If you are a prime contractor you are expected to monitor, oversee, and administer your subcontracts.

We've written before about DCAA's wrongheaded (and judicially dismissed) notions of what that means. We've written before about what a subcontractor is (and is not); and, while admitting that the definition of what is a "subcontractor" is context-dependent, we've also skewed toward the interpretation that a "subcontractor" is an external supplier providing goods and/or services called-forth in a prime contract Statement of Work (SOW). Thus: this article isn't about those topics. Take them as a given. If you need to know more, do a keyword search on the home page and find those articles. (Trust us, we've written *extensively* about subcontractor management on this site.)

This article is about prime contractor management of changes that arise during performance of a subcontract. Changes happen; they are a fact of life, especially in the government contracting environment. The subcontract you've awarded is often not the subcontract that gets performed, especially in a development or immature production situation. Things change and often they change frequently; and it is incumbent on the prime to have a subcontractor change management strategy in place before contract (or *sub*contract) performance starts.

As we've noted before, some prime contractors think they are effectively managing the impacts of subcontractor changes by awarding only firm, fixed-price subcontracts. They issue FFP subcontracts and they assume the price is fixed—*and it is*!. But only for the priced work. If the work changes, then the subcontractor is entitled to an "equitable adjustment" in the contract price.

Interestingly, the value of the subcontract equitable adjustment varies depending on whether or not the subcontract is for procurement of "commercial items" (as that phrase is defined in FAR 2.101). If the prime contractor has made a Commercial Item Determination (CID) and awarded a "commercial subcontract," then there is one course of action to be taken when a subcontractor asserts its subcontract has been changed and therefore it is entitled to an equitable adjustment of contract price; and if the subcontract is not a "commercial subcontract," then there is an entirely different course of action to be taken.

The cause of the differences noted above are found in the differing language of the "Changes"

clause found it the different contract types. There is one “Changes” clause for commercial subcontractors and another, entirely different, “Changes” clause for non-commercial subcontracts.

The Changes clause in each contract is what gives the customer the authority to make changes to the performance requirements after contract award. Absent that language, the government would be stuck with exactly what it initially contracted for, even if it no longer needed it. But the Changes clause establishes the right of the government to make changes, and it establishes the right of the contractor to be make whole from those changes.

As the Defense Acquisition University (DAU) states on its website:

Contract modifications (frequently referred to as ‘mods’) are common actions for many contracting professionals. These changes may be related to contract cost, delivery schedule, schedule, fee, terms and conditions, and personnel. Changing technologies, funding, and mission requirements may create the need for changes to a contract. The complexity of contracts—which can involve numerous people from different functional areas on both the Government and contractor teams — can lead to misinterpretations and miscommunications of requirements and administrative issues that do not become evident until the contract is under way. Whenever the Government wants something different than was originally envisioned for the original contract or something unforeseen occurs, a modification may become necessary. ….

When dealing with non-commercial subcontracts, there are several different Changes clauses to choose from, depending on contract type. The clauses are numbered from 52.243-1 to 52.243-5. However, there is only one Changes clause for commercial subcontracts, and that is 52.212-4.

As the DAU site explains—

Contracts for non-commercial items may be modified by use of a change order, which is a unilateral order signed by the contracting officer directing the contractor to make changes using the authority of the various Changes clauses. If the change order causes an increase or decrease in the cost of, or time required for, performance of any part of the work under the

contract, the contracting officer must make an equitable adjustment in the contract price, the delivery schedule, or both. …

A contracting officer may need to issue an out-of-scope modification. This can occur if the Government requires an increase or decrease in the scope of work beyond what is contained in the statement of work, and which will result in a change to the cost of the contract. In such cases, the modification is considered 'bilateral' and must be agreed to and signed by both the Government and the contractor.

Right away, we can see that there are two types of changes in the world of non-commercial subcontracts: there are in-scope changes (which can be issued unilaterally), and there are out-of-scope changes (which must be agreed-to by both contracting parties). There is also a third type of change (constructive) but the government doesn't like to admit those ever happen and, since constructive changes aren't germane to this article, we're going to skip them.

The key takeaway from the discussion of changes to non-commercial contracts (or *sub*contract s) is that both types of changes, whether they result from a unilateral change order or a bilateral agreement of the parties, entitle the contractor to an equitable adjustment in contract price. The contractor will be made whole from the increased cost of performance. Or, to make it more on-point with this article:
the subcontractor will be made whole by the prime contractor for its increased cost of performance, if the cost increase stems from changes made by the prime.

Importantly, the basis for the equitable change in contract price to the non-commercial subcontract is the change to the subcontractor's *costs*. For example, contract clause 52.243-1 (Changes-Fixed Price, Aug. 1987) states "If any … change causes an increase or decrease in the cost of, or the time required for, performance of any part of the work under this contract … the Contracting Officer shall make an equitable adjustment in the contract price, the delivery schedule, or both, and shall modify the contract." Obviously, in order to determine the value of the equitable adjustment, the subcontractor must submit a separate proposal that establishes the amount by which its costs have been increased as the result of the change (or changes) made by the prime contractor.

Remember, the subcontract has already been awarded. Competition (if any) has ended. Consequently, any post-award changes made to the contract will be made on a single-source basis. This means that if the subcontractor's change proposal exceeds the TINA threshold

(currently $2 million) then the prime contractor will be looking for certified cost or pricing data from the subcontractor. The process of preparing a change proposal in the format required by FAR 15.408 (Table 15-2) and providing cost or pricing data for analysis, and then analyzing the cost or pricing data, and then negotiating an “equitable” adjustment to the subcontract price, may be a long and resource-intensive process.

Which is why we wrote at the beginning of this article that the prime contractor must have a subcontractor change management process established and implemented before subcontractor performance starts.

All the above is for non-commercial subcontracts; as we stated, the process is different for commercial subcontracts. The commercial contract (or subcontract) clause 52.212-4(c) states “Changes in the terms and conditions of this contract may be made only by written agreement of the parties.” Right there, the commercial subcontract states that the prime contractor does *no t*
have the right to issue unilateral change orders; the commercial contract may only be changed via bilateral agreement. As the DAU site notes, if the parties do agree on a change, the result is not a contract mod; instead, the result is a “supplemental agreement.” (We confess that the nuances of the terms escape us.)

But what about pricing changes associated with commercial subcontracts?

Generally, a commercial item or service is being acquired at a price, and price analysis is the technique used to determine that the price is fair and reasonable. Thus, equitable adjustments to commercial contracts and subcontracts may be made on the basis of price, and the (sub)contractor’s costs can be irrelevant. But there's a hierarchy to be followed ....

FAR 15.403-1 clearly states that commercial items are exempt from the requirements to provide certified cost or pricing data. (“Any acquisition of an item that the contracting officer determines meets the commercial item definition in 2.101, or any modification … that does not change the item from a commercial item to a noncommercial item, is exempt from the requirement for certified cost or pricing data.”) However, commercial item contractors (and subcontractors) may be asked to provide information other than certified cost or pricing data to support a determination that the proposed price is fair and reasonable.

The DoD Commercial Item **Handbook** , Part B ("Commercial Item Pricing") provides a clear hierarchy of information that may be used to support a determination that the commercial item price is fair and reasonable. The first source is market research, which is obvious because if the item isn't being sold to the public, then why is it a commercial item? The second source is "public resources other than the offeror," and the Handbook provides an extensive list of sources that may be used. Only if the first two sources don't provide sufficient information (as may happen if the item is merely offered for sale but no sales have yet occurred) should the contracting officer (or prime contract buyer) turn toward the third source (the offeror itself) to obtain additional, noncertified, cost or pricing data. The (sub)contractor may, in certain circumstances, be asked to provide uncertified cost data.

If the offeror is asked to provide data, the Handbook clearly emphasizes price information rather than cost information. However, price information is insufficient, the Handbook recognizes that commercial suppliers may not have the ability to provide detailed cost information in the manner the analyst may wish. It states "When obtaining uncertified cost data on commercial items, requests should not impose undue requirements on the offerors to provide data that is not normally maintained in the offeror's business operation."

We asserted above that an equitable adjustment to a commercial contract or subcontract is, generally, valued at price without respect to costs incurred, whereas an equitable adjustment to a non-commercial (sub)contract price is valued on the basis of costs incurred related to the change. Readers may reasonably ask us to support that assertion. Where in the FAR or DFARS does it say that? Where in the DoD Commercial Item Handbook does it say that?

Well, nowhere really. Remember, the FAR and DFARS and the DoD Commercial Item Handbook are not written for prime contractors managing subcontractors. Those documents are written for government contracting officers managing prime contractors. Accordingly, one must "read between the lines" to figure out that a prime contractor may value a change to a commercial subcontract on the basis of price rather than cost, unless there is some unique circumstance that drives the use of cost data. Certainly, where the commercial subcontract has been valued at priced units, acquiring more (or less) units than planned is easy to value. But sometimes it's not that clear.

In the next article, we'll discuss two ASBCA cases that clarify the principles associated with subcontractor change management. Those two cases will (hopefully) show the differences in valuing commercial (sub)contracts and non-commercial (sub)contracts. In one case, the prime contractor's mishandling of subcontractor changes cost it millions of dollars. In the other case, the government's mishandling of changes to a commercial prime contract cost it $240 million.

Stay tuned.