Slow the Flow: New DoD Rule for Commercial Products and Services Will Bar Contractors from Flowing Down the Kitchen Sink

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PRACTICES Government Contracts

Many defense contractors will be contractually required to revise their subcontract templates to address a recent update to the DFARS. Under a November 17, 2023 Final Rule, "Inapplicability of Certain Laws and Regulations to Commercial Items," 88 Fed. Reg. 80,462 (Nov. 17, 2023), defense contractors will be barred on new defense contracts from taking a "kitchen sink" approach to flowing down FAR and DFARS clauses to commercial products (including commercially available off-the-shelf items) or commercial services subcontractors on DoD contracts.

Moving forward, DoD solicitations and prime contracts will include DFARS 252.244-7000, "Subcontracts for Commercial Products or Commercial Services" (Nov. 2023), which requires that contractors *only* include in commercial products and services subcontracts at any tier (1) the specific lists of clauses required to be flowed down under the FAR: 12.301(d), 52.212-5(e)(1), and 52.244-6(b)(1), as applicable; and (2) DFARS clauses that specify flow down in the particular clause (without exempting commercial products or services or COTS items, as applicable). The updated DFARS clause states explicitly that prime contractors and higher-tier subcontractors "shall not" include the terms of any other FAR or DFARS clauses.

The new prohibition replaces language that said: "While not required, the Contractor may flow down to subcontracts for commercial products or commercial services a minimal number of additional clauses necessary to satisfy its contractual obligation." The Proposed Rule, 83 Fed. Reg. 30,646 (Jun. 29, 2018), quoting a subcontractor trade association, explained that the former language "was being abused by contractors, who were overloading commercial item subcontracts 'with whatever flow down clauses they felt were even remotely deemed necessary, regardless of any harmful consequences to the Government[']s commercial item acquisition process." The DAR Council added that "A contractor can, of course, still impose its own requirements on subcontractors, but cannot flow down FAR and DFARS clauses as a whole."

It is important to note that under FAR 52.244-6 and FAR 52.212-5(e)(2), civilian agency contractors are still permitted to include a "minimal number of additional clauses necessary to satisfy . . . contractual obligations" in subcontracts for commercial products and services. Also, while the new rule became effective November 17, 2023, defense contractors are not compelled to comply with this requirement immediately for *existing* contracts, but only with contracts that include the new version of clause 252.244-7000. The preamble to the Final Rule notes that COs have discretion to apply the requirement to existing contracts under FAR 1.108(d), but are not required to do so.

As a practical matter, prime contractors and upper-tier subcontractors should include certain clauses in subcontracts beyond the mandatory flow down clauses to address their obligations–and the government's rights–under prime contracts with DoD. For example, contractors should include a convenience termination clause in subcontracts, including subcontracts for commercial products and services, so that it is possible to terminate the subcontract for convenience if the prime contract

is terminated for convenience. Similarly, contractors need to be able to suspend work or stop work under a subcontract if the government suspends or stops work under the prime contract. A "changes" clause should generally be included in all subcontracts so that the prime contractor can pass on any changes within the general scope of the prime contract as directed by the Contracting Officer under the prime contract changes clause. Buy American Act and Trade Agreements Act obligations must be passed on to subcontractors supplying end items, including commercial products, and the Buy American Act may make it necessary to include a clause requiring supply of domestically sourced commercial components as well. None of these are mandatory FAR or DFARS clauses, so these terms will all need to be separately addressed in commercial subcontract templates, if they are not already. And these are just examples; contractors will need to review their obligations under other prime contract FAR or DFARS clauses as well and consider whether they should be addressed in subcontracts for commercial products or services.

In addition to restricting prime contractors from flowing down extra clauses in commercial subcontracts, the Final Rule added language to the DFARS limiting agencies' discretion to include clauses that are not required at the prime contract level as well. DFARS 212.301(f) now states that, apart from clauses prescribed in DFARS 212, "[t]he contracting officer shall not use other FAR or DFARS provisions and clauses" except for those "required by the FAR or DFARS or consistent with customary commercial practices . . . ." This language implements Section 874 of the 2017 National Defense Authorization Act (NDAA), which stated that the Under Secretary of Defense "[t]o the maximum extent practicable . . . shall ensure that . . . the Defense Federal Acquisition Regulation Supplement does not require the inclusion of contract clauses" in contracts for commercial product or services or COTS items "unless such clauses are – (i) required to implement provisions of law or executive orders applicable to such contracts; or (ii) determined to be consistent with standard commercial practice."

It is not clear how the new DFARS language restricting clauses in prime contracts for commercial products and services will interact with the FAR Part 12 language allowing contracting officers to obtain a waiver to include additional or modified terms inconsistent with customary commercial practice in commercial contracts. FAR 12.302(c). The addition of the language at DFARS 212.301(f) was prompted by a comment to the Final Rule, which urged DoD to add language prohibiting inclusion of extra clauses, but cited as an exception clauses "approved in accordance with FAR 12.302." Neither the response to the comment nor DFARS 212.301(f) mentions FAR 12.302 approval, however.

The Final Rule removed one change included in the Proposed Rule, prescribed by Section 874 of the 2017 NDAA and codified at 10 U.S.C. § 3452(c)(3), pertaining to the definition of "Subcontract." The statute defines the term "subcontract" for purposes of the subsection to include interorganizational transfers and exclude "agreements entered into by a contractor for the supply of commodities that are intended for use in the performance of multiple contracts with the Department of Defense and other parties and are not identifiable to any particular contract." The proposed rule was to have implemented the statute by adding these details to definitions of subcontract throughout the DFARS. The Final Rule deferred these changes to be addressed in a new DFARS case 2023-D022, citing the need for consistency with the FAR and a pending FAR case 2018-006 addressing the definition of "subcontract" in the FAR.

This Final Rule is part of a broader effort driven by Congress to limit the number of government-unique requirements imposed on companies providing commercial products and services to the U.S. government. Next year will mark the thirtieth anniversary of the Federal Acquisition Streamlining Act (FASA), a major purpose of which was to encourage and provide a preference for the federal government to purchase commercial products and services. Ironically, while calling for

fewer government-unique requirements in contracts and subcontracts for commercial products and services, Congress has at the same time added significantly to such requirements with new legislation. The Department of Defense has similarly added new specialized government requirements through new regulations. A recent white paper from the Baroni Center for Government Contracting at George Mason Business School found that declines in the Defense Industrial Base were in significant part attributable to the rising regulatory burden on government contractors, urging that DoD address this problem head-on. Schwartz and Johnson, How Not to Alienate Business Partners: A Framework for Addressing Factors Impacting Retention of Defense Contractors (Nov. 2, 2023). The white paper echoes recommendations of the Section 809 Panel, which urged the federal government to minimize government-unique terms applicable to commercial buying.

The DoD should take these critiques seriously and do more to reduce the burden on contractors. For now, the Final Rule and forthcoming changes to the definition of what constitutes a "Subcontract" will offer some relief, at least for commercial products and services.