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Annual Survey of Virginia Law: Construction Law

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CONSTRUCTION LAW

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I. INTRODUCTION

This article reviews recent legislation and judicial decisions in Virginia affecting owners, contractors, and design professionals in the construction context. The discussion includes amendments to the Code of Virginia promulgated by the General Assembly in the 1992 and 1993 legislative sessions, as well as important cases dealing with construction law issues decided by Virginia's state and federal courts in 1992 and the first half of 1993.

II. LEGISLATION

During the 1992 and 1993 legislative sessions, the General Assembly enacted a number of statutes affecting mechanic's liens, public procurement, the statewide building code, and the general regulation of contractors.

A. *Mechanic's Lien Laws*

The General Assembly substantially changed Virginia's mechanic's lien laws in its 1992 legislative session with the passage of Code of Virginia section 43-4.01.¹ This added section establishes new procedures by which persons who provide labor or materials to one- or two-family housing construction projects may be required

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1. Act of Apr. 6, 1992, chs. 779, 787, 1992 Va. Acts 1217, 1239 (codified at VA. CODE ANN. § 43-4.01 (Cum. Supp. 1993)). The passage of section 43-4.01 does not change the procedures for perfecting mechanic's lien claims for commercial construction projects. *Id.* § 43-4.01(A), (C).

to perfect their mechanic's lien rights. The purpose of this amendment is to give title companies additional protection from mechanic's lien claims in order to encourage these companies to continue providing insurance against mechanic's lien claims.²

Under section 43-4.01, if the building permit for any new residential construction designates a "mechanic's lien agent," then the party seeking to perfect a mechanic's lien claim against the property must follow the procedures set forth in the section. If the building permit does not include such a designation, then section 43-4.01 does not apply and the claimant may file its lien as in the past under other sections of Title 43.³

Where the building permit provides the mechanic's lien agent designation, section 43-4.01 specifies that:

(1) The building permit must be posted on the property before any labor is performed or materials furnished and must remain posted until all construction work is completed;

(2) any mechanic's lien claimant must give the mechanic's lien agent written notice by registered or certified mail of its involvement in the project. The notice must include specific identifying information for the claimant and state that the person seeks payment for the labor or materials furnished. Written evidence of delivery, or refusal of the mechanic's lien agent to accept delivery, shall be *prima facie* evidence of receipt under the statute;

(3) the written notice to the mechanic's lien agent must be received within thirty days after the first date that the claimant performs labor or furnishes material, or within thirty days of when the building permit is issued if the claimant began furnishing labor or materials prior to issuance of the permit. If the claimant fails to file such written notice as specified, it may still impose a lien on the property at a later date, but only for labor or materials furnished after notice is given; and,

2. See R. Gouldner, *Changes in Virginia's Mechanic's Lien Law*, VIRGINIA LAWYER, Sept. 1992, at 30, 31.

3. VA. CODE ANN. § 43-4.01 (Cum. Supp. 1993). The General Assembly also added a new statute to Title 36 of the code which specifies that the building permit for one- and two-family housing projects may include the name and address of a designated "mechanic's lien agent." Act of Apr. 6, 1992, chs. 719, 787, 1992 Va. Acts 1217, 1239 (codified at VA. CODE ANN. § 36-98.01 (Cum. Supp. 1993)).

(4) the mechanic's lien agent is required to transmit notices of lien to the "settlement agent" upon receipt.⁴

In a separate amendment, the General Assembly specified that the following entities can serve as "mechanic's lien agents:" (1) a Virginia attorney; (2) a title insurance company authorized to write title insurance in Virginia, one of its subsidiaries, or one of its licensed title insurance agents; or, (3) a financial institution engaged in the banking or savings business in Virginia or a service corporation, subsidiary, or affiliate of such financial institution.⁵

Finally, the General Assembly added section 43-13.2 which imposes disclosure duties on the owner/developer of residential housing relative to mechanic's lien claims.⁶ An owner of residential property, who is also the developer, contractor, or a subcontractor, must provide an affidavit at the time of sale to the buyer. The affidavit must state that all persons providing labor and materials in privity of contract with the owner have been paid, or otherwise identify those persons in privity who claim to have not been paid and also the amount of their claims. The section further states that willful omissions or misstatements in the affidavit that cause financial loss to any person shall be punishable as a felony.⁷

B. *Public Procurement*

In its 1992 legislative session, the General Assembly amended code section 11-61 to permit a contractor bidding on a public project to furnish as security for the bid a personal or property bond

4. VA. CODE ANN. § 43-4.01 (Cum. Supp. 1993). Mechanic's lien agents are entitled under section 43-4.01 to enter written agreements relative to handling funds used to pay for labor and materials for the project, and may charge a reasonable fee for the services rendered. *Id.*

5. Act of Apr. 6, 1992, chs. 779, 787, 1992 Va. Acts 1217, 1239 (codified at VA. CODE ANN. § 43-1 (Cum. Supp. 1993)). Elsewhere in the Code the General Assembly addressed the duties of the "settlement agent" who will be receiving the notices of any mechanic's lien claims from the mechanic's lien agent. The settlement agent is defined in section 6.1-2.10 of the Code as the person "responsible for conducting the settlement and disbursement of the settlement proceeds. . ." VA. CODE ANN. § 6.1-2.10 (Cum. Supp. 1993). The settlement agent is responsible for informing purchasers of residential real estate of the availability of title insurance, including mechanic's lien coverage, and to obtain a written statement from the purchaser indicating whether the purchaser elects to buy such coverage. VA. CODE ANN. § 6.1-2.13 (Cum. Supp. 1993); VA. CODE ANN. § 38.2-4616 (Cum. Supp. 1993).

6. Act of Apr. 6, 1992, chs. 779, 787, 1992 Va. Acts 1217, 1239 (codified at VA. CODE ANN. § 43-13.2 (Cum. Supp. 1993)).

7. *Id.*

or a letter of credit in lieu of a payment and performance bond.⁸ The alternative security must be approved by the Virginia Attorney General, in the case of state agencies, or the attorney for the political subdivision, in the case of political subdivisions.⁹

In its 1993 legislative session, the General Assembly added section 11-46.3¹⁰ to the Public Procurement Act.¹¹ Section 11-46.3 requires contractors who contract with the Commonwealth or its agencies to carry workers' compensation coverage for the duration of the contract.¹² The section also requires the contractor to supply evidence of such coverage on a form to be provided prior to the award of the contract.¹³ The same obligation is imposed on all subcontractors on the project. Finally, the section imposes the same insurance requirement on contractors and subcontractors doing work for any locality after January 1, 1994.¹⁴

The General Assembly also amended code section 11-79 in 1993.¹⁵ Prior to amendment, section 11-79 barred a firm providing architectural or engineering services to a public body from selling to that body building materials or supplies to be used on the project in question.¹⁶ After the amendment, any design firm, acting as a subcontractor to the architectural or engineering firm in contractual privity with the public body, is similarly barred from designating itself as the sole source for any building materials or supplies to be used on the project.¹⁷

Finally, the General Assembly amended section 22.1-140 changing the certification architects and engineers designing public school construction projects are required to include in their plans.¹⁸ Prior to amendment, section 22.1-140 required the design professional to certify that "to the best of his knowledge and belief" the plans complied with the board of education's regulations

8. Act of Apr. 5, 1992, ch. 765, 1992 Va. Acts 1187 (codified at VA. CODE ANN. § 11-61 (Repl. Vol. 1993)).

9. *Id.*

10. Act of Mar. 26, 1993, ch. 642, 1993 Va. Acts 882 (codified at VA. CODE ANN. § 11-46.3 (Repl. Vol. 1993)).

11. VA. CODE ANN. §§ 11-35 to -80 (Repl. Vol. 1993).

12. VA. CODE ANN. § 11-46.3 (Repl. Vol. 1993).

13. *Id.*

14. *Id.*

15. Act of Mar. 15, 1993, ch. 202, 1993 Va. Acts 228 (codified at VA. CODE ANN. § 11-79 (Repl. Vol. 1993)).

16. VA. CODE ANN. § 11-79 (Repl. Vol. 1989).

17. *Id.*

18. VA. CODE ANN. § 22.1-140 (Cum. Supp. 1993).

and the statewide building code.¹⁹ After the amendment, the design professional must certify that in his "professional opinion and belief" the plans so comply.²⁰ The obvious intent of the amendment is to impose an express professional standard of care on the designer such that negligent preparation will violate the certification, as opposed to the previous standard based solely on the designer's knowledge and belief.

C. *Building Code Matters*

In the 1992 legislative session, the General Assembly modified section 19.2-8 of the code to provide a new statute of limitations for criminal prosecution of building code violations.²¹ With passage of the amendment, criminal prosecution can be initiated within one year of discovery of the violation by the owner or building official, provided that such discovery occurs within one year after occupancy or use of the building or issuance of a certificate of occupancy.²²

In the 1993 legislative session, the General Assembly amended code section 36-106 to specify the fines to be imposed on those persons convicted of multiple violations of the Uniform Statewide Building Code.²³ A person convicted of a second building code offense within five years of the first offense shall be punished by a fine between \$1000 and \$2500. If the second conviction is more than five years — but less than ten years — after the first offense, the fine shall be between \$500 and \$2500. Any person convicted of three or more offenses within ten years of the first offense shall be punished by a fine of between \$1500 and \$2500. The fine schedule is limited to building code violations which render the building or structure "unsafe or unfit for human habitation."²⁴

During the 1993 session, the General Assembly also added section 54.1-1115.1 to the Code.²⁵ This new section permits the Board

19. VA. CODE ANN. § 22.1-140 (Cum. Supp. 1992).

20. VA. CODE ANN. § 22.1-140 (Cum. Supp. 1993).

21. Acts of Mar. 5, 1992, Mar. 23, 1992, Apr. 3, 1992, chs. 177, 435, 650, 1992 Va. Acts 229, 557, 956, (codified at VA. CODE ANN. § 19.2-8 (Cum. Supp. 1993)).

22. *Id.*

23. Act of Mar. 28, 1993, ch. 788, 1993 Va. Acts 1136 (codified at VA. CODE ANN. § 36-106 (Cum. Supp. 1993)).

24. *Id.*

25. Act of Apr. 7, 1993, ch. 942, 1993 Va. Acts 1525 (codified at VA. CODE ANN. § 54.1-1115.1 (Cum. Supp. 1993)).

of Contractors, when conducting a hearing pursuant to section 54.1-1114, to consider as evidence written documentation of a building code violation provided by local building officials. Such evidence, however, shall not be deemed *prima facie* evidence of such violation.²⁶

Finally, the General Assembly amended section 55-518 in 1993 to require the builder of new residential property to disclose to the purchaser in writing all known material defects in the construction which would constitute a violation of the building code.²⁷ The disclosure obligation imposed by the section will not abrogate any warranty imposed by law or contract that might otherwise exist and cannot be disclaimed contractually by the builder.²⁸

D. Regulation of Contractors

In 1992 the General Assembly amended two sections of Title 54 of the code regarding regulation of contractors. First, the General Assembly changed the definitions of Class A and Class B contractors in section 54.1-1100.²⁹ Class B contractors can perform or manage construction-related activity for any project involving a total value of less than \$70,000 as long as the total value of all construction-related activity performed or managed for any twelve-month period is less than \$500,000.³⁰ A Class A contractor's license will be required if either the \$70,000 single-project value or the \$500,000 annualized value is exceeded.³¹ Additionally, the General Assembly amended the section to require a Class A license for all landscape irrigation work, regardless of the value of the construction to be performed.³²

Finally, the General Assembly amended section 54.1-1110 to authorize the Virginia Board of Contractors to suspend, revoke, or deny renewal of an existing license, or refuse to issue a license, to

26. *Id.*

27. Act of Mar. 29, 1993, ch. 824, 1993 Va. Acts 1195 (codified at VA. CODE ANN. § 55-518(B) (Cum. Supp. 1993)).

28. *Id.*

29. Act of Mar. 10, 1992, ch. 243, 1992 Va. Acts 303 (codified at VA. CODE ANN. § 54.1-1100 (Cum. Supp. 1993)).

30. *See id.*

31. *Id.*

32. *Id.*

any contractor who fails to pay for unemployment or workers' compensation insurance in violation of Virginia law.³³

III. JUDICIAL DECISIONS

A. *Mechanic's Liens*

Through numerous anti-lien decisions, the Supreme Court of Virginia has created several procedural barriers to the valid enforcements of a mechanic's lien claim.³⁴ The decisions by the supreme court in 1992 and the first half of 1993, however, may signal a move away from an "anti-lien" orientation. In several cases, the court ruled in favor of the mechanic's lien claimant and rejected the procedural attack on the claim presented on appeal.

Since the beginning of 1992, the Virginia Supreme Court has decided three new "necessary party" cases: *James T. Bush Construction Co. v. Patel*,³⁵ *George W. Kane, Inc. v. NuScope, Inc.*,³⁶ and *Air Power, Inc. v. Thompson*.³⁷ The necessary party concept is of particular importance in the mechanic's lien context, in that failure to name all necessary parties in the memorandum of mechanic's lien and/or in the suit to enforce the lien will render the lien invalid, unless the claimant by amendment can correct the defect within the time periods imposed in the mechanic's lien statutes.³⁸

In *Bush*, the supreme court ruled that the mechanic's lien claimant had failed to add a necessary party to the enforcement suit.³⁹ The claimant, an excavating subcontractor, had filed a memorandum of mechanic's lien prior to the recordation of a deed of trust on the same property.⁴⁰ After the deed of trust was filed, the sub-

33. Act of Mar. 10, 1992, ch. 243, 1992 Va. Acts 303 (codified at VA. CODE ANN. § 54.1-1110 (Cum. Supp. 1993)).

34. Thomas M. Wolf, *Virginia's Mechanic's Lien Statute — Needed Improvements to Make It Work*, VIRGINIA LAWYER, Sept. 1991, at 13-14.

35. 243 Va. 84, 412 S.E.2d 703 (1992).

36. 243 Va. 503, 416 S.E.2d 701 (1992).

37. 244 Va. 534, 422 S.E.2d 768 (1992).

38. See, e.g., *Mendenhall v. Cooper*, 239 Va. 71, 387 S.E.2d 468 (1990) (holding that original lender, its trustee, and two condominium unit owners were necessary parties and failure to name them in bill to enforce mechanic's lien claim within six months of filing of the memorandum of mechanic's lien rendered claim unenforceable). For a discussion of the necessary party doctrine in Virginia as applied to mechanic's lien claims, see J. Hart, *Due Process and Mechanic's Liens*, VIRGINIA LAWYER, Jan. 1993, at 22-27.

39. *Bush*, 243 Va. at 85, 412 S.E.2d at 703-04.

40. *Id.* at 85, 412 S.E.2d at 703-04.

contractor filed a bill to enforce its mechanic's lien. The subcontractor named the trustees under the deed of trust as defendants in the enforcement suit, but did not name the deed of trust beneficiary within the requisite six-month limitation period.⁴¹

The Supreme Court of Virginia held that the mechanic's lien claim was invalid because of the claimant's failure to include the deed of trust beneficiary in the suit. The court reasoned that the purpose of the mechanic's lien suit was to subject the liened real estate to sale, and that such sale may not be sufficient to satisfy the mechanic's lien and the subsequently filed deed of trust. Because the deed of trust beneficiary could find its lien "defeated or diminished" as a result of the mechanic's lien suit, due process considerations required that it be a necessary party to the pending suit.⁴² The claimant's failure to include the beneficiary in the suit within the required six-month time limit invalidated the mechanic's lien claim.⁴³

41. *Id.* at 84, 412 S.E.2d at 704. The six-month limitation period for filing the bill to enforce a mechanic's lien is found in § 43-17 of the Code. VA. CODE ANN. § 43-17 (Cum. Supp. 1993).

42. *Id.* at 88, 412 S.E.2d at 704-05. The Supreme Court of Virginia in *Bush* relied upon its decision in *Walt Robbins, Inc. v. Damon Corp.*, 232 Va. 43, 348 S.E.2d 223 (1986), where the court held that failure to include the trustee and beneficiary of an antecedent deed of trust was fatal to the enforcement of the mechanic's lien claim. *Robbins*, 232 Va. at 47-48, 348 S.E.2d at 227. The *Bush* court refused to follow its earlier decision in *Monk v. Exposition Corp.*, 111 Va. 121, 68 S.E. 280 (1910). *Bush*, 243 Va. at 87-88, 412 S.E.2d at 705. In *Monk*, the supreme court held that bondholders secured by a deed of trust and their trustees were not necessary parties to a mechanic's lien enforcement suit, where the deed of trust had been filed after the filing of the memorandum of mechanic's lien. *Monk*, 111 Va. at 122, 68 S.E. at 280. Obviously, the supreme court has become more sensitive to due process concerns in the 80 years since it decided *Monk*.

43. *Bush*, 243 Va. at 88, 412 S.E.2d at 705. In a footnote, the *Bush* court did raise the question of whether an amendment to the Code of Virginia section 8.01-6 while the case was pending may have called for a different result, but the court expressed no opinion since neither the parties nor the trial court had made note of the statute. *Bush*, 243 Va. at 88 n.2, 412 S.E.2d at 705 n.2. The amendment to Code of Virginia section 8.01-6 to which the court alludes in *Bush* permits a plaintiff's amendment to its pleadings, which names a new defendant, to relate back to the original filing if: (1) the claim asserted in the amended pleading arose out of the same transaction as that set forth in the original pleadings; (2) the party to be added by amendment received notice of the claim within the original limitations period so as to not be prejudiced in having to defend the case; and, (3) the party knew or should have known that, but for a mistake concerning the identity of the proper party, the action would have been filed correctly in the first instance. VA. CODE ANN. § 8.01-6 (Repl. Vol. 1992). It is difficult to see how the amendment to section 8.01-6 could have had any bearing on the outcome in *Bush*, however, since the suit was dismissed because of a failure to include additional necessary parties in the original pleadings, and not because of a failure to name the "proper party" initially.

In *Kane*, the Supreme Court of Virginia had its first opportunity to consider the "necessary party" concept in the context of Virginia's bonding-off statute.⁴⁴ The subcontractor in *Kane* had filed a mechanic's lien which the general contractor had promptly bonded off with surety approved by the trial court. The subcontractor thereafter filed its bill to enforce, naming as parties only the general contractor and the sureties on the bonds. Over the defendants' objection, the commissioner in chancery who heard the case ruled that all necessary parties were before the court, which ruling the defendants appealed to the supreme court.⁴⁵

The Supreme Court of Virginia affirmed the commissioner's ruling, holding that the owner of the property and the beneficiaries and trustees of the antecedent deed of trust were not necessary parties to the suit to enforce the mechanic's lien.⁴⁶ The court observed that the purpose of the bonding-off statute is to provide the mechanic's lien claimant an alternative form of security for the claim, while allowing the real estate to be freed of the encumbrance so that further financing of the construction will not be withheld.⁴⁷ Upon filing of the bond, the statute specifies that the mechanic's lien ceases to exist and the bond becomes the claimant's sole security for its lien claim.⁴⁸ At the point that the mechanic's lien is bonded off, the owner of the property and the beneficiaries and trustees of any deeds of trust no longer have "an interest . . . which is likely either to be defeated or diminished" by the outcome of the ongoing mechanic's lien suit.⁴⁹ Therefore, these entities are not necessary parties to a bonded-off mechanic's lien claim, and there are no due process considerations requiring that they be included in the suit to protect their property interests.⁵⁰

In *Air Power* the Supreme Court of Virginia addressed whether a beneficiary of a land trust is a necessary party to a mechanic's lien enforcement action.⁵¹ In a land trust, the trustees hold both equitable and legal title to the real estate, and the beneficiaries of the trust possess only a personal property right in the "rents, pro-

44. VA. CODE ANN. § 43-71 (Repl. Vol. 1990).

45. *George W. Kane, Inc. v. NuScope, Inc.*, 243 Va. 503, 505, 416 S.E.2d 701, 702 (1992).

46. *Id.* at 510, 416 S.E.2d at 705.

47. *Id.* at 508-09, 416 S.E.2d at 703-04.

48. *Id.*

49. *Id.* at 509, 416 S.E.2d at 705 (quoting *Mendenhall v. Cooper*, 239 Va. 71, 75, 398 S.E.2d 468, 470 (1990)).

50. *Kane*, 243 Va. at 503, 416 S.E.2d at 704.

51. *Air Power, Inc. v. Thompson*, 244 Va. 534, 535, 422 S.E.2d 768, 769 (1992).

ceeds, and profits" from the real estate.⁵² Given the unique legal arrangements of a land trust, the supreme court noted that any due process considerations the beneficiaries may be entitled to pertain only to the "proper distribution of rents, proceeds and profits from the property, not in the property itself."⁵³ As such, the beneficiaries of the land trust are proper, but not necessary, parties to the mechanic's lien enforcement suit.⁵⁴

In 1992, the Supreme Court of Virginia also considered a case involving the "blanket lien" concept. As in two of the three "necessary party" cases, the court ruled in favor of the mechanic's lien claimant. In *Blue Ridge Construction Co. v. Stafford Development Group*,⁵⁵ the supreme court considered whether a general contractor who built access roads, performed clearing and grading activities, and installed water and sewer main lines and laterals on certain property had filed an over-inclusive lien.⁵⁶ The property consisted of two noncontiguous subparts of a larger parcel from which certain conveyances had been made prior to the contractor beginning its work. Much of the contractor's work had been done on one, but not the other, of the two subparts. The two subparts had been subdivided into a series of lots on a preliminary site plan that had been incorporated in the contract documents for the project. The site plan, however, had never been recorded and approved as a plat of subdivision.⁵⁷

The contractor filed its single lien on the two subparts describing the property by a metes and bounds description available in the land records of the courthouse. The owner challenged the lien on the ground that the contractor should have filed liens on the separate subparts of the property. The supreme court acknowledged that it had in its recent decisions made clear that a mechanic's lien will be deemed invalid if it is over-inclusive; that is, if it extends beyond the property actually improved to include other property not so benefitted.⁵⁸ In *Blue Ridge*, however, the

52. *Id.* at 537, 422 S.E.2d at 770 (citing *Curtis v. Lee Land Trust*, 235 Va. 491, 494, 369 S.E.2d 853, 854 (1988)).

53. *Id.* at 537, 422 S.E.2d at 770 (citing *Lamar Corp. v. City of Richmond*, 241 Va. 346, 349-50, 402 S.E.2d 31, 33 (1991)).

54. *Air Power*, 244 Va. at 538, 422 S.E.2d at 772.

55. 244 Va. 361, 421 S.E.2d 199 (1992).

56. *Id.*

57. *Id.* at 362-63, 421 S.E.2d at 200.

58. *Id.* at 364-65, 421 S.E.2d at 200-01 (citing *Woodington Elect. v. Lincoln Sav.*, 238 Va. 623, 385 S.E.2d 872 (1989); *Rosser v. Cole*, 237 Va. 572, 379 S.E.2d 323 (1989)).

court held that the lien in question was not overly inclusive and that the contractor should be able to rely on the description of the property as set forth in the land records.⁵⁹ These records reflected a single parcel from which some portions of the property had been conveyed to third parties. The contractor had incorporated in its lien filings the metes and bounds description that was available in the land records. The supreme court observed that the owner could have avoided the result of a single lien burdening the entire property by simply recording an improved subdivision plat in the land records of the local court.⁶⁰

The Supreme Court of Virginia considered three novel mechanic's lien issues in *American Standard Homes Corp. v. Reinecke*.⁶¹ In *American Standard*, a prefabricated home manufacturer entered into a contract to sell homes to a single buyer who thereafter sold the units to third parties. The manufacturer and buyer also entered into a second written contract, designated as a "material order contract," in which certain "extras" were identified to be provided with each home.⁶² The material order contract obligated the buyer to pay eighteen percent interest on all debts due after thirty days and further required the buyer to pay the manufacturer twenty-five percent attorneys' fees if collection efforts were required. Finally the material order contract stipulated that it was the "complete agreement" between the parties.⁶³

After the manufacturer had delivered a number of homes under the general contract and the customized "extras" under the material order contract, the buyer ceased doing business. The manufacturer filed memoranda of mechanic's liens against the properties where the homes had been located and subsequently bills to enforce the liens.⁶⁴ During the proceedings before the commissioner in chancery, some of the owners of the affected lots objected to the validity of the liens on the ground that they had not been filed within the requisite ninety-day period mandated in section 43-4 of the Code of Virginia.⁶⁵

59. *Blue Ridge*, 244 Va. at 365, 421 S.E.2d at 201.

60. *Id.* at 364-65, 421 S.E.2d at 201.

61. 245 Va. 113, 425 S.E.2d 515 (1993).

62. *Id.* at 116, 425 S.E.2d at 516.

63. *Id.*

64. *Id.*

65. *Id.* at 117-18, 425 S.E.2d at 516. Section 43-4 of the Code requires a mechanic's lien claimant to file its lien not later than ninety days after the last day of the month in which the claimant last furnished materials to the site. VA. CODE ANN. § 43-4 (Repl. Vol. 1990).

The lot owners in *American Standard* contended that the "extras" furnished pursuant to the material order contract had been delivered greater than ninety days before the liens were filed. The home manufacturer, on the other hand, contended that the ninety-day period had been tolled by the buyer's subsequent purchase orders for additional materials to replace original materials that had been lost, damaged, or stolen.⁶⁶

The supreme court in *American Standard* rejected the manufacturer's tolling argument. The court reasoned that, upon delivery of the extras provided in the material order contract, the manufacturer had furnished all materials called for in that contract, which expressly stated that it represented the complete agreement of the parties.⁶⁷ Subsequent purchase orders for replacement materials, the court concluded, were separate contracts that would not extend the date for filing the lien as to the material order contracts.⁶⁸

The second issue presented in *American Standard* was whether the manufacturer could recover interest at the contract rate of eighteen percent as part of its mechanic's lien claim. The supreme court ruled that contract interest was so recoverable.⁶⁹ In reaching this result, the *American Standard* court first noted that code section 6.1-330.53 specifies that a contract rate of interest is recoverable on a judgment based on the contract.⁷⁰ The court then noted that, while the mechanic's lien statutes are silent as to interest, the forms prescribed in sections 43-5, -8, and -10 of the code⁷¹ contain a blank for the claimant to include the date from which interest is claimed. The court reasoned that these references to interest in the forms signaled that the General Assembly intended for interest to be recoverable on a mechanic's lien claim.⁷² The court then reasoned that the General Assembly could have expressly excluded interest as a recoverable item on a mechanic's lien claim or could

66. *American Standard*, 245 Va. at 119-20, 425 S.E.2d at 517.

67. *Id.* at 120, 425 S.E.2d 519.

68. *Id.* The supreme court in *American Standard* observed that a ruling in favor of the manufacturer on the tolling argument would permit materialmen to preserve their rights to file mechanic's liens indefinitely by merely making other sales for replacement materials to the buyer well beyond the original ninety-day period set out in section 43-4 of the Code of Virginia. *Id.* The supreme court rejected the mechanic's lien claimant's argument that a "good faith" rule should be crafted to limit the claimant's right to file claims under such circumstances. *Id.* at 121 n.2, 425 S.E.2d at 519 n.2.

69. *American Standard*, 245 Va. at 123, 425 S.E.2d at 520.

70. VA. CODE ANN. § 6.1-330.53 (Repl. Vol. 1988).

71. VA. CODE ANN. §§ 43-5, -8, -10 (Repl. Vol. 1990).

72. *American Standard*, 245 Va. at 123, 425 S.E.2d at 520.

have limited such recovery to the legal rate of interest had either alternative been its intent. The court, therefore, concluded that the General Assembly's failure to impose any limitations on interest demonstrated a legislative intent that interest at the contract rate, as permitted in code section 6.1-330.53 was recoverable as part of a mechanic's lien claim.⁷³

The *American Standard* court finally considered whether the mechanic's lien claimant could recover contractually permitted attorneys' fees in the mechanic's lien suit. In deciding it could not,⁷⁴ the court contrasted the mention of interest in the statutory forms to the absence of any reference to attorneys' fees anywhere in the mechanic's lien statutes. This omission, the court reasoned, demonstrated a legislative intent that contractual attorneys' fees not be recoverable as part of the lien claim.⁷⁵

The final recent case dealing with a mechanic's lien issue decided by the Supreme Court of Virginia is *Vansant and Gusler, Inc. v. Washington*.⁷⁶ In *Vansant*, the court addressed whether code section 43-13 creates a private right of action for damages in favor of subcontractors who are not paid by their general contractor.⁷⁷ Section 43-13, a criminal statute, treats a contractor's diversion of funds due its subcontractors to other uses with the intent to defraud as larceny. The statute also imposes criminal liability on the contractor's officers, directors, and employees in such circumstances.⁷⁸

In *Vansant*, the subcontractor, a consulting engineering firm, sued both the general contractor, an architectural firm, and the architectural firm's officers and directors. The architectural firm suffered a default judgment on the subcontractor's contract claim. The subcontractor continued its suit against the architectural firm's officers and directors, alleging that section 43-13 not only imposed criminal liability on them, but also provided the subcontractor a private cause of action against them individually to recover the funds not paid by the contractor.⁷⁹

73. *Id.* at 122-23, 425 S.E.2d at 519-20.

74. *Id.* at 123-24, 425 S.E.2d at 520-21.

75. *Id.* The *American Standard* court did acknowledge that the chancery court as part of its equity proceedings would have the authority to enter a separate money judgment for attorneys' fees as a claim sounding in contract. *Id.* at 124, 425 S.E.2d at 520.

76. 429 S.E.2d 31 (1993).

77. *Id.* at 32.

78. VA. CODE ANN. § 43-13 (Repl. Vol. 1990).

79. *Vansant*, 429 S.E.2d at 32.

The supreme court rejected the subcontractor's argument that section 43-13 provided it a private cause of action against the individual defendants. The court noted that the statute is "purely a criminal statute" which does not expressly provide any civil cause of action. Moreover, the court observed that a private cause of action could not be implied because the statute expressly provided for a remedy (the criminal sanction) and, absent language to the contrary, that remedy must be deemed exclusive.⁸⁰

The *Vansant* court rejected the subcontractor's additional ingenious argument that code section 8.01-221 provided express recognition of the private cause of action when read in conjunction with section 43-13.⁸¹ Section 8.01-221 states in pertinent part that:

Any person injured by the violation of any statute may recover from the offender such damages as he may sustain by reason of the violation, even though a penalty or forfeiture for such violation be thereby imposed, unless such penalty or forfeiture be expressly mentioned to be in lieu of such damages.⁸²

The supreme court relied upon its prior decisions construing section 8.01-221 to reject the subcontractor's argument. The court observed that for decades the recognized purpose of section 8.01-221 has been to prevent a party from avoiding a civil obligation on the basis of having paid a parallel criminal penalty.⁸³

The court further observed that there was no cause of action established by statute or common law that would permit the subcontractor to sue the officers and directors of the contractor individually to recover funds not paid to the subcontractor during the course of the construction.⁸⁴ Accordingly, the court dismissed the subcontractor's appeal.⁸⁵

80. *Id.* at 33 (citing *Kayhoe Constr. Co. v. United Va. Bank*, 220 Va. 285, 289, 257 S.E.2d 837, 839 (1979), and *School Bd. v. Giannoutsos*, 238 Va. 144, 147, 380 S.E.2d 647, 649 (1989)).

81. *Id.*

82. VA. CODE ANN. § 8.01-221 (Repl. Vol. 1992).

83. *Vansant*, 429 S.E.2d at 33. In *Connelly v. Western Union Tel. Co.*, 100 Va. 51, 40 S.E. 618 (1902), the supreme court first rejected the idea that section 8.01-221's predecessor created a new cause of action. In *Connelly* the supreme court held that the predecessor statute's purpose was merely to prevent a person who was subjected to criminal sanction from contending that the criminal sanction was an exclusive remedy, thereby barring subsequent civil suit to recover damages. *Connelly*, 100 Va. at 62-63, 40 S.E. at 622.

84. *Vansant*, 429 S.E.2d at 34.

85. *Id.*

A recent circuit court case regarding mechanic's liens dealt with the tolling effect bankruptcy has on the requirement to file an enforcement suit within six months of the filing of the lien.⁸⁶ In *United Sprinkler Co. v. HCP 505 Ltd., Inc.*,⁸⁷ a sprinkler trade contractor filed a memorandum of mechanic's lien against the property of an owner that had been forced into bankruptcy. Because of the bankruptcy stay, the contractor did not file its enforcement suit within six months after filing its memorandum of lien.⁸⁸

During the bankruptcy proceedings, the court granted the construction lender relief from the stay to institute foreclosure proceedings against the lien property. The lender thereafter purchased the foreclosed property and assigned the bid to HCP 505. Several months later, the contractor, United Sprinkler, brought its enforcement suit against the property. HCP demurred on the ground that United Sprinkler did not file the suit within six months as required by code section 43-17.⁸⁹

The circuit court rejected the demurrer, observing that section 108(c) of the Bankruptcy Code⁹⁰ and section 8.01-229 of the Code of Virginia⁹¹ jointly tolled the six-month time period imposed in section 43-17.⁹² The court rejected HCP's argument that the six-month time period, even if tolled during the bankruptcy proceedings, began to run when the bankruptcy court granted the lender

86. VA. CODE ANN. § 43-17 (Repl. Vol. 1990) ("No suit to enforce [a mechanic's lien] shall be brought after six months from the time when the memorandum of lien was recorded.")

87. 27 Va. Cir. 135 (Fairfax County 1992).

88. *Id.* at 135-36.

89. *Id.* at 136.

90. 11 U.S.C. § 108(c) (1978). Section 108(c) states in pertinent part:

[I]f applicable nonbankruptcy law . . . fixes a period for commencing . . . a civil action in a court other than a bankruptcy court on a claim against the debtor . . . and such period has not expired before the date of the filing of the petition, then such period does not expire until the later of:

(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or (2) 30 days after notice of the termination or expiration of the stay under section 362 . . . with respect to such claim.

Id.

91. VA. CODE ANN. § 8.01-229 (Repl. Vol. 1992). Section 8.01-229 states in pertinent part: When the filing of an action is obstructed by a defendant's (i) filing a petition in bankruptcy or filing a petition for an extension or arrangement under the United States Bankruptcy Act or (ii) using any other direct or indirect means to obstruct the filing of an action, then the time that such obstruction has continued shall not be counted as any part of the period within which the action must be brought. . . .

Id.

92. *United Sprinkler*, 27 Va. Cir. at 136-37.

relief from the stay and had thus expired when United Sprinkler filed its enforcement suit over six months later.⁹³ Rather, the court concluded that the relief from the stay did not start the six-month period running because the bankruptcy court only lifted the stay as to the construction lender, and not the other creditors of the bankrupt debtor.⁹⁴ As such, the property remained property of the bankruptcy estate and subject to the stay until the lender concluded foreclosure less than five months before United Sprinkler initiated its enforcement action. The court, therefore, concluded that the enforcement suit had been timely filed.⁹⁵

B. *Contract Disputes Between Contractors and Subcontractors*

The Supreme Court of Virginia recently decided an important case dealing with the evidentiary requirements of lost profit and "extra" claims that will affect how such damage claims are proved in the future. In *TechDyn Systems Corp. v. Wittaker Corp.*,⁹⁶ a general contractor sued its subcontractor for delay damages and lost profits from a software program contract with the United States Air Force.⁹⁷ The subcontractor counterclaimed for work performed outside the scope of the original contract.

A jury awarded the general contractor over one million dollars on its claims, and the subcontractor over \$500,000 on its counterclaim. The trial court set aside the verdict in favor of the general contractor and entered judgment in favor of the subcontractor.⁹⁸ On appeal, the general contractor contended that the trial court erred in setting aside the jury verdict on the delay claim.⁹⁹ The subcontractor, in contrast, contended that the general contractor was not entitled to delay damages because delay on the project was

93. *Id.* at 137.

94. *Id.*

95. *Id.* at 137-38. On the related issue of timely filing of a payment bond claim under the Miller Act, 40 U.S.C. § 270b(a) (1978), see *United States ex rel. American Sheet Metal Corp. v. Fidelity and Deposit Co. of Maryland*, 807 F. Supp. 391 (E.D. Va. 1992) (failure to give statutory ninety-day notice to contractor and surety barred subcontractor's payment bond claim).

96. 245 Va. 291, 427 S.E.2d 334 (1993).

97. *Id.* at 293-94, 427 S.E.2d at 336. The *TechDyn* case is not technically a construction case as the contract in question dealt with creation of a computer software package and not a structure or building. The legal issues in the case, however, are directly applicable to the construction context and the case will certainly have impact in future construction law cases.

98. *Id.* at 293, 427 S.E.2d at 336.

99. *Id.* at 296, 427 S.E.2d at 337.

caused by numerous factors, some of which had nothing to do with the subcontractor's actions. The subcontractor asserted that the delay claim was defective because the general contractor had not apportioned the damages specifically caused by the subcontractor.¹⁰⁰

The supreme court in *TechDyn* initially conceded that where a plaintiff's damages result from multiple causes, some of which are not attributable to the defendant, the plaintiff must prove with a "reasonable degree of certainty" the portion of damages actually caused by the defendant in order to recover.¹⁰¹ The court concluded that the general contractor had presented sufficient evidence of the delay damages directly attributable to the subcontractor's actions on the project. The fact that the subcontractor presented counter-evidence to suggest that the delay had other causes presented a jury issue, which the jury resolved in favor of the contractor. Based on this analysis, the supreme court overturned the trial court's ruling which set aside the jury verdict on the delay damage claim.¹⁰²

In *TechDyn*, the supreme court also considered whether the trial court correctly struck the general contractor's lost profit claim.¹⁰³ The general contractor contended at trial that the subcontractor's delays prevented the contractor from releasing its employees from proposals to obtain new business. In analyzing the trial record, the supreme court observed that the general contractor did not produce evidence at trial to show that it would have been successful in obtaining new business had the employees in question been available to prepare proposals or even that these employees had a proven track record in attracting new business in the past.¹⁰⁴ Given this lack of evidence, the supreme court characterized the general contractor's lost profit claim as "remote, speculative, and uncertain, and therefore, not recoverable."¹⁰⁵

100. *Id.*

101. *Id.* (citing *Carr v. Citizens Bank & Trust*, 228 Va. 644, 325 S.E.2d 86 (1985); *Cooper v. Whiting Oil Co.*, 226 Va. 491, 311 S.E.2d 757 (1984); *Sachs v. Hoffman*, 224 Va. 545, 299 S.E.2d 694 (1983); and *Pebble Bldg. Co. v. G.J. Hopkins, Inc.* 223 Va. 188, 288 S.E.2d 437 (1982)).

102. *Tech Dyn*, 245 Va. at 298, 427 S.E.2d at 338-39.

103. *Id.* at 298, 427 S.E. 2d at 339.

104. *Id.*

105. *Id.* at 298-99, 427 S.E.2d at 339 (relying on *Murray v. Hadid*, 238 Va. 722, 385 S.E.2d 898 (1989); *ADC Fairways Corp. v. Johnmark Constr., Inc.*, 231 Va. 312, 243 S.E.2d 90 (1986)); and *Boggs v. Duncan*, 202 Va. 877, 121 S.E.2d 359 (1961).

Finally, the supreme court considered the merits of the subcontractor's counterclaim. The jury awarded the subcontractor compensation for extra work it was allegedly required to perform beyond the original contractual scope of work.¹⁰⁶ At trial, the subcontractor submitted a one-page trial exhibit summarizing the hours worked by his employees on the extra work. The data used to produce the trial exhibit was assembled by subcontractor employees who did not testify at trial. Those employees, who did testify as to the extra claim, lacked personal knowledge of the factual substance of the claim. The general contractor objected to the evidence at trial on hearsay grounds.¹⁰⁷

The supreme court agreed with the general contractor and reversed the jury verdict in favor of the subcontractor's counterclaim. The court observed that the trial testimony in support of the claim relied on the "veracity and competency" of someone who did not testify, and thus, was inadmissible hearsay.¹⁰⁸

Two recent cases have considered the validity of an owner's termination of a construction contract. In *W. C. English, Inc. v. Virginia Department of Transportation*,¹⁰⁹ the Court of Appeals of Virginia considered whether the owner could terminate a contract when, without fault of either the contractor or the owner, it becomes obvious that the amount of work and time required to complete the contract would greatly exceed that which the parties originally contemplated when the contract was executed.¹¹⁰

In *W.C. English*, the Virginia Department of Transportation (VDOT) terminated the contract when eight-one percent of the dollar value of the contract had been expended, but only forty-seven percent of the work completed. VDOT terminated the contract pursuant to a provision allowing termination for conditions beyond VDOT's control that prevented it from continuing.¹¹¹

The contractor argued that VDOT's lack of funding necessary to complete the contract was not a condition beyond VDOT's control. The contractor further contended that the termination clause of

106. *Id.* at 299-300, 427 S.E.2d at 339-40.

107. *Id.*

108. *Id.* at 299-300, 427 S.E.2d at 340 (quoting *Williams v. Morris*, 200 Va. 413, 416-17, 105 S.E.2d 829, 832 (1958); and citing *Stevenson v. Commonwealth*, 218 Va. 463, 237 S.E.2d 779 (1977), and *Lee v. Artis*, 295 Va. 343, 136 S.E.2d 868 (1964)).

109. 14 Va. App. 951, 420 S.E.2d 252 (1992).

110. *Id.* at 952-53, 420 S.E.2d at 253.

111. *Id.*

the contract was similar to the doctrine of impossibility of performance. Because additional funding could have been made available for the project, it was not impossible for VDOT to continue with the contract.¹¹²

The court of appeals in *W.C. English* rejected the view that the termination clause should be interpreted as an impossibility of performance provision. The court concluded that the clause permitted termination if a condition existed that merely hindered or forestalled continuation of the contract. The court also reasoned that the contractor's overruns, not the unavailability of funding, qualified as a condition beyond VDOT's control.¹¹³ If VDOT were not allowed to terminate the contract due to the substantial cost overruns encountered, the Commonwealth's treasury would be at the mercy of highway contractors' overruns, a condition which the contract was drafted to avoid. Therefore, the court of appeals affirmed the trial court's holding that VDOT had properly terminated the contract.¹¹⁴

In *Spotsylvania County School Board v. Seaboard Surety Co.*,¹¹⁵ the contract in question granted the school board the right to terminate the contract if the contractor was guilty of a "substantial violation" of a provision of the contract documents.¹¹⁶ After the school board terminated the contract and the surety agreed to perform all work not completed by the contractor, the surety employed the contractor as its subcontractor to complete the project. Once again, the school board gave notice that it was terminating the contract. The school board then engaged another contractor and the project was completed at almost two times the original contract amount.¹¹⁷

The school board in *Spotsylvania County* then brought suit against the surety for breach of the performance bond, and the contractor brought suit against the school board seeking damages for breach of contract. The school board filed a counterclaim seeking damages resulting from the contractor's alleged breach. The

112. *Id.* at 954, 420 S.E.2d at 254.

113. *Id.* at 954-55, 420 S.E.2d at 254.

114. *Id.* at 955, 420 S.E.2d at 255. The trial court in *W.C. English* failed to address whether VDOT was entitled to liquidated damages from the contractor; therefore, the court of appeals reversed and remanded the decision for the trial court to hear evidence on that issue.

115. 243 Va. 202, 415 S.E.2d 120 (1992).

116. *Id.* at 205, 415 S.E.2d at 122.

117. *Id.*

jury held that the school board was not justified in terminating the contract and the trial court awarded damages in the amount of \$146,430.¹¹⁸

On appeal, the supreme court rejected the school board's argument that serious violations of the BOCA Code,¹¹⁹ as admitted by the contractor's witnesses, established as a matter of law that the contractor was guilty of a material breach of the contract. The court reasoned that these admissions could not be considered alone or in the abstract in determining the breach of contract issue, but rather had to be considered by the jury along with the abundant evidence of contractual interference by the school board's project architect.¹²⁰

The supreme court nonetheless reversed and remanded the case because, while "substantial violation" was the standard agreed upon in the contract, a jury instruction required the school board to prove a "material or substantial breach of contract" in order to succeed.¹²¹ A second jury instruction defined a material or substantial breach of contract as the failure to do something which is so important and central to the contract that the breach defeats the purpose of the contract.¹²² The court reasoned that the instructions were improper because they increased the burden imposed upon the school board above the "substantial violation" standard already agreed upon by the parties in the contract.¹²³

The court then addressed two potential evidentiary issues that may arise on remand. First, the court held that the trial court erred in admitting evidence of pre-contract discussions and correspondence between the parties.¹²⁴ The supreme court observed that the contract not only was unambiguous, but it also contained a merger clause. Thus, no evidence of pre-contract discussions and correspondence should be admitted at retrial.¹²⁵

118. *Id.* at 206, 415 S.E.2d at 122. The *Spotsylvania County* trial consisted of three phases: liability, damages, and remaining issues.

119. BOCA is an acronym for the Building Officials and Code Administration. The parties agreed that "the BOCA Code was incorporated by reference in Sherman's contract with the School Board." *Id.* at 207, n.1, 415 S.E.2d 123 n.1.

120. *Id.* at 209, 415 S.E.2d at 124.

121. *Id.* at 212, 415 S.E.2d at 126.

122. *Id.* at 212, 415 S.E.2d at 125-26.

123. *Id.*

124. *Id.* at 212, 415 S.E.2d at 126.

125. *Id.*

Second, the supreme court held that evidence that the school building was overdesigned was inadmissible.¹²⁶ The contractor argued that, due to overdesign, the contractor's failure to comply with each safety feature did not make its work defective nor make the building unsafe. The supreme court, however, reasoned that it is the contract, not the contractor, which controls what design features are necessary.¹²⁷ Evidence of overdesign was thus inadmissible at retrial.¹²⁸

The supreme court also addressed two evidentiary issues that would arise in the damage phase of the retrial. The court held that the trial court had correctly excluded the school board's evidence of the cost of repairing items defectively constructed by the contractor.¹²⁹ The court reasoned that the provisions in the contract holding the contractor liable for the cost of correcting its defective work were not intended to apply in the event that the school board was in breach. Because the jury determined that the school board was in breach, it was proper to exclude the school board's offset damage evidence.¹³⁰ If, upon retrial, the jury verdict was *again* in favor of the contractor, the school board would *again* be denied the right to present evidence on its costs of repair.¹³¹

The supreme court also upheld a contractual provision that limited the contractor's damages in the event of a termination without cause.¹³² The contractor argued that, in light of the school board's breach, the limitation on the contractor's damages did not apply.¹³³ The court disagreed noting that the clause was designed for this very situation. Therefore, if the retrial demonstrated that the contract termination was without cause, the contractor's presentation of damage evidence would again be limited to the work done before termination, plus profit.¹³⁴

126. *Id.* at 213, 415 S.E.2d at 126.

127. *Id.*

128. *Id.*

129. *Id.* at 215, 415 S.E.2d at 127-28.

130. *Id.* (relying on *Hurley v. Bennett*, 163 Va. 241, 253, 176 S.E. 171, 175 (1934), and distinguishing *Kirk Reid Co. v. Fine*, 205 Va. 778, 788-89, 139 S.E.2d 829, 836-37 (1965) and *Erllich v. Hendrick Constr. Co.*, 217 Va. 108, 114-15, 225 S.E.2d 665, 669-70 (1976)).

131. *Spotsylvania County*, 243 Va. at 215, 415 S.E.2d at 128.

132. *Id.* at 216-17, 415 S.E.2d at 128-29. The contract in *Spotsylvania County* provided that, in the event of a termination without cause, the contractor was entitled to payment for work executed plus profit and any loss on materials, but not for profit on materials or labor not furnished.

133. *Id.* at 217, 415 S.E.2d at 129.

134. *Id.*

On a procedural error, the supreme court dismissed the school board's appeal of the trial court's sustaining the surety's demurrer to the school board's bad faith claim. After the jury verdict in favor of the contractor, the trial court granted summary judgment for the surety on "all claims" asserted against the surety. Because the school board had failed to object in the trial court to the awarding of summary judgment on "all claims." The supreme court, therefore, dismissed the school board's appeal on the demurrer because the school board's failure to object to the summary judgment order or to assign error as to that order on appeal.¹³⁵ Finally, the supreme court held that after the school board's nonsuit of the indemnification claim following the surety's demurrer, and motion for summary judgment on the indemnification claim was denied, questions raised by the demurrer and motion were mooted and could not be raised by the surety on appeal.¹³⁶

In *Brown v. State Board for Contractors*,¹³⁷ the Williamsburg circuit court considered when a claim against the Contractors Transaction Recovery Fund (the fund) accrued. The fund allows certain persons to make claims and obtain up to \$10,000 for unsatisfied judgments obtained against contractors for improper or dishonest conduct.¹³⁸ The plaintiffs filed suit against their contractor in May 1987 and obtained a judgment in May 1988. In the interim, however, the General Assembly passed an amendment requiring that the dollar amount of the underlying contract be within the contractor's authorized limits before a party could make a claim against the fund.¹³⁹

135. *Id.* at 219, 415 S.E.2d at 130.

136. *Id.* at 220, 415 S.E.2d at 130.

137. 27 Va. Cir. 500 (Williamsburg City 1989). Although the court rendered the *Brown* decision in 1989, it was not published until 1993.

138. VA. CODE ANN. §§ 54.1-1118 to -1127 (Repl. Vol. 1991).

139. Prior to the amendment, the Code of Virginia section 54-145.3:3 provided:

Recovery from fund generally. — Whenever any person is awarded a final judgment in a Court . . . against any individual . . . for improper or dishonest conduct and such conduct occurred during a period when such individual . . . was a regulant and occurred in connection with a transaction involving contracting, as defined in § 54-113, the judgment creditor may file a claim in the court awarding the judgment to obtain an Order directing payment from the fund of the amount unpaid upon the judgment subject to the following conditions. . . .

The 1987 amendment narrowed Virginia Code § 54.1-145.3:3 as follows:

Recovery from fund generally. — Whenever any person is awarded a judgment in a Court against any individual . . . for improper or dishonest conduct and such conduct occurred (e) during a period when such individual . . . was a regulant contracting within its license category (Class A or Class B). . . .

The plaintiffs argued that their claim accrued at the time the contractor abandoned the job. Therefore, even though the amount of their contract exceeded the contractor's authorized limits, their claim would not be barred by the subsequent statutory amendment.¹⁴⁰ The defendant State Board for Contractors, however, argued that the plaintiff's claim against the fund did not arise at the same time as their claim against the contractor. The fund had an obligation to make payment, but not until the plaintiffs had become judgment creditors.¹⁴¹ The court agreed with the defendant, holding that the plaintiffs' claim against the fund did not accrue until the judgment for improper conduct was entered against the contractor. Thus, the plaintiffs were not entitled to recover from the fund.¹⁴²

In *Halco Engineering, Inc. v. Commonwealth*,¹⁴³ the Fairfax circuit court considered a number of defenses asserted by the Commonwealth to preclude a contractor from recovering damages for a delay allegedly caused by the Commonwealth's acts and omissions. First, the Commonwealth contended that the contract expressly provided, as the contractor's exclusive remedy for delay, an extension of time and relief from the imposition of liquidated damages.¹⁴⁴ The provision in question stated that the contractor would be obligated to pay liquidated damages if it did not complete the work within the contract time, unless the contractor was delayed because of an "act or neglect" of the owner or engineer, or by changes in the work. In that situation the time for completion would be reasonably extended and the contractor would not be charged with "liquidated or actual damages" during the extended period.¹⁴⁵

Citing United States Supreme Court authority,¹⁴⁶ the Commonwealth argued that the extension of time provision provided the contractor's only remedy and barred any claim for monetary dam-

In 1990, Code of Virginia section 54.1-145.3:3 (now section 54.1-1120) was again amended by the deletion of the phrase "contracting within its license category (Class A or Class B)" following "regulant."

140. *Brown*, 27 Va. Cir. at 502.

141. *Id.*

142. *Id.* at 503.

143. 27 Va. Cir. 111 (Fairfax County 1992).

144. *Id.* at 113.

145. *Id.* at 112-13.

146. *Id.* at 112. The Commonwealth relied on the case of *United States v. Rice*, 317 U.S. 61 (1942).

ages. The circuit court rejected the Commonwealth's argument, observing that the authority cited had been "nullified" by the federal courts and not followed by other state courts.¹⁴⁷ The court, therefore, held that time extension was not the contractor's only remedy for delay caused by the owner. The contractor was free to pursue other remedies at law.¹⁴⁸

In *Halco*, the Commonwealth also argued that the contractor waived its delay damages claim by accepting two change orders extending the completion time and providing additional compensation.¹⁴⁹ The Commonwealth contended that the contractor's acceptance of the change orders represented an accord and satisfaction and thus barred an additional monetary claim. The court concluded that waiver and accord and satisfaction were factual issues to be resolved at trial. While some delays preceded the change orders, others were unrelated and thus evidence on the question was required.¹⁵⁰ Lastly, the court agreed with the Commonwealth's position that the contractor could not recover pre-judgment interest against the Commonwealth absent an express contractual right.¹⁵¹

In a memorandum opinion, *DNM, Inc. v. S.H. Clark & Sons Roofing, Inc.*,¹⁵² the Supreme Court of Virginia considered whether the trial court wrongly dismissed an owner's claim against a contractor on the ground that there was no contractual privity. The contractor entered into an agreement with the owner's construction manager, rather than the owner. Contractual privity existed only if an agency relationship between the owner and its construction manager could be found.¹⁵³

147. *Halco*, 27 Va. Cir. at 113. The circuit court in *Halco* did not cite any federal authority that had "nullified" the *Rice* doctrine. The court did cite two cases from other states which had held that the remedies otherwise available to contracting parties for breach of the contract would not be limited by the remedies set out in the contract, unless there was clear evidence that the parties intended for the contractual remedies to be exclusive. *Id.* at 114 (citing *Nave v. Powell*, 96 N.E. 295 (Ind. App. 1911), and *J.L. White Furnace Co. v. C.W. Miller Transfer Co.*, 115 N.Y.S. 625 (1909)).

148. *Halco*, 27 Va. Cir. at 114.

149. *Id.*

150. *Id.*

151. *Id.* at 114-15 (citing *Highway Comm'r v. Parsonage Trustees*, 220 Va. 402, 258 S.E.2d 503 (1979), and *City of Lynchburg v. County of Amherst*, 115 Va. 600, 80 S.E. 117 (1913)).

152. No. 91123, 1992 Va. LEXIS 102 (Apr. 17, 1992). The supreme court specified at the outset of its opinion in *DNM, Inc.* that the opinion would not be published and is not to be cited or relied upon as precedent in future cases.

153. *Id.* at *3.

Focusing on the written contract to determine if an agency relationship existed, the court observed that some provisions granted the owner control over the construction manager's activities. The contract authorized the owner's on-site representative to control certain details and methods of operation including approval of the budget and any change orders recommended by the construction manager.¹⁵⁴ Other provisions of the contract also suggested that an agency relationship, such as the construction manager's agreement to complete the project in a "manner consistent with the interest of the Owner" and its acknowledgement that a relationship of "trust and confidence" existed between the parties evidenced an agency relationship.¹⁵⁵ Other contract provisions, however, suggested that the construction manager was an independent contractor retaining control over its own methods and details of work.¹⁵⁶ Because of this ambiguity in the contract, the court affirmed the trial court's ruling that the owner failed to prove an agency relationship. Absent such agency the owner lacked privity with the contractor and therefore had no legal basis to pursue a breach of contract action against the contractor.¹⁵⁷

In an unpublished opinion, *Perry Engineering Co., Inc. v. AT&T Communications, Inc.*,¹⁵⁸ the United States District Court for the Western District of Virginia considered whether the contractor's failure to timely notify the owner of an contract price increase terminated its right to payment under the contract.¹⁵⁹ The contractor and the owner contracted for the underground installation of seventy-three miles of fiber optic cable.¹⁶⁰ A unit price was set for removing considerable rock expected to be encountered during the cable installation.¹⁶¹ The contract required the contractor to submit a written proposal regarding changes affecting the contract price within ten days of receipt of the request for a change.¹⁶²

During construction, the owner considerably changed the depth of trenching, thereby greatly reducing the rock which had to be removed. The reduction in work allegedly eliminated the contrac-

154. *Id.* at *5.

155. *Id.* at *4.

156. *Id.* at *5.

157. *Id.*

158. No. 90-0153-H, 1992 U.S. Dist. LEXIS 12332 (W.D. Va. July 31, 1992).

159. *Id.* at *1-2.

160. *Id.* at *3.

161. *Id.*

162. *Id.* at *11-12.

tor's ability to recover certain expenses it incurred on the project.¹⁶³ The contractor failed to alert the owner of these unreimbursed expenses during the course of construction but submitted a change order ten months after the project's completion.¹⁶⁴ The contractor argued that it should not be held to the ten-day notice requirement because the owner's repeated requests to modify the work would not normally affect the contract price.¹⁶⁵ The court agreed, but held that when the cumulative effect of the owner's requests produces a loss to the contractor exceeding ten percent of the anticipated billings, the contractor must alert the owner of the change in the contract price within ten days.¹⁶⁶ Because the contractor failed to do so, it had no right to payment.¹⁶⁷

The contractor also argued that the owner waived the requirement that the contractor submit a written proposal for project changes by orally submitting its modifications.¹⁶⁸ The court, however, observed that the contract required the contractor to notify the owner when any requested change in the work would result in a price change, and that the owner's oral directives, absent such notice, could not constitute waiver of the written notice provision. Moreover, the court observed that the contractor timely submitted twenty-one written change orders.¹⁶⁹ Given this clear course of dealing, the court found no basis for the contractor's waiver claim.¹⁷⁰

The court also rejected the contractor's argument that it should be allowed to recover under quantum meruit.¹⁷¹ Because the contract was valid and unambiguous, the court held quantum meruit was not available.¹⁷² Therefore, the court granted the owner's mo-

163. *Id.* at *5.

164. *Id.* at *6.

165. *Id.* at *11-12.

166. *Id.* at *12.

167. *Id.* at *12-13.

168. *Id.* at *18-19.

169. *Id.* at *19.

170. *Id.* at *19-20. The *Perry Engineering* court noted there must be "clear and unmistakable evidence" of waiver of contractual terms requiring written approval and timely notice of claims for extra work." *Id.* at *19 (citing *Service Steel Erectors Co. v. SCE, Inc.*, 573 F. Supp. 177, 180 (W.D. Va. 1983)).

171. *Perry Engineering* at *20-21.

172. *Id.* at *20-21 (citing *Hendrickson v. Meredith*, 161 Va. 193, 170 S.E.2d 602 (1933), and *Marine Development v. Rodak*, 225 Va. 137, 300 S.E.2d 763 (1983)).

tion for summary judgment on the contractor's claims for unbillable costs under the contract.¹⁷³

In *Rader v. Commonwealth*,¹⁷⁴ the Court of Appeals of Virginia considered the appeal of a contractor convicted of construction fraud in violation of section 18.2-200.1 of the Code.¹⁷⁵ The contractor argued that the code section did not apply because the \$9,600 payment from the homeowner was not an advance but payment for completed work. The court disagreed as the contractor received the payment conditioned on completing the project that same day. Further, the contractor failed to order additional building materials, apply for the necessary building permits, or communicate delays to the homeowners, evidencing his intent to never complete the project.¹⁷⁶

The court also held that evidence of the contractor's building code violations were admissible because the violations were relevant to the contractor's intent not to abide by building codes and restrictions as prescribed by the contract.¹⁷⁷ Therefore, the court of appeals upheld the contractor's conviction for construction fraud.¹⁷⁸

In *United States ex rel. Whitaker's Inc. v. C.B.C. Enterprises, Inc.*,¹⁷⁹ the United States District Court for the Eastern District of Virginia considered the application of Virginia's commercial code to a dispute between a general contractor and a materialman. The materialman, Whitaker's Inc. of Sumter, contracted to supply cabinets to the contractor, C.B.C Enterprises.¹⁸⁰ According to the con-

173. *Perry Engineering* at *21.

174. 15 Va. App. 325, 423 S.E.2d 207 (1992).

175. VA. CODE ANN. § 18.2-200.1 (Repl. Vol. 1988). Section 18.2-200.1 provides:

If any person obtain from another an advance of money, merchandise or other thing of value, with fraudulent intent, upon a promise to perform construction, removal, repair or improvement of any building or structure permanently annexed to real property . . . and fail or refuse to perform such promise, and also fail to substantially make good such advance, he shall be deemed guilty of the larceny of such money, merchandise or other thing if he fails to return such advance within fifteen days of a request to do so sent by certified mail, return receipt requested, to his last known address or to the address listed in the contract.

Id.

176. *Rader*, 15 Va. App. at 329-30, 423 S.E.2d at 211.

177. *Id.* at 332, 423 S.E.2d at 212.

178. *Id.*

179. No. 2:92cv477, 1993 U.S. Dist. LEXIS 6207 (E.D. Va. Apr. 30, 1993).

180. *Id.* at *1.

tract, Whitaker's agreed to supply the cabinets in batches of fifteen units each.¹⁸¹

However, the first shipment of cabinets failed to meet specifications and the owner rejected them. C.B.C. nevertheless installed the cabinets based on Whitaker's assurances that the cabinets would be brought into compliance with the specifications.¹⁸² Whitaker's failed to cure the problem and C.B.C. subsequently gave notice of termination.¹⁸³ C.B.C. then contracted with another cabinet company and directed Whitaker's to remove the nonconforming cabinets. When Whitaker's did not respond, C.B.C. removed and destroyed the cabinets.¹⁸⁴

The district court ruled that C.B.C.'s decision to install the nonconforming cabinets constituted acceptance under Virginia's commercial code.¹⁸⁵ C.B.C.'s knowing acceptance of the nonconforming cabinets precluded it from revoking the acceptance and C.B.C. was required to compensate Whitaker's for the first shipment.¹⁸⁶ The court also found that Whitaker's breached its obligations under the commercial code to cure the defects in the accepted cabinets, giving rise to C.B.C.'s right to recover from Whitaker's the additional costs in procuring the additional cabinets from another supplier.¹⁸⁷

C. *Disputes Arising Under the Virginia Public Procurement Act*

The Virginia courts have recently decided a number of cases requiring interpretation of the Virginia Public Procurement Act, ("the Procurement Act").¹⁸⁸ In *W. M. Schlosser Co., Inc. v. Board of Supervisors of Fairfax Co.*,¹⁸⁹ the Supreme Court of Virginia decided whether, under the provisions of the Procurement Act, a designee of a county executive was a "disinterested person" qualified

181. *Id.* at *4.

182. *Id.* at *6.

183. *Id.* at *6-7.

184. *Id.* at *7.

185. *Id.* at *12 (citing VA. CODE ANN. § 8.2-606(1)(c) (Repl. Vol. 1991)).

186. *C.B.C.* at *13 (citing VA. CODE ANN. § 8.2-607(2) (Repl. Vol. 1991)). The court also observed that, even if C.B.C. had possessed the right to reject the nonconforming cabinets after installing them, it did not have the right under the U.C.C. to discard the cabinets after removal. C.B.C., the court observed, had the obligation to either store the goods, return them to the seller, or resell them. The court noted that C.B.C. did not attempt to salvage the goods as was required by the U.C.C.; rather C.B.C.'s decision to discard the cabinets rendered them valueless. *Id.* at *14 n.6 (citing VA. CODE ANN. § 8.2-604 (Repl. Vol. 1991)).

187. *C.B.C.* at *16 (citing VA. CODE ANN. § 8.2-714 (Repl. Vol. 1991)).

188. VA. CODE ANN. §§ 11-35 to -80 (Repl. Vol. 1989).

189. 245 Va. 451, 428 S.E.2d 919 (1993).

to decide contractual disputes involving the county.¹⁹⁰ In *Schlosser*, the contractor entered an agreement with the county to renovate the courthouse. The contract permitted the county executive or his designee to hear the contractor's appeal of any claim submitted to the county. When alleged design defects in the plans and specifications disrupted and suspended the completion of the contract, the contractor submitted a written claim to the county for additional costs and damages in accordance with the administrative appeal process established in the contract.¹⁹¹ Both the county's director of public works and the acting county executive's designee successively denied the claim.¹⁹² The contractor then sought judicial review of the designee's decision, but the trial court sustained the county's demurrer and special plea in bar on the ground that the contract's administrative procedures had been satisfied.¹⁹³

On appeal, the contractor argued the county violated the Procurement Act's requirement that a "disinterested person or panel" preside over the administrative hearings, because the county appointed one of its own employees to serve as the hearing officer to decide the claim.¹⁹⁴ The supreme court noted that the Procurement Act uniquely balanced many competing interests and conferred certain rights and obligations upon citizens, non-governmental contractors, and governmental entities.¹⁹⁵ The supreme court reasoned that, even though the contractor executed an agreement that permitted the county executive or his designee to preside over the contractor's administrative appeal, the contract could not elim-

190. *Id.* at 452, 428 S.E.2d at 919 (citing VA. CODE ANN. § 11-71(A) (Repl. Vol. 1989)). Section 11-71A provides:

A public body may establish an administrative procedure for hearing protests of a decision to award or an award, appeals from refusals to allow withdrawal of bids, appeals from disqualifications and determinations of nonresponsibility, and appeals from decisions on disputes arising during the performance of a contract, or any of these. Such administrative procedure shall provide for a hearing before a *disinterested person or panel*, the opportunity to present pertinent information and the issuance of a written decision containing findings of fact. The findings of fact shall be final and conclusive and shall not be set aside unless the same are fraudulent or arbitrary or capricious, or so grossly erroneous as to imply bad faith. No determination on an issue of law shall be final if appropriate legal action is instituted in a timely manner.

Id. (Emphasis added.)

191. *Schlosser*, 45 Va. at 453, 428 S.E.2d at 920.

192. *Id.*

193. *Id.*

194. *Id.*

195. *Id.*

inate the contractor's right to a hearing before a disinterested person as required under the Procurement Act.¹⁹⁶

The court then held that an employee of a governmental entity against whom a claim has been filed cannot be a disinterested person under the provisions of section 11-71A.¹⁹⁷ The court observed that this particular designee had been appointed by the acting county executive who served at the pleasure of the board of supervisors, the entity against whom the contractor's claim had been made. Moreover, the designee was the county's director of general services initially involved in the scope of the renovation project, even though he had no prior knowledge of the contractor's claim.¹⁹⁸ Under these circumstances, the court reasoned that the contractor had been denied the disinterested person called for in section 11-71(A).¹⁹⁹

Several recent cases have addressed another provision of the Procurement Act. In *W.M. Schlosser Co., Inc. v. Fairfax County Redevelopment and Housing Authority*,²⁰⁰ the United States Court of Appeals for the Fourth Circuit considered whether code section 11-70,²⁰¹ which provides that a contractor does not necessarily have to utilize administrative review procedures prior to filing

196. *Id.* Relying upon *Hladys v. Commonwealth*, 235 Va. 145, 366 S.E.2d 98 (1988), the county argued that the contractor's rights were not abridged because there was no showing of bias or improper conduct on the part of the hearing officer. The *Schlosser* court, however, distinguished *Hladys* because it dealt with minimum requirements of due process, while the case at hand concerned the express statutory requirement that the hearing be before a disinterested person. *Schlosser*, 245 Va. at 457, 428 S.E.2d at 922-33.

197. *Schlosser*, 428 S.E.2d at 922.

198. *Id.*

199. *Id.* In an earlier unpublished decision, *Gust K. Newberg Construction Co. v. County of Fairfax*, Nos. 91-1674, 91-1798, 1992 U.S. App. LEXIS 18478 (4th Cir. Aug. 7, 1992), the Fourth Circuit also addressed the disinterested person provisions of the Procurement Act. While specifically refraining from ruling on whether any of the hearing officers in the case did not meet the disinterested person requirement, the court suggested that future controversies could be best avoided by a panel of hearing officers who (1) are not employees of the county, (2) are completely independent of the parties, and (3) are knowledgeable of the construction business. *Newberg Construction*, 1992 U.S. App. LEXIS 18478 at *8.

200. 975 F.2d 1075 (4th Cir. 1992).

201. VA. CODE ANN. § 11-70 (Repl. Vol. 1989). Section 11-70 provides in pertinent part:

E. A contractor may bring an action involving a contract dispute with a public body in the appropriate circuit court.

F. A bidder, offeror or contractor need not utilize administrative procedures meeting the standards of § 11-71 of this Code, if available, but if those procedures are invoked by the bidder, offeror or contractor, the procedures shall be exhausted prior to instituting legal action concerning the same procurement transaction unless the public body agrees otherwise.

Id.

suit against a public body, would preempt a contractual provision requiring the contractor to submit to the public body's administrative review procedures.²⁰² Although the contract called for prior exhaustion of all administrative remedies, the contractor brought suit in federal district court seeking damages resulting from the denial of payment for three change orders.²⁰³ The court of appeals, however, observed that code section 11-70 clearly stated that a contractor in a dispute with a public body could pursue administrative remedies or bring an action in the courts. The court held that parties could not enter into a valid contract contrary to the plain terms of the statute.²⁰⁴

Citing code section 11-70(F) which mandates that if administrative procedures are invoked, they must be exhausted prior to instituting legal action concerning the "same procurement transaction,"²⁰⁵ the defendant also argued that the contractor's invocation of administrative review procedures on a different claim arising under the same contract required it to exhaust administrative procedures on the change order claims as well.²⁰⁶ The court of appeals disagreed, reasoning that if administrative procedures were invoked those procedures must be exhausted before the contractor could file a court action on that specific claim. As to other claims arising under the contract, however, the contractor had the option to either utilize the administrative scheme or proceed by direct legal action.²⁰⁷

The court of appeals' decision in *Schlosser* was consistent with its two other unpublished decisions considering the exhaustion provisions of the Procurement Act.²⁰⁸ In *Gust K. Newberg Construction Co. v. County of Fairfax*,²⁰⁹ the contractor entered into a contract with the county which provided three administrative levels of dispute resolution. Because the contractor repeatedly pursued administrative relief, the court held that the contractor should exhaust all administrative remedies prior to instituting le-

202. *Schlosser*, 975 F.2d at 1077.

203. *Id.* at 1076-77.

204. *Id.* at 1078.

205. *Id.* at 1079 (citing VA. CODE ANN. § 11-70F (Repl. Vol 1989)).

206. *Id.* at 1078-79.

207. *Id.*

208. *Gust K. Newberg Construction Co. v. Loven*, Nos. 92-1017, 92-1103, 1993 U.S. App. LEXIS 3456 (4th Cir. Feb. 23, 1993); *Gust K. Newberg Construction Co. v. County of Fairfax*, Nos. 90-2463, 90-2513, 1991 U.S. App. LEXIS 18714 (4th Cir. Aug. 15, 1991).

209. Nos. 90-2463, 90-2513, 1991 U.S. App. LEXIS 18714 (4th Cir. Aug. 15, 1991).

gal action. Therefore, the trial court properly dismissed the contractor's claims.²¹⁰

In *Gust K. Newberg Construction Co. v. Loven*,²¹¹ the court of appeals again held that once invoked, a contractor must exhaust administrative remedies before it institutes legal proceedings.²¹² In that case the contractor sued the county's engineer in tort claiming that the engineer's alleged concealment of design defects amounted to fraud and tortious interference with the contractor's contract with the owner. The engineer argued that a provision in the county's contract with the contractor required the exhaustion of administrative remedies relative to all claims, including any claims the contractor may have against the engineer. The engineer contended that he was the third-party beneficiary of this provision and thus could require the contractor to exhaust the administrative remedies set forth in the contract before instituting judicial proceedings.²¹³

The contractor argued that the engineer could not be a third-party beneficiary because its state registration had lapsed. The court deferred to the state board,²¹⁴ which had primary jurisdiction over the matter. The board has investigated the contractor's complaints regarding the engineer's violation of registration requirements and found no regulatory or statutory violation.²¹⁵

210. *Id.* at *7. In a later unpublished decision arising out of the same contract, *Gust K. Newburg Construction Co. v. County of Fairfax*, Nos. 91-1674, 91-1798, 1992 U.S. App. LEXIS 18478 (4th Cir. Aug. 7, 1992), the Fourth Circuit Court of Appeals considered the contractor's motion for relief from judgment pursuant to Federal Rule of Civil Procedure 60(b). The court of appeals reiterated its earlier position that, under Virginia law, if the contractor invokes the administrative process, the contractor's allegations of interest and bias within the administrative process must first be exhausted before the contractor may seek relief in the courts. *Id.* at *7.

211. Nos. 92-1017, 92-1103, 1993 U.S. App. LEXIS 3456 (4th Cir. Feb. 23, 1993).

212. *Id.* at *2. While the opinion in *Loven* did not indicate whether the contractor had initiated administrative review procedures before filing suit, in light of the court of appeals' earlier decision in *W.M. Schlosser Co, Inc. v. Fairfax County Redevelopment and Housing Authority*, 975 F.2d 1075 (4th Cir. 1992), the contractor had apparently started, but failed to exhaust, its administrative review option. If not, the *Schlosser* case would indicate that the provisions in the contract which required the contractor to advance all claims through the administrative process would be invalid as they are contrary to the plain terms of Code Section 11-70. *Schlosser* 975 F.2d at 1078.

213. *Loven*, 1993 U.S. App. LEXIS 3456, at *5.

214. The State Board for Architects, Professional Engineers, Land Surveyors and Landscape Architects has jurisdiction over licensing of architect/engineering firms. See VA. CODE ANN. §§ 54.1-400 to -415 (Repl. Vol. 1991).

215. *Loven*, 1993 U.S. App. LEXIS 3456, at *6.

The court also rejected the engineer's argument that the settlement between the contractor and the county discharged its liability to the contractor. The settlement agreement explicitly did not release the defendants in the suit. The court observed that the release of one of two persons liable in tort for the same property damage does not discharge the other, unless the parties so intend.²¹⁶ The court observed no evidence that the contractor intended to release its tort claims against the engineer in its settlement with the county.²¹⁷

D. *Cases Pertaining to Arbitration as the Exclusive Forum for Dispute Resolution*

Several courts recently dealt with whether arbitration provides the exclusive forum for resolution of construction disputes. In *W. M. Schlosser Co. v. School Board of Fairfax County*,²¹⁸ the United States Court of Appeals for the Fourth Circuit considered whether, under Virginia law, a school board possessed the authority to agree to arbitrate contractual disputes. If not, the court reasoned, the contract entered into by the school board providing for arbitration of all claims, disputes or other matters upon the written demand of either party was *ultra vires* and the contractor's motion to compel arbitration under the terms of the Federal Arbitration Act²¹⁹ would be denied.²²⁰

Under the traditional Dillon rule, a school board possesses only those powers expressly granted to it by the General Assembly,

216. *Id.* at *8 (citing VA. CODE ANN. § 8.01-35.1 (Repl. Vol. 1992)).

217. *Loven* at *8-9. In *Becon Services Corp. v. Fairfax County Redev. and Housing Auth.*, 27 Va. Cir. 269 (Fairfax County 1992), a Virginia circuit court also considered the exhaustion requirement of the Procurement Act. In *Becon Services*, the contractor had submitted its request as a claim for final decision and stated that it was not invoking the administrative procedures of the contract, but the director of the housing authority denied the claim and insisted that the contractor exhaust its administrative appeal procedure with the county executive before filing an action in circuit court. The contractor then sought a declaration that it could seek judicial relief. The court noted that sections 11-70(E) and (F) of the Code provide that a contractor need not use the administrative process, but if it does so, it must exhaust the administrative route before appealing the claims to the court. The contractor had not invoked the administrative process and, therefore, the court held that it could litigate its claim in the circuit court without first exhausting available administrative remedies. *Becon Services*, 27 Va. Cir. at 272.

218. 980 F.2d 253 (4th Cir. 1992).

219. 9 U.S.C. §§ 1-16 (1987).

220. *W. M. Schlosser*, 980 F.2d at 254-55 (citing *Richmond, F. & P. R.R. v. Richmond, F. & P. and R. & P. R.R. Connection Co.*, 145 Va. 266, 299, 133 S.E. 888, 898 (1926), and *Richard L. Deal & Assoc., Inc. v. Commonwealth*, 224 Va. 618, 299 S.E.2d 346 (1983)).

those necessarily or fairly implied therefrom, and those powers which are essential and indispensable.²²¹ The Constitution of Virginia did not bestow the power to agree to arbitrate on a school board, and the parties admitted that the power to agree to arbitrate was not essential or indispensable to the school board's functioning. The issue, therefore, was whether the power to agree to arbitrate could be implied from a power explicitly granted to school boards.²²² Under the Procurement Act, disputes are decided by the public body and appeals are made through the public body's administrative procedures or through the courts. The court of appeals noted there was no provision in the act for disposition by an arbitrator.²²³

In *W. M. Schlosser* the court of appeals observed that the General Assembly had recently amended section 15.1-508 of the Code of Virginia²²⁴ granting to the governing body of a county the explicit power to enter into contracts containing arbitration provisions.²²⁵ Because the General Assembly did not similarly amend a corresponding code section regarding school boards, the court of appeals reasoned that the General Assembly had not accorded school boards with the power to enter arbitration agreements within their general power to contract.²²⁶

The contractor then argued that the Federal Arbitration Act preempted application of the Dillon rule. The Federal Arbitration Act prohibits states from placing greater restrictions upon arbitration provisions than those placed upon other contractual terms.²²⁷ The court of appeals concluded that the Dillon rule did not single out or disproportionately burdened arbitration provisions. Therefore, federal preemption was not appropriate.²²⁸

221. *W.M. Schlosser*, 980 F.2d at 255 (quoting *City of Richmond v Confrere Club*, 239 Va. 77, 387 S.E.2d 471 (1990)). The Dillon Rule is a rule of construction applicable in Virginia when determining the powers of local government. *Id.*

222. *W.M. Schlosser*, 980 F.2d at 254-55.

223. *Id.* at 256.

224. VA. CODE ANN. § 15.1-508 (Repl. Vol. 1988).

225. *W. M. Schlosser*, 980 F.2d at 257.

226. *Id.* The *Schlosser* court also noted that several circuit courts in Virginia had held that the power to contract did not include the power to arbitrate. *Id.* (citing *Hanover County School Board v. Gould* c-23-1984 (Hanover County Apr. 4, 1984); *Spotsylvania County School Board v. Sherman Construction Corp.*, 14 Va. Cir. 333 (Spotsylvania County 1989)).

227. 9 U.S.C. § 2 (1987).

228. *W.M. Schlosser*, 980 F.2d at 259.

In *Sargis & Jones, Ltd. v. Moran Associates*,²²⁹ the Loudoun County Circuit Court considered whether the defendants lost their right to compel arbitration by first utilizing the judicial process. The contractor filed suit seeking to enforce its mechanic's lien and to recover for breach of contract. Because the contract was not referenced in or attached to the bill of complaint, however, defendants' counsel answered the suit without invoking the contract's arbitration provision. Six months later, during the discovery process, defendants' counsel realized there was an arbitration provision in the contract and sought to compel arbitration on the breach of contract claim.²³⁰

Although the contractor argued that the defendant waived the right to compel arbitration by participating in the judicial proceedings, the *Sargis* court noted that public policy favored arbitration settlements and that further compelling arbitration on the breach of contract claim would not prejudice the contractor on the mechanic's lien claim.²³¹ Therefore, the court stayed the proceedings on the breach of contract claim and directed the contractor to proceed to arbitration as required under the contract.²³²

E. Cases Involving Design Professionals

The United States Court of Appeals for the Fourth Circuit recently decided *Transduller Center, Inc. v. USX Corp.*,²³³ which raises troubling questions for owners who engage professional designers and are later sued by third parties because of defects in the plans. Prior to *Transduller*, it would have been reasonable to assume that an owner could pass through all liability arising out of the defective design to the design professional based on principles of restitution and indemnity.²³⁴ It also would have been reasona-

229. 27 Va. Cir. 57 (Loudoun County 1992).

230. *Id.* at 58.

231. *Id.* at 59 (citing *Land v. Dean Witter Reynolds, Inc.*, 617 F. Supp. 52 (E.D. Va. 1985), and Virginia's adoption of the Uniform Arbitration Act, VA. CODE ANN. § 8.01-581.01 to -589.16 (1992 Repl. Vol.)).

232. *Sargis*, 27 Va. Cir. at 60. The *Sargis* court relied on Virginia Code section 8.01-581.02(A) which requires a court to order the parties to proceed with arbitration on the application of one of the parties, a showing of a contract with a valid arbitration clause, and refusal of the opposing party to arbitrate. VA. CODE ANN. § 8.01-581.02(A) (Repl. Vol. 1992).

233. 976 F.2d 219 (4th Cir. 1992).

234. See RESTATEMENT OF RESTITUTION § 76 (1937). As noted in the RESTATEMENT OF RESTITUTION, the common law recognized an implied right of indemnity to recover from a party upon whom one relied to one's detriment, where that reliance resulted in liability to third parties. A typical example of implied indemnity at common law is the employee's obligation

ble to assume that the owner could collect attorneys fees and related costs in defending an action brought by a third party as a result of malpractice. After *Transdullles*, these reasonable assumptions are invalid, at least in Virginia's federal courts.

In *Transdullles*, a developer, USX Corp., hired an engineering firm, Gannett Fleming Civil Engineering, Inc., to design a storm water drainage system. Gannett Fleming did not design drainage pipes of sufficient size to handle the expected drainage, thus failing to comply with the county's Facilities Standards Manual.²³⁵

Prior to discovery of the problem, USX sold the property, which was subsequently resold. The third owner leased the property to Transdullles Center, Inc. The county required Transdullles to correct the drainage system. After making substantial repairs, Transdullles sued USX to recover for breach of contract, and USX filed a third-party action against Gannett Fleming.²³⁶

At trial the jury awarded Transdullles \$912,000 in damages from USX, but awarded USX only \$638,400 in damages from Gannett Fleming.²³⁷

On appeal, Gannett Fleming argued that USX should have been required to present engineering expert testimony to show that Gannett Fleming's work deviated from the standard of care, and, conversely, that Gannett Fleming should have been allowed to present certain engineering expert testimony that it had not so deviated. The court of appeals rejected that argument, observing that the contract between USX and Gannett Fleming required the engineer to design the plans in accordance with the county's applicable

to indemnify the employer for damages the employer must pay to third parties because of the acts of the employee. *See, e.g., Maryland Casualty Co. v. Aetna*, 191 Va. 225, 60 S.E.2d 876 (1950).

235. *Transdullles*, 976 F.2d at 222.

236. *Id.* at 222-23. Transdullles acquired its contract action against USX by assignment from the county. USX had entered a "Subdivision Agreement" with the county prior to construction. The agreement required USX to construct the improvements in accordance with the county's subdivision and zoning ordinances, which included provisions requiring adequate storm water drainage on the site. *Id.*

237. *Id.* at 223. The *Transdullles* court dealt with a number of other issues which are not discussed in this article, including whether the county had the power under the Dillon Rule to assign its contract right to Transdullles (yes); whether the County's review and recordation of Gannett Fleming's plans constituted approval such that no breach of contract action would lie (no); and whether Transdullles's expenses in building a detention pond upstream to resolve the drainage problem were direct damages that could be recovered in a breach of contract action (yes). *Id.* at 224-26.

storm water regulations.²³⁸ The court found that the contract set an objective standard of care for Gannett Fleming's performance, the application of which was within the common understanding of the jury. Thus, expert opinion was not admissible.²³⁹

The court also considered USX's request for a new trial, based on the contention that the jury verdict was contrary to the evidence and instructions in that it should have awarded USX damages against Gannett Fleming equal to the damages awarded Transdulles against USX. The court of appeals rejected USX's argument, finding that the dissimilar results were a result of dissimilar evidence. Specifically the court observed that Transdulles's contract claim rested on the county's Subdivision Agreement, while USX's claim rested on its separate contract with Gannett Fleming.²⁴⁰ Further, the jury instructions governing Transdulles's claim against USX differed from the instructions governing USX's claim against Gannett Fleming.²⁴¹ Given the differing instructions, the differing evidence, and the differing contracts, the court con-

238. *Id.* at 226.

239. *Id.* at 227. The *Transdulles* court cited the Virginia Supreme Court's decision in *Nelson v. Commonwealth*, 235 Va. 228, 368 S.E.2d 239 (1988), which held that architectural practice is sufficiently technical as to require an expert to set the standard of care for the jury in a malpractice action. *Transdulles*, 976 F.2d at 227. The Fourth Circuit has now created an exception to the *Nelson* requirement — where the design professional agrees to comply with some law or regulation, there is no place for an expert to address the governing standard the design professional is to meet. In such cases, violation of the local ordinance is, in effect, negligence *per se*, a concept the court of appeals could have used to express the exception it was creating.

240. *Transdulles*, 976 F.2d at 227. The court of appeals' recognition of a rational basis for the dissimilar jury verdicts based on differences in the county's Subdivision Agreement with USX, and USX's separate engineering contract with Gannett Fleming, is subject to question. The Subdivision Agreement required USX to provide an adequate storm drainage system. USX's contract with Gannett Fleming required Gannett Fleming to prepare plans in accordance with the county's storm drainage system regulations. The issue before the trial court was whether the storm drainage system that was installed conformed with the county's regulations. There is nothing in the *Transdulles* opinion to explain how the jury could have concluded, as the court of appeals suggests, that the county's Subdivision Agreement imposed greater obligations on USX than it imposed on Gannett Fleming in its contract.

241. *Id.* The jury in *Transdulles* was not expressly instructed that if it found against USX it must by necessity award USX an identical award against Gannett Fleming. Rather, the instructions permitted the jury to consider independently whether USX had breached the Subdivision Agreement and, if so, what damages were reasonably foreseeable by the parties at the time the contract was executed. In addition, the jury could determine whether Gannett Fleming had breached its engineering contract with USX and, if so, what damages were reasonably foreseeable at the time that the contract was executed. *Id.* at 227-28 n.8.

cluded that the differences in damages were within the discretion of the jury.²⁴²

The court of appeals also considered USX's appeal of the denial of USX's right to recover attorneys' fees it had to pay Transdullles and that it incurred in defense of Transdullles' claim.²⁴³ USX contended it had an implied indemnity right arising out of its contractual relationship with Gannett Fleming to recover attorneys' fees. The court rejected USX's indemnity claim observing that no "unique factors" nor "special relationship" existed between USX and Gannett Fleming that would support an implied indemnity right to recover such attorneys' fees.²⁴⁴ In ruling against USX's attorneys' fees claim the court held that there was no right in Virginia to recover one's own attorney's fees in defending a lawsuit from another party.²⁴⁵

242. *Id.* at 228. While the court of appeals identified differences in the instructions, contracts, and evidence as potential bases for the inconsistent jury results, it did not explain how any of these differences demonstrated that the jury had a rational basis for awarding differing damages to Transdullles and USX. Later in the opinion, in fact, the court asserts that the jury's failure to pass through all of Transdullles's damages to Gannett Fleming demonstrates that the jury held USX independently responsible for the defective design "to some unknown degree." *Id.* at 229. Given that Gannett Fleming agreed contractually to design the drainage system, that its design turned out to be defective, and that USX incurred liability for failing to provide a satisfactory design, it is difficult to perceive how a rational jury could avoid passing through the entire liability to the design professional.

243. *Id.* at 229. USX's obligation to pay Transdullles's attorneys' fees arose out of an express contractual provision in the Subdivision Agreement. *Id.*

244. *Id.* at 228. In *Transdullles*, the court cited, but did not follow, *General Electric Co. v. Moretz*, 270 F.2d 780 (4th Cir. 1959), *cert. denied*, 361 U.S. 964 (1960). *Moretz* recognized an implied indemnity right in a contract between a carrier and shipper based on federal statutes and regulations that were to be read into the contract. *Moretz*, 270 F.2d at 787. The court of appeals in *Transdullles* suggested that *Moretz* was decided under admiralty law as if that distinction alone should make a difference. *Transdullles*, 976 F.2d at 228 (citing *Wingo v. Celotex Corp.*, 834 F.2d 375 (4th Cir. 1987)). In fact, *Moretz* was not based on admiralty law, although the court in that decision relied on prior U.S. Supreme Court authority, construing admiralty law, as a basis for recognizing an implied indemnity right between interstate shippers and carriers. *Moretz*, 270 F.2d at 788 (relying on *Ryan Stevedoring Co. v. Pan-Atlantic S.S. Corp.*, 350 U.S. 124 (1956)). It is interesting to note that, as in *Moretz*, USX based a right of indemnity on a violation of governmental regulation that had been incorporated into the private contract. In *Moretz*, the regulations were federal and pertained to interstate transportation; in *Transdullles* the regulations were local and pertained to storm water drainage design. On this ground it is difficult to see any rational basis for not applying the indemnity right recognized in *Moretz* to the situation presented in *Transdullles*.

245. *Transdullles*, 976 F.2d at 228. The court distinguished *Hiss v. Friedberg*, 201 Va. 572, 112 S.E.2d 871 (1960), on the ground that USX was not the prevailing party in its action against Transdullles, a necessary prerequisite to recovering attorneys' fees under the *Hiss* holding.

In *Schrieider v. Continental Casualty Co.*,²⁴⁶ the court of appeals considered the meaning of an asbestos exclusion provision contained in a professional liability policy that the insurer, Continental Casualty (CNA), issued to its insured, Sherertz, Franklin, Crawford, and Shaffner (SFCS), an architectural and engineering firm. The policy excluded coverage for any claim arising out of "failure to detect or advise of the existence or proportion of asbestos."²⁴⁷ SFCS was retained by a prospective purchaser of an apartment building to prepare reports regarding the possible conversion of the apartment building into retirement housing. After the owner acquired the building, it incurred substantial costs in abating asbestos found inside. The owner thereafter sued SFCS in contract and tort for allegedly failing to report the possible existence of asbestos.²⁴⁸

SFCS subsequently settled with the owner, assigning its rights against CNA for insurance coverage to the owner. The owner thereafter sued CNA, and CNA asserted the policy's asbestos exclusion as a defense.²⁴⁹

The trial court held that the policy exclusion did not bar the assigned claim, and the court of appeals reversed. The court of appeals found the plain language of the exclusion was clear and directly applicable to the owner's claim that SFCS had failed to discover and warn about the presence of asbestos and the costs associated with its removal.²⁵⁰ The court of appeals found no ambiguity in the policy language and refused to interpret the insurance policy differently from any other contract. As such, the court held that the trial court erred in admitting expert affidavits that distinguished "detecting and advising of the existence of asbestos," which the experts contended represented a specialized extra architectural service within the asbestos exclusion, and the "failure to warn about the possible existence of asbestos," which the experts contended represented the breach of a normal architectural service outside of the exclusion.²⁵¹ Given that the exclusion language was unambiguous, the court concluded that the trial court erred in per-

246. 989 F.2d 728 (4th Cir. 1993).

247. *Id.* at 729.

248. *Id.*

249. *Id.* at 730.

250. *Id.*

251. *Id.*

mitting the extrinsic expert evidence proffered by the owner and reversed the jury verdict in favor of the owner.²⁵²

F. *Workers' Compensation Cases Arising Out of Construction*

Under the Virginia Workers' Compensation Act,²⁵³ a contractor becomes the "statutory employer" of its subcontractor's employees when it hires the subcontractor for the execution or performance of the whole or any part of the work undertaken by the contractor.²⁵⁴ A statutory employer is liable to pay any workers' compensation award for which it would have been liable if that worker had been immediately employed by such contractor.²⁵⁵ A subcontractor also becomes the statutory employer of a sub-subcontractor's employees.²⁵⁶

The issue in *States Roofing v. Bush Construction Corp.*²⁵⁷ was whether a subcontractor's sister subsidiary was the statutory employer of a sub-subcontractor's employee, even though there was no direct contract between the sister subsidiary and either the general contractor or the sub-subcontractor. All assets of Eastern Roofing Corporation ("Eastern"), the subcontractor, were acquired by Marepcon Financial Corporation, a wholly owned subsidiary of Norshipco.²⁵⁸ The assets were immediately transferred to States Roofing Corporation, another wholly owned subsidiary of Norshipco. Consistent with its promise to the general contractor, States Roofing then began to fulfill Eastern's obligations under the contract.²⁵⁹ When an employee of the uninsured sub-subcontractor filed a claim with the Industrial Commission, States Roofing argued that it was not a statutory employer of the claimant because the requisite contractual relationship did not exist between it and either the general contractor or the sub-subcontractor.²⁶⁰

The Court of Appeals of Virginia, however, held that States Roofing's conduct manifested an implied agreement to assume Eastern's contractual liabilities with the general contractor and

252. *Id.* at 732.

253. VA. CODE ANN. §§ 65.2-100 *et seq.* (Repl. Vol. 1991).

254. VA. CODE ANN. § 65.2-302 (Repl. Vol. 1991).

255. *Id.*

256. *Id.*

257. 426 S.E.2d 124 (Va. Ct. App. 1993).

258. *Id.* at 125.

259. *Id.* at 126.

260. *Id.*

sub-subcontractor.²⁶¹ States Roofing purchased Eastern's equipment, accounts receivable, contract rights and inventory, and hired most of Eastern's former employees. Moreover, States Roofing pledged to complete the Eastern contract, demanded that the sub-subcontractor perform under the contract, and sought and received payment from the general contractor. Therefore, the court held that States Roofing was the statutory employer of the claimant at the time of his injury.²⁶²

IV. CONCLUSION

Over the past two years, the Virginia General Assembly and Virginia's courts have made numerous changes in the law affecting the construction industry. The most dramatic changes have occurred in the law governing prosecution of mechanic's liens and public procurement claims, the exclusivity and applicability of alternative dispute remedies, and professional malpractice. The judicial cases discussed in this article can hopefully teach the practitioner important lessons on how to prosecute and defend construction claims more effectively, and how to avoid procedural and evidentiary problems that inevitably arise in the course of construction litigation.

261. *Id.* at 127 (relying upon *City of Richmond v. Madison Management Group, Inc.*, 918 F.2d 438, 450 (4th Cir. 1990)).

262. *Id.*

