

WHEN CAN A SUBCONTRACTOR SUE THE GOVERNMENT WHEN THE PRIME FAILS TO PAY IT: RARELY

By Richard Lieberman, Consultant and Retired Attorney

A recent Court of Federal Claims case provides some clarification on when and how a subcontractor may sue the government and recover, when the prime contractor fails to pay it. *G4S Technology LLC v. United States*, No. 12-8C, (Fed. Cl. Feb. 11, 2014). It is the general rule that a subcontractor that agrees to supply materials or labor to a prime contractor is only an incidental beneficiary of any contract between the prime and the government, and therefore cannot sue the government on the prime contract. The key difference is between an “intended beneficiary” of a prime contract (which establishes a government duty to the subcontractor) and contracts that merely create “incidental beneficiaries” which do not establish any such obligation on the part of the government. But how do you distinguish between these two beneficiaries?

G4S was a subcontractor to Open Range Communications, Inc. (“Open Range”) in a loan agreement to provide broadband services to rural areas. Open Range went bankrupt and G4S claimed it was an intended beneficiary that should be paid by the Government.

The Court established the following rules:

Rule 1: A subcontractor is entitled to enforce a contract where the subcontractor is made a joint-payee of the prime contract. See *D&H Distrib. Co. v. United States*, 102 F. 3d 542 (Fed. Cir. 1996). Here, the Government amended the prime contract to assign payment to both D&H and the prime jointly; but the Government wrongly issued a check in the prime’s name only. D&H won.

Rule 2: The Government’s ratification of a contract provision that expressly provides for direct payment to a subcontractor is unenforceable by the subcontractor, unless there is evidence of such an intent by an authorized government official. See *Flexfab, LLC v. United States*, 424 F. 3d 1254 (Fed. Cir. 2005). Flexfab had failed to show that the relevant, authorized contracting officer had intended to convey a benefit on Flexfab—the contracting officer had lacked authority. Flexfab lost.

Rule 3: Even though JGB was not listed by name as a joint payee, the government contracting officer with authority understood that an amendment to the payment procedure was to set aside money for JGB using an escrow account, which was in actuality, JGB’s bank account. This made JGB an intended third party beneficiary. *JGB Enters. Inc. v. United States*, 497 F. 3d 1259 (Fed. Cir. 2007). JGB won.

So what happened to G4S? It was unable to show than an authorized government official had approved a contract provision for the express purpose of effectuating payment from the government to the subcontractors. Therefore it was not an intended beneficiary, and was merely an incidental beneficiary, not entitled to sue the government. The Court said this,

For the court to hold otherwise would transform the “exceptional privilege of status as an intended third-party beneficiary into a broad right of subcontractors to sue the federal government in any case where the contracting officer closely oversees the prime contractor’s work with its subcontractors, or whenever an agency pays a prime contractor with the knowledge that some of that payment would be used to compensate subcontractors.

TIP: If you are uncertain that the prime will pay you, or that the prime might become insolvent before paying you, enter into a “joint payment agreement” between the government, the prime and the sub, requiring the government to assign payment to both the subcontractor and the prime contractor directly. This should be made as a formal modification to the contract, signed by the responsible warranted contracting officer, and also signed by prime and sub.