

**The Pulse of GovCon + Koprince Law LLC**

# **Teaming Arrangements Resource Guide**

**Part II: Prime/Subcontractor Teaming**

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## Part II: Prime/Subcontractor Teaming

### *The Big Picture and Definitions*

Prime/subcontractor teaming is the second major form of teaming for U.S. federal government contracts. (Joint venturing, which we covered in Part I, is the first major form of teaming).

Like joint venturing, prime/subcontractor teaming can be a powerful tool. Done right, it can help contractors compete more effectively for government contracts and perform contracts that a single company, working alone, might not have the resources or capabilities to fully perform.

For small businesses in particular, subcontracting can be a key component of success in the government marketplace. Many successful government prime contractors started their government contracting journey as subcontractors—often to large businesses, but sometimes to other small businesses as well. And for small prime contractors, subcontracting can be critical to the ability to successfully compete for and perform larger and more complex contracts.

Regardless of whether a contractor is large or small, prime/subcontractor teaming is a central component of the federal contracting landscape, and it pays to know the rules, processes and best practices.

### *Who is a “Subcontractor” Anyway?*

FAR 9.601(2) says that a prime/subcontractor teaming relationship exists where “a potential prime contractor agrees with one or more other companies to have them act as its subcontractors.” Prime/subcontractor teaming is sometimes called a “vertical” teaming relationship because the parties are not on the same contracting “level.” Instead, one company (the subcontractor) is subordinate to the other (the prime).

It should be obvious who the “prime contractor” is the entity holding, in its name, a prime contract awarded by the government. But who qualifies as a “subcontractor” to that prime?

Unfortunately, that question is trickier than it should be. Instead of using a single, consolidated definition, the FAR and DFARS<sup>1</sup> have more than twenty (count ‘em!) separate definitions of the terms “subcontract” and “subcontractor”!<sup>2</sup> Talk about confusing!

For purposes of this article, we will use the definition found in FAR 44.101, which defines a subcontractor as “any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor.” A “subcontract,” in turn, is defined as “any contract [as that term is defined in FAR 2.101] entered into by a subcontractor to furnish supplies

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<sup>1</sup> The DFARS is the Defense Federal Acquisition Regulations Supplement.

<sup>2</sup> See <https://smallgovcon.com/statutes-and-regulations/far-dfars-have-27-distinct-definitions-of-subcontract/>.

or services for performance of a prime contract or a subcontract. It includes but is not limited to purchase orders, and changes and modifications to purchase orders.”

We’ve chosen these definitions because FAR Part 44 is the part of the FAR dealing with “Subcontracting Policies and Procedures,” and in practice, these are the definitions we see used most often by government procurement officials.

### *Common Misunderstandings*

So, let’s take a closer look at the definitions of “subcontractor” and “subcontract.” If you haven’t read them before, you may be thinking, “my, that seems awfully . . . broad.”

And you would be right! In fact, in our experience, contractors often believe that the terms “subcontractor” and “subcontract” are much more limited than they actually are under FAR Part 44. Here are some of the common misunderstandings we see surrounding those definitions:

MISUNDERSTANDING	COMMENT
An agreement with a “vendor” or “supplier” is not a subcontract.	The definition expressly includes vendors and suppliers.
A consultant cannot be a subcontractor.	There is no exception for consultants. If the consultant is providing services or supplies within the meaning of the definition, the consultant is a subcontractor.
A 1099 independent contractor cannot be a subcontractor.	There is no exception for 1099s. If the 1099 is providing services or supplies within the meaning of the definition, he or she is a subcontractor. <sup>3</sup>
If I don’t label my agreement a “subcontract,” it isn’t one.	Substance governs, not form. If an agreement is, in substance, a subcontract, it is one –no matter what label is put on it.

<sup>3</sup> The SBA has addressed this question directly, stating that 1099s are subcontractors for purposes of determining compliance with the limitations on subcontracting. See <https://smallgovcon.com/statutes-and-regulations/sba-independent-contractors-are-subcontractors/>.

These misunderstandings can create serious compliance problems. For instance, a prime contractor may neglect to include mandatory FAR flow-downs<sup>4</sup> in vendor agreements, supplier agreements, 1099 independent contractor agreements, purchase orders, delivery orders and/or consulting agreements, believing that these are not “subcontracts” to which the flow-down requirements apply.

Remember: when it comes to subcontracting the rule is “substance over form.” *Regardless of whether an agreement is labeled as a subcontract, if it meets the FAR definition, it should be treated as a subcontract.*

### *Pros and Cons of Prime/Subcontractor Teaming*

Like joint venturing, there are some important pros and cons to consider before forming a prime/subcontractor team. But unlike a joint venture, in which all members are essentially on equal footing (except for any SBA-mandated elements), the prime contractor and subcontractor are in very different positions. Sometimes, what is a pro for the prime is a con for the subcontractor, and vice versa. So, let’s discuss some of the key pros and cons from each party’s perspective, starting with the prime.

#### *Pros and Cons: Prime Contractor’s Perspective*

From the prime’s perspective, choosing a prime/subcontractor teaming arrangement can have a number of important advantages over a joint venture, including the following:

- ***More Control Over The Big Picture.*** A prime contractor generally has more control over the “big picture” teaming relationship than does a joint venture partner. While the terms of a subcontract are subject to negotiation between the parties (except for mandatory flow-downs), it is commonplace for the subcontract to include terms giving the prime contractor considerable control over the relationship. For example, a standard subcontract agreement almost always permits the prime to terminate the subcontract if the subcontractor defaults. Some subcontracts even allow the prime to terminate for convenience! In contrast, one joint venture partner ordinarily cannot simply terminate the other—after all, the partners are co-owners of a separate legal entity.
- ***Exclusive (or Close-to-Exclusive) Relationship with the Government.*** As the entity holding the prime contract, the prime contractor often has a monopoly over communications with the Government customer. Some contracting officials will refuse to communicate directly with subcontractors because of the absence of a direct contractual relationship. And even if the Government is willing to communicate directly with a subcontractor, it is commonplace for a subcontract to prevent (or severely restrict) the subcontractor from engaging in such communications. In contrast, since all members of a joint venture are part of the prime contract

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<sup>4</sup> We will cover FAR flow-downs a little later in this Guide.

entity, it is extraordinarily unusual for a joint venture partner to be prohibited from communicating with the Government.

- ***Direct CPARS Eligibility.*** Past performance is a key part of many government contracting competitions. The rules governing how the government evaluates past performance gained as part of a joint venture are in a state of flux, and it is not certain that a procuring agency will count that past performance at all, or weigh it equally with past performance obtained as a prime contractor. When a company serves as the prime contractor, it is eligible for past performance reviews in its own name, typically in the Contractor Performance Assessment Report System. (Of course, this is only a “pro” if those CPARs are good!)
- ***Keeping Profits.*** As we discussed in Part I, a joint venture typically splits profits and losses, while a subcontractor is paid on a predetermined basis—such as a lump sum or an agreed-upon hourly rate. This means that when the teaming arrangement is set up as a prime/subcontractor team if the project is profitable, the prime doesn’t have to split those profits with its partner.
- ***Less Red Tape.*** For both primes and subcontractors, establishing a prime/subcontractor relationship takes a lot less work than setting up a joint venture. There are no Secretary of State filings, no new DUNS, EIN, CAGE, or SAM, and (if pursuing a small business or socioeconomic contract) no worrying about SBA’s mentor-protégé program, mandatory joint venture agreement provisions, or two-year bidding window. That’s not to say that there is *no* administrative burden—a good, compliant subcontract is a must, and a strong written teaming agreement is a best practice. But this paperwork is still a lot less than what is required to establish a joint venture.
- ***Avoid (Some) Size Issues.*** As we discussed in Part I, if the team wishes to pursue small business or socioeconomic contracts as a joint venture, ordinarily all members of the JV must be small businesses under the solicitation’s size standard (except for SBA-approved mentor-protégé joint ventures). In contrast, there is no size restriction for subcontractors performing work under small business and socioeconomic prime contracts—although the limitations on subcontracting, which we will discuss a little later in this Guide, restrict how much work a large subcontractor can perform.

Prime/subcontractor teaming isn’t all rainbows and unicorns, though. From the prime’s perspective, here are a few key cons:

- ***100% Responsibility for Full Performance.*** The prime holds the government contract in its own name—and as far as the government is concerned, that means that the prime has promised to complete 100% of the work. If a subcontractor walks off the job, defaults, goes bankrupt, or simply does terrible work, the government’s response is, essentially, “tough—figure it out” The buck stops at the prime, and the government rarely accepts “my subcontractor . . .” as the start to an acceptable reason not to have completed the project successfully and on time.

- ***Ostensible Subcontractor Affiliation.*** If the parties will pursue a small business or socioeconomic contract, and the subcontractor is a large business, the prime must be careful to comply with the SBA’s ostensible subcontractor rule. That rule, which is found in 13 C.F.R. §121.103(h)(2), says that the SBA may treat the prime contractor and subcontractor as affiliates when the subcontractor will perform the “primary and vital” portions of the prime contract and/or the prime contractor is “unusually reliant” upon the subcontractor. The ostensible subcontractor rule has been interpreted in many published decisions of the SBA’s Office of Hearings and Appeals. While a fuller discussion of the rule is beyond the scope of this Guide, we recommend that those subject to the rule familiarize themselves with it and adopt practices to help ensure compliance.
- ***Responsibility for Losses.*** The flip side of getting all the profits to yourself? Getting all the losses to yourself if the project isn’t profitable. Because a subcontractor typically is paid on a predetermined basis, the prime may owe the subcontractor the full amount specified in the subcontract, even if it turns out that the prime contract, as a whole, is in the red.
- ***Legal Liability for Non-Compliance (Sometimes).*** Sometimes, a prime contractor can be legally responsible if the subcontractor violates a law applicable to the prime contract—even if the prime didn’t know about the violation when it occurred! For example, the federal Davis-Bacon Act and Service Contract Act, when applicable, require certain employees performing work on the contract to receive prevailing wages and fringe benefits. If a subcontractor fails to comply with these laws, the government may force the prime contractor to provide back pay to the subcontractor’s employees! A good subcontract agreement can offer some protection, such as through indemnity clauses (something we’ll discuss later in this Guide).

### ***Pros and Cons: Subcontractor’s Perspective***

From the subcontractor’s perspective, things look a little different. Here are some pros of serving as a subcontractor:

- ***Limited Responsibility.*** Unlike a joint venture partner, a subcontractor is not responsible for ensuring that the entire project is successfully completed. The subcontractor’s responsibilities start and end with the work it is allocated in the subcontract. Remember, as far as the government is concerned, the prime contractor is 100% responsible for successfully completing the project.
- ***Predetermined Payment.*** As we have discussed, a subcontractor is usually paid on a predetermined basis. If it turns out that the prime contractor estimated the project wrong, or the prime simply has other difficulties performing the project at a profit, that’s usually not the subcontractor’s problem.

- ***Easier to Obtain.*** Many (though not all) companies find that it's much easier to start their government contracting journey as a subcontractor instead of a prime. Especially for small businesses without relevant past performance, it can be very difficult to break into the government marketplace at the prime level. Starting as a subcontractor can help build past performance and capabilities before taking the leap to prime contracting.

But subcontracting has some cons, too, such as:

- ***No Formal Relationship with Government.*** A subcontractor does not have a formal relationship with the government—and as we discussed earlier, many prime contracts prohibit subcontractors from engaging in most communications with the government customer. If the prime contractor doesn't pay on time or is otherwise being unreasonable, the subcontractor may find that any complaints it makes to the government fall on deaf ears.
- ***One-Sided Subcontracts.*** Government prime contracts can be complex and confusing, but they also give the prime contractor many rights—things like (often) the right to a cure notice before a default, the right to file claims, the right to appeal to a Board of Contract Appeals, and so on. Subcontracts, well . . . not so much. Contrary to a common misconception, rights like these are not automatically flowed-down to subcontractors. Instead, primes (particularly large primes dealing with small businesses) often insist on rather one-sided and restrictive agreements in the prime's favor.
- ***No CPARs.*** A subcontractor ordinarily will not receive a government report on the subcontractor's past performance. If the subcontractor later wishes to bid as a prime, it may find that the past performance it gained as a subcontractor isn't given the same weight as the government would give to past performance as a prime—or perhaps, not considered at all.

### ***Key Compliance Considerations***

So, you've thought it through, considered the pros and cons, and decided that a prime/subcontractor teaming relationship is right for you. The next step, clearly, is to find a subcontract template somewhere, give it a quick once-over, and sign the thing as fast as you can. Right?

We'll cover templates a little later in this Guide (spoiler: using a largely unaltered template is a bad idea). But before you get to the paperwork, it's wise to think about some key compliance considerations. Some of these compliance considerations may affect whether you want to proceed with that subcontract after all; others will influence the terms of the subcontract.

Below, we briefly cover some of the key compliance considerations when establishing a prime/subcontractor relationship. Although extensive discussions of these compliance considerations are beyond the scope of this Guide, we have provided regulatory references for each so that you can learn more if you wish.

#### **1. Consent to Subcontract (FAR 52.244-2)**

Prime contractors generally have considerable discretion when it comes to choosing their subcontractors. But that discretion is not unlimited. Sometimes, a prime contractor cannot use a specific subcontractor without the government’s permission.

FAR 44.201 is called “Consent to Subcontract.” As the name suggests, this portion of the FAR specifies situations in which the government’s permission may be required before awarding a subcontract. Under the implementing clause, FAR 52.244-2, subcontracting consent is required when the contractor does not have an approved purchasing system<sup>5</sup> and the subcontract will be awarded on a cost-reimbursement, time-and-materials or labor-hour basis. Certain fixed-price contracts may also require consent.

Even when the contractor does have an approved purchasing system, the Contracting Officer can require consent to award specific subcontracts when the Contracting Officer believes that consent is necessary to protect the government “because of the subcontract type, complexity, or value, or because the subcontract needs special surveillance.”

Prime contractors should be careful to account for consent requirements not only in their subcontracts, but in teaming agreements (which we will discuss in more detail a little later in this Guide). Check the solicitation before signing a teaming agreement: a prime should not *promise* the award of a subcontract if there is a reasonable possibility that the government could deny consent to subcontract.

## 2. Debarred & Suspended Subcontractors (FAR 52.209-6)

Prime contractors must also avoid subcontracting (in most cases) with entities or individuals that have been debarred, suspended, or proposed for debarment from government contracts. FAR 52.209-6 requires the prime contractor to obtain a certification from each subcontractor regarding whether it has been suspended, debarred or proposed for debarment.

Except for subcontracts for commercially available off-the-shelf items and subcontracts below the threshold set forth in FAR 9.405-2 (currently \$35,000), prime contractors can only award subcontracts to these entities for “compelling reasons” and with advance written notice to the Contracting Officer.

## 3. Subcontractor Responsibility (FAR 9.104-4)

Generally speaking, “prospective prime contractors are responsible for determining the responsibility of prospective subcontractors,” except for matters involving subcontractors that have been debarred, suspended, or proposed for debarment. Responsibility is a broad concept under the FAR, and includes things like having adequate financial resources to perform the work, a satisfactory performance record, the ability to comply with delivery schedules, and so on. See FAR Subpart 9.1 for more information about responsibility.

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<sup>5</sup> A discussion of approved purchasing systems is beyond the scope of this Guide. Please see FAR 44.3 for more information.

While primes generally enjoy fairly broad discretion in determining a subcontractor's responsibility, the government can require a prospective prime contractor to "provide written evidence of a proposed subcontractor's responsibility." In our experience, this isn't a demand Contracting Officers frequently make, but we have seen it on occasion. Additionally, "[w]hen it is in the Government's best interest to do so, the contracting officer may directly determine a prospective subcontractor's responsibility." For example, this could occur "when the prospective contract involves medical supplies, urgent requirements, or substantial subcontracting." Again, this isn't something we frequently see, but it's good to know that the possibility exists.

#### 4. Small Business Subcontracting Plans (FAR 19.7 & FAR 52.219-9)

As stated in FAR 19.201(a), it is the "policy of the Government to provide maximum practicable opportunities in its acquisitions to small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small, disadvantaged business, and women-owned small business concerns." While this policy is implemented in part through set-aside and sole source contract opportunities at the prime contract level, the FAR also provides that "such concerns must also have the maximum practicable opportunity to participate as subcontractors in the contracts awarded by any executive agency, consistent with efficient contract performance."

To implement this policy, the FAR generally requires that large prime contractors awarded contracts over certain dollar thresholds<sup>6</sup> must "submit and negotiate a subcontracting plan, where applicable, that separately addresses subcontracting with small business, veteran-owned small business, service-disabled veteran-owned small business, HUBZone small business, small, disadvantaged business, and women-owned small business concerns." Small prime contractors are exempt from the subcontracting plan requirement—even when they win an unrestricted contract, that is, one that has not been set-aside for small businesses or any socioeconomic subcategory of small businesses.

If you are a large business subject to the subcontracting plan requirements, you should ensure that you have a thorough understanding of what is required to adopt and implement a compliant and effective small business subcontracting plan. Non-compliance may be more than a breach of contract—it could count against the large business in future government competitions<sup>7</sup> or even result in allegations of violating the False Claims Act.<sup>8</sup> Many large businesses appoint one or more knowledgeable individuals (often called Small Business Liaison Officers, or SBLOs) to

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<sup>6</sup> As of the publication of this Guide, the thresholds were \$750,000 for most acquisitions and \$1.5 million for

<sup>7</sup> For instance, in a 2015 case, the GAO upheld an agency's decision to downgrade a large prime's evaluation rating because of the large prime's "consistent failure" to meet its subcontracting plan goals on prior contracts. See <https://www.gao.gov/products/b-410886>.

<sup>8</sup> For example, shortly before this Guide was published, a large business agreed to pay more than \$3 million to resolve FCA allegations involving the large business's subcontracting plan. See <https://www.justice.gov/usao-edwa/pr/ch2m-hill-plateau-remediation-company-agrees-pay-more-3-million-settle-hanford>

oversee their subcontracting plans and other interactions with small businesses. In our opinion, appointing an SBLO is an important “best practice” for any large prime contractor.

## 5. Ostensible Subcontractor Affiliation (13 C.F.R. § 121.103(h)(2))

The subcontracting plan requirements apply when the prime contractor is a large business. But what about when the prime contractor is a small business? When a contract is set-aside or otherwise reserved for small businesses, two special and important subcontracting rules apply: the ostensible subcontractor affiliation rule and the limitations on subcontracting. We will cover the ostensible subcontractor rule first.

You won’t find the ostensible subcontractor rule in the FAR. Instead, it’s in 13 C.F.R. § 121.103(h)(2) —in the SBA’s section of the Code of Federal Regulations. The rule states:

*A contractor and its ostensible subcontractor are treated as joint venturers for size determination purposes. An ostensible subcontractor is a subcontractor that is not a similarly situated entity, as that term is defined in § 125.1 of this chapter, and performs primary and vital requirements of a contract, or of an order, or is a subcontractor upon which the prime contractor is unusually reliant. All aspects of the relationship between the prime and subcontractor are considered, including, but not limited to, the terms of the proposal (such as contract management, technical responsibilities, and the percentage of subcontracted work), agreements between the prime and subcontractor (such as bonding assistance or the teaming agreement), and whether the subcontractor is the incumbent contractor and is ineligible to submit a proposal because it exceeds the applicable size standard for that solicitation.*

A full discussion of the ostensible subcontractor rule could be long enough for its own Guide. But for our purposes, here are three key things to know about the rule:

- ***It is an affiliation rule.*** If the SBA finds that a subcontractor is actually an “ostensible subcontractor,” the SBA will deem the prime contractor and subcontractor affiliates for purposes of the contract in question. This means that the subcontractors average annual receipts or average employee count will be added to the prime’s.<sup>9</sup> If the combined total exceeds the contract’s size standard, the prime is ineligible for the contract.
- ***The subcontractor cannot be solely responsible for perform the “primary and vital” portion of the contract.*** The SBA’s Office of Hearings and Appeals, or OHA, has written that the primary and vital requirements are “those associated with the principal purpose of the acquisition.”<sup>10</sup> Per OHA, the primary and vital requirements are “frequently . . . those which account for the bulk of the effort, of the contract value.” But the SBA will also consider “qualitative factor, such as the relative complexity and importance of the requirements.”

<sup>9</sup> The SBA’s small business size standards are calculated either on the basis of average annual receipts or average employee count, depending on the industry. The industry-by-industry size standards are set forth in 13 C.F.R. §121.201.

<sup>10</sup> *Size Appeal of Kuponon Gov’t Servs., LLC*, SBA No. SIZ-5967 (2018).

- *The prime contractor cannot be “unusually reliant” on the subcontractor.* In reviewing potential unusual reliance, the SBA will consider “all aspects” of the relationship between the prime contractor and subcontractor, and the review is very fact-specific. OHA’s case law provides some guidance, however. Potential risk factors for ostensible subcontractor affiliation include (but are not limited to) things such as a significant role for the subcontractor in overall contract management, the splitting of profits with the subcontractor, the subcontractor’s provision of many (or all) key employees necessary to perform the work, and cases where the prime contractor hired its managerial employees from the subcontractor.

Given the case-by-case nature of the SBA’s “all aspects” review, assuring compliance with the ostensible subcontractor rule can sometimes be quite tricky. In such cases, it can be wise to seek professional guidance.

## 6. Limitations on Subcontracting (13 C.F.R. § 125.6)

There is no public policy served by setting aside a contract for a small business, only to have that small business subcontract the entire scope of work to a large subcontractor. But on the other hand, the government realizes that it can be difficult for a single small business to self-perform 100% of the scope of work under a prime contract, particularly where a contract is larger and/or complex.

The rules limiting subcontracting aim to achieve a balance: a small business awarded a contract set-aside or reserved for small business, or a socioeconomic subcategory of small businesses can subcontract portions of the work, including to large businesses. But for most such contracts,<sup>11</sup> the amount that can be subcontracted to large businesses is limited.

Confusingly, the government’s rules regarding subcontracting have been in a state of flux since late 2012, when Congress amended the underlying statute. In 2016, the SBA changed its regulations to reflect the statutory change; the SBA’s regulation is set forth in 13 C.F.R. §125.6. But, as of the publication of this Guide, the FAR Council has yet to amend the FAR to conform with the statute and SBA regulations. We anticipate a final rulemaking this amendment relatively soon, and in the meantime, some agencies (such as the DoD) have taken matters into their own hands by issuing class deviations to their agency FAR supplements. In this section of the Guide, we cover only the SBA’s regulation, since this is the regulation that conforms with the statute.

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<sup>11</sup> The limitations on subcontracting do not apply to small business set-asides with a value less than the simplified acquisition threshold. They do, however, apply to contracts set-aside or reserved for socioeconomic subcategories of small businesses both at and below the simplified acquisition threshold.

Like the ostensible subcontractor rule, a thorough discussion of the limitations on subcontracting could be its own lengthy Guide.<sup>12</sup> But here are some of the key, high-level things you should know:

- **Limits Vary by NAICS.** The permitted amount of subcontracting varies considerably based on the NAICS code assigned to the contract. Contracts for services and manufactured products<sup>13</sup> are subject to a 50% subcontracting limit. For a specialty trade construction contract, up to 75% can be subcontracted. For general construction, the amount is even larger—85%.
- **Know the Formulas.** Under 13 C.F.R. §125.6, the amount that can be subcontracted is always based on some percentage of the amount paid by the government. Considerations like labor hours or personnel costs are not relevant. In some cases, certain costs should be excluded from the calculation. For instance, for construction contracts, the cost of materials is excluded. Review the regulation carefully and be sure to know the formula or formulas applicable to you.
- **Timeframe for Compliance.** It is commonly misunderstood that compliance with the limitations on subcontracting is determined at the end of the entire period of performance—including any options. Instead, for a set-aside contract, the period of time to determine compliance is “the base term and then each subsequent option period.”<sup>14</sup> So if, for example, the subcontractor exceeds the limit during the base period, this would be a violation; it cannot be “made up” in subsequent option years.

## 7. Flow-Downs

Flow-down provisions are clauses of the prime contract that the prime contractor must include with (or “flow-down” to) any subcontract. The obligations of the prime will become the obligations of the subcontractor, as well—although there may be some minor modifications to account for the prime/subcontractor relationship in place of government/prime.

How do you know if a prime contract clause must be flowed down? Well, there’s really no shortcut: you have to read the clause. Here is an example, from FAR 52.203-7 (Anti-Kickback Procedures):

*(5) The Contractor agrees to incorporate the substance of this clause, including this paragraph (c)(5) but excepting paragraph (c)(1) of this clause, in all subcontracts under this contract that*

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<sup>12</sup> If you are looking for more detailed information on the subcontracting limits, please see Steven Koprince’s industry-specific step-by-step compliance guides, available through the links posted here: <https://smallgovcon.com/statutes-and-regulations/limitations-on-subcontracting-step-by-step-plain-english-guides/>

<sup>13</sup> Many companies selling manufactured products qualify for the “nonmanufacturer rule,” which is essentially an exception to the ordinary limitations on subcontracting in contracts for supplies or products. The nonmanufacturer rule is found in 13 C.F.R. §121.406.

<sup>14</sup> For orders set-aside under unrestricted contracts, the time frame is the “period of performance for each order.”

*exceed the threshold specified in Federal Acquisition Regulation 3.502-2(ii) on the date of subcontract award.*

If your prime contract includes FAR 52.203-7, you must flow it down to the subcontractor (except for the referenced paragraph) so long as the subcontract exceeds the threshold under FAR 3.502-2(i).<sup>15</sup>

Making matters slightly more complicated, many FAR clauses and clauses from agency FAR supplements, such as the DFARS, may not be set forth in your contract in full text. Instead, as a space-saving device, government prime contracts often include only the clause's name and number. If the contractor wants to review the clause, the contractor has to look it up.

So, does this mean that you must parse through every government prime contract you're awarded, look up every FAR clause that isn't included in full text, and then identify, by name and number, each clause that flows down to your subcontractors? For many prime contracts, that would be a lot of work!<sup>16</sup>

Some prime contractors (usually large primes with more resources) do spend the time and energy required to specifically identify each flow-down applicable to a subcontractor. But many primes don't have the resources to devote to such a task. These primes use an "incorporation by reference" clause instead.

An incorporation by reference clause is simply a clause stating, in essence, that the subcontract includes all provisions of the prime contract required to be flowed down. A good clause, of course, offers some additional detail, such as specifying that references in a flowed-down clause to the "Contractor" shall mean the "Subcontractor." And, of course, if a prime contractor uses an incorporation by reference clause, it must make sure that the subcontractor has a copy of the prime contract—or at least the clauses in the prime contract. Otherwise, the subcontractor has no basis to determine what has been flowed down.

Incorporation by reference clauses are commonplace in government subcontracts. Even when a prime takes the effort to specifically identify every flowed-down clause, it typically includes an incorporation by reference clause just as a "belt and suspenders" protection in case it inadvertently omitted something.

### *Legal Relationship and Set-Up*

We're finally to the part of this Guide where we will discuss the documents themselves—teaming agreements and subcontracts. But first things first: what is the difference between a teaming agreement and a subcontract, anyway?

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<sup>15</sup> As of this writing, the threshold was \$150,000.

<sup>16</sup> The prime's flow-down obligations are much more limited when the prime contract is for commercial items. In those cases, the prime generally must flow-down only those clauses identified in FAR 52.244-6 (Subcontracts for Commercial Items), plus any other clauses the prime contract requires be flowed-down.

If you're hunting through the FAR for a definition of a "teaming agreement", good luck—there isn't one! In the government contracting industry, though, the term "teaming agreement" is often used to describe an agreement between a prospective prime contractor and a prospective subcontractor to jointly pursue a government contracting opportunity. In industry parlance, a teaming agreement is a "chasing the contract" document.

In contrast, a subcontract is a "performing the contract" document. Even under the broad definition in FAR 44.101, a subcontract presupposes the existence of a prime contract. This means that a prime/subcontractor relationship often involves both documents. First comes the teaming agreement, which governs the parties' relationship as they jointly pursue the contract. Then, if the prospective prime contractor is successful in its pursuit of the prime contract, the subcontract governs the parties' relationship in the performance of the contract.

Now that the differences between teaming agreements and subcontracts are clear, let's take a look at some best practices for drafting these agreements.

### Teaming Agreements

Teaming agreements are so commonplace that some contractors believe that the FAR requires them. Nope. Neither the FAR nor the SBA's regulations require teaming agreements. Sometimes, in a solicitation, an agency will require a teaming agreement in order to allow for the consideration of a prospective subcontractor's past performance, experience and/or capabilities. But otherwise, a teaming agreement is optional.

Wait, wait—don't skip to the next section yet! Nobody likes paperwork and it may seem easier to avoid a teaming agreement if the FAR doesn't require one. But for prime contractors and subcontractors alike, having a strong written teaming agreement is itself a best practice and can help avoid all sorts of unpleasant headaches and surprises.

### Some advantages of a written teaming agreement include:

- Establishing whether the parties' relationship is exclusive or whether either party may work with other potential prime contractors/subcontractors.
- Avoiding difficult post-award disputes, such as disputes about the potential subcontractor's scope of work or payment. In our experience, it is much better to negotiate key items like these as part of the teaming agreement then put it off until after a prime contract is awarded. By then, the government is likely expecting a quick and seamless transition, and likely will have little patience for delays occasioned by subcontract negotiations.
- Demonstrating compliance with the ostensible subcontractor rule. If the procurement is one to which SBA size rules apply, a teaming agreement can help show that the prospective prime contractor is in charge of the relationship and will perform the primary and vital portions of the work.

- Demonstrating intended compliance with the limitations on subcontracting. Similarly, a teaming agreement can show that the parties intend to comply with this rule by stating that the prospective subcontractor will perform no more than the amount permitted.

A written teaming agreement is almost always a wise idea, but not all teaming agreements are created equally. We have drafted, reviewed and negotiated many teaming agreements over the years. Here are some of our key “best practices” to include in an effective teaming agreement:

- **Exclusivity.** We sometimes see teaming relationships go south when the parties aren’t on the same page regarding exclusivity. An effective teaming agreement should clearly spell out whether the subcontractor is bidding exclusively with the prime or may also work with other potential primes.<sup>17</sup> Similarly, the agreement should specify whether the prime contractor has the right to consider any other potential subcontractors for the work the prospective subcontractor wishes to perform.
- **Proposal Responsibilities.** There is a lot to be said for having well-defined expectations for the division of team responsibilities at the outset in any type of teaming arrangement. Spelling out each party’s duties for the preparation and submission of proposals in your teaming agreement can help to ensure all solicitation and submission requirements are met and clarify each party’s role in meeting them. Generally, the prime plays the lead role in preparing and submitting the proposal, while the subcontractor’s role is limited to its own scope and pricing information. Again, if the procurement is one to which SBA size rules apply, a teaming agreement clearly establishing the prime’s lead role in preparing and submitting the proposal can help show that the prime is in charge of the relationship and will perform the primary and vital portions of the work. But on the other side of that coin, a teaming agreement that shows the subcontractor has a lead role in preparing and submitting the proposal could be indicative of affiliation.
- **Non-Disclosure.** Many subcontract agreements include non-disclosure provisions or incorporate a separate non-disclosure agreement. But what about all the confidential and proprietary pricing and past performance information that the parties typically share with one another during proposal preparation? An effective and fair teaming agreement will equally ensure the protection of both parties’ confidential and proprietary information or will expressly refer to a separate non-disclosure agreement that does so. Either way, the teaming agreement should also account for the FAR’s whistleblower requirements (FAR 52.203-18 & FAR 52.203-19), which ensure that employees and subcontractors shall not be prohibited from lawfully reporting waste, fraud, or abuse related to Government contracting.

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<sup>17</sup> If a subcontractor is teaming with multiple primes pursuing the same acquisition, it can create the potential for a violation of the FAR’s Certificate of Independent Price Determination, FAR 52.203-2. While a discussion of this issue is beyond the scope of this Guide, we recommend that prospective prime contractors and subcontractors consider this matter when forming teaming relationships.

- **Termination.** An effective teaming agreement will spell out the occurrence of each event that will result in termination, generally, including the following: (a) the prime decides not to submit a proposal for the solicitation the parties initially agreed to pursue; (b) another prime contractor wins the award (often allowing a window for a potential protest); (c) the parties are unable to agree on a subcontract after good faith negotiations; (d) one party defaults on its teaming agreement obligations; and (e) the government disapproves of the proposed subcontractor. Often, the teaming agreement will also automatically terminate upon the execution of the anticipated subcontract, which takes over as the team’s governing contract. The parties should also decide whether or not they want to include a termination for convenience provision, typically requiring prior notification of the other party
- **Prospective Subcontractor’s Scope of Work.** When used properly, a teaming agreement can be an effective tool to prevent and resolve post-award disputes, especially those involving the contract’s work share division. The agreement should specify whether or not the subcontractor is guaranteed a subcontract upon award. It should also state what, specifically, the subcontractor’s scope of work under the resulting contract will be. How much work, and what portions of the work, will the subcontractor be performing upon award? The anticipated division of the parties’ scope of work should be detailed and well-defined, explaining which equipment, resources, and labor each party will provide and what each party’s performance responsibilities. Where an agency requires submission of the teaming agreement with the proposal, a detailed scope of work analysis can support the agency’s acceptance of the subcontractor’s past performance and capabilities. Also, for procurements to which SBA’s size rules apply, this section can demonstrate the parties’ plan to comply with the limitations on subcontracting and reduce affiliation concerns (so long as it demonstrates the prime will be performing the required workshare and the primary and vital contract work).
- **Prospective Subcontractor’s Payment.** One can hardly talk about preventing and resolving post-award disputes without mentioning payment. Setting expectations in the teaming agreement about the work the subcontractor will perform and how it will be compensated for that work is a highly-effective way to mitigate payment issues later on. The payment provisions of a teaming agreement should take into consideration the pricing structure of the anticipated contract (i.e. Firm Fixed Price, Time & Materials, etc.), and should set a specific structure for the subcontract, listing all rates, product pricing, and other payment terms that the parties anticipate will apply to the subcontract.

### Subcontract Agreements

The subcontract is the “performing the contract document” that generally supersedes or replaces the teaming agreement (or the “chasing the contract document”). Typically, the subcontract is much more detailed than the teaming agreement. While the FAR does not include requirements for a teaming agreement, it has specific requirements for the subcontract. For one, as detailed in Section 7, a subcontract must include the FAR’s mandatory flow-down provisions, which

essentially impose the prime's contract obligations onto the subcontractor. In addition to the FAR, the SBA's regulations provide additional subcontract requirements, though those are sometimes less well-known.

Thus, a written subcontract is not only a wise idea but is also required (as there is no way to effectively flow down FAR clauses orally). And like teaming agreements, not all subcontracts are created equally. We have drafted, reviewed, and negotiated many subcontracts over the years as well. So naturally, we also want to provide some of our key "best practices" to include in an effective subcontract.

- ***Tailored Subcontract.*** Something we see an awful lot of is companies finding an unedited commercial subcontract somewhere online and trying to use it to pursue a federal government contracting opportunity. One big issue with this: those subcontracts are almost certain not to include the required FAR flow-downs. They are also highly unlikely to address key SBA requirements, such as compliance with limitations on subcontracting for procurements to which SBA's size rules apply. The best practice is to have a subcontract drafted that is specifically tailored to the government contract to be performed and the parties performing it.
- ***Subcontractor's Scope of Work.*** Just like including the anticipated subcontractor scope of work in a teaming agreement, spelling out the subcontractor's specific scope of work in the subcontract itself can help to prevent and resolve disputes later on. Once an award has been issued to the parties, it is typically possible to get even more specific regarding the parties' roles, division of work responsibilities, and division of equipment, resources, and labor required for performance. If so, definitely do it. Outside of mitigating issues with who is performing what work and how much work each party is guaranteed, the subcontract is one of the first places the government will look to review any affiliation concerns and to determine a prime's compliance with the limitations on subcontracting. So (and again, this is only for procurements to which SBA's size rules apply), a detailed and SBA-rule-compliant scope of work division can effectively demonstrate the parties' plan to comply with the limitations on subcontracting and reduce affiliation concerns.
- ***Subcontractor's Payment.*** Mitigating potential payment disputes is something most teaming partners are on board with. The best way to do this is to include as many payment terms and details as possible in the subcontract. Though a solicitation often has pricing expectations, the exact award amount is often unknown until the contract is officially awarded. The subcontract should consider the pricing structure and terms of the prime contract and establish clear payment terms and conditions for the prime and subcontractor relationship. Will there be a "pay-when-paid" requirement? How soon will the subcontractor be paid? What will be the basis of payment (i.e. Firm Fixed Price, Time & Materials, etc.)? How will the invoicing procedures look? Will there be a review and acceptance or rejection period prior to payment of the subcontractor for services or products? An effective agreement will include terms and conditions addressing each of these items and others relevant to the nature of the work to be performed.

- ***“Pass-through” Dispute Resolution.*** In a prime-subcontractor relationship, the prime contractor is the only party in privity of contract with the government. That is a fancy way of saying that the prime contract can only confer rights and impose obligations between the government and the prime (not the government and the subcontractor). This means that, in the event that the government is to blame for something that affects the subcontractor, the subcontractor has no way to pursue an action against the government. It could only pursue an action against the prime (even if the prime is innocent). For this reason, a subcontract that effectively protects both parties' rights should include a provision that allows the subcontractor to pass claims against the government through the prime to the government. The subcontract should also address the procedures and costs of pass-through (costs are typically each party paying their own).
- ***Term and Termination.*** An effective subcontract will establish the agreement's anticipated term and termination if performance goes as planned. It should account for potential government modifications and extensions and explain how option periods will be addressed. But it should also establish whether or not the subcontract can be terminated for convenience. As you are probably aware, the contracting agency can terminate a prime contract for the convenience of the government (essentially) whenever it wants to. A thorough subcontract termination section will address whether or not the prime can terminate the subcontract in the event of a government termination for convenience or otherwise. This is important, as there is a common misconception that the termination for convenience clause is included in the FAR's mandatory flow-downs; but often, it is not. Additionally, the agreement should specify whether the parties can terminate for default, and what that procedure will look like. What are the specific default rights? Are the parties entitled to a cure notice or cure period?
- ***Non-Disclosure.*** While the teaming agreement should protect the parties' confidential and proprietary pricing and past performance information to be shared during the proposal phase, the subcontract should cover the exchange of all other information that may be required in contract negotiations and performance. If the parties instead elected to execute a separate non-disclosure agreement, it should encompass the proposal phase and contract performance non-disclosure terms. And it should be expressly incorporated into the subcontract (just as it was into the teaming agreement).
- ***Ensured Compliance With Subcontracting Limitations (set-asides only).*** The best bet for making sure the subcontract demonstrates that the parties will comply with the limitations on subcontracting for set-aside contracts is to simply state it. Generally, the subcontract should use the regulatory language (or cite to the regulation itself) for the limitation on subcontracting applicable to the prime contract. Of course, simply saying that the parties will comply does not substitute for a detailed division of work demonstrating compliance, but this assurance from the parties should still be included in all effective subcontracts for set-aside prime contracts.

- ***Representations and Certifications.*** The prime is the party obligated to make truthful and accurate representations to the government. And both the prime and subcontractor often have to rely on certain representations by the other party in regard to contract eligibility, size, status, and other matters. As such, an effective subcontract will contain detailed representations and certifications by both parties (a good place to start for key representations and certifications for a subcontract is FAR 52.209-5). These should include, at a minimum, assertions regarding (even potential) conflicts of interest, compliance with state and federal laws, suspensions and debarments, and representations as to size and socioeconomic status. They should also include notification requirements in the events that such representations and certifications change.

### ***Final Thoughts and Conclusion***

Teaming-up with a prime or subcontractor to compete for U.S. federal government contracts can be a very powerful tool. Done properly, it can maximize the team members' resources, capabilities, and ultimately, ability to compete in a highly competitive marketplace. It can give small businesses the opportunity to work on contracts that they simply do not have the capacity to perform on their own. And it can give larger companies the opportunity to participate in small business and other socioeconomic set-asides that they would otherwise be ineligible for. But the keyword in this paragraph is "properly."

Part II of our teaming series discussed many of the benefits of these prime-subcontractor arrangements. But it also enumerated a wide variety of pitfalls and consequences for teaming up without regard for SBA's rules and regulations and without utilizing some of the best practices. A company could lose a hard-earned and highly valuable award. It could risk findings of affiliation with its teaming partners. And it could open itself up to breach of contract litigation and even allegations of violating the False Claims Act. So, we said it already, but we'll say it again: it pays to know the rules, processes, and best practices. When you do, you can utilize a prime-subcontractor relationship to the fullest extent and gain valuable experience and capabilities in the process.



## About



Founded in 2017, The Pulse of GovCon is a small, self-funded, women-owned, for-profit business located in the DMV region.

The Pulse was founded to break down barriers across the Government Contracting ecosystem and bridge the fundamental gaps surrounding federal procurement through our writing, training, consulting, and customized membership platform. We serve as an accessible supplemental resource for large-, mid-, and small-sized Government Contractors, as well as the U.S. federal government, media, trade organization, academia, and Procurement Technical Assistance Centers (PTACs), finding, translating, and analyzing complex federal procurement information and data to develop actionable solutions.

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[WWW.THEPULSEGOVCON.COM](http://WWW.THEPULSEGOVCON.COM) | [PUNDITS@PULSEGOVCON.COM](mailto:PUNDITS@PULSEGOVCON.COM)

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