Grabbing the Lion by the Tail: Pass-Through Claims and Liquidating Agreements

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I. INTRODUCTION

Most construction contractors will deal with pass-through claims and liquidating agreements at some point in their career. Others will be constantly involved with them. Despite the relative ubiquity of liquidating agreements, they are often overlooked as a means of controlling the risk in owner disputes. The purpose of this paper is to highlight some of the purposes for liquidating agreements and to discuss from the different parties’ perspectives particular issues that arise in drafting liquidating agreements.

Towards that end Section II of this paper discusses the need for liquidating agreements generally as a means of limiting duplicative litigation and controlling risk with a particular focus on the Severin Doctrine. Section III defines what liquidating agreements are and some of the standard terms. Section IV attempts to highlight particular issues in drafting liquidating agreements from the subcontractor’s perspective and provide sample alternate clauses. Section V approaches drafting liquidating agreements from the prime’s perspective. Finally, Section VI of the paper looks at the owner’s defenses to pass through claims, where the claim is brought pursuant to a liquidating agreement.

II. THE SEVERIN DOCTRINE, ITS EXCEPTIONS AND THE NEED FOR LIQUIDATING AGREEMENTS.

As is typically the case in the construction context, the project owner—whether a governmental entity or a private owner—enters into a contract with the prime contractor, who is then responsible for the overall coordination of the project. The prime contractor then hires the various subcontractors to perform specified portions of the work. The prime thus operates at the center of the owner/prime/subcontractor trio because it alone has contractual privity with both the individual subcontractors and the project owner.
Subcontractors, lacking a contractual relationship with the owner, have no privity of contract with the owner, and this fact can prove problematic for a subcontractor who believes it has a claim for damages against the owner. Indeed, the lack of privity can leave a subcontractor without recourse against the owner, the effect of which may be that the subcontractor seeks relief from parties other than those ultimately responsible for the subcontractor’s loss.

A. The Severin Doctrine and Its Exceptions

Under certain circumstances, particularly in the federal arena, the ability to assert a pass-through claim is limited. The most well-known and significant limitation is imposed by the Severin Doctrine, which takes its name from the case of Severin v. United States.\(^1\) *Severin* held that a subcontractor cannot sue the government directly due to the lack of privity between the parties, and further that a prime cannot sue an owner on behalf of a subcontractor to recover monies due to the subcontractor unless the prime is itself liable to the subcontractor. Consequently, the *Severin* Doctrine mandates that recovery against an owner cannot be had where a subcontract or a release of liability expressly negates the prime’s liability to the subcontractor for the owner’s actions. In other words, if the prime has no liability of its own to the subcontractor, then it cannot bring a breach of contract claim against the owner on the subcontractor’s behalf.

The *Severin* Doctrine remains established law in claims involving the federal government on the basis that the government has waived its sovereign immunity only as to claims for which privity of contract exists. A pass-through claim that does not involve a prime’s own contractual liability to the subcontractor (and thus the prime’s own
potential for loss based upon the owner’s actions) is not actionable against the federal government.²

Over time, however, the strict application of the Severin Doctrine has been eased:

First, the Severin Doctrine is an affirmative defense and its application can be waived by the federal government’s failure to assert Severin’s applicability.

Second, the doctrine only bars claims brought for breach of contract, as compared with requests for “equitable adjustment.”³⁴

Third, today the doctrine is of limited effect because it can usually be avoided by contract. Liquidating agreements, sponsorship agreements, and other similar agreements often include a conditional release that limits the subcontractor’s recovery to the amount that the prime recovers from the government. But agreements that contain a water-tight release of prime liability can still find a subcontractor’s claim barred by Severin. One example is the “no damage for delay” clause contained in many subcontracts that state that the prime shall not be liable to the subcontractor for any loss, damage, detention, or delay caused by the owner.⁵ But in the absence of an “iron-bound release” by the subcontractor of all claims against the prime, Severin will not operate as a bar.⁶

The Severin Doctrine has been applied outside of the federal context to owners who are private entities or connected with state government. However, at least one court has stated that Severin’s reach should be limited to projects involving the federal government because the original case was premised on the federal government’s limited waiver of sovereign immunity as to parties in privity with it.⁷

B. The Need for Pass-Through Agreements
Enter the pass-through claim to the rescue. A pass-through claim is a claim “(1) by a party that has suffered damages; (2) against a responsible party with whom it has no contract; (3) presented through in intervening party, such as a contractor, who has a contractual relationship with both.”8 Stated differently, the claim is presented, or “passed through,” by an intervening party who is in privity with both the other parties.

Pass-through claims are premised on the concept that the owner is liable to the prime for harm to the subcontractor. Additionally, the prime’s right of recovery is premised on the fact that it is liable to the subcontractor for harm caused by the owner. Thus, so long as the owner’s actions make both the owner liable to the prime and the prime liable to the subcontractor, a pass-through claim may be asserted.

Pass-through claims and liquidating agreements are an efficient and practical way to streamline the litigation process and facilitate the resolution of contractual disputes. Without a liquidating agreement in place, the subcontractor would be obligated to bring its claims directly against the prime, who in turn would have to sue the owner. This arrangement requires the involvement of additional parties, and as a result is expensive, time-consuming, and could erode potential recovery. Liquidating agreements thus provide a vehicle for dispute resolution between a prime and a subcontractor where the parties jointly focus on recovery from the owner.

Liquidating agreements also enable the prime and subcontractor to align their common interests in a single claim against the owner instead of litigating amongst themselves and eroding their potential recoveries. The prime and subcontractor can work together in a non-adversarial fashion to present the testimony and documents that support
their claim against the owner. Liquidating agreements thus provide both strategic and financial benefit.

The benefit to the prime is that it quantifies and contains its liability, and eliminates the chance that the prime will have to engage in litigation or arbitration not only with subcontractor, but also with the owner. The benefit to the subcontractor is that it is able to proceed directly against the owner. A subcontractor with a small claim relative to an over-all project claim may benefit from the greater resources available to the prime while minimizing its own costs.

Liquidating agreements also may be useful to the subcontractor where the prime is experiencing financial hardship, or where the subcontractor knows that the prime is not at fault. Where parties align to bring claims in a harmonized fashion, there is less of a chance of inconsistent judicial results or recovery, which in turn promotes judicial efficiency. An additional benefit of pass-through claims and agreements, from the viewpoint of subcontractors and primes, is that it prevents owners from avoiding liability to subcontractors due to the privity “shield.”

Pass-through claims have been asserted against the federal government, states governments, municipalities, and private entities and individuals. As of 2013, twenty-three states have followed the federal government’s lead in allowing pass-through claims. III. WHAT ARE PASS-THROUGH AGREEMENT/LIQUIDATING AGREEMENTS?

A pass-through agreement, also called a “liquidating agreement,” is used frequently by contractors and subcontractors in addressing construction disputes. These agreements are essentially a form of settlement agreement in which a dispute between two parties is settled (“liquidated”) based on terms that establish the rights and
obligations of the involved parties. What is being “passed-through” in a liquidating agreement is not simply the subcontractor’s claim against the owner, but also the prime’s liability to the subcontractor on that claim. Such agreements not only contain the prime’s assent to turn over to the subcontractor whatever recovery, if any, it secures from the owner, but they also limit the exposure of the prime to the subcontractor should the pass-through claim fail.

Liquidating agreements facilitate the ability of the prime to present a pass-through claim directly to an owner because the parties will already have established the procedures needed for the prime to “sponsor” the subcontractor’s claim and bring it directly against the owner. The prime can either bring the claim personally on behalf of the subcontractor, or the subcontractor can prosecute the claim in the prime’s name. The agreement does not settle the issue of liability or damages between the subcontractor and owner, but merely sets a limit upon recoverable damages once the owner’s liability and damages, if any, are established.

The liquidating agreement also includes the implied covenant of good faith and fair dealing. This covenant requires the prime to take all reasonable steps to protect the subcontractor’s rights to an eventual recovery, if any, from the owner. Courts have interpreted this covenant to mean that the prime has a duty to make a good faith effort to present the subcontractor’s claim in a fair and serious manner.⁹

Pass-through agreements can take many forms. Although oral pass-through agreements have been enforced, a written agreement is more legally sound.¹⁰ There is no requirement that a liquidating agreement be part of the original subcontract. Rather, “the general contractor may assume liability for pass-through claims of the subcontractor by
way of a separate liquidating agreement.” That being said, a subcontract agreement is drawn up long before litigation and may not reflect the needs and wants of the parties by the time a claim has presented itself. Thus, a separate agreement that includes a provision iterating the parties’ intent to supersede any conflicting subcontract provisions is advisable. Courts have accepted that a pass-through agreement may alter the rights and obligations of the parties as imposed by the subcontract.

A well-drafted liquidating agreement provides that the subcontractor will release (liquidate) all claims it may have against the prime in exchange for the prime’s promise to pursue the subcontractor’s claim against the owner. A well-drafted liquidating agreement will hit upon numerous important points, but it must provide for three basic elements, as noted in Rad & D’Aprile, Inc. v. Arnell Const. Co.:

(1) the imposition of liability upon the general contractor for the subcontractor’s increased costs, thereby providing the general contractor with a basis for legal action against the owner; (2) a liquidation of liability in the amount of the general contractor’s recovery against the owner; and, (3) a provision that provides for the pass-through of that recovery to the subcontractor.

With these three elements in mind, a well-drafted liquidating agreement should include the following:

1. **Identification of the parties** to be bound by the agreement. In addition to the prime and subcontractor, the drafter should consider other parties such as sureties, sub-subcontractors and suppliers.

2. **Identification of the claim(s)** to be passed-through.

3. “**For and on behalf of**” language. In Owens-Corning Fiberglass Corp. v. United States, the court noted that language indicating that the subcontractor would pursue its claim “by and through” the prime created confusion as to whether the
subcontractor’s claim actually passed through the prime. As such, parties should use the words “for and on behalf of” the subcontractor because this language unequivocally establishes the parties’ intent to pass the subcontractor’s claim through to the owner.

4. **Provision of imposition of some liability upon the prime for the subcontractor’s increased costs.** It is this imposition of liability that creates a basis of legal action against the owner. The prime must remain liable to the subcontractor until such time as the prime has turned over the subcontractor’s share of recovery. This prevents problems with the *Severin* Doctrine. Care should be taken to be sure that a separate agreement, if any, does not grant the prime a complete release.

5. **Liquidated Damages.** Frequently the prime will want to limit its damages to those recovered from the owner. But the parties can also agree otherwise; for instance, the prime may make a contribution to the damages claimed in addition to the amount recovered from the owner.

6. **A trigger provision.** The agreement must contain a trigger provision that provides for the pass-through of the recovery to the subcontractor. The “payment trigger” is the event that requires the prime to pay the subcontractor. The trigger may be when the claim has been resolved, or when the prime actually receives payment from the owner.

7. **Good faith.** The agreement should bind the prime to act in good faith and undertake all reasonable steps to procure payment from the owner to the subcontractor. In the absence of good faith, the agreement can provide that the prime is liable for all of the subcontractor’s damages.

8. **Attorneys’ fees.** If the subcontractor pursues the pass-through claim in the name of the general contractor, the subcontractor will bear all of the attorneys’ fees.
However, if the prime bears responsibility for pursuing the claim, it will likely want to share attorneys’ fees with the subcontractor.

9. **Payment of costs.** Who is responsible for fees (filing, experts)? One possibility is for the parties to share the costs proportionally based on each party’s pro-rata share of the claim amount.

10. **Cooperation obligations.** The agreement should address who is responsible for various aspects of the claim, as well as their various obligations to each other. The agreement can contain a “good faith” or “best efforts” clause that requires the parties to use their best efforts, in good faith, to quickly pursue the pass-through claim.

11. **Settlement authority.** The agreement should address who has settlement authority in several kinds of scenarios and at various stages of the claim process. These are discussed later in the paper.

12. **Extent of prime’s role.** The agreement should touch on the prime’s obligation towards the subcontractor’s claim. In other words, is the prime contractor simply obligated to pass-through the claim to the owner and then be done, or does the prime remain obligated to pursue the claim through litigation, arbitration, or on appeal?

13. **Release language.** The prime will want a complete release from the subcontractor such that the prime’s (and its payment bond surety’s) only liability to the subcontractor is the amount recovered from the owner relative to the subcontractor’s pass-through claim. The key to the release language, however, is that it becomes operable only when the prime prosecutes the claim against the owner to final judgment.

**IV. ISSUES PERTAINING TO SUBCONTRACTORS IN PASS-THROUGH/LIQUIDATING AGREEMENTS**
The road to the City of Emeralds is paved with yellow brick,” said the Witch, “so you cannot miss it.”¹⁶

Like Dorothy, a subcontractor with a claim arising out of some act or omission by a devious owner finds itself not in Kansas anymore and with no apparent way home. The path to recovery in these instances frequently runs through the prime in the form of the liquidating agreement. There are particular issues with these agreements however for subcontractors, regardless of the benefits to the subcontractor.

A. Who Will Present and Control the Claim?

Many subcontracts require that subcontractors pass any claims related to acts or omissions of the owner through the prime. Frequently, however, they do not express in any detail how those claims will proceed or who will present the claims. Sample language might read as follows:

In the event the Subcontractor asserts that it should receive additional compensation because of an act or omission on the Owner’s part, or someone for whom the Owner is responsible, the Subcontractor shall promptly submit the claim to the Contractor in writing at least three (3) working days before the date the Contractor is required to submit such claims under the Prime Contract. If timely submitted with all documentation required by the Prime Contract, the Contractor will, on behalf of the Subcontractor, submit the same to the Owner for its consideration.

The clause is good as far as it goes, but issues arise where the owner disputes entitlement or compensation under the pass-through claim and pursuit of the claim requires further efforts, including litigation. Under the subcontract the contractor was required to present the timely submitted pass-through claim to the owner, which it has done, but now what?
Where the subcontractor or the contractor wishes to pursue the claim beyond mere presentation to the owner, the subcontract is frequently silent as to how this will be accomplished. In such instances, the subcontractor may want to request the ability to pursue its pass-through claim on its own in the name of the contractor so that it can present and control its own claim.

Several issues arise in trying to negotiate the ability to directly pursue a pass-through claim in the name of the contractor. Where the subcontractor’s claim is discrete and no other disputes between contractor and owner exist, it may be possible to obtain permission from the contractor to simply pursue the claim in the contractor’s name. In fact, some subcontracts take this as a default position. This avoids the contractor incurring costs in pursuing a claim in which it has little interest. Where, however, the pass-through claim also involves contractor or other subcontractor claims arising from the same facts or where there are other disputes between the owner and contractor it becomes much more difficult, if not impossible, to pursue the claim in the name of the contractor. The subcontractor may not have the project knowledge to adequately pursue the contractor’s portion of the claim. Similarly, because of the likelihood that the owner will assert offsetting claims, some of which do not arise from the subcontractor’s work, the prime will not want to leave the dispute to the subcontractor alone.

Where the subcontractor cannot obtain the right to pursue the claim directly in the contractor’s name an effort should be made to establish in any liquidating agreement that will pursue and control the presentation of the pass-through claim. Often the preferred resolution for the subcontractor would be an agreement whereby the subcontractor retains its own counsel to prepare and present its portion of the claim to the owner and where, as
a result of the subcontractor presenting its own claim, it does not share in or limits its share in the fees and costs incurred by the contractor. An example of this allocation is as follows:

Contractor shall retain and pay for its current counsel and experts to analyze and present its entitlement issues against Owner in the Arbitration (the “Prosecution Costs”). Subcontractor shall be responsible for all of its own fees and costs incurred to support and present its Subcontractor Claims at the Arbitration, including, but not limited to, its own attorneys’ and expert(s) fees. Contractor shall advance the Prosecution Costs and shall allocate to Subcontractor its pro rata share of the Prosecution Costs based on the percentage that Subcontractor’s damages represent of the total Claim, after deduction of any Contractor markup on Subcontractor Claim and less any fees or costs incurred by Subcontractor in its own behalf in supporting and presenting the Subcontractor Claim.

Retention of separate counsel however, is only beneficial where the dollar value of the pass-through claim is sufficiently large to justify the additional cost. Where the dollar value of the pass-through claim is not large enough the claim should either be dropped or the subcontractor’s focus should shift to limiting its downside risk for the contractor’s costs in presenting the overall claim to the owner. The following provision accomplishes that goal “In no instance shall Subcontractor owe Contractor more for its share of prosecution costs then Subcontractor actually recovers pursuant to this Agreement.”

B. Who Has the Authority to Settle the Claim?

Assuming that the parties can reach an agreement on who will present and pursue the claim at some point during the claim process there will likely be an attempt to mediate or otherwise settle the claim. Who is going to have the authority to decide whether or not to settle the pass-through portion of the claim?
If the claim is purely the pass-through claim this is a relatively simple issue to resolve. It is much more difficult, however, where the pass-through claim is one of several claims being asserted in a single forum, or where the owner is asserting offsets or counterclaims which may or may not relate to the work performed by the subcontractor. The subcontractor could attempt to reserve the ability to control settlement of at least its pass-through claims, however, this is almost always futile.

If the subcontractor cannot negotiate a right to accept or reject any settlement of the pass-through claim, it should seek to limit any reduction in its recovery on the pass-through claim as a result of the settlement due to claims not related to the subcontractor’s work. A standard approach to determining the amount of recovery on a pass-through claim where it is part of a more complex or larger claim resolved through settlement is to allocate recovery based on the relationship between the dollar value of the pass-through claim and the dollar value of the overall claim. Such an approach may be inequitable to the subcontractor where the owner has limited defenses to the pass-through claim, but the remainder of the overall claim is of dubious validity or where the owner has offsetting claims that arise largely from the acts or omissions of the contractor or other subcontractors and suppliers for whom the subcontractor is not responsible. In this situation, the overall settlement value may reflect a much lower percentage recovery of the overall claim than would have been possible if the pass-through claim had been resolved separately. It may be wise to negotiate that in any settlement or mediation the pass-through claim be separately identified and included as a line item in the settlement.

An alternate approach, with its own difficulties, is to grant the contractor the authority and discretion to settle the pass-through claim, but preserve the right of the
subcontractor to contest the allocation of the settlement amount to the pass-through claim. Such an approach has the obvious downside that settlement of the overall claim does not end the dispute as between the contractor and the subcontractor. It may be an acceptable resolution however where settlement of the claims against the owner is believed to be compromised due to acts of the contractor or other subcontractors thus creating the potential for a lower recovery on the pass-through claim than would be anticipated. In this situation thought should be given to establishing the settlement amount on the pass-through claim as presumptively reasonable and allocating any additional costs and fees as a result of continued dispute proceedings based on whether the amount ultimately recovered on the claim is more or less than the amount recovered through settlement.

C. Right to Appeal an Interim Decision

Subcontracts frequently require the contractor to present subcontractor’s claims arising from the owner’s acts or omissions, but are silent as to what happens after. The purpose of a liquidating agreement is normally to specify how the claim will proceed in any dispute resolution process. Unfortunately, many liquidating agreements do not address the process any further than the next immediate step in the dispute resolution process.

On a federal project, assuming that the contracting officer has rejected the claim, what happens if the subcontractor or contractor is unhappy with the decision at the Board of Contract Appeals or other initial review forum? Does it make a difference if the subcontractor does not wish to pursue the claim any further, but the contractor does? What if the subcontractor is unhappy with the resolution of the pass-through claim, but
the contractor does not wish to pursue a further challenge? What happens if the owner appeals?

Thought should be given to what the stages of the dispute resolution process are likely to be and how the resolution of the pass-through claim should be handled at each stage. In most liquidating agreements the subcontractor will be responsible for a share of the contractor’s fees and costs incurred in presenting the claim. The subcontractor will want to negotiate the ability to elect to accept an amount calculated in accordance with the liquidating agreement at the conclusion of each stage and avoid incurring additional costs.

It becomes more difficult however when the subcontractor or the owner is the one pushing for additional proceedings. In both instances, any agreement should address the difference in result depending on exactly what claims are appealed. If the only issue on appeal is the subcontractor pass-through claim, it may be possible for the subcontractor to continue to prosecute its claim, if it is paying all of the costs. Similarly, if the issues in the owner’s appeal do not relate to the pass-through claim or the subcontractor’s work, one should attempt to negotiate the ability to not participate in any further proceedings. Where, however, the claims on appeal remain intermixed the subcontractor may have to be satisfied with the resolution of its claim or with continuing to participate in the appeal.

D. Claim Certification

Liquidating agreements arose originally in the federal contracting arena and have since gained acceptance in most state courts. One particular aspect of pass-through claims, however, is the federal requirement that a contractor provide a certification of its
claim when that claim is for more than $100,000.00.\textsuperscript{19} The contractor passing through the claim to the government must make this certification.

A problem arises where the contractor and subcontractor do not agree as to whether the claim is actually due to the acts or omissions of the owner. Most subcontracts provide separate dispute resolution methods depending on whether the claim is ultimately attributable to the owner or the contractor. Frequently a subcontractor will assert claims directly against the contractor either because it does not know whether the claims are owner issues or because it is easier to pursue the claims directly against the contractor, but the contractor will allege that the claims are owner claims subject to the dispute resolution provisions of the prime contract.\textsuperscript{20} In such an instance the contractor may seek to stay and pass-through some or all of the subcontractor’s claims to the government, but must find a way to address the certification requirement. This is often done through the subcontractor certifying its claim.

Where a contractor is passing through a subcontractor claim it need only certify that the contractor believes that there is good grounds for the claim, not that the contractor believes the claim to be certain.\textsuperscript{21} Thus the certification has to certify that 1) the claim is made in good faith (good grounds for claim); 2) the supporting data are accurate and complete to the best of the contractor’s knowledge and belief; 3) the amount requested accurately reflects the amount the contractor believes the government is responsible for; and 4) the person is authorized to certify the claim on behalf of the contractor.\textsuperscript{22} The problem for the contractor is being able to certify that the subcontractor’s data is accurate and complete. The problem for the subcontractor is the certification that the amount requested is the amount for which the government is liable.
A subcontractor often may not know whether or not the government is the cause of the claim, or may even actively be claiming that it is the contractor, not the government’s, liability. For example, where the subcontractor’s claim is for delay related costs the subcontractor may not know the ultimate cause of the delay. Even where the claim relates to an obvious change on design build contracts, the contractor and government may dispute whether the change was made by the government or was the result of the failure of the design to comply with the government’s requirements. A solution may be a modified version of the FAR certification language:

I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment to which Subcontractor believes it is entitled and I am authorized to certify the claim on behalf of Subcontractor.

The subcontractor is thus certifying the amount of the claim and the supporting data for purposes of submission, but does not make any assertion as to whether the claim is actually the responsibility of the government. It is then up to the contractor to certify whether or not the government is responsible for the amounts claimed, which would conform with the subcontract provisions.

E. False Claims Liability

Often the contractor is concerned that it is passing through a claim for which it may be subject to false claims liability. The contractor’s false claims liability in connection with pass-through claims is discussed in another section of this paper. There is, however, the potential under a liquidating agreement that the subcontractor loses its
ability to recover on the pass-through claim because of problems with other claims asserted against the government.

In federal contracting, the submission of a claim, which includes a fraudulent claim, may result in the forfeiture of the entirety of the claim.\textsuperscript{23} The subcontractor thus runs a risk of losing any compensation for its claim as a result of falsification in some other portion of a combined claim. While this is obviously not a likely result, when negotiating a liquidating agreement the subcontractor should always attempt to include a provision addressing loss of recovery due to the acts of others. A savings clause may remedy the problem\textsuperscript{24}, but because it is difficult to take back the release simply as a result of non-recovery the focus should be on events that would prevent recovery, like false claims. Consider inclusion of a savings clause that allows the subcontractor to proceed with the claim directly against the contractor in the event that the pass-through claim is denied solely or primarily as a result of specific acts of the contractor or its other subcontractors.

\textbf{F. Subcontract Limitations on Pass-through Claims}

Subcontract terms can eliminate the ability to present pass-through claims under the \textit{Severin Doctrine}. Unfortunately, often attention is not paid to preserving the ability to present a pass-through claim at the front end in the subcontract negotiations and it is left to the parties to try and recover the ability after the fact in a liquidating agreement. Fortunately, the courts have backed away from strictly enforcing the bar of the \textit{Severin Doctrine}. Attention should still be paid however in drafting any liquidating agreement to providing the strongest position if the \textit{Severin Doctrine} is asserted as a defense.
Accordingly, careful attention should be paid to how the pass-through claim is expressed in the liquidating agreement. Courts have recognized that the *Severin Doctrine* does not apply where the claim seeks recovery of costs or time pursuant to the terms of the prime contract, rather than breach of the prime contract. In most subcontracts the prime contract provisions are incorporated by reference into the subcontract. Thus, when drafting a liquidating agreement counsel should specifically identify the provisions of the prime contract or the subcontract that allow for recovery and form the basis of the pass-through claim. For example, when negotiating a claim for delay damages the liquidating agreement could cite to the provisions of the prime contract allowing for equitable adjustments due to delay by the government, notwithstanding the fact that the subcontract may include a no damages for delay provision.

For subcontractors, a further precaution is often necessary in order to obtain the best possible chance of recovery. For subcontractors, that is to retain control over the briefing and argument on any *Severin Doctrine* defenses. While counsel for the contractor may be able to handle these arguments, as the effect of the *Severin Doctrine* is to insulate both the contractor and the government from liability the contractor has a reduced incentive to contest its application. Regardless of which party will handle the presentation of the claim generally an effort should be made to control presentation of any defense to application of the doctrine.

G. Limitations Through the Conduct of the Parties

It is not only the front-end subcontract negotiations that can prove to be a bar to a subcontractor’s recovery on a pass-through claim. The claim can also be barred by the subsequent acts of the contractor or subcontractor, whether intended or not. Obviously a
subcontractor may by its own conduct create a bar under the *Severin Doctrine* by executing a release fully relieving the contractor of any liability. However, “Post-Severin opinions often interpret releases and contracts very generously in order to let primes press their subs’ claims”. The same is not necessarily true, however, of actions by the contractor that may release or eliminate pass-through claims. A contractor may release an otherwise acceptable pass-through claim by failure to comply with the notice provisions contained in the prime contract. A contractor may also release a subcontractor’s pass-through claims through execution of a change order and release covering the same factual basis for recovery.

A subcontractor should therefore reserve in any liquidating agreement the ability to pursue the pass-through claims directly against the contractor or its surety in the event that the pass-through claim is barred by some act or omission by the contractor. This may be done with an exception to the release contained in the liquidating agreement as follows:

Notwithstanding any other provision of this Agreement, Subcontractor does not release Contractor from any claims where Subcontractor’s Claims to the Owner pursuant to this Agreement were denied as a result of the acts or omissions of Contractor or other subcontractors or suppliers for whom Subcontractor is not responsible.

**H. Who Will Be Bound?**

It is self-evident that in entering into a liquidating agreement the contractor and subcontractor bind themselves to the terms of the agreement. Is there anyone else who should be included in and be bound by the agreement?

Because the agreement liquidates liability based on some future event, the decision on the pass-through claim essentially stays any dispute between the contractor
and subcontractor until the occurrence of that event. It may result in the lapse of the limitations period for claims against either the subcontractor’s or the contractor’s surety. If the parties proceed strictly with a liquidating agreement there may also be no required notice to the sureties of potential claims. This is particularly true where the pass-through claim actually or potentially includes claims for damages by the contractor or where the owner is asserting offsets as a result of the subcontractor’s work. In either case, at the conclusion of the litigation of the pass-through claim, there may be a determination that one or the other of the parties is liable for amounts not solely the result of owner actions. If the surety is not a party to the liquidating agreement recovery of such liability may have been impaired. Even where the dispute is limited to a truly owner caused issue and the liquidating agreement provides for the contractor to make payment to the subcontractor upon receipt of funds from the owner, what if the contractor can’t or doesn’t pass through the payment or files for bankruptcy protection during the claims process? Based on these and other concerns an effort should be made to bind any sureties to the results of the liquidating agreement and to stay any statutes of repose, statutes of limitations or other limitation periods.

Liquidating agreements can be beneficial to contractors since they limit duplicative litigation and release claims other than to the extent recovered from the owner. For the same reason, a subcontractor should consider trying to include major sub-subcontractors or suppliers in any liquidating agreement.

I. How Will the Damages Be Liquidated?

One of the most important terms in any liquidating agreement is exactly how the damages will be liquidated and when they will be paid. Particular attention should
therefore be paid to the drafting of these provisions. As indicated earlier the standard means of providing for liquidating are either to tie the liquidated amount to the amount recovered on the pass-through claim, or, to provide for a pro rata distribution.

Each of these can present problems that should be addressed in drafting the agreement. While the liquidating agreement may bind the parties, it is not binding on any court, arbitrator, mediator or other decision maker. Thus, a liquidating agreement that simply provides for the contractor to pay the subcontractor the amount recovered on the pass-through claim may suffer from an inability to determine how much was recovered when the claim was one of many claims in an undifferentiated award.

Moreover, even where the number and amount of claims are limited, it may present difficulties where the contractor asserts its own claim for markup on the pass-through claim and the markup is challenged by the owner. Any potential ambiguity may be partially addressed through a provision requiring that the pass-through claim be separately stated and that the contractor attempt to obtain a specific decision on the claim.30 This does not help in determining the amount recovered however where the claim is resolved through settlement or mediation. Another approach is to allow for the party prosecuting the claim to allocate any recovery with the other party given the right to challenge the allocation.

A separate problem arises with pro rata distribution of recovery--not all of the claims being presented to the owner may have the same likelihood of recovery. A relatively small, but well supported claim, would fair badly under a pro rata distribution methodology when the other claims are long shots. A similar variant of this issue arises
with allocation of claim prosecution costs where some claims need little effort and others require extensive effort and expert testimony.

A third issue arises with both approaches when the owner is asserting offsets or counterclaims. Why should a subcontractor share in a reduced recovery under a pro rata distribution when the owner claims do not relate to the subcontractor’s work? On the other hand, why should the contractor have to pass on the recovery on the subcontractor’s pass-through claim and shoulder the burden of the owner claims? Any known owner claims should always be addressed in the liquidating agreement and some language should be included to address the possibility of owner claims, whether anticipated or not. The amount recovered on the pass-through claim can be subject to offset for owner claims related to the subcontractor’s work with such language as.

Before making payment to Subcontractor, Contractor shall be entitled to deduct from Subcontractor’s recovery any amounts awarded to Owner arising from Subcontractor’s work.

It may also be handled through an indemnity provision;

Subcontractor agrees to indemnify and hold harmless Contractor from any counterclaims or third-party claims made or asserted by Owner regarding or arising out of Subcontractor’s work.

This by no means limits the parties in negotiating an agreement to liquidate damages based on the amount recovered or pro rata distribution method. Liquidating agreements, more than almost any other contractual agreement, are very context specific. Is there a significant likelihood of contractor delay responsibility such that a liquidating agreement benefits the contractor by allowing additional time and a determination of the amounts owed by the owner prior to attempting to settle the remaining delay claims? If so, why not trade off the grant of that additional time to obtain a partial up-front payment
or liquidate the contractor’s liability at a certain amount of the claim with the remainder being based on any additional recovery from the owner?

**J. What Is the Trigger for Liability?**

Generally, there are only two potential triggers for payment; either the determination of the claim or the payment of the claim. The subcontractor will want to establish the payment trigger based on the determination of the claim as it results in an earlier payment. The contractor will want to establish the payment trigger based on actual receipt of payment. The receipt of payment trigger, however, assumes that funds will be received simply because there was a determination on the pass-through claim in favor of the subcontractor. Unfortunately, where the owner is asserting offsetting claims this may not be true.\(^\text{31}\) The offsetting claims may completely eliminate any recovery to the contractor. To address this contingency subcontractor’s counsel should use the same approaches used to negotiate and limit contingent payment clauses in a subcontract. This ties the payment trigger to when payment is or should have been received by the contractor or providing that payment is still due where the failure of the contingency was due to the acts or omissions of the contractor.

**K. Use of Joint Defense or Prosecution Privilege**

While not necessary for a liquidating agreement providing for a joint defense and prosecution privilege is beneficial. This is particularly true where the pass-through subcontractor claim is one of multiple claims or where, due to an overlap of claims, the parties wish to consider the use of joint witnesses or experts. For example, the pass-through claim asserted by the subcontractor may be for unforeseen site conditions, which affected multiple subcontractors and resulted in a delay to the project as a whole.
The joint defense/prosecution privilege or common interest doctrine is not actually a privilege under the rules of evidence, instead, it is an exception to the rule that no privilege attaches to communications between a client and an attorney in the presence of a third party. The common interest doctrine extends the attorney-client privilege to otherwise non-confidential communications “where the parties undertake a joint effort with respect to a common legal interest, and the doctrine is limited strictly to those communications made to further an ongoing enterprise.” It is easy to see how this doctrine would apply to the joint efforts of a contractor and subcontractor to present a singular claim for recovery to the owner.

There are, however, a couple specific items that should be addressed in a liquidating agreement from counsel’s perspective. Particularly if counsel will be participating in or presenting the pass-through claim the liquidating agreement should make clear that counsel for the subcontractor is not acting as counsel for any other party, including the contractor in whose name the claim is brought. The other concern that often arises both for the subcontractor and the contractor and should be expressed in the liquidating agreement is a limitation on the use and disclosure of any information obtained pursuant to the liquidating agreement.

V. ISSUES PERTAINING TO PRIME CONTRACTORS IN PASS-THROUGH/LIQUIDATING AGREEMENTS

The prime’s concerns are much the same as the concerns of the subcontractor, but obviously the perspective on how these issues should be resolved is different.

A. Control of Claim Presentation/Cooperation

From a prime’s perspective, controlling the claim is often as much of a client relations matter as it is a recovery of damages matter. The prime may hope to work with
the owner again and so controlling how the claims are presented is important. If the subcontractor wants to take a hard line, intractable positions in the litigation or arbitration may reflect on the prime negatively. On the other hand, there is an implied covenant of good faith and fair dealing in liquidating agreements and so the prime needs to make a good faith effort to see that the subcontractor’s claims are adequately presented.

Any liquidating agreement should specifically identify the rights and obligations of each party. For example, an agreement should define the obligations of cooperation between the parties and identify which party will be responsible for taking the lead in the prosecution of the claims. Responsibility for producing documents and providing witnesses for key meetings, deposition, trial and/or arbitration should also be addressed.

A liquidating agreement should set forth the responsibilities of the parties for the costs of litigation, including attorneys’ fees and expert fees. It should also provide a formula for allocating any recovery obtained under the claim, whether such amounts are recovered in the form of a lump sum settlement, a judgment, or an arbitration award.

B. Settlement Authority

Primes should seek to retain full settlement control of claims. Conversely, subcontractors with a substantial portion of an over-all claim should seek the right to participate in settlement discussions and the right to not be bound by any settlement they do not approve.

C. Right to Appeal

Who controls the right to take an appeal is another issue that should be resolved in the liquidating agreement. As mentioned at the outset of the paper, the prime may have multiple considerations at play in the claims process, including client relations. Because
of the potential for competing needs by the prime, the language in the liquidating agreement should give the prime the absolute authority to determine whether a claim will be appealed.

Should the subcontractor want to appeal and should the prime agree that an appeal can be made the liquidating agreement should make clear who bears the costs of bringing the appeal. At the very least each party should bear its own costs if both claims are being appealed. In the case where the subcontractor is pressing the appeal, the prime should have language in the liquidating agreement stating that the subcontractor should bear the costs of both parties in pressing the appeal. As stated in the previous section, however, the prime should retain the right to settle at any time and the right to end the appeal at any time.

D. Certification of Claims

The prime has a duty to independently assess claims (including evaluating delay and impact causes). The prime, however, does not necessarily need to agree with claims. Under the Contract Disputes Act ("CDA"), claims over $100,000 must include certifications that the claim is made in good faith, the supporting data are accurate and complete, and the amount requested accurately reflects the amount for which the government is liable. When "passing-through" subcontractor claims to the government, primes must make this certification. Of concern to a prime contractor, however, is that prime’s false certification of its subcontractor’s costs in a pass-through claim can give rise to liability under the FCA.

When submitting pass-through claims, primes do not need to “believe the subcontractor’s claim to be certain. Rather, the prime need only believe that there is good
In United States v. Turner Construction, the Federal Circuit held that in addition to certifying there is “good ground” for the subcontractor’s claim:

[H]ow the prime contractor itself would resolve the dispute should not be relevant to the certification issue; the prime contractor should not, through the requirement that it certify subcontractor claims, be used as a substitute for the contracting officer or the board in the determination of the merits of the submitted claims under the CDA.

Although “the prime contractor [is] required to review and manage the claims of the subcontractor in order to prevent fraudulent or frivolous claims by the subcontractor,” a prime only needs to make “a good faith effort to comply” with its legal obligations when submitting pass-through claims. Accordingly, primes can protect against FCA liability for pass-through claims, and against “expos[ure] to liability for a false certification,” because the prime “is permitted to qualify its certification of the claim under the CDA by relying on the subcontractor’s representations.”

Nevertheless, in addition to checking the subcontractor’s claims the prime should always require that the subcontractor certify its claims, regardless of the amount of the claim.

E. False Claims Liability

Both primes and subcontractors are subject to False Claims Act (FCA) liability when presenting pass-through claims to the government. FCA liability, whether civil or criminal, attaches when any person:

(A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval;
(B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim;
(C) conspires to commit a violation of subparagraph (A), (B), (D), (E), (F), or (G);
(D) has possession, custody, or control of property or money used, or to be used, by the Government and knowingly delivers, or causes to be delivered, less than all of that money or property;
(E) is authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;
(F) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge property; or
(G) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government.\(^4\)

“In False Claims Act actions, statements of the subcontractor, when submitted by the general contractor, may serve as a basis for liability against the general contractor.”\(^4\) A subcontractor’s false claim can be “attributed to” the prime contractor; “where the prime contractor allegedly knows that a material certification by a subcontractor was false,” courts hold “as a matter of law that the prime contractor has adopted the subcontractor’s certification by submitting it to the government.”\(^4\)

\textbf{F. Limitations Contained in the Subcontract}

The language of the subcontract itself can have consequences to the prime in the ability to pass-through subcontractor claims. For example, in jurisdictions where they are enforceable, no damage for delay clauses should have language that exempts owner-caused delay as recoverable to the extent recovered by prime. If that language exemption language does not exist in the subcontract, the prime may not have any ability to pass through that portion of the subcontractor’s claim.

From the prime’s perspective, the subcontract should have a clause that binds the subcontractor to the dispute resolution clause contained in the owner/prime agreement when an owner caused dispute is at issue. Otherwise a prime may not be able to impose
the dispute resolution mechanisms contained solely in the prime’s contract with the owner onto the subcontractor.

In addition to incorporating the disputes clause between the owner and the prime contractor the subcontract should also, if possible, provide that all non-owner related claims, including any payment bond claims, are stayed until final resolution of claims covered by the prime contract’s dispute process. Otherwise, a prime may find itself battling multiple, and potentially conflicting, claims on more than one front.

Finally, a prime should insert language into the subcontract that makes pursuit of an owner-caused pass-through claim a prerequisite to claim against the prime and any failure to do so results in the subcontractor waiving its right to pursue additional compensation directly against the prime.

G. Limitations through Prior Conduct of the Party Sponsoring the Claim

While agreements between prime and subcontractors may adequately avoid the harshness of the Severin Doctrine, each party’s conduct during construction may unintentionally nullify the pass-through claims. If the parties desire to permit pass-through claims, they must be conscious of boilerplate language in certain documents, like releases and waivers, settlement agreements, etc.

For example, a prime’s presentation of waivers and releases signed by the subcontractor in exchange for payment may bar a pass-through claim. In Appeal of H.E. Johnson Co., the subcontractor sought payment from the contractor based on the owner’s decision to change the location of several wells being constructed by the subcontractor. The subcontractor eventually signed an unconditional release for payment from the prime on the work it performed on the wells. The Armed Services Board of
Contract Appeals (ASBCA) held that, because of the signed unconditional release, the prime contractor had no legal obligation to pay the subcontractor the amount the prime claimed for increased costs on the subcontractor’s behalf.

Not only can pass-through claims be denied by prior conduct, but the failure of the parties to cooperate during litigation can also unintentionally bar a pass-through claim. In *Appeal of Clearwater Constructors, Inc.*, the subcontractor presented a pass-through claim based on a differing site condition grounded on incorrect geotechnical information supplied by the owner. The prime sponsored the claim and presented it to the owner. The owner did not dispute that the information was incorrect or that the subcontractor didn’t rely on the information. The ASBCA, however, denied the prime’s claim because it found no evidence that the prime contractor accepted or relied on the subcontractor’s bid, which had relied on the incorrect geotechnical information.

Once a claim is barred, efforts to revive a pass-through claim are generally ineffective. The Court of Federal Claims denied a pass-through claim on the basis that it was not revived by a liquidating agreement because the subcontractor endorsed a check containing a full release to the prime.

The settlement of claims can also bar recovery for pass-through claims. If the prime agrees to settle the subcontractor’s claim and the subcontractor assigns the claim to the contractor, courts might only allow the prime to recover for the amount for which the subcontractor settled because the subcontractor released the remainder of any claims above the settled amount. The liability of the entire claim should be retained in order for the parties to recover the full.

H. Who Pays?
Because a pass-through claim belongs to the subcontractor and the prime only passes the claim on to the owner, the prime may want the subcontractor to be responsible for all fees and costs, especially if only claims by the subcontractor are being presented. Subcontractors, however, may not agree and execution of the liquidating agreement may fall through. Moreover, if primes want to have more control over litigation because their name is on the lawsuit, subcontractors can use this as an excuse to suggest the fees and costs be split more evenly.

The tendency is for liquidating agreements to provide that each party pays its respective fees and costs for prosecuting the claim. Additionally, the parties should also expressly provide for any changes in the responsibility of fees and costs in response to any counterclaims or defenses asserted by the owner.

Other less common methods of determining who pays can be:

- allocated based on time spent on claim
- pro-rata based on the amount of the claim
- pro-rata based on the complexity of the claim
- contingency percentage fee

I. Who Will Be Bound?

Not only should the liquidating agreement cover the parties to the agreement, but also successors in interest and assignees. Other potential parties, including the prime contractor’s surety, should be added to the agreement as well. Leaving out the surety could result in additional litigation if claims against the bond are made. Moreover, failure to include the surety could result in any later claims against it being dismissed as untimely. The prime should also consider whether to include sub-subcontractors and
suppliers. These parties may have lien or bond claims that can directly affect the prime. The prime should also add the subcontractor’s surety as well. Adding the surety to the liquidating agreement may prevent the prime from having to sue the surety for reimbursement of its legal fees in pursing the subcontractor’s pass-through claim pursuant to the liquidating agreement.

Irrespective of the party, adding sureties to the liquidating agreement can prevent further litigation after the determination of the pass-through claim.

J. What Is the Trigger for Liability?

The payment trigger occurs when the prime’s future liability converts to a present obligation to pay the subcontractor. Subcontractors would like the trigger to occur when the claim has been determined while primes generally would like the trigger to occur only when the claim has been paid by the owner.

As a prime, the subcontract should limit the subcontractor’s recovery on owner-related claims to amounts actually recovered from the owner to avoid additional litigation with the subcontractor. This is where pay-when-paid language in the subcontract can be particularly important.

Furthermore, the prime should remove any language where a recovery for the subcontractor would include payments credited to the contractor in case of an offset. Such language will prevent the prime from having to pay the subcontractor even when an owner’s offset claim or counterclaim is greater than the amount recovered on the pass-through claim.

K. How Should Counsel Address Owner Offsets and Counterclaims?
Claims asserted by the owner in response to a pass-through claim are a concern for prime contractors. The owner may delay payments while the pass-through claim in being resolved, hindering the prime’s work. In order to address defenses and counterclaims asserted by the owner, the liquidating agreement should provide the prime with reassurances from the subcontractor. A way to address this could include an indemnity agreement for losses incurred on the claim or specifically for interest on delayed payments to the prime. To further reduce the risk, the liquidating agreement could provide that any claim granted in favor of the owner will reduce the parties’ recovery by a certain percentage.

L. Use of Joint Defense or Prosecution Privileges

As discussed earlier, use of the joint defense doctrine can preserve each party’s privileges while communicating and collaborating around a common interest. When asserting pass-through claims, joint defense or common interest agreements protect each party’s privileges. The joint defense agreement should be separate from the liquidating agreement, because, if proof of common interest needs to be shown, the parties will not have to produce the liquidating agreement.

The common interest agreement should include:

- An express statement of the common interest being pursued
- Communications between the parties and their counsel are in furtherance of this common interest
- These communications intend to be privileged and protected
- Any work product in furtherance of the common interest intended to be protected
Neither party has the right to unilaterally waive these privileges

VI. ISSUES PERTAINING TO OWNERS IN PASS-THROUGH /LIQUIDATING AGREEMENTS

Clearly, pass-through claims and agreements make it possible for parties lacking privity with owners to reach past this contractual void and proceed directly against the owner despite the absence of a contractual agreement. The pass-through claim thus exposes owners to liability that they might otherwise have avoided. But even where a pass-through claim is asserted, there are still a number of impediments to the pass-through arrangement that work as a limitation upon the ability of subcontractors and primes to align against an owner.

B. Certification Procedures on Federal Jobs

In the federal context, the Federal Acquisition Regulation (FAR) expressly permits pass-through claims. FAR 44.203(c) states as follows:

Contracting officers should not refuse consent to a subcontract merely because it contains a clause giving the subcontractor the right of indirect appeal to an agency board of contract appeals if the subcontractor is affected by a dispute between the Government and the prime contractor. Indirect appeal means assertion by the subcontractor of the prime contractor’s right to appeal or the prosecution of an appeal by the prime contractor on the subcontractor’s behalf. The clause may also provide that the prime contractor and subcontractor shall be equally bound by the contracting officer’s or board’s decision. The clause may not attempt to obligate the contracting officer or the appeals board to decide questions that do not arise between the Government and the prime contractor or that are not cognizable under the clause at 52.233–1, Disputes Avoid multiple litigations – costs, risks of inconsistent results.

FAR also requires that for pass-through claims asserted against a federal owner in excess of $100,000, the prime must certify the claim pursuant to the form established in FAR 52.233-1(d)(iii), as follows:
I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the Contractor believes the Government is liable; and that I am authorized to certify the claim on behalf of the Contractor.

The prime thus needs to certify that the claim is made in good faith and, to the best of its knowledge and belief, the claim is supported by accurate data.

The certification process is one of the most effective ways to combat fraudulent or inflated claims. The contractor’s certification includes language placing responsibility for misrepresentation of fact or fraud on the contractor, and certification is an “unequivocal prerequisite” for a claim to be considered valid under FAR. That said, courts have recognized that a sponsoring prime often does not have as in-depth an understanding or knowledge of the subcontractor’s facts and records, or perhaps the parties disagree on the amount of the subcontractor’s claims, creating problems for the prime’s ability to certify the claim.

Consequently, numerous courts have recognized that the prime who sponsors a subcontractor’s claim will not have the same level of responsibility to investigate the documents supporting a pass-through claim. So long as the claim is based on “good grounds,” the certification is valid—even if the prime disagrees with the bottom line. As mentioned earlier in this paper, in United States v. Turner Construction Co., the court held that “the certification requirement requires not that the prime contractor believes the subcontractor’s claim to be certain, but that the prime contractor believe that this is good ground for the claim.” Thus, under Turner, a prime can meet the certification requirements of FAR even if it does not fully support the claim.
C. Defenses to Pass-Through Claims

An owner cannot be held liable on a subcontractor's claims if it has a defense to claims brought by the prime. There are numerous defenses available to an owner, including:

1. **Written Notice of Claim Requirement.** Construction contracts typically include clauses requiring the lower-tier party to provide prompt written notice of claims for additional compensation or contract time. Timely notice of a claim is a matter of basic fairness, but notice obligations can often be unevenly applied in that they burden the subcontractor or prime, but not the owner. Frequently, courts have balanced the owner’s need to know about claims that could affect the schedule or overall costs against the contractor’s right to payment for work performed. One way to overcome the defense of lack of timely notice is to show actual or constructive knowledge of the claim, or that the lack of notice caused no material prejudice to the owner.

2. **Requirement for a Written Change Order.** Most construction contracts state that there will be no payment for changes in the work unless there is a signed writing. These clauses are generally enforceable and can obviously affect a contractor’s right or ability to collect for changes, delays and other claims. It may not matter how much work was done, how much it cost or who ordered the work if there are no signed change orders.

3. **Failure to Exhaust Contractual Remedies.** A subcontractor may be bound to arbitration or bound to let the architect decide a claim before filing suit.49

4. **Sovereign Immunity.** The federal government has not waived sovereign immunity against suit except as to those claims bought by parties with whom it shares
privity. Thus, where the Severin Doctrine operates as a bar to a pass-through claim, the federal government enjoys immunity against subcontractor claims. This is true for some states, as well, such as Connecticut.50

5. **Counterclaims, Crossclaims, Offsets.**

A counterclaim, crossclaim, or offset may actually diminish or defeat a pass-through claim where the counterclaim, crossclaim, or offset exceeds the pass-through claim presented to the owner.

**VI. CONCLUSION**

As we said earlier, pass-through claims and liquidating agreements are an efficient and practical way to streamline the litigation process and facilitate the resolution of contractual disputes. Liquidating agreements also enable the prime and subcontractor to align their common interests in a single claim against the owner instead of litigating amongst themselves and eroding their potential recoveries. The prime and subcontractor can work together in a non-adversarial fashion to present the testimony and documents that support their claim against the owner. Liquidating agreements thus provide both strategic and financial benefit.

Pass through claims are, however, potential mindfields. Without benefit of strong and well-vetted pass through claim and a well-crafted liquidating agreement that considers all the issues that we have discussed in this paper, you are essentially grabbing a tiger by the tail.
The decided cases make abundantly clear that a suit of this nature may be maintained only when the prime contractor has reimbursed its subcontractor for the latter’s damages or remains liable for such reimbursement in the future. These are the only ways in which the damages of the subcontractor can become, in turn, the damages of the prime contractor, for which recovery may be had against the Government.

See Blount Bros. Constr. v. United States, 348 F.2d 471 (Ct. Cl. 1965); Owens-Corning Fiberglas Corp. v. United States, 419 F.2d 439 (Ct. Cl. 1969); and Umpqua River Navigation Co. v. Crescent City Harbor Dist., 618 F.2d 588 (9th Cir. 1980).

A claim is defined in FAR § 2.101 as “a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract. However, a written demand or written assertion by the contractor seeking the payment of money exceeding $100,000 is not a claim under the Contract Disputes Act of 1978 until certified as required by the Act.” There is no official definition, in the FAR or anywhere else, of the terms “Request for Equitable Adjustment” or “REA.” Nevertheless, an REA is commonly understood to be a request for compensation (time, money, or both) that falls short of a claim in terms of its procedural requirements.

See Blount Bros. Constr. v. United States, 348 F.2d 471 (Ct. Cl. 1965); Owens-Corning Fiberglas Corp. v. United States, 419 F.2d 439 (Ct. Cl. 1969); and Umpqua River Navigation Co. v. Crescent City Harbor Dist., 618 F.2d 588 (9th Cir. 1980).

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19 48 C.F.R. §33.207


22 48 C.F.R. §33.207(c)


27 *Morrison Knudsen Corp. v. Fireman’s Fund Ins. Co.*, 175 F.3d 1221, 1251 (10th Cir. 1999)


30 A particularly useful discussion and sample clause is provided in the American Bar Association, Forum on the Construction industry’s Forms & Substance: Specialized Agreements for the Construction Project, Carina Y. Ohara, John I. Spangler, III and Michael D. Tarullo Eds.


32 U.S. v. *BDO Siedman, LLP*, 492 F.3d 806, 815 (7th Cir. 2007).

33 Id.

34 41 U.S.C. §§ 7101 et seq.

35 41 U.S.C. § 7103(b).


37 See, e.g., *Daewoo Eng’g & Constr. Co. v. United States*, 557 F.3d 1332 (Fed. Cir. 2009) (holding prime contractor violated FCA by submitting false claim that included subcontractor costs).


40 *George Hymnan Constr. Co. v. United States*, 30 Fed. Cl. 170, 176 n.11 (1993) (citing *Transamerica Ins. Corp. v. United States*, 973 F.2d 1572, 1580 (Fed. Cir. 1992)); see also *Century Constr. Co.*, 22 Cl. Ct. at 65 (prime contractor “must provide ‘minimum assurances’ of its own belief in a subcontractor claim.”); *Trafalgar House Constr., Inc. v. U.S.*, 77 Fed. Cl. at 56 (2007)(prime contractor had a good faith belief that the total cost method of calculating damages used by the subcontractor was reasonable under the circumstances).


43 *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 793 (4th Cir. 1999); see also *Blake Constr. Co. v. United States*, 28 Fed. Cl. 672, 681 (1993) (pass-through claim submission requires that the prime “considers there are good grounds for the claim, and that [the prime] intends for it (not [the subcontractor]) to be held liable for any possible fraud attributable to assertion of the claim”).

44 ASBCA No. 50861, 98-2 BCA ¶ 29,868.

45 ASBCA No. 45712, 96-2 BCA ¶ 28,495.


47 Id.

48 Supra.
See International Cement Co. v. Beifeld, 48 173 Ill. 179, 50 N.E. 716 (1898) (Supreme Court of Illinois held that an owner’s backcharge against a non-performing masonry trade contractor was barred because the claimant had failed to comply, or explain its non-compliance with, a contract requirement to have all defaults in performance certified by the project architect).

See Federal Deposit Insurance Corp. v. Peabody, N.E. Inc., 239 Conn. 93, 680 A.2d 1321 (1996) (holding that a contractor sued by its subcontractor on a state project could not implead the state unless the contractor unequivocally admitted its liability to the subcontractor and folded the subcontractor’s claim into its own).