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Walking the tightrope: Liquidation agreement 'traps for the unwary'

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When crafting a liquidation or "pass-through" agreement for a subcontractor claim against the government, the key provision from the prime contractor's perspective is a release from any liability for the subcontractor's claim with the exception of amounts recovered from the government related to that claim.

If the release language is too broad, however, the agreement may provide the government a legal defense to the pass-through claim known as the *Severin* doctrine.

The *Severin* doctrine prohibits a prime contractor from passing through a subcontractor claim to the government if the prime contractor is not liable for the subcontractor's claimed costs.

Simply put, to pass through a subcontractor claim, the prime contractor must maintain some form of liability for the subcontractor claim or risk rejection of the claim.

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Indeed, if the prime contractor expressly disclaims liability for the subcontractor's claim or the subcontractor's release of the prime contractor is too broad, the *Severin* doctrine may bar the claim and the government will rely on this defense before ever looking at the merit of the claim.

A recent decision issued by the Armed Services Board of Contract Appeals demonstrates how far the government has tried to stretch the *Severin* doctrine defense.[1]

Alderman Building Company was the general contractor, pursuant to a contract with the Navy, on a renovation project at a Marine Corps base. The project suffered from significant government-caused delays.

Alderman sponsored a pass-through claim on behalf of its subcontractor, Big John's Electric Co., Inc. seeking compensation for the delays.

One of the recitals in the pass-through agreement between Alderman and Big John's stated that "the Owner is the ultimate responsible party to pay for the Subcontractor's and Contractor's claims."

In this appeal, the Navy argued that the *Severin* doctrine mandated dismissal of the claim because, *vis-a-vis* the recital language, Alderman had asserted it was not responsible for the costs Big John's incurred.

Fortunately, the board rejected the Navy's argument holding that the Navy failed to demonstrate that Alderman was *not* responsible for Big John's costs.

First, the board noted that the pass-through agreement did not contain an "iron-bound release" and it did not contain an "express undertaking" to release Alderman from any obligation to Big John's.

Second, the board found "Alderman's unqualified undertaking" in the pass-through agreement to promptly pay any amounts owed to Big John's. The board stated this fact to be the "antithesis" of any release of Alderman's liability.

Although *Alderman* is a victory for the contractor, it is also a cautionary tale. In terms of a "victory," the board imposed a strict burden on the government to demonstrate that the prime contractor has no liability for a subcontractor's claim pursuant to the *Severin* doctrine.

Nevertheless, this case serves as a warning to carefully avoid language in a pass-through agreement that would suggest in any way, shape or form that the prime contractor has no liability for the subcontractor's claim by factoring in the likelihood that the government will look to a *Severin* doctrine defense to avoid liability for an otherwise meritorious claim.

Notes

[1] *See* Alderman Building Company, Inc., ASBCA No. 58082 (May 21, 2020) https://bit.ly/3hqMlyi

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