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## PASS-THROUGH CLAIMS AND THE SEVERIN DOCTRINE

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### *Solving the Problem of Subcontractor Claims*

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#### INTRODUCTION

In Federal Government contracting, Subcontractors and Prime Contractors often face the dilemma of how to handle **Subcontractor claims against the Prime** that result from **Government action or inaction**. The most common solution is a “**pass-through**” or “**sponsored**” claim, which allows the Prime to assert a claim against the Government on behalf of the Sub. Because the *Severin Doctrine* places some restrictions on these types of claims, contractors commonly use Liquidating Agreements to avoid such restrictions and properly assert their claims.

#### THE PROBLEM

The scenario often arises where a Subcontractor’s claims against the Prime Contractor arise out of the actions of the Government (i.e., delays, changes, etc.). The Subcontractor in that situation can rarely assert a claim directly against the Government,<sup>1</sup> because there is **no privity of contract** between the two parties — that is to say, no contractual relationship exists between the Sub and the Government.

In that case, the Sub may then look to the Prime for recovery under the terms of the subcontract. Often, however, the Sub does not want to litigate with the Prime for any number of reasons: the Sub recognizes that the Prime was not at fault, the Prime is on shaky financial ground and may not be able to pay on the claim, or bringing this type of claim may damage a working relationship with the Prime.

#### THE SOLUTION

The issue then becomes whether the Prime Contractor can assert a claim against the Government on behalf of its Sub. The solution is what is referred to as a “pass-through” or “sponsored” claim. In this type of claim, the Sub presents its claim to the Prime, and asks that it be passed-through or sponsored by the Prime, to the Government. Therefore, the Prime asserts the claims

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<sup>1</sup> See Nagle and DeMella, *A Primer on Prime Contractor-Subcontractor Disputes Under Federal Contracts*, The Procurement Lawyer, Winter 2011 at 13 (illustrating the difficulty in establishing privity of contract with Government as owner).

to the Government **on behalf of the Sub**. This is legally possible because the Prime is in privity of contract with both the Sub and the Government.

One benefit of a pass-through claim is that, instead of pursuing two separate claims — one between the Sub and Prime, and another between the Prime and the Government — pass-through claims allow the Prime to **pursue the Sub’s claims directly against the Government** in one cause of action (including an REA or other administrative claim). Under typical “pass-through” claims the Prime remains liable to the Sub, but only to the extent that the Prime receives payment from the Government.

## SEVERIN DOCTRINE

One hurdle to overcome in pursuing “pass-through” or “sponsored” claims is what is known as the **Severin Doctrine**.<sup>2</sup> Under this doctrine, pass-through claims are allowable only if the Prime is liable to the Sub and can charge the cost of the Sub’s claims to the Government, or can make a claim against the Government based on the Sub’s actual or anticipated recovery.<sup>3</sup> Therefore, a Sub’s claims may be passed through to the Government if the Prime has already reimbursed the Sub for the Sub’s damages on the contract, or if the Prime **remains liable** to the Sub on the claim (i.e., the Sub has not released Prime’s liability).

Since the inception of the *Severin Doctrine*, the courts have narrowed the scope of its limitations. In fact, sponsorship of claims will currently be allowed unless the Prime Contractor has absolutely no liability on the claims. Therefore, even a conditional liability will not invoke *Severin’s* limitations.<sup>4</sup>

## LIQUIDATING AGREEMENTS

The best, most straightforward method to avoid the *Severin Doctrine* limitations and establish a right to bring a pass-through claim is by entering into a **Liquidating Agreement** (a/k/a Liquidation Agreement, or Pass-through Agreement). Liquidating Agreements recognize the existing liability of the Prime to the Sub and outline how that liability will be satisfied.

These agreements do not settle the issues of damages or liability between the two, but rather set forth what claims will be brought in the Prime’s name, what damages are sought, and how any damages that are collected from the Government will be disbursed. A Liquidating Agreement

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<sup>2</sup> See *Severin v. United States*, 99 Ct. Cl. 435 (1943), *cert. denied*, 322 U.S. 733 (1944).

<sup>3</sup> Nagle and DeMella, *A Primer on Prime Contractor-Subcontractor Disputes Under Federal Contracts*, The Procurement Lawyer, Winter 2011 at 14.

<sup>4</sup> See *M.A. Mortenson Co.*, ASBCA No. 53761, 06-1 BCA ¶ 33,180 at 164,439; See also *Castagna & Son, Inc.*, GSBCA No. 6906, 84-3 BCA ¶17612.

may be included as a clause in the subcontract, or may be entered into later during the life of the subcontract as a stand-alone agreement.

Both parties will want to incorporate some **standard clauses** in their Liquidating Agreement, including the establishment of the Prime's liability to the Sub, liquidation of all other claims on the subcontract, and a determination formulating the share of any recovery that will be passed on by the Prime to the Sub.

Additionally, the **Prime** may want to consider including clauses regarding indemnification, the Prime's control of claims assertion and litigation, and the authority to settle claims. The **Sub** may want to consider including clauses that ensure the Sub is present and has the final decision in all settlement negotiations, as well as favorable cost sharing formulas for attorneys' fees and witness fees.

## CONCLUSION

In situations where Subcontractors have claims against the Prime Contractor that are attributable to the Government, Liquidating Agreements that enable pass-through claims are often a necessary tool in recovering costs. These agreements, if drafted carefully by a seasoned professional, can be beneficial to both Subcontractors and Prime Contractors. Please give the experts at Excell Consulting a call to discuss whether a Liquidating Agreement is the right tool for your (potential) claims.

**In the end, you will be glad you made the call; by the way, it's a FREE CALL.**

***EXCELL CONSULTING: "HERE TODAY FOR YOUR TOMORROW."***

*Author's note: The information contained in this article is for general informational purposes only. This information does not constitute legal advice, is not intended to constitute legal advice, nor should it be relied upon as legal advice for your specific factual pattern or situation. – Taylor Benson, Esq., Asst General Counsel*