

COFC Decisions Reinforce Challenges, But Open the Door, for Subcontractors Pursuing Claims for Nonpayment Directly Against the Government

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Most subcontractors under U.S. Government prime contracts know all too well that they have limited, if any, rights to pursue a claim directly against the Government if their prime contractor fails to pay them, as they lack privity of contract with the Government. In two recent companion decisions issued by the U.S. Court of Federal Claims, the Court reinforced that reality by dismissing one such subcontractor suit in its entirety and almost all of a second suit brought by another subcontractor under the same prime contract. In doing so, however, the Court created a clear roadmap that some essential subcontractors can use to ensure payment by the Government for work performed under a subcontract.

The Contract

The two cases, *Threshold Technologies, Inc. v. United States*, No. 13-599C (Fed. Cl. Aug. 29, 2014) and *New Hampshire Flight Procurement, LLC v. United States*, No. 13-567C (Fed Cl. Aug. 29, 2014), arose out of a prime contract between the National Aeronautics and Space Administration (NASA) and Flight Test Associates, Inc. (FTA). The purpose of the contract was to conduct “High Ice Water Content” flight research to study the causes of jet engine power-loss events occurring around areas of deep tropical convection at high altitudes. The flight campaign was to be conducted out of Darwin, Australia during the monsoon season.

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FTA entered into subcontracts with Threshold Technologies, Inc. (Threshold) and New Hampshire Flight Procurement, LLC (NHFP) to support FTA's performance of the prime contract. NHFP was to supply the aircraft, and Threshold would provide operations, maintenance and installation services. The prime contract included a clause that specifically recognized Threshold's performance as being "critical to the success of the contract," and required FTA to obtain the Contracting Officer's written approval to substitute another operations subcontractor.

According to the subcontractors, the prime contract went south almost immediately. Threshold and NHFP alleged that FTA stopped paying them only a few months after the contract began. NASA subsequently terminated FTA's prime contract. The subcontractors alleged that following the termination, in coordination with NASA, Threshold arranged to fly the aircraft to its own hangar in Chino, California. The aircraft was stored there for a period of eight months, after which NASA had the government equipment removed from the aircraft.

The Lawsuits

Both subcontractors filed suit in the U.S. Court of Federal Claims seeking payment from the U.S. Government for services provided under their subcontracts with FTA. Threshold also sought compensation for storing the aircraft after FTA's prime contract was terminated. The subcontractors claimed that NASA (1) breached express contracts with them and owed payment to the subcontractors as third party beneficiaries to the prime contract, (2) breached implied contracts with the subcontractors, (3) breached the covenant of good faith and fair dealing, and (4) was liable to the subcontractors under a theory of quantum meruit. The United States filed a motion to dismiss seeking dismissal of virtually all of Threshold's claims and NHFP's suit in its entirety, for lack of subject matter jurisdiction and failure to state a claim upon which relief may be granted.

The Court quickly dispatched with the subcontractors' express contract claims, finding that the subcontractors were not signatories to the prime contract, and NASA was not a party to their subcontracts with FTA. The Court also found no merit to their quantum meruit claims, as the Court does not have jurisdiction over implied-in-law contract claims except under very narrow circumstances not present in these cases.

The Court devoted most of its attention to grappling with the issue of whether Threshold and NHFP were intended third party beneficiaries to the prime contract between NASA and FTA. In support of their claims, the subcontractors argued that NASA knew they would be heavily involved in contract performance and expressly recognized in the prime contract that Threshold was "critical to the success of the contract."

The Court ultimately found that the subcontractors had not shown any intent by the Government to directly benefit them at the time of awarding the prime contract to FTA. The Court noted that there was no clause in the prime contract or the subcontracts granting a remedy or right to payment to the subcontractors, or otherwise guaranteeing them any right to recourse against NASA. Following an extensive discussion of the Federal Circuit's case law concerning third party beneficiaries, the Court concluded that:

[I]ntent to endow third party beneficiary status requires more than notice to the government; [it] also requires that the government 'knows of a condition precedent to a third-party's performance of a subcontractor, and *specifically modifies the prime contract so as to ensure the third-party's continued performance.*'

(quoting *Flexfab, L.L.C. v. United States*, 424 F.3d 1254, 1263 (Fed. Cir. 2005)). The Court found that even if NASA was aware in this case that the subcontractors would be involved in contract performance, the Contracting Officer never modified the prime contract in a manner that would assure payment to Threshold and NHFP. As for the clause in the prime contract identifying Threshold as a "critical" subcontractor, the Court found that it was designed to protect *the Government's* interests, not confer any right or remedies to Threshold.

The Court dismissed NHFP's entire complaint and most Threshold's claims. The Court found that Threshold had pled sufficient facts to support a claim that an implied-in-fact contract was created when it stored the aircraft for NASA after FTA's contract was terminated.

Lesson for Subcontractors

These cases reinforce that subcontractors have very limited rights against the Government if their prime contractor does not pay them. Even in Threshold's case, where the prime contract explicitly recognized its status as a "critical" subcontractor that could not be removed without the Contracting Officer's written approval, the Court refused to find an obligation on the part of the Government to ensure that Threshold was paid for its work.

The cases also show, however, that a subcontractor is not without options if it is not being paid by its prime contractor, particularly if it has valuable supplies or services that the Government needs. The Court recognized that third party beneficiary status is created where the Contracting Officer amends the prime contract to have payments remitted directly to the subcontractor, or otherwise modifies the prime contract to unambiguously effectuate payment from the government to the subcontractor. In that scenario, the subcontractor becomes a third party beneficiary to the prime contract because the Government has specifically modified the contract to ensure the subcontractor's continued performance.

Not all subcontractors will have the leverage required to force such a significant modification to the prime contract, particularly if the prime contractor is under financial distress. But for those subcontractors providing essential supplies or services that the Government absolutely must have, it may be a way to ensure payment for work performed even if the prime contractor fails to meet its obligations under the subcontract.