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CLIENT ALERT

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# Fourth Circuit Upholds Summary Judgment Dismissing Material Supplier's Miller Act (40 U.S.C. § 3131 et seq.) Lawsuit Due to Collusion Between a Subcontractor and Its Supplier

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In a recent unpublished opinion, the Fourth Circuit Court of Appeals upheld the dismissal of a lawsuit filed under the Miller Act by a supplier of air-conditioning parts. The case illustrates the perils of dealing with parties to construction contracts that are in weak financial condition.

In 2005 the United States entered into a contract to expand and modify a Coast Guard facility in Chesapeake, Virginia. The general contractor hired a subcontractor to perform the HVAC work. In turn, the subcontractor engaged the supplier to provide the needed equipment and parts. Unbeknownst to both the general contractor and the supplier, the subcontractor was in serious financial jeopardy.

The subcontractor submitted bills for its work on the Coast Guard job, including the materials received by the supplier. It received payment in due course but did not pay the supplier with the funds received. Instead, the subcontractor used the Coast Guard funds to pay unrelated bills. This was a clear breach of its subcontract. When the supplier discovered this problem, it believed that the subcontractor needed to stay in business so that the supplier could get paid. Therefore, the supplier negotiated a new contract with the subcontractor. In exchange for the supplier's agreement not to notify the general contractor of the subcontractor's failure to make the contractually required payments, the subcontractor agreed to make monthly payments to the supplier. Shortly thereafter, however, the subcontractor went out of business without paying anything.

Because this was a public project, the general contractor was required to post a payment bond "for the protection of all persons supplying labor and material in carrying out the work provided for in the contract …" See 40 U.S.C. § 3131(b)(2) (the "Miller Act"). The supplier filed a claim and later a lawsuit under the Miller Act seeking payment from the bond for the materials that it had supplied to the job. However, the trial court ruled against the supplier. On appeal, the Fourth Circuit upheld that decision.

By entering into a side deal that kept the general contractor unaware of the subcontractor's default, the supplier's claim against the payment bond was held to be barred by the equitable doctrines of estoppel and unclean

hands. According to the Fourth Circuit, the side deal amounted to a misrepresentation by the subcontractor and supplier, which defeated the claim against the payment bond.

> Our precedent under the Miller Act establishes that a materialman makes a misrepresentation by acting with the subcontractor to enable the subcontractor to mislead the general contractor and surety.

United States of America for the use and benefit of Damuth Services, Incorporated, trading as Damuth Trane; Damuth Services, Incorporated, trading as Damuth Trane v. Western Surety Company, No. 09-1170, slip op. at 10 (4th Cir. March 4, 2010).

The Fourth Circuit then explained why the side deal between the subcontractor and supplier misled the general contractor and the surety:

> When Damuth (the "supplier") learned that H&L (the "subcontractor") had disregarded its obligation, Damuth's response was to strike a bargain with H&L, by which Damuth procured a consideration, i.e., payment, in exchange for a promise not to 'tell.'
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> Damuth and H&L acted affirmatively in concert to cause VCMI (the "general contractor") to believe that H&L had discharged its obligation to pay for services rendered.
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> Damuth's conduct exceeded the bounds of mere silence and is sufficient to satisfy the requirement of a misleading representation for purposes of the doctrine of equitable estoppel.
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> [T]he central notion of the estoppel defense is that A cannot either intentionally or negligently represent to B that one state of affairs exists … and then pursue his normal statutory remedy when it becomes apparent that the state of affairs represented is inaccurate or false. (citations omitted)

Damuth Trane v. Western Surety Company, No. 09-1170, slip op. at 14, 15, 16, 17 (4th Cir. March 4, 2010).

The result was that the supplier lost hundreds of thousands of dollars in materials. This case illustrates the danger of attempting to craft "creative" solutions to construction disputes without carefully considering the potential consequences. With numerous offices throughout the United States, Hunton & Williams is able to handle all your needs relating to construction matters.

Please contact Kevin Cosgrove, Bob Tata and Carl Gray, if you have any questions.