

**39<sup>TH</sup> ANNUAL CONSTRUCTION & PUBLIC CONTRACTS LAW  
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**Virginia Continuing Legal Education**

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**What Every Practitioner Should Know  
about Pass-Through Claims**

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## **I. An Introduction to “Pass-Through” Claims**

Most construction litigators are at times faced with evaluating the requirements for a prime contractor to sponsor a claim of its subcontractor against the government or owner. Alternatively, counsel for a subcontractor is seeking to obtain the agreement of the prime to “pass through” its client’s claim to the owner. Because subcontractors are not in privity of contract with the owner, a prime contractor must sponsor or pass-through a subcontractor’s claim for damages not caused by the prime – or risk facing contractual exposure to the subcontractor for its claim.

A pass-through claim can be defined as a claim: (1) by a party who has suffered damages; (2) against a responsible party with whom it has no contract; (3) presented through an intermediary who has a contractual relationship with both. A contractor sponsors the subcontractor’s claim by bringing an appeal on the subcontractor’s behalf, or by allowing the subcontractor to bring an appeal in the prime contractor’s name.

Generally speaking, sponsored claims are only allowed if the prime contractor can make a claim against the government or owner based on the subcontractor’s theory of recovery. This limitation is based upon the *Severin* doctrine, coined after the case of *Severin v. United States Court of Claims*, 99 Ct. Cl. 435 (1943), which provides that a prime contractor cannot sponsor a subcontractor’s claim against the Government if the prime contractor has no liability to the subcontractor for the costs or damages at issue. While a lack of privity of contract would normally preclude such recovery, under the federal regulatory framework and some several state statutes, pass-through claims are recognized under limited circumstances.

Specifically, the Federal Government recognizes the right of contractors to bring “pass through” or “sponsored” claims on behalf of their subcontractors under FAR 44.203(c) which states:

Contracting officers should not refuse consent to a subcontract merely because it contains a clause giving the subcontractor the right of indirect appeal to an agency board of contract appeals if the subcontractor is affected by a dispute between the Government and the prime contractor. Indirect appeal means assertion by the subcontractor of the prime contractor's right to appeal or the prosecution of an appeal by the prime contractor on the subcontractor's behalf. The clause may also provide that the prime contractor and subcontractor shall be equally bound by the contracting officer's or board's decision. The clause may not attempt to obligate the contracting officer or the appeals board to decide questions that do not arise between the Government and the prime contractor or that are not cognizable under the clause at 52.233-1, Disputes.

At present, the Commonwealth of Virginia only specifically allows pass-through or sponsored claims under VDOT contracts pursuant to Virginia Code §§ 33.2-1101, et seq.

## **II. The Starting Point for Understanding Pass-Through Claims: The *Severin* Doctrine**

As most construction lawyers know, under the *Severin* doctrine, the linchpin of pursuing a valid pass-through claim is that the prime contract has to be liable to the subcontractor. The doctrine arose out of the 1943 decision in *Severin v. United States*<sup>1</sup> and states that a contractor has no standing to sue the federal government for actual losses incurred by one of its subcontractors unless the contractor has some obligation to the subcontractor for the amount claimed. In *Severin*, the subcontract stated that the contractor was not “responsible for any loss...or delay caused by the Owner....” The contractor was able to prevail against the government and recover its own delay damages, but not its subcontractor’s damages. This is because the contractor was unable to prove that it suffered any actual damages as a result of the subcontractor’s claim arising from the government’s breach.<sup>2</sup>

Under *Severin*, the contractor had the burden of proving that it remained liable to the subcontractor for the amount at issue. However, the modern day application of *Severin* now places the burden of proof squarely on the government to demonstrate that the contractor has no liability to the subcontractor for the amount in dispute.<sup>3</sup>

## **III. Modern Day Application of *Severin***

Despite the implications of *Severin*, the doctrine has been substantially chipped away over the last eighty years. Courts now generally apply the doctrine narrowly reasoning that only “an iron-bound release or contract provision immunizing the prime contractor completely from any liability to the sub” is necessary to preclude the prime contractor from submitting a claim for its subcontractor.<sup>4</sup> A recent Armed Services Board of Contract Appeals (ASBCA) decision discusses

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<sup>1</sup> 99 Ct. Cl. 435 (1943)

<sup>2</sup> Roy, M., *The Elusive Permissibility of Pass-Through Claims in Virginia*, Virginia Lawyer, December 2015.

<sup>3</sup> See *Harper/Nielsen-Dillingham Builders, Inc. v. United States*, 81 Fed. Cl. 667, 675 (2008); *Ace Constructors, Inc. v. United States*, 70 Fed. Cl. 253, 289 (2006).

<sup>4</sup> *Cross Construction Co. v. United States*, 225 Ct. Cl. 616, 618 (1980).

the *Severin* doctrine and its impact on subcontractor pass-through claims, confirming that this defense to liability may only be used in very limited circumstances by the Government.

A. Government Bears the Burden of Proof of Establishing *Severin*

Establishing that the prime contractor is not liable to the subcontractor is the Government's burden,<sup>5</sup> thus this defense must be raised and established by the Government. In a recent decision, *BAE Systems San Francisco Ship Repair*,<sup>6</sup> the Board confirmed the limited applicability of *Severin* and that the Government bears the burden of establishing this defense.

The underlying facts relevant to the Board's decision in *BAE Systems* are as follows. BAE was awarded a Delivery Order under its existing MATOC contract with the Army in 2006 to perform, among other tasks, removal and replacement of all existing potable water, air-conditioning and gray water drain systems. BAE subcontracted with Custom Ship Interiors, Inc. ("CSI") to perform the removal and replacement of the piping.

During performance, CSI discovered additional piping systems that were not visible during the site inspection and were not identified on the contract drawings. CSI then submitted 19 change proposals related to the newly-identified piping that totaled approximately \$986,000. The Contracting Officer failed to negotiate or settle the 19 change orders, yet nonetheless directed BAE to "proceed diligently with the work." BAE issued purchase orders for the work that stated they were issued pending Government settlement of the additional work. BAE also conditionally advanced \$350,000 to CSI for the work.

In BAE's appeal of the Contracting Officer's denial of the claim for the 19 change proposals, the Government argued that it was not liable to BAE pursuant to the *Severin* Doctrine. The Board summarily rejected this argument. Notwithstanding that the \$350,000 payment by BAE to CSI was a conditional payment and that BAE was not directly liable to CSI – the Board relied on the fact that BAE agreed that it would be liable to CSI for the amount, if any, recovered from the government and that BAE had advanced \$350,000 to CSI, reflecting an acknowledgement that CSI was entitled to payment for the work performed.

Consistent with the Board's restrictive application of the *Severin* doctrine, it has also rejected application of this defense raised by the Government on the basis that there was no formal

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<sup>5</sup> See *E.R. Mitchell Constr. Co. v. Danzig*, 175 F.3d 1369, 1370 (Fed. Cir. 1999).

<sup>6</sup> ASBCA No. 58818, 59642 (June 13, 2016).

subcontract between the prime contractor and its subcontractor and therefore, no liability by the prime to its sub.

B. No Formal Subcontract Required to Accept Pass-Through Claim

1. *Parsons-UXB Joint Venture*, ASBCA No. 56481, 13-1 BCA ¶ 35,378 (Aug. 1, 2013)

The ASBCA had occasion to address whether the *Severin* doctrine applies in situations where no written subcontract exists. In this decision, Parsons and UXB formed a joint venture to complete a Navy project to restore an island in Hawaiian, which had been used as a weapons range. A joint venture was set up to formally hold the contract with the Navy, although Parsons and UXB did all the work. There were no subcontracts in place between the JV and either Parsons or UXB. When a dispute developed over costs incurred on the project, the JV brought the case to the Armed Services Board. The Navy cited to *Severin*, arguing that without a subcontract, the JV could not be liable for costs incurred by Parsons or UXB and therefore could not pursue claims on their behalf. Citing Hawaiian state law, the Board held that the JV was a partnership and was therefore “obligated to reimburse or indemnify its partners for payments made, or liabilities incurred, by them in the ordinary course of the partnership’s business, unless the partnership agreement provides otherwise.” As such, the claims were safe from the *Severin* doctrine because “Hawaii law obligated the JV to reimburse the partners.”<sup>7</sup>

2. *Appeal of BearingPoint, Inc.*, ASBCA No. 55354, 08-2 BCA ¶ 33890 (June 19, 2008)

In *BearingPoint*, the prime contractor (Custer Battles) and its subcontractor executed a letter of intention only “to enter into a binding written” agreement, yet never executed such an agreement. Despite the lack of an agreement, BearingPoint received services from its subcontractor, Custer Battles, and invoiced the Government for these costs. The contracting officer denied the costs claimed by BearingPoint for Custer Battles’ costs and demanded repayment in a Contracting Officer’s Final Decision. On appeal, the Government moved to

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<sup>7</sup> B. Waagner, *The Contractor’s Perspective, Pass-through Claims Without a Contract* (April 1, 2014), <https://www.contractorsperspective.com>

dismiss BearingPoint's claim on the grounds that BearingPoint lacked standing under the *Severin* doctrine because there was no executed subcontract so BearingPoint was not liable to Custer Battles.

Rejecting the government's defense, the Board stated that there was no "iron-clad release" or other provision that would limit BearingPoint's liability to Custer Battles. More importantly, however, the Board stated: "[W]e cannot accept the government's argument that the less formal subcontracting arrangements that were obtained here are necessarily inconsistent with liability from BearingPoint to Custer Battles." Thus, the Board confirms that a subcontract does not need to be a formal agreement in order to defeat a *Severin* defense.

C. Recent Decisions Limiting Severin's Application and Allowing Subcontractor Claims to Proceed.

1. *M.K. Ferguson Co. v. United States*, No. 12-57C, 2016 WL 1551650 (Fed. Cl. Apr. 14, 2016)

Ground Improvement Techniques, Inc. served as a subcontractor to M.K. Ferguson on a Department of Energy project dating back to the 1990s. The subcontractor won a judgment against M.K. Ferguson arising out of a contract dispute, but M.K. Ferguson went bankrupt before it could fully satisfy the judgment. The bankruptcy court ordered M.K. Ferguson to file a "pass-through" CDA claim with the Department of Energy in an effort to have its subcontractor's judgment satisfied. The Government thereafter moved to dismiss the claim on three grounds: (1) the claim was never properly certified to a contracting officer; (2) M.K. Ferguson was not liable for GIT's claim, so it could not sponsor the claim; and (3) the claim could not be an "allowable cost" under M.K. Ferguson's prime contract with the Government.

The Court of Federal Claims rejected all three arguments and denied the Government's motion to dismiss. First, the court analyzed at length the Government's argument that M.K.'s claim failed for lack of proper certification, finding that although the first certification had not contained all the elements required by the CDA, it had filed a corrected certification satisfying the CDA and, moreover, the initial certification did not amount to a complete and incurable failure to certify. Second, the court held that the *Severin* doctrine did not apply because any proceeds from a successful claim by M.K. Ferguson would go to the owners of GIT's claim. Lastly, the court determined that no authority supported the Government's

argument that "an unsatisfied judgment that is part of a prime contractor's bankruptcy estate cannot be allowable" to a contract like M.K.'s prime contract with the Department of Energy. The court remanded the matter to DOE for renewed consideration of M.K.'s claim by a contracting officer.

2. *Turner Construction Company v. Smithsonian Institution*, CBCA No. 2862, 17-1 BCA ¶ 36739 (April 14, 2017)

Turner, the prime contractor, passed through approximately \$7 million in subcontractor delay and disruption claims in a dispute involving the renovation of the National Museum of American History. Because each subcontractor had executed lien releases and change order releases in connection with the project, the Smithsonian argued that *Severin* applied to bar the claims as Turner had no remaining liability to its subcontractors. Each progress payment release stated, in relevant part, that the subcontractor: "represents and warrants that there are no outstanding claims by the [subcontractor]... through the date of Application for Payment No. \_\_\_ except for any retention, pending modifications and changes, or disputed claims for extra work as stated herein[;]" and "does hereby forever release, waive, and discharge ... any and all ... claims and demands ... by reason of delivery or material and/or performance of work relating to the project through Application for Payment No. \_\_\_, except for those items listed under No. 1 above."

The Board found that the release language was limited to the periodic progress payments and did not releases claims related to pass-through delay and disruption claims. The ASBCA held that even though the progress payment releases did not carve out the pass-through claims, the *Severin* doctrine did not bar them mainly because the releases were "clearly tied" to each progress payment. Their main purpose was to ensure that subcontractors had paid lower tiers and that the project site remained unencumbered, not to relieve Smithsonian, vis-à-vis releasing Turner, from any liability for overall project delay. As such, the Smithsonian was unable to rely on the *Severin* doctrine to avoid liability for subcontractor claims.

#### D. Severin Doctrine Recently Enforced to Bar Subcontractor Claims

1. *MW Builders, Inc. v. United States*, 136 Fed. Cl. 584 (Fed. Cl. 2018).

MW Builders ("MW Builders") held an Army Corps of Engineers contract for electrical utility services necessary to build an Army Reserve Center in Sloan, Nevada. The contract was silent as to who

was responsible for securing easements for this work. When delays arose because of difficulties relating to these easements, the Army claimed MW Builders was responsible and refused to pay on a cost claim associated with the delay.

MW Builders made a claim that the Army Corps of Engineers breached its contract for electrical utility services and violated the duty of good faith and fair dealing. The COFC determined that the claims of MW Builders' subcontractor, Bergelectric, were waived as a result of a lien waiver in its subcontract providing that Bergelectric waived "any other claim whatsoever in connection with this Contract..." MW Builders moved for reconsideration of Bergelectric's pass-through claims, arguing that the precedent relied upon in the initial decision was inapplicable because that case was about a settlement dispute, whereas Bergelectric and MW agreed that the contract does not evidence their intent. In the alternative, MW Builders claimed that the court should reform the release language.

The court rejected both arguments. First, it held that the terms of the contractual release were unambiguous and that the court was therefore precluded from considering the extrinsic evidence regarding the parties' intent even though the scope of the release included in the contract was unintentionally broad. Second, the COFC held that it does not have jurisdiction to reform an agreement between a contractor and its subcontractor, citing the *Severin* doctrine. Accordingly, the court denied the motion for reconsideration.

#### **IV. Bypassing the *Severin* Doctrine with Liquidating Agreements**

Federal courts have allowed contractors to bypass the *Severin* Doctrine through properly drafted liquidating agreements. Liquidating agreements are a favored risk allocation tool among contractors in which a contractor and subcontractor agree that the contractor is liable to the subcontractor for the owner's acts, omissions, and responsibilities to the extent that the contractor is able to recover from the owner for the same.<sup>8</sup>

In *J.L. Simmons v. United States*,<sup>9</sup> the Court of Federal Claims allowed a contractor to pass through the claims of twelve subcontractors, including nine that had executed a release discharging all claims against the contractor "with the exception of [their] claim for losses because of engineering errors in design committed by the [owner]."<sup>10</sup> Notably, the court allowed the pass-

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<sup>8</sup> Roy, M., *The Elusive Permissibility of Pass-Through Claims in Virginia*, Virginia Lawyer, (December 2015).

<sup>9</sup> 304 F.2d 886 (Ct. Cl. 1962).

<sup>10</sup> *Id.* at 887.



through claims even though the contractor's obligations to the subcontractors regarding the amount in dispute would be extinguished if the court denied the claim against the owner, finding that the contractor's liability was not negated by the releases. This is contrary to Virginia law, however, as discussed in Section VII below.

In order to minimize the potential for disputes between the prime contractor and the subcontractor, the pass-through agreement should be reduced to a comprehensive written document that spells out the parties' rights and responsibilities. Pass-through agreements should:

- clearly delineate the claims that are to be passed through to the owner;
- contain a representation by the subcontractor that the claims are valid;
- indicate which party will fund the prosecution of the claims;
- indicate which party will control the litigation;
- contain a representation that the controlling party will use its best efforts to prosecute the claims successfully;
- spell out the role (if any) to be played by the non-controlling party;
- indicate which party has the right to accept a settlement offer;
- spell out the breadth of the liability release that the parties are willing to provide to the owner in order to reach a settlement;
- indicate how any settlement proceeds will be shared;
- specify the extent to which the subcontractor has waived or reserved its claims against the prime contractor; and
- identify how disputes arising from the pass-through agreement will be resolved.

Because pass-through agreements are frequently made part of the record in trial and arbitration proceedings, both to establish the subcontractor's right to proceed on a pass-through basis and to facilitate the participation of its counsel in the proceedings. Therefore, such agreements should be drafted with these disclosures highlighted and couched in terms that show the existence of a legitimate business agreement. Moreover, before negotiating the agreement, counsel for the parties should consider entering into a joint prosecution/common interest agreement to prevent, to the extent possible, their otherwise non-privileged communications concerning strategy and the prosecution of the claims from becoming discoverable by the owner.

## **V. Prime Contractor Sponsorship Obligations**

As has been noted above, the prime contractor has certain sponsorship obligations with any submitted claim. The claim must be brought “through, and with the consent and cooperation of the prime [contractor], and in the prime's name,” *Erickson Air Crane Co. of Wash., Inc. v. United States*, 731 F.2d 810 (Fed. Cir. 1984) and the claim must be brought in “good faith.” *TRW, Inc.*, ASBCA 11373, 66-2 BCA ¶5882. If a Contract Disputes Act certification is required, that prime contractor must believe and certify that there is “good ground” for the claim. *Turner Constr. Co. v. United States*, 827 F.2d 1554 (Fed. Cir. 1987). *See also, Oconto Elec., Inc.*, ASBCA No. 45856, 94-3 BCA 26,958 (holding the prime contractor’s certification acceptable even though the person certifying the claim lacked personal knowledge of the amount claimed.)

FAR 33.207 (c) contains the specific language required for submission of claims. The certification language for claims in excess of \$100,000 is:

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.

It should be noted that under FAR 33.207 (f), a defective certification will not bar a tribunal of jurisdiction but that prior to entry of final judgment, a proper certification must be submitted. If a prime contractor does not believe the subcontractor has “good grounds” to pursue its claim, the prime contractor is in a dilemma. It can’t pass through the subcontractor’s claim but if it doesn’t, the prime contractor is sure to be sued directly by the subcontractor. Resolution of this factual conflict is not often easily resolved.

## **VI. The Miller Act and Pass-Through Claims**

The question addressed in this section is whether a pass-through clause in the subcontract precludes a subcontractor from filing a Miller Act lawsuit to enforce its claims against a prime contractor and its surety because the subcontract contains a clause precluding Subcontractor from instituting an action or suit against a prime contractor until prime contractor has exhausted its administrative remedies under its contract with Government.

Case law supports the proposition that the administrative remedies included in a prime contract should not preclude a subcontractor from pursuing its Miller Act rights. Often, a subcontract will contain a clause stating:

In the event that the Subcontractor asserts a claim against the General Contractor for additional compensation or damages for breach of contract, and if such claim entitles the General Contractor to relief, in whole or in part, against and/or from the Government, then the Subcontractor shall institute no action or suit against the General Contractor in any court until the General Contractor has exhausted its remedies against the Government for recovery of said additional compensation or damages for breach of contract before any relevant contracting officer, board of contract appeals, and/or courts.

Does the above pass-through clause prevent the Subcontractor from pursuing its Miller Act lawsuit? The answer is, in most instances, no. The clause does not prevent the Subcontractor from filing its Miller Act lawsuit. First, Congress amended the Miller Act in 1999 to provide that the Miller Act rights of a subcontractor can only be waived if the waiver is (1) in writing; (2) signed by the person whose right is waived; and (3) executed after the person whose right is waived has furnished labor or material for use in the performance of the contract. If the above provision, or one similar to it, is included in the subcontract between the parties before the work was performed, Courts should not consider the subcontract provision a valid waiver of Miller Act rights. 40 USC § 3133(c).

A. Any Waiver must be Timely, Clear and Explicit to Preclude a Miller Act Lawsuit

Case law strongly supports the premise that unless the waiver is clear and explicit, Subcontractor may proceed with its Miller Act claims against a General Contractor and its surety. In *US f/u/b/o Aarow Electrical Solutions, LLC v. Continental Casualty Company, et al.*, ELH-16-3047 (D.MD. 2017), the Court held that the Miller Act permitted the Subcontractor to bring suit against the sureties 90 days following the completion of the work, without regard to whether the General Contractor's claim against the Government has been resolved pursuant to the CDA. The Court held that the CDA claims process does not justify a stay of the Subcontractor's case. The Court additionally held that the Subcontract did not contain "unambiguous language" that "provides for a stay..." In *Fanderlik-Locke Co. v. United States for the Use of M.B. Morgan*, 285

F.2d 939 (10th Cir.1960), the Court held that ordinarily the fact that a prime contractor has a claim for the same amounts pending under the ‘disputes clause’ of the prime contract, does not affect Miller Act cases.

Other cases provide similar support for the proposition that any waiver of a subcontractor’s Miller Act rights must be clear and explicit. In *United States for use & benefit of Tusco, Inc. v. Clark Constr. Grp., LLC*, 235 F. Supp. 3d 745, 760 (D. Md. 2016), the Court held that the dispute resolution provisions in the Subcontract did not preclude the Subcontractor’s Miller Act litigation. The dispute resolution provisions in the subcontract at issue did not provide a clear and explicit waiver of the Subcontractor’s Miller Act rights.

The Court cited approvingly to *U.S. for Use of DDC Interiors, Inc. v. Dawson Const. Co.*, 895 F. Supp. 270, 272–74 (D. Colo. 1995), *aff’d*, 82 F.3d 427 (10th Cir. 1996) where that Court stated that “At a minimum, an effective waiver of Miller Act rights must include mention of the Miller Act and unambiguously express intention to waive the rights provided by it. No such language is found in the contract documents before me.” The Court further stated that courts “do not favor finding that a subcontractor has contractually abandoned his rights under the act.” *H.W. Caldwell & Son, Inc. v. United States for Use and Benefit of John H. Moon & Sons, Inc.*, 407 F.2d 21, 23 (5th Cir.1969). Indeed, such a “drastic curtailment” of a subcontractor’s rights will not be read into a general agreement by the subcontractor to be bound by the terms of the prime contract. *Id.*; see *Central Steel Erection Co. v. Will*, 304 F.2d 548 (9th Cir.1962); *Fanderlik–Locke Co. v. United States for Use of Morgan*, 285 F.2d 939 (10th Cir.1960), *cert. denied*, 365 U.S. 860, 81 S.Ct. 826, 5 L.Ed.2d 823 (1961).

#### B. Pay When and if Paid Clause Usually Does Not Preclude Miller Act Litigation

In *U.S. for Use & Benefit of Walton Tech., Inc. v. Weststar Eng’g, Inc.*, 290 F.3d 1199 (9th Cir. 2002) the Court addressed whether permitting a Miller Act surety to avoid liability on the payment bond because the subcontract contained a “pay when and if paid” clause and the prime contractor had not been paid. The Court held that where the Government does not pay the prime contractor within the one year statute of limitations period, the subcontractor would be barred from asserting its Miller Act rights. The Court stated:

Walton has performed its obligations under the subcontract and waited the requisite ninety days. Permitting Defendants to avoid liability on the Miller Act payment bond based on the unsatisfied “pay if and when paid” clause in the Subcontract Agreement would prevent Walton from exercising its rights in accordance with the express terms of the Miller Act. It would, in effect, transform Walton's agreement concerning Weststar's contractual obligations into an implied waiver of Walton's rights under the Miller Act. Thus, the validity of Defendants' defense depends on whether the “pay when and if paid” clause constitutes a valid waiver of Walton's Miller Act rights. We conclude that it does not. U.S. for Use of Youngstown Welding & Eng'g Co. v. Travelers Indem. Co., 802 F.2d 1164, 1166–67 (9th Cir. 1986)(“It is well settled that the Miller Act provides security for those furnishing labor and materials on government projects and should be construed liberally to effect this object.”).

A more recent case from Western District of Virginia reaches a similar conclusion. In U.S. f/u/b/o VT Milcom, Inc. v. PAT USA, Inc., 2017 U.S. Dist. Lexis 109572 (W.D. Va. July 14, 2017), the Court held that where the paid if paid clause was not a clause involving the measure of the Subcontractor’s recovery but addressed whether the Subcontractor could or could not recover its claim, the paid if paid clause did not preclude the Subcontractor’s Miller Act litigation.

## **VII. Pass-Through Claims in Virginia**

In the public realm, Virginia allows pass-through claims against VDOT, but not other governmental entities. The only categories in which pass-through claims will be permitted in Virginia include: (1) if the action is brought in the contractor’s own name; (2) the contractor has asserted its own damages independent of the subcontractor’s damages; and (3) the contractor has not entered into a liquidating agreement making its liability entirely contingent on recovery from the owner. In other words, the existence of a liquidating agreement, in and of itself, is not likely to protect a subcontractor’s claim. In Virginia, if the contractor’s liability is made contingent on recovery from the owner, the pass through claim will be barred. However, a contractor’s claim against an owner for its subcontractor’s damages may be allowed if the claims are presented as the contractor’s own damages. Below is a brief description of the guiding “pass-through claim” jurisprudence, including the aged trilogy of the *Hyman*, *APAC*, and *Tyger* cases.

1. *George Hyman Constr. Co. v. McLean Hotel Associates, L.P.*, 14 Va. Cir. 187 (Fairfax 1988).

No new cases have evolved recently in Virginia concerning the allowability of pass-through claims. As such, the existing framework begins with *George Hyman Constr. Co. v. McLean Hotel Associates, L.P.* In that case, a contractor's pass-through claim was permitted in Fairfax Circuit court when the claim was brought in the contractor's own name against a private owner under Virginia Code 8.01-281(A). That Code section provides that a claim asserted:

....may be based on future potential liability, and it shall be no defense thereto that the party asserting such claim, counterclaim, cross-claim, or third-party claim has made no payment or otherwise discharged any claim as to him arising out of the transaction or occurrence.

Under the statute, the contractor was permitted to maintain its suit against the owner, on behalf of the subcontractors without having incurred liability to those subcontractors. The court reasoned the contractor could prove damages allegedly suffered by each subcontractor, and establish that the damages could be directly recovered by the subcontractors from the contractor. If the damages suffered result from the owner's breach of contract, it made sense to the Court to "promote judicial economy by having all claims, actual or potential, arising from the same transaction or occurrence determined in one proceeding."

2. *APAC-Virginia, Inc., ex rel, etc. v. VDOT*, 9 Va. App. 450 (1990).

In *APAC*, a contractor brought claims "on behalf of" its subcontractor, for only damages the subcontractor sustained and did not sue the agency in its own name. The court stated that privity of contract is a prerequisite in Virginia for an action based solely upon economic loss, and that a contract action "must be brought in the name of the party in whom the legal interest is vested."

The contractor argued that VDOT waived sovereign immunity under Va. Code § 33.2-1102 and privity of contract, but the Court of Appeals of Virginia refused to allow the contractor to bring a pass-through claim against VDOT. The holding prompted legislative action and the Virginia Code was amended in 1991 to expressly permit subcontractor pass-through claims on projects for that one particular agency only, VDOT. The statute has not been expanded to permit pass-through claims in connection with other non-highway state construction projects. However,

section VII below discusses proposed legislation that would potentially provide much needed parity for presentation of pass-through claims to other public agencies in Virginia.

3. *Marriott Corporation v. Thomas P. Harkins, Inc.*, 30 Vir. Cir. 515 (Fairfax 1990).

The circuit court decision in *Marriott* is critical to an understanding of the interplay of liquidating agreements and pass-through claims in Virginia. First, the pass-through claims presented by the subcontractor in this case were denied on grounds of lack of privity, in reliance on the *APAC* decision. Significantly, the contractor in *Marriott* presented subcontractor claims on behalf of its subcontractors, as opposed to the contractor in *Hyman*, who brought the claims in its own name. The court ruled that it needed to see an actual nexus between the claims and the contractor's own damages. In *Marriott*, the court held that the liquidating agreement entered into between subcontractor and contractor established that the contractor's liability to the subcontractor was contingent on its recovery from the owner. As such, the court reasoned that the contractor had no real fear of being held liable to the subcontractors and lacked any potential future liability. On these grounds, practitioners in Virginia are well-advised to preserve at least some liability for the contractor, even if the contractor is unable to recover from the owner.

4. *Tyger Construction Co., Inc. v. VDOT*, 17 Va. App. 166 (1993).

The Court of Appeals of Virginia appeared to limit its previous holding in *APAC*, when it resolved a contractor's claim against VDOT based upon its subcontractor's claimed damages. The court decided that the contractor could proceed with its suit because it brought the suit in its own name as the aggrieved party, thus taking it "outside the ambit of *APAC*." While the court addressed and approved of the contractor's styling of the suit in its own name to address the privity requirement, the court did not discuss whether the contractor alleged to have suffered its own damages resulting from the owner's alleged breaches. Hence, the decision only re-establishes and underscores that in Virginia, contractors cannot bring claims "on behalf of" their subcontractors against a private or public owner, except against VDOT.

### **VIII. Proposed Legislation to Permit Pass Through Claims to All Public Entities in Virginia – Beyond VDOT**

As mentioned above, the Virginia Code allows for subcontractor pass through claims only under VDOT contracts. *See* Virginia Code §§ 33.2-1101, 33.2-1102 and 33.2-1103. In 2000, the Virginia General Assembly addressed a Joint Resolution (House Joint Resolution No. 229) which proposed that a joint subcommittee be established to study the Virginia Public Procurement Act, specifically relating to the submission of claims on public construction projects and whether to allow contractors to submit claims to public owners on behalf of subcontractors and suppliers who have incurred costs and expenses on public projects due to acts or omissions of the public owner. The Resolution failed and no effort by the General Assembly to address this issue has been identified by the authors here.

Amending the Virginia Code to allow for pass-through claims to governmental entities in addition to VDOT is not a heavy lift, however. Any relevant statute entitling a contractor to bring an action against a governmental entity would only have to be amended as follows:

- a. Upon the completion of any contract for the construction awarded by the Governmental Entity to any contractor, if the contractor fails to receive such payment as she claims to be entitled to under the contract for herself or for her subcontractors or for persons furnishing materials for the contract for costs and expenses caused by the acts or omissions of the Governmental Entity, she may pursue her claims as called for by the administrative procedures of the Governmental Entity.
- b. No suit or action shall be brought against the Governmental Entity by a contractor or any persons claiming under her or on behalf of a subcontractor of the contractor or a person furnishing materials for the contract to the contractor on any contract executed pursuant to this article or by others on any claim arising from the performance of the contract by the contractor, subcontractor, or person furnishing materials to the contractor, unless the claimant has exhausted the review process established by the Governmental Entity.
- c. As to such portion of the claim as is denied by the Governmental Entity, the contractor may institute a civil action for such sum as she claims to be entitled to under the contract for herself or for her subcontractors or for persons furnishing materials for the contract by the filing of a petition in the Circuit Court wherein the contract was performed. Any civil action brought on behalf of a subcontractor or person furnishing materials for the contract shall only be brought for costs and expenses caused by the acts or omissions of the Governmental Entity and shall not



be brought for costs and expenses caused by the contractor. Trial shall be by the court without a jury. The Governmental Entity shall be allowed to assert any and all defenses in a case brought by or on behalf of the subcontractor or a person furnishing materials to the contractor which are available to the contractor.