR 52.215-2.
- 6/ E.g., FAR 52.204-2, para. (d) (requiring inclusion of "Security Requirements" clause only in subcontracts that involve access to classified information); see Patricia Meagher, "Feature Comment: Revisiting Subcontract Flow-Down Provisions," 38 GC ¶ 361 (July 31, 1996).
- 7/ E.g., FAR 52.222-4, para. (e) (requiring inclusion of "Contract Work Hours and Safety Standards Act—Overtime Compensation" clause only in subcontracts exceeding \$100,000).
- 8/ See, e.g., American Bar Association Section of Public Contract Law, *Guide to Fixed-Price Supply Subcontract Terms and Conditions* (3d ed. 2001); National Defense Industrial Association, *A Study of the Applicability of FAR Clauses to Subcontracts Under Prime Defense and NASA Contracts* (revised Jan. 2002) (for further information, see the NDIA procurement webpage at <http://www.ndia.org>).
- 9/ E.g., FAR 52.243-1, -2, -3, -4.
- 10/ FAR 52.243-7.
- 11/ See, e.g., Grumman Aerospace Corp., ASBCA 46834 et al., 03-1 BCA ¶ 32,203.
- 12/ E.g., FAR 52.249-2. See generally Paul J. Seidman & Robert D. Banfield, "Preparing Termination for Convenience Settlement Proposals for Fixed-Price Contracts," Briefing Papers No. 97-11 (Oct. 1997); Paul J. Seidman & Robert D. Banfield, "Maximizing Termination for Convenience Settlements," Briefing Papers No. 95-5 (Apr. 1995).
- 13/ See FAR 49.202.
- 14/ E.g., FAR 52.249-6, -8.
- 15/ E.g., FAR 52.246-2, -3.
- 16/ E.g., FAR 52.26-17, -18.
- 17/ See FAR 46.702.
- 18/ See, e.g., FAR 52.26-17, para. (b), -18, para. (b).
- 19/ E.g., FAR 52.214-27, 52.215 -10, -11.
- 20/ 10 U.S.C. § 2306a; 41 U.S.C. § 254b; see FAR 15.403.
- 21/ 10 U.S.C. § 2306a(h)(1); 41 U.S.C. § 254b(h)(1); see FAR 2.101.
- 22/ 10 U.S.C. § 2306a(h)(1); 41 U.S.C. § 254b(h)(1); see FAR 2.101.
- 23/ 10 U.S.C. § 2306a(a)(2); 41 U.S.C. § 254b(a)(2); see FAR 15.406-2.
- 24/ 10 U.S.C. § 2306a(e); 41 U.S.C. § 254b(e); see FAR 15.407-1, 52.215 -10, -11.
- 25/ See TGS Int'l, Inc., ASBCA 31120, 87-2 BCA 19,683, at 99,630, recons. denied, 87-3 BCA ¶ 19,989.
- 26/ See FAR 52.215 -10, -11; see, e.g., Motorola, Inc., ASBCA 48841, 96-2 BCA ¶ 28,465, 38 GC ¶ 533.
- 27/ 10 U.S.C. § 2306a(b); 41 U.S.C. § 254b(b); see FAR 15.403-1.
- 28/ 10 U.S.C. § 2306a(b); 41 U.S.C. § 254b(b); see FAR 15.403-1. See generally Lynda Troutman O'Sullivan & Douglas E. Perry, "Commercial Item Acquisitions," Briefing Papers No. 97-5 (Apr. 1997).
- 29/ FAR 52.232-16.
- 30/ FAR 32.501-1.
- 31/ See FAR 52.232-16, para. (f).
- 32/ 67 Fed. Reg. 70,520 (Nov. 22, 2002) (amending FAR pts. 32, 52).
- 33/ See FAR 32.504(b), 52.232-16, para. (a)(2).
- 34/ See FAR subpt. 32.10.
- 35/ See FAR subpt. 32.2; see also O'Sullivan & Perry, *supra* note 28, at 14–16.
- 36/ FAR 32.501-1.
- 37/ See FAR 52.227-12 ("Patent Rights—Retention by the Contractor (Long Form)" clause); FAR 52.227-14 ("Rights in Data—General" clause); DFARS 52.227-7013 ("Rights in Technical Data—Noncommercial Items" clause); DFARS 52.227-7014 ("Rights in Noncommercial Computer Software and Noncommercial Computer Software Documentation" clause).



- 38/ See FAR 52.227-12 ("Patent Rights—Retention by the Contractor (Long Form)" clause); FAR 52.227-14 ("Rights in Data—General" clause); DFARS 52.227-7013 ("Rights in Technical Data—Noncommercial Items" clause); DFARS 52.227-7014 ("Rights in Noncommercial Computer Software and Noncommercial Computer Software Documentation" clause). See generally David W. Burgett, Daniel C. Sweeney & S. Gregg Kunzi, "Government Rights in Data and Software," Briefing Papers No. 95-11 (Oct. 1995).
- 39/ See FAR 52.227-12 ("Patent Rights—Retention by the Contractor (Long Form)" clause); FAR 52.227-14 ("Rights in Data—General" clause); DFARS 52.227-7013 ("Rights in Technical Data—Non-commercial Items" clause); DFARS 52.227-7014 ("Rights in Noncommercial Computer Software and Noncommercial Computer Software Documentation" clause).
- 40/ DFARS 227.7103-15 (a), (d).
- 41/ Unif. Arbitration Act § 23 (2000); Taunton Mun. Light Plant Comm'n v. Paul L. Geiringer & Assocs., 560 F. Supp. 1249 (D. Mass.), *aff'd.*, 725 F.2d 664 (1st Cir. 1983).
- 42/ See generally Donald P. Arnavas, "Alternative Dispute Resolution/Edition III," Briefing Papers No. 03-5 (Apr. 2003); Donald P. Arnavas & Joseph P. Hornyak, "Alternative Dispute Resolution/Edition II," Briefing Papers No. 96-11 (Oct. 1996); Donald P. Arnavas & John J. Duffy, "Alternative Dispute Resolution," Briefing Papers No. 88-8 (July 1988), 8 BPC 167; Carol Park Conroy & Martin J. Harty, "Alternative Dispute Resolution at the ASBCA," Briefing Papers No. 00-7 (June 2000).
- 43/ See American Arbitration Association, Commercial Arbitration Rules and Mediation Procedures (July 1, 2003) (available at <http://www.adr.org>) [hereinafter AAA Arbitration Rules].
- 44/ See Unif. Arbitration Act § 19 (2000); Lisbon School Comm. v. Lisbon Educ. Ass'n, 438 A.2d 239 (Me. 1981).
- 45/ See AAA Arbitration Rules, *supra* note 43, R-10.
- 46/ See *Necchi S.p.A. v. Necchi Sewing Machine Sales Corp.*, 348 F.2d 693 (2d Cir. 1965), *cert. denied*, 383 U.S. 909 (1966).
- 47/ See *Todd Shipyards Corp. v. Cunard Line, Ltd.*, 943 F.2d 1056 (9th Cir. 1991).
- 48/ See Timothy E. Travers, "Arbitrator's Power To Award Punitive Damages," 83 A.L.R.3d 1037 (1978).
- 49/ See AAA Arbitration Rules, *supra* note 43, R-41.
- 50/ See AAA Arbitration Rules, *supra* note 43, R-42, -43.
- 51/ FAR 44.203(c). See generally Martin J. Healy, "Subcontractor Claims: Strategies for the Prime," Briefing Papers No. 95-7 (June 1995).
- 52/ See, e.g., *Coastal Drilling, Inc., ASBCA 54023, 03-1 BCA ¶ 32,241* (board did not have jurisdiction to hear the subcontractor's claim against the Government notwithstanding the subcontractor's claim that the prime was defrauding it); see also *Erickson Air Crane Co. of Washington, Inc. v. United States*, 731 F.2d 810, 814 (Fed. Cir. 1984); *Brandt-Airflex Corp., ASBCA 48436, 92-1 BCA ¶ 24,679*, at 123,124; *Technic Servs., Inc., ASBCA 38411, 89-3 BCA ¶ 22,193*, at 111,651.
- 53/ Restatement (Second) of Contracts § 59 (1981).
- 54/ U.C.C. § 2-207 (emphasis added).
- 55/ U.C.C. § 2-104(1), (3) (a "merchant" is one who deals "in goods of the kind" and "between merchants" means between parties "chargeable with the knowledge or skill of merchants").
- 56/ See, e.g., *Ralph Shrader, Inc. v. Diamond Int'l Corp.*, 833 F.2d 1210 (6th Cir.1987); *Daitom, Inc. v. Pennwalt Corp.*, 741 F.2d 1569 (10th Cir.1984); *Lockheed Elecs. Co. v. Keronix, Inc.*, 170 Cal. Rptr. 591 (1981).
- 57/ J. White & R. Summers, 1 Uniform Commercial Code §1-3, at 18 n.32 (4th ed. 1995).
- 58/ UCC § 2-207 cmt. 4.
- 59/ See *id.*
- 60/ See *id.* cmt. 5; see also White & Summers, *supra* note 57, at 19 n.36.
- 61/ White & Summers, *supra* note 57, at 28.
- 62/ Restatement (Second) of Contracts § 59 (1981).
- 63/ See generally Douglas E. Perry & Richard C. Park, "Exclusive Teaming Agreements: Impact of Antitrust Guidelines," Briefing Papers No. 00-6 (May 2000).

**Table I**  
**ILLUSTRATIVE LIST OF MANDATORY FLOW-DOWN CLAUSES**

<b>FAR &amp; DFARS Clauses</b>
FAR 52.203-6 (RESTRICTIONS ON SUBCONTRACTOR SALES TO THE GOVERNMENT (JUL 1995))
FAR 52.203-7 (ANTI-KICKBACK PROCEDURES (JUL 1995))
DFARS 252.203-7001 (PROHIBITION ON PERSONS CONVICTED OF FRAUD OR OTHER DEFENSE CONTRACT RELATED FELONIES DFARS (MAR 1999))
FAR 52.203-11 (CERTIFICATION AND DISCLOSURE REGARDING PAYMENTS TO INFLUENCE CERTAIN FEDERAL TRANSACTIONS (APR 1991))
FAR 52.215-2 (AUDIT AND RECORDS — NEGOTIATION (JUN 1999))
FAR 52.219-8 (UTILIZATION OF SMALL BUSINESS CONCERNS (OCT 2000))
FAR 52.222-21 (PROHIBITION OF SEGREGATED FACILITIES (FEB 1999))
FAR 52.222-22 (PREVIOUS CONTRACTS AND COMPLIANCE REPORTS (FEB 1999))
FAR 52.222-25 (AFFIRMATIVE ACTION COMPLIANCE (APR 1984))
FAR 52.222-26 (EQUAL OPPORTUNITY (APR 2002))
FAR 52.222-35 (EQUAL OPPORTUNITY FOR SPECIAL DISABLED VETERANS, VETERANS OF THE VIETNAM ERA, AND OTHER ELIGIBLE VETERANS (DEC 2001))
FAR 52.222-36 (AFFIRMATIVE ACTION FOR WORKERS WITH DISABILITIES (JUN 1998))
FAR 52.222-37 (EMPLOYMENT REPORTS ON SPECIAL DISABLED VETERANS, VETERANS OF THE VIETNAM ERA, AND OTHER ELIGIBLE VETERANS (DEC 2001))
FAR 52.225-8 (DUTY-FREE ENTRY (FEB 2002))
FAR 52.225-13 (RESTRICTIONS ON CERTAIN FOREIGN PURCHASES (JUN 2003))
FAR 52.227-1 (AUTHORIZATION AND CONSENT (JUL 1995))
FAR 52.227-2 (NOTICE AND ASSISTANCE REGARDING PATENT AND COPYRIGHT INFRINGEMENT (AUG 1996))
FAR 52.242-17 (GOVERNMENT DELAY OF WORK (APR 1984))
FAR 52.244-6 (SUBCONTRACTS FOR COMMERCIAL ITEMS (APR 2003))
FAR 52.246-16 (RESPONSIBILITY FOR SUPPLIES (APR 1984))
DFARS 252.247-7023 (TRANSPORTATION OF SUPPLIES BY SEA (MAY 2002))
FAR 52.248-1 (VALUE ENGINEERING (FEB 2000))

**Table II**  
**ILLUSTRATIVE LIST OF NECESSARY FLOW-DOWN CLAUSES**

<b>FAR &amp; DFARS Clauses</b>
FAR 52.209-5 (CERTIFICATION REGARDING DEBARMENT, SUSPENSION, PROPOSED DEBARMENT, AND OTHER RESPONSIBILITY MATTERS (DEC 2001))
FAR 52.211-5 (MATERIAL REQUIREMENTS (AUG 2000))
FAR 52.211-14 (NOTICE OF PRIORITY RATING FOR NATIONAL DEFENSE USE (SEP 1990))
FAR 52.211-15 (DEFENSE PRIORITY AND ALLOCATION REQUIREMENTS (SEP 1990))
FAR 52.214-27 (PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA — MODIFICATIONS — SEALED BIDDING (OCT 1997))
FAR 52.215-10 (PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA (OCT 1997))
FAR 52.215-11 (PRICE REDUCTION FOR DEFECTIVE COST OR PRICING DATA — MODIFICATIONS (OCT 1997))
FAR 52.215-12 (SUBCONTRACTOR COST OR PRICING DATA (OCT 1997))
FAR 52.215-13 (SUBCONTRACTOR COST OR PRICING DATA — MODIFICATIONS (OCT 1997))
FAR 52.219-1 (SMALL BUSINESS PROGRAM REPRESENTATIONS (APR 2002) ALTERNATE 1 (APR 2002))
FAR 52.219-9 (SMALL BUSINESS SUBCONTRACTING PLAN (JAN 2002))
FAR 52.219-22 (SMALL DISADVANTAGED BUSINESS STATUS (OCT 1999))
DFARS 252.219-7003 (SMALL, SMALL DISADVANTAGED AND WOMEN-OWNED SMALL BUSINESS SUBCONTRACTING PLAN (DOD CONTRACTS) (APR 1996))
FAR 52.229-3 (FEDERAL, STATE, AND LOCAL TAXES (APR 2003))
DFARS 252.231-7000 (SUPPLEMENTAL COST PRINCIPLES (DEC 1991))
FAR 52.232-16 (PROGRESS PAYMENTS (APR 2003))
FAR 52.233-3 (PROTEST AFTER AWARD (AUG 1996))
FAR 52.243-1 (CHANGES — FIXED-PRICE (AUG 1987))
FAR 52.243-1 (CHANGES — FIXED-PRICE (AUG 1987) ALTERNATE II (APR 1984))
DFARS 252.243-7001 (PRICING OF CONTRACT MODIFICATIONS (DEC 1991))
DFARS 52.243-7002 (REQUEST FOR EQUITABLE ADJUSTMENT (MAR 1998))
FAR 52.245-2 (GOVERNMENT PROPERTY (FIXED-PRICE CONTRACTS) (DEC 1989))
FAR 52.246-2 (INSPECTION OF SUPPLIES — FIXED-PRICE (AUG 1996))
FAR 52.246-4 (INSPECTION OF SERVICES — FIXED-PRICE (AUG 1996))
FAR 52.249-2 (TERMINATION FOR CONVENIENCE OF THE GOVERNMENT (FIXED-PRICE) (SEP 1996))
FAR 52.249-4 (TERMINATION FOR CONVENIENCE OF THE GOVERNMENT (SERVICES) (SHORT FORM) (APR 1984))
FAR 52.249-8 (DEFAULT (FIXED-PRICE SUPPLY AND SERVICE) (APR 1984))

**THOMSON**  
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**WEST**