



Pass-Through Claims: Priming Your Prime-Sub Relationship to Ease Cooperation and Avoid Pitfalls

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September 9, 2020



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Basics of the Contracts Disputes Act Process and Sponsored Claims

The Contract Disputes Act

- The Contract Disputes Act of 1978, 41 U.S.C. §§ 7101 *et seq.*: provides the framework for resolution of contractual disputes between the government and its contractors.
- Most cases are founded in money damages (but not all: *e.g.*, CPAR appeals).
- The CDA permits both contractor and government claims.
- Prime contracts contain FAR 52.233-1, Disputes clause – specifically incorporates the CDA.

CDA Overview

- CDA process officially starts with a Claim to the Contracting Officer.
 - Contractors will often use a pre-Claim “REA,” but that is not a part of the formal CDA process.
- Claims exceeding \$100,000 must be certified by the contractor.
- The Contracting Officer is required to render a final decision on a claim. For claims over \$100,000, the Contracting Officer must either provide the decision, or state when it will be provided, within 60 days.
- Statute of Limitations: 6 years to assert a Claim

CDA Overview (cont)

- For an adverse Contracting Officer's final decision (or a failure to decide within a reasonable time – a “deemed denial”), the contractor may then pursue an Appeal.
- The contractor must select one of two (exclusive) forums:
 - Board of Contract Appeals (within 90 days of final decision)
 - ❖ ASBCA: DoD and NASA
 - ❖ CBCA: Civilian Agencies
 - Court of Federal Claims (within 12 months of final decision)
- Appeals from either a BCA or the COFC are made to the Court of Appeals for the Federal Circuit.

What are Sponsored Claims?

- Subcontractors lack privity of contract with the government. With very limited exceptions, there is no jurisdiction for direct subcontractor claims under the CDA.
- Sponsored, or ‘pass-through’ claims, are brought either:
 - By the prime contractor, on behalf of the subcontractor; or
 - By the subcontractor, in the name of the prime contractor
- It is common that primes and subs will have related and overlapping claims and cooperate in asserting their respective causes of action.

Addressing Sponsored Claims in Contracts

Integrating Sponsored Claims Language

Why?

- Unique nature of government subcontracts
 - Hybrid agreements –governed by both commercial and government obligations
 - Duality of government involvement
 - No privity of contract
- BUT
- Retains large measure of control in both formation and administration

Sponsored Claim Benefits – Prime

- Liability avoidance – let the government cover the damages
- Relationship maintenance – defer to the government/ Boards/ courts to decide the merits
- Preserve resources – prime may not have cash or resources to cover the claim

Sponsored Claim Benefits – Subcontractor

- Greater control over your own destiny
- More at stake in the outcome and may work harder on its enforcement
- May be the only one in possession of the necessary facts

Sponsored Claim Potential Risks – Prime

- Defective certification
- Fraudulent claim under Contract Disputes Act
- False Claims Act liability
- Customer relationship

Sponsored Claim Potential Risks – Subcontractor

- Prime Contractor discretion to sponsor
- Prime's level of involvement in prosecuting the claim
- Prime's higher level contract actions can create barriers to recovery
 - Prior release of claims
 - Untimely notice

Standard Contract Provisions

- Bifurcate Disputes clause – commercial vs. government
- Discretion level – “May” vs. “Shall” sponsor
- Notice obligations and timing
- Level of Prime involvement post-claim filing
- Responsibility to cooperate
- Both parties bound by the ultimate decision
- Who controls (and pays for) the litigation

Example – Buyer Favorable

Any final decision of the Government Contracting Officer under the Prime Contract relating to this Agreement, or Seller's performance hereunder will be conclusive and binding upon Seller ***unless appealed at Buyer's sole discretion***. Nothing in this Agreement grants Seller any direct or indirect right of action against the Government under the Prime Contract. ***Buyer shall notify Seller and provide a copy in a timely fashion*** (as permitted by law) after receipt of any final decision of the Government or administrative and/or judicial bodies (if appealed) which adversely affects Seller's interest.

If Seller wishes to contest a Government decision that is binding upon Seller, ***Seller shall submit a request to the Buyer to appeal*** such decision within 30 days after the Government decision has been communicated to Seller. ***Buyer agrees to approve any reasonable request to appeal on Seller's behalf***. If Buyer elects to pursue any appeal pursuant to the Disputes Clause of the Prime Contract, ***Seller will cooperate fully*** with Buyer in the prosecution of such appeal including, but not limited to, timely access to applicable Seller personnel and non-privileged documents. ***All costs and expenses incurred by Buyer in prosecuting any appeal taken or brought at Seller's request will be borne by Seller. The final decision in any appeal or judgment will be binding on Seller.***

Example – Seller Favorable

Subcontractor shall have the right to assert in Prime Contractor's name, and at Subcontractor's expense, 'sponsored claims' to the Client for a Contracting Officer final decision on issues directly affecting Subcontractor's rights and obligations, to the extent that Prime Contractor declines to file such claim directly in its own name and at its own expense. If a final decision is made by the Contracting Officer of Client, and such final decision pertains to the subject matter of this Subcontract, then such final decision shall be binding upon Subcontractor with respect to such matter. ***Contractor shall notify Subcontractor and immediately provide a copy*** of any such Government decision to Subcontractor.

If Prime Contractor elects not to appeal any such decision, it shall so ***notify Subcontractor within forty-five (45) days*** of Prime Contractor's receipt of the Contracting Officer's final decision. Subcontractor shall have the right to assert in Prime Contractor's name, and ***at Subcontractor's expense***, Prime Contractor's right to appeal from such determination under the Disputes clause of the Prime Contract. ***Once final, the decision on appeal shall be conclusive and binding as between Contractor and Subcontractor***, to the extent provided in such Disputes clause.

Special Issues for Non-Traditional Government Contractors

Vendor Providing Commercial Software (On-Premises or Cloud)

- Typically through GWACs (i.e. GSA Schedule 70; SEWP)
- IT Vendors Utilize Partner Channel as Go-to-Market
(Vendor → Distributor → Reseller → Government)
- Resellers Have Wide-Range of Experience with Government Contracting (SBs, Traditional Primes, FSIs)
- Primary Concern: Ensuring Pass-Through of License Terms (EULA; Terms of Service) to End-User AND Enforcing those Terms

Special Issues for Non-Traditional Government Contractors

License Terms Vendor May Seek to Enforce

- License Restrictions (Third-Party Use; Prohibited Uses)
- Decompile/Modify/Reverse Engineer the Software
- Circumvent/Violate Software's Technological Restrictions
- Audit Rights – Recover Underpayments for Over-Deployment
- Disclosure of Confidential Information
- Prohibited Transfer of License Rights

Special Issues for Non-Traditional Government Contractors

Partner Agreements Mechanism to Ensure Pass-Through of End User License Terms to Government Customer

- Partner Must Enter Agreement with either (a) End User or (b) Reseller, as appropriate, resulting in End User's binding written agreement to End User License Terms
- Partner must promptly notify vendor of any breach
- Partner shall not include any additional or contravening terms with Reseller without Vendor's authorization
- Partner shall indemnify Vendor for any cost/loss/liability/damage from failure to obtain End User's written agreement to End User Terms

Special Issues for Non-Traditional Government Contractors

Sponsored Claims Language Included in Partner Agreement

- Requires Partner to Cooperate in Vendor's Efforts to Enforce License Terms against a U.S. Government Customer
- When Requested by Vendor, Claim, Appeal or Enforcement Action Brought in Partner's Name
- Vendor Bears its Own Expenses and Reimburses Partner for its Reasonable Expenses in bringing the Sponsored Claim
- Vendor Controls Prosecution of Sponsored Claim

Special Issues for Non-Traditional Government Contractors

Negotiating Sponsored Claim Language with Partners

- “We already passed through the EULA – the rest is up to you.”
 - Contractual privity issues remain
- Exception for Fraudulent Claims
- Partner/Prime Control of Sponsored Claim
- Remain Liable for any Misrepresentations = False Claims Act

Avoiding Waivers in Prime/Sub Settlements

The “*Severin* Doctrine”

- An agreement between a prime and sub to pursue a sponsored claim often also involves the resolution of disputes and/or liability between the prime and sub.
- The resolutions of those issues presents the biggest pitfall in the sponsored claim process: the *Severin* Doctrine.
- Basic holding of *Severin* is that a contractor cannot pursue a claim on behalf of a subcontractor if the contractor cannot demonstrate that it remained liable to the subcontractor for that amount.

The “*Severin* Doctrine” (cont)

- The implication of *Severin* is that a subcontractor’s granting of a release to a prime in connection with the resolution of their disputes could result in the inadvertent waiver of potential pass-through claims.
- *Severin* may be used as a government affirmative defense to a pass-through claim.
- Accordingly, the Boards and Court now hold that the burden of proving the application of *Severin* is on the government.

Recent Applications of *Severin*

- *MW Builders, Inc. v. United States*, 136 Fed. Cl. 584 (Fed. Cl. 2018): In order to receive each payment under the subcontract, the subcontractor executed a release stating that it
irrevocably and unconditionally releases and waives any and all mechanic's liens or other liens against the Realty or any other claims on any bonds or any other claims whatsoever in connection with this Contract.”
- *Severin* problem?

Recent Applications of *Severin* (cont)

- The Court said **Yes** – the waiver of subcontractor’s claims against the prime were fatal to the ability of the prime to bring pass-through claims.
- “The lien waiver and release language, however, contains no express reservation authorizing [subcontractor] to pass through claims for payment against the Government and [subcontractor] signed waivers covering the entire period [in dispute].”
- The prime offered extrinsic evidence that they did not intend to waive pass-through claims. But the court rejected those arguments because it found the waivers to be unambiguous.

Recent Applications of *Severin* (cont)

- *Turner Construction Company v. Smithsonian Institution*, CBCA No. 2862, 17-1 BCA ¶ 36739 (April 14, 2017): the subcontractor executed releases in connection with each progress payment under the subcontract, stating that it:
 - does hereby forever release, waive, and discharge ... any and all ... claims and demands ... by reason of delivery or material and/or performance of work relating to the project through Application for Payment No. __, except for those items listed under No. 1 above.
- *Severin* problem?

Recent Applications of *Severin* (cont)

- The Board said **No**.
- Even though there was no carve-out in the release for potential pass-through claims, the Board found that the releases were “clearly tied to the periodic progress payments” and did not apply to all potential payments under the contract/

Avoiding *Severin* Issues

- Ensure that release language in connection with payments or modifications is tied to the specific action rather than unqualified.
- In any settlement and release agreement between the prime and subcontractor:
 - Require that the prime pass through defined claims of the sub; and
 - State that the prime remains liable to the sub for any amounts recovered by the prime from the government.

Maintaining Privilege Through Common Interest Agreements

Common Interest Exception

- The Common Interest Doctrine provides an exception in circumstances that would otherwise constitute waivers of attorney-client privilege.
- Attorney-client communications may be shared with third parties without a waiver where the parties are engaged in a joint effort or strategy in pursuit of common interest.
- Often called a “joint defense agreement” – has application to prime and subcontractors pursuing sponsored claims.
- Written agreements are preferable, but oral agreements will be enforced if their terms can be proven.

Limitations of Common Interest Exception

- The Common Interest Doctrine is relatively untested in published CDA decisions.
- The Court and Boards will generally look to federal courts for guidance on resolving discovery disputes. Federal courts recognize the Common Interest Doctrine, but construe it narrowly to situations where there is true alignment of interest.
- Notably, pre-settlement/liquidation communications between the parties are likely not subject to the exception.

Features of Common Interest Agreements

- Explicitly define the nature of the common interest.
- State the parties intent to allow communications among their counsel that remain subject to attorney-client privilege.
- Define the types of materials and communications to be shared.
- Require all common interest communications to be held in confidence by the parties.
- State that the parties have an obligation to withdraw from the agreement if their interests are no longer aligned.

Other Potential Common Interest Issues

- Representation by current counsel if the parties have a post-common interest dispute.
- Potential tolling of applicable statutes of limitations if the parties have not yet resolved potential claims between them.
- Provisions regarding the conduct of pass-through claims *if not otherwise addressed in an agreement between the parties*.

Prime/Sub Roles in the Claims and Appeals Processes

Sponsored Claim/Appeal Process

1. Subcontractor submits claim to Prime
2. Prime conducts diligence
3. Prime submits the claim *in its own name* to the Government
 - If the claim is >\$100K, *Prime* must certify the claim
4. Contracting Officer Final Decision issued
5. Prime or Subcontractor brings the appeal in the Prime's name
 - Board of Contract Appeals: 90 days from receipt of final decision
 - Court of Federal Claims: 12 months from receipt of final decision

Prime's Concerns – Revisited

- Primes often cite concern over claim validity as a reason to not sponsor a subcontractor's claim
- Risk of
 - Defective certification
 - Fraudulent claim under Contract Disputes Act
 - False Claims Act liability
 - Adverse customer perception/relationship impacts

Claim Certification – FAR 33.207(c)

- 4 components:
 1. Claim is made in good faith;
 2. Supporting data are accurate and complete to the best of the contractor's knowledge and belief;
 3. Amount requested accurately reflects the amount for which the contractor believes the government is liable; and
 4. Signatory is authorized to certify the claim

Certification Standard for Sponsored Claims

- *United States v. Turner Construction Co.*, 827 F.2d 1554, 1561 (Fed. Cir. 1987) articulates the standard
 - “[T]he certification requirement requires not that the prime contractor believe the subcontractor’s claim to be certain, but that the prime contractor believe that there is good ground for the claim.”
 - “[H]ow the prime contractor itself would resolve the dispute should not be relevant to the certification issue....”

Prime Diligence Considerations & Potential Risk Mitigations

- Claim-based diligence
 - Sufficient to feel comfortable the claim is not frivolous and is brought in good faith
 - Prime may certify even if reasonable minds may disagree on the strength of the claim
- Relationship-based diligence
 - Primarily during contract formation/negotiation
 - Informs claim-level diligence and ongoing involvement
- Contractual Protections
 - Require equivalent FAR 33.207(c) claim certification from subcontractor
 - Include associated liability/indemnification obligations for faulty certification

Subcontractor Considerations & Potential Risk Mitigations

- Expressly describe the parties' respective rights and obligations in the subcontract
 - Including liability implications for breach
- Cooperate with Prime's reasonable diligence requests
 - Provide FAR 33.207(c) certification
- Obtain evidence of Prime's affirmative sponsorship of the claim – do not rely on subcontract language alone!
 - *Binghamton Simulator Company*, ASBCA No. 59117, 21 August 2014

Subcontractor Perspective

- Sponsored Claim May Be Only Viable Means to Enforce End User License Terms Against U.S. Government Customer
 - Breach of License Terms Still Subject to CDA
 - Vendor's due diligence includes ensuring that all Partners in the route-to-market channel passed through license terms and secured binding written agreement for End User to accept those terms
 - More difficult for Vendor to have visibility into how U.S. Government Customer deploys and/or uses the software

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