**Subcontracting Reform – Going Beyond Contract Privity**

**Solution**

Government shall require prime contractors to include with their proposals fully executed subcontracts that are conditioned on the prime contractors’ receipt of contract awards. Subcontracts shall be effective throughout the entire life cycle of the contract.

Consistent with the opportunity described, the government shall craft evaluation criteria to include evaluation of offerors’ record of actual use of small business concerns under current and prior contracts.

Government shall instruct its contracting officers that compliance with subcontracting plans constitutes a material element of contract performance; with an instruction to issue show cause notices and default terminations to prime contractors, who fail to comply with their subcontracting plans.

**Benefits**

* Government could make evaluation of offerors’ subcontracts a part of the source selection evaluation process; and thereby insist that prime contractors adhere to them.
* Subcontractors are afforded legally enforceable subcontracts that are entered into before the government’s prime contracts are awarded, when small business negotiating power is at its highest.
* Government ensures that it receives the work allocations that its prospective prime contractors propose
* Small business subcontractors receive a legally enforceable mechanism to protect the work allocations that their prime contractor team members promised.

**Background and Discussion**

Small businesses provide the engine that drives our economy. Companies with fewer than 500 employees provide jobs for over half of the nation's private workforce. Although 99.7 percent of all employer firms are small, they receive only about 23 percent of direct federal procurement dollars, and only 40 percent of subcontracting dollars. Despite mandatory subcontracting programs aimed at increasing small business participation in the federal procurement, significant barriers exist that prevent small businesses from realizing their fair share of federal procurement dollars.

A significant barrier is the government’s *laissez faire* attitude towards enforcement of teaming arrangements and subcontracts between large business prime contractors and their small business team members and subcontractors. How often does a large business prime contractor leave its small business team member empty-handed after obtaining the small businesses’ assistance to obtain contract awards? Whether under the guise of failed negotiations between a large business prime contractor and its small business teaming partner, asserted changes in the government’s requirements; or demands by the large business prime contractor that its small business teaming partner accept reduced labor rates to preserve profitability; small businesses, are all too often left empty handed after assisting large businesses to obtain government contracts.

A significant reason for why this condition persists is the application of the doctrine of “privity of contract” that constrains the government’s Contracting Officers from intervening to protect small businesses. Two parties are in “privity of contract” when they are both parties to the same contract. In federal procurements, the prime contractor and the government are in “privity of contract” by virtue of the government contract awarded to the large business. However, a subcontractor has no “privity” of contract with the government notwithstanding the significant indirect relationship that exists between them. Thus, if a small business subcontractor is adversely affected by actions or inactions of its large business teaming partner or prime contractor, the government will rarely if ever intervene on behalf of the small business because its lacks “privity of contract” with the small business.

At first blush, strict adherence to the “privity of contract” doctrine appears to make sense; particularly considered in the context of traditional commercial contracting. This follows because the prime contractor assumes the ultimate risk of contract performance, and the prime contractor is the entity that must answer to the customer. However, government contracting is significantly different than traditional commercial contracting. In government contracting, our government uses its procurement system and processes to implement its public policy objectives, which includes its objective “*to fuel the small business engine that fuels our economy.”*

Consistent with the objective, our government regularly interjects itself directly into the prime/subcontractor relationship. For example, the government reserves the right to “consent” to proposed subcontractors. During its proposal evaluations, the government considers such factors as technical need for services, compliance with goals for subcontracting with small disadvantaged business and women-owned business concerns, adequacy of competition, responsibility of proposed subcontractors, proposed subcontract types, terms and conditions, and the adequacy and reasonableness of subcontractors’ proposed prices.

Post award, the Government reserves the right to audit subcontractor books and records; to impose liability on subcontractors for violations of minimum wage provisions, and also reserves the right to impose false claims liability directly against subcontractors who submit inflated or defective invoices to their prime contractors for ultimate payment by the government. In other words, despite the lack of “privity of contract” that exists between the government and its small business subcontractors, the Government routinely exercises direct control over subcontractors.

Considering the public policy mandate to maximize small business participation in the federal procurement process, it makes little sense that the government, after awarding its prime contracts to large businesses, declines to intervene to ensure that they honor their agreements with their proposed teaming partners. Yet, our government declines to intervene to ensure its prime contractors honor promised small business work and revenue allocations because it asserts that it lacks “privity of contract” with them. Despite routinely intervening into the prime/subcontractor relationship to impose such things as subcontracting plan requirements, and small business subcontracting goals; our government adheres to the “privity of contract” doctrine as a legal principle that prevents it from intervening to ensure its prime contractors fully utilize their small business subcontractors.

By its assertion of the “privity of contract” doctrine, the government foregoes use of its potentially most effective tool to achieve maximized use of small businesses in the federal procurement process. Just as the government currently intervenes in the prime/subcontractor relationship to impose subcontracting goals, it could similarly intervene to ensure that they adhere to promised work and revenue allocations with their small business subcontractors. To accomplish this all the government would have to do is direct prospective prime contractors to include with their proposals fully executed subcontracts that are conditioned on the prime contractors’ receipt of contract awards. This way the government could make evaluation of offerors’ subcontracts a part of the source selection evaluation process; and thereby insist that prime contractors adhere to them. The government would also provide a mechanism for subcontractors to protect themselves by affording them legally enforceable subcontracts that are entered into before the government’s prime contracts are awarded, when small businesses’ negotiating power is at its highest.

Consistent with the opportunity described the government could also craft its evaluation criteria to include evaluation of offerors’ record of actual use of small business concerns under current and prior contracts. The government currently uses this approach effectively to evaluate offerors’ history of quality past performance. It could also instruct its contracting officers that compliance with subcontracting plans constitutes a material element of contract performance; with an instruction to issue show cause notices and default terminations to prime contractors who fail to comply with their subcontracting plans. Currently, although liquidated damages may be assessed against prime contractors for noncompliance with their subcontracting plans, they are rarely assessed, and adherence to subcontracting plans is rarely enforced by federal contracting officers.

The government should not be constrained by the “privity of contract” doctrine in its undertaking to maximize small business participation in the federal government procurement process. Just as the government includes provisions in its contracts mandating compliance with minimum wage mandates and other public policy objectives, it could similarly insist that prospective prime contractors disclose the allocation of work amongst proposed team members and insist that already concluded subcontracts be provided with their proposals. In this manner, the government would not only ensure that it receives the work allocations that its prospective prime contractors propose, but would also provide a legally enforceable mechanism for small businesses to protect the work allocations that their prime contractor team members promised. This, coupled with the government’s incorporation of prospective prime contractors’ record of actual use of small businesses on past and current contracts, would vastly increase the amount of actual participation by small business in the federal procurement process.