DoD Limits Flowdown Clauses for Commercial Subcontracts

A new rule prohibits DoD prime contractors from flowing down non-mandatory *FAR* and *DFARS* clauses in subcontracts for commercial products and services.

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The federal government relies on its prime contractors to "flow down" certain requirements to subcontractors by incorporating *FAR* and *DFARS* clauses in their subcontracts. This is a critical component of subcontract and supply chain management policy for any contractor that does business with the government.

It is common practice for prime contractors to satisfy their flowdown obligations by incorporating many or even all *FAR* and *DFARS* clauses in their subcontracts, including clauses that are not mandatory. This "kitchen sink" approach to flowdowns simplifies compliance for prime contractors, but it places a significant burden on subcontractors throughout the supply chain.

That burden is particularly acute for small companies that provide commercial products and services. Indeed, onerous regulatory compliance burdens are among the major factors that have contributed to a shrinking defense industrial base.

In the National Defense Authorization Act of Fiscal Year 2017, Congress sought to address this issue by prohibiting the inclusion of non-mandatory flowdown clauses in subcontracts for commercial items.[1] In late 2023, the Department of Defense (DoD) published a long-awaited final

rule to implement this statutory requirement.[2]

The new rule represents one of the most significant shifts in subcontract management policy in recent memory. Unlike the previous regime governing flowdown clauses, the new rule codified at DFARS 252.244-7000 clearly prohibits prime contractors from flowing down non-mandatory clauses in subcontracts for commercial products and services.

This rule is intended to minimize the regulatory compliance burdens on commercial subcontractors by clarifying that they should only be required to comply with a finite number of specific *FAR* and *DFARS* clauses. It is critical for prime contractors and subcontractors to understand the implications of this new rule.

The Old Flowdown Regime

The previous version of DFARS 252.244-7000 stated that the prime contractor was not required to flow down any clauses "unless so specified in the particular clause."[3] However, prime contractors also had discretion to flow down "a minimal number of additional clauses necessary to satisfy its contractual obligation."[4]

The relevant *FAR* clauses similarly permit prime contractors to include "a minimal number of additional clauses."[5]

The permissive language under the old version of DFARS 252.244-7000 gave prime contractors substantial flexibility to include non-mandatory clauses. And, because that clause did not clearly specify the "minimal number of additional clauses" that could be included, many prime contractors would routinely flow down numerous FAR and DFARS clauses in their subcontracts for commercial products and services.

This approach makes compliance easier for prime contractors because it avoids the need to specifically identify the applicable *FAR* and *DFARS* clauses. It also simplified subcontract management because prime contractors could include the same clauses in both commercial and non-commercial subcontracts.

From the subcontractor's perspective, the "kitchen sink" approach to flowdowns creates additional unnecessary compliance obligations. Moreover, when prime contractors incorporate a long list of clauses by reference, it is especially difficult for subcontractors to identify and understand what requirements may be applicable to their subcontracts.

The New *DFARS* Rule

The final rule represents a paradigm shift in DoD subcontracting policy. It amends DFARS 252.244-7000 to unequivocally prohibit the flowdown of *FAR* and *DFARS* clauses to commercial subcontracts unless explicitly mandated by regulation.

Specifically, the new clause states that "[t]he Contractor *shall not* include" any *FAR* or *DFARS* clauses in its subcontracts for commercial products and services unless inclusion of the clause is mandatory.[6] The *DFARS* clauses that must be included are specified in the particular clause.[7]

The required *FAR* clauses are listed at FAR 12.301(d), or specified at FAR 52.215-5(e)(1) or FAR 52.244-6, as applicable.[8] These clauses include a limited number of requirements that the government has deemed important enough to mandate in all commercial subcontracts.

The clause at DFARS 252.244-7000 is one of the mandatory *DFARS* clauses that must be flowed down to subcontracts. As a result, subcontractors are also prohibited from flowing down non-mandatory clauses to their lower-tier subcontractors.

The final rule also amended the *DFARS* to prohibit contracting officers from including *FAR* or *DFARS* clauses in prime contracts for commercial products and services "unless required by the *FAR* or *DFARS* or consistent with customary commercial practices."[9]

This makes clear that non-mandatory *FAR* and *DFARS* clauses should be used sparingly, and only if the clause is consistent with commercial practices that are relevant to the products or services at issue.

New Compliance Obligations

The new *DFARS* clause, which took effect November 17, 2023, is beginning to find its way into DoD contracts, requiring contractors to adjust their subcontract flowdown policies.

Contractors that have historically used a "kitchen sink" approach to flowdowns are at risk of breaching their contracts if they do not revise their policies in accordance with DFARS 252.244-7000.

Notably, DoD may review subcontract flowdown clauses in connection with the review of a contractor's purchasing system if the prime contract includes DFARS 252.244-7001.

That clause specifically provides that DoD may review whether the contractor maintains adequate "policies and procedures to ensure orders and subcontracts contain mandatory and applicable flowdown clauses."[10]

Thus, contractors may be at risk of a finding that their purchasing systems are deficient if their commercial subcontracts include non-mandatory flowdowns.

Although DFARS 252.244-7000 prohibits certain flowdown clauses, it does not prevent prime contractors from including commercial clauses in their subcontracts that address similar issues.

If prime contractors previously relied on non-mandatory flowdown clauses, they should consider drafting commercial alternatives to ensure that those subjects are adequately addressed in their subcontracts.

This includes, for example, clauses that address the parties' rights and obligations with respect to terminations for convenience, which are among the "non-mandatory" flowdown clauses prohibited by DFARS 252.244-7000.

Prime contractors also need to evaluate whether they will adopt different subcontract flowdown policies for their DoD and civilian agency contracts. Because the new rule only applies to DoD contracts, civilian agency prime contractors may continue to flow down non-mandatory clauses in their commercial subcontracts.

It appears likely, however, that the FAR Council will eventually adopt similar restrictions on the use of non-mandatory flowdown clauses.[11]

More Leverage for Subcontractors

The new *DFARS* rule represents a major victory for companies that provide commercial products and services to DoD prime contractors. The rule gives commercial subcontractors much greater leverage in their negotiations with prime contractors regarding the inclusion of *FAR* and *DFARS* clauses in their subcontracts.

In the past, commercial subcontractors often had to accept a long list of non-mandatory flowdown clauses to satisfy prime contractors that typically have more bargaining power than their lower-tier suppliers. Now, commercial subcontractors can point to DFARS 252.244-7000 as legal authority for striking any non-mandatory clause from their subcontracts.

This is a welcome development for many subcontractors that are keen to minimize the regulatory burdens imposed on their businesses via flowdown clauses. While this rule is not a panacea for small commercial providers, it is an important step in the right direction that should ease the cost and administrative complexity of doing business in the DoD supply chain.

Conclusion

The new *DFARS* rule will require an overhaul of subcontracting flowdown practices for many DoD contractors. Prime contractors must adapt their standard subcontract flowdown terms to align with DFARS 252.244-7000.

Any prime contractors that continue to include non-mandatory flowdown clauses in their subcontracts are at risk of violating their prime contract obligations. Subcontractors should use the new rule as a negotiating tool to eliminate non-mandatory clauses that higher-tier contractors may seek to impose in their subcontracts. **CM**

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ENDNOTES

1 Pub. L. 114–328; see also 10 U.S.C. 3452.
2 88 Fed. Reg. 80462 (Nov. 17, 2023).
3 DFARS 252.244-7000(a) (SEP 2020).
4 DFARS 252.244-7000(b) (SEP 2020).
5 See FAR 52.212-5(e)(2); FAR 52.244-6(c)(2).
6 DFARS 252.244-7000(a) (NOV 2023)
7 DFARS 252.244-7000(a)(1) (NOV 2023).
8 DFARS 252.244-7000(a)(2) (NOV 2023).
9 DFARS 212.301(f).
10 DFARS 252.244-7001(c)(19).
11 See FAR Case No. 2018-006 (stating that the contemplated rule would provide "a new approach to the prescription and flowdown for provisions and clauses applicable to acquisitions of commercial items or acquisitions that do not exceed the simplified acquisition threshold.")