Pass-Through Subcontractor Claims and Disputes: How to Avoid a Losing Two-Front War

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Purpose and Limits of Prime’s Use of Subcontracting

• Spreads Technical Scope and Brings Expertise
• Spreads Commercial and Legal Risks and Responsibility
• Also Assumes New Obligations to the Subs
• Does Not Reduce Its Obligations to the Owner
• So That for Subcontracted Work, The Prime Acts as a Conduit . . .
• So that the Technical or Legal Responsibility Will Be with Either the Owner or the Sub
The Prime as a Conduit

- That Conduit Structure Must Be Reflected
  - In the Subcontract
  - Throughout Subcontract Administration
  - In Dealings with the Owner
  - And Particularly in Dealing with Claims and Disputes

- If the Prime Fails to Respect This Structure,

- It Can Face an Unwinnable Two Front War, Battling the Owner and the Sub at the Same Time on the Same Issue.
Flow Down Obligations
• General Flow Down (Legal vs. Scope)
• Binds subs to prime as the prime is bound to owner!
• Rights and Duties usually flow both ways
• Incorporation by Reference of Prime Contract Alone – May Not Cut It.
• Distinguish from Sub’s Scope of Work . . .
Scope of Work

• Generally Technical, Not Legal
• Incorporation by Reference of Specs May Not Be An Effective “Flow-down”
• Define Carefully
• Cross-Reference The Specification
• “Including But Not Limited To…”
• Beware of Gaps Between Trades
More than General Flow Down
Specific Issues to Address

• Liquidated Damages
• Change Order & Claim Process
  • Liquidating Language
• Disputes Procedures . . . More
  • Liquidating Language
• Termination Rights . . . more
• Duty to Proceed?
• Resolve Inconsistencies
More than General Flow Down Disputes Procedures

• **Key!** Avoiding the Risk of Inconsistent Results on Claims Involving the Owner
• What About Claims that Do Not Involve Owner?
• Mediation?
• Arbitration vs. Litigation
• “Special” Arbitration Procedures
• Optional Arbitration
• Choice of Law
• Choice of Forum
More than General Flow Down
Attorney Fees & Costs!

• Statutory Rights?
  • Especially Public Bonds and Liens

• Terms of Bonds

• Contractual Recovery by Prevailing Party?

• Beware: Who is the Prevailing Party?
  • Statutory
  • Contractual

• One Way Prevailing Party – Only for Prime?

• Offer of Judgment
  • Statutory – limited in Federal Court
  • Arbitration?
  • Contractual?
More than General Flow Down
Subcontract Specific Termination Clause

• “The Prenuptial Agreement”
• Flexibility
• Termination For Convenience
• Constructive Termination
• Bases For Termination - Not Limited
• Procedures: Notice, Cure Period, Meetings, Certification
• Subcontracts: Assignments & Incorporation
• Rights & Obligations Upon Termination
Subcontract Administration

- No Special Rules
- Do Unto Others…
- Loading The Owner’s Gun
- Loading The Sub’s Gun
- Be Cautious About
  - Shielding Owner from Bad News
  - Shielding Subs from Bad News
- Uncomfortable on the Fence at Times
• There is No Such Thing as . . .
  • Unofficial or Off the Record Communications
  • Confidential Files, except with attorneys and maybe in anticipation of litigation
  • Personal Files, if they Relate to the Project
• Assume Everything Will Come Out in Litigation (Audit Rights)
• Don’t Say Stupid Things You May Regret
• Email is like any other “Document”
Subcontractor Claims & Disputes

• Avoiding the Two Front War – From the Beginning!
• Generally, Easier and more Likely to Align with Sub
• Ideally with a Liquidating Agreement
  • Hopefully you have it in subcontract Already!
  • Still Better to Get a Specific Liquidating Agreement
• Beware the Severin Doctrine! - Sub Claim Barred If rights Against Prime Released
• General Selling Points of a Liquidating Agreement
• “Reverse” Liquidating Agreement
If You Cannot Make Peace,
At Least Avoid War

• Liquidating Agreement is Ideal,
  • But Not Worth Going to War Over
• You May have One Already in the Subcontract
  • Cooperation & Joint Defense Agreements
• Avoid Pushing Sub to Legal Action or Lawyer Up
  • Tolling Agreements
• If there is Legal Action, Try to Calm/Slow It Down
  • Stay the Litigation or Arbitration
• Whatever You Can Do to Focus on Common Goals
• Including All the Way Through Trial/ Arbitration
Sub Claim Certification Dilemma

• Federal False Claims Act and State Law Counterparts

• Certification required!

• “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 duly authorized to certify the claim on behalf of the Contractor.” FAR 52.233-1

Disputes
Sub Claim Certification Dilemma

• Prime does not have to guarantee the sub’s claim.
• But the courts and the boards have held that Prime must certify claim and contain all required elements.
• Prime may not qualify certificate:
  • “based upon subcontractor certification…”
  • “subject to further review…”
• Prime is held to a separate standard when certifying pass through sub claims.
  • Prime may not fully agree with the positions asserted by the subcontractor.
  • Prime must rely, to some extent, on supporting data and information submitted by the subcontractor.
• Prime needs to cover itself with sub certification and subcontract provisions.
The prime allowed to have some doubts about its sub’s claim:

• “the 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.” *Turner and Transamerica v. US*, 973 F.2d 1572 (Fed. Cir. 1992)

• Prime contractor not required “prior to submitting a certified claim covering subcontractor costs, would have for a claim to secure an equivalent level of certainty as to the government’s liability for the subcontractor costs as it over the contractor’s own costs.”

• Prime agrees sub’s claim is not frivolous and made in good faith.

• STILL, is often a challenging issue.
Thank You!