

Contractor Side Deals Can Waive Rights



Here at Construction Law Musings, we are quite fond of the Federal Miller Act and it's Virginia counterpart, the "[Little Miller Act](#)". Both of these statutes allow a subcontractor or supplier on a government construction project the security to perform their work with the knowledge that a bonding company will back their claim for payment. These acts are necessary because a construction company cannot file a [mechanic's lien](#) on a government owned piece of property.

As a general rule the Miller Acts impose almost strict liability on a contractor and its surety to pay for work performed by a downstream supplier or subcontractor. However, as a recent case out of the [Fourth Circuit Court of Appeals](#) makes clear, this rule is not without exceptions.

In [US ex rel Damuth Services v. Western Surety, et al.](#), the Virginia based federal appellate court examined a side deal between a mechanical contractor and its supplier regarding payment for equipment supplied to a project in Chesapeake, VA. In the Damuth case, the Plaintiff entered into an agreement with the mechanical subcontractor (H & L) for full payment for other work unrelated to the Chesapeake project and for payments over time until Damuth was paid in full after finding out that H & L used payments on the project to pay for work performed elsewhere. Furthermore (and this was the kicker), Damuth agreed *not to inform the general contractor of the agreement*. H & L reneged on its agreement and Damuth sued on the bond under the Miller Act.

The Court stated that, in failing to inform the general contractor and surety, Damuth participated in misleading the general and surety. The Court found that, in light of H & L's contractual and statutory obligation to pay Damuth from funds paid to it on the project, Damuth essentially agreed to accept payment under other terms in exchange for a promise not to "rat out" H & L. This activity kept the General Contractor from being able to deal with the situation and therefore the surety did not have to pay.

The take away? Always be honest with everyone when making deals outside of the contractual chain. I would advise that you, as a subcontractor or supplier, don't make such deals on bonded projects or at the very least keep the general contractor and surety in the loop. By keeping the general contractor and surety in the loop, you avoid looking like you are in on the scam and also give the surety a chance to protect itself by paying you or at worst having to pay you when you have to make a claim.

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