

Pass through claims and the Severin doctrine

by Lawrence C. Melton

The Consolidated Procurement Code (CPC), S.C. Code Ann. § 11-35-4230, applies to controversies between the state and a "subcontractor when the subcontractor is the real party in interest." *Id.* § 11-35-4230 (1) and (2). The extent to which a "subcontractor" may assert claims directly against the state under the CPC, however, has recently been the subject of a surprising ruling by the state engineer.

In the case of *In Re: Graduate Science Research Facility University of South Carolina State Project H27-9751-AC* (posting date April 21, 2003, www.state.sc.us/mmo/ose/osemenu/htm), the state engineer ruled first that the phrase "or

subcontractor when the subcontractor is the real party in interest," as used twice in S.C. Code § 11-35-4230, does not mean that a subcontractor is a "real party in interest" unless the subcontractor also fits into one of the categories of "real party in interest" recognized in Rule 17 of the South Carolina Rules of Civil Procedure. A subcontractor injured by the state's defective specifications cannot, therefore, be a "real party in interest" unless the subcontractor is also an executor, administrator, guardian, bailee, trustee of an express trust or a third-party beneficiary of a contract. S.C. R. Civ. P. 17 (a). Rule 17 also makes a "party authorized by statute" a real party in interest. If § 11-35-4230 has said plainly that a

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subcontractor is a real party in interest — which is apparently how most lawyers read the statute — then, presumably, this controversy would not have arisen. The statute, however, says “when the subcontractor is the real party in interest . . .” Under this ruling, it is very unlikely that a subcontractor would ever qualify as a “real party in interest.”

The state engineer also ruled that the subcontractor’s execution of a release of claims against the prime contractor barred the prime contractor’s claim under the *Severin* doctrine. In the 1943 case of *Severin v. the United States*, the U.S. Court of Claims denied recovery in a breach of contract action for subcontractor damages because the subcontract contained a provision exculpating the contractor from liability to the subcontractor for damages resulting from government actions. 99 Ct. Cl. 435 (1943). See J. Cibinic and R. Nash, *Administration of Government Contracts* (3d ed.), 105 at 689-90 and

1255-56 for a full discussion of the impact of the *Severin* doctrine on subcontractor claims. Based on *Severin*, the state engineer ruled that a “claims liquidating agreement” that released the general contractor from “any claim, demand, action, or suit of whatsoever kind or nature, resulting from or in any way related to the Project,” without any reservation of rights meant that the contractor had no damage from the subcontractor’s loss and, therefore, precluded the contractor from presenting the subcontractor’s claim on a pass through basis. A “liquidation agreement” is a form of a settlement agreement in which a dispute between two parties with contractual privity is liquidated (settled) on terms delineating the rights, responsibilities and procedures for presenting a pass through claim to a third party and allocating the costs expended and benefits received when doing so. Carl A. Calvert and Carl F. Ingwalson Jr., “Pass Through Claims and Liquidation

Agreements,” *The Construction Lawyer*, October 1998, p. 29.

The state engineer’s decision can be questioned on several grounds. The decision applied a rule of strict interpretation to the CPC as a waiver of sovereign immunity. In fact, the CPC is much more than a waiver of sovereign immunity and should not always be construed strictly against parties who do business with the state. The state waives sovereign immunity whenever it enters into commerce. *Cooke v. United States*, 91 U.S. 389, 398 (1875) (When the government, “comes down from its position of sovereignty and enters the domain of commerce, it submits itself to the same laws that govern individuals there.”); *Unisys Corp. v. South Carolina Budget and Control Board* 551 S.E.2d 263, 268 (S.C. 2001) (“ . . . by entering a contract, the State waives its sovereign immunity and consents to be sued for breach thereof.”). Rather than a limited waiver of

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sovereign immunity, the CPC is an effort by the state to introduce concepts of "fair and equitable treatment" into a process that would otherwise go straight to court as a breach of contract. See, S.C. Code Ann. § 11-35-20 (f). Harsh rules of construction should not become the basis for rewriting a statute that was intended to accomplish much more than waive sovereign immunity. In *Unisys Corp. v. S.C. Budget and Control Board*, *supra*, the Supreme Court held that the exclusive jurisdiction provision of the CPC (§ 11-35-4230) was a waiver of sovereign immunity subject to strict interpretation in the state's favor. Other provisions of the CPC, however, go well beyond a waiver of immunity from suit and should be interpreted in accordance with the terms of the statute to effect the purposes of the law as passed by the General Assembly.

The state engineer's application of the Rules of Procedure for the circuit courts is also questionable. The Rules of Procedure for the circuit courts do not apply to the administrative resolution of contract controversies under § 11-35-4230. If a subcontractor were only allowed to pursue a claim in its own name after it qualified as a "real party in interest" under Rule 17, there would have been no point in referring either to "subcontractors" or to "real party in interest" in § 11-35-4230. The state engineer's decision therefore renders the § 11-35-4230 references to subcontractors meaningless. An interpretation that renders statutory language meaningless is to be avoided. *Savannah Bank and Trust Co. v. Shuman*, 157 S.E.2d 864 (S.C. 1967) (the Supreme Court is not at liberty to treat statutory language as surplusage). The state engineer's position also appears to be inconsistent with the interpretation of § 11-35-4230 published in the *State Engineer's Manual*. "Only the Agency, the A/E and its direct consultants, and the Contractor and its direct subcontractors are entitled to submit a request for resolution of a contract controversy to the Office of the State Engineer." *State Engineer's Manual*, § 7.20(C), p -11 (07/01 Edition).

See www.state.sc.us/mmo/ose/osemenu.htm. Based on interviews with a number of experienced practitioners, the state engineer's decision upsets established expectations as to what § 11-35-4230 means.

The *Severin* doctrine is applied only in breach of contract cases, not to claims arising under remedy granting clauses such as the federal "changes," "suspension of work" or "differing site conditions" clauses. See *F.E. Constructor*, ASBCA 25784, 82-1 BCA ¶ 15,780; *Ayden Corp.*, EBCA 355-5-86, 89-3 BCA ¶ 15,907; *Cibinic & Nash*, p. 1256. The AIA A201-1997 used by the state has clauses that parallel all of the federal remedy granting clauses. Compare, FAR 52.243-5, "Changes & Changed Conditions," with AIA A201-1997 Art. 7, "Changes in the Work." Compare, FAR 52.242-14, "Suspension of Work," with AIA A201-1997 Art. 14.3, "Suspension by Owner for Convenience." Compare, FAR 52.236-2, "Differing Site Conditions," with AIA A201-1997 Art. 4.3.4, "Claims for Concealed or Unknown Conditions."

Further, under federal case law, the *Severin* doctrine does not bar the subcontractor's claim, even if the subcontractor releases the contractor from further liability, provided that the contractor has agreed to pass the subcontractor's claim through to the government. *Casting & Son, Inc.*, GSBGA 6906, 84-3 BCA ¶ 17,612; *Folk Constar. Co. v. United States*, 2 Cl. Ct. 681 (1983); *Pan Arctic Corp. v. United States*, 8 Cl. Ct. 546 (1985). Courts have long recognized that the *Severin* doctrine produces the kind of harsh results that the South Carolina CPC was intended to prevent. *Sager v. United States*, 469 F.2d 292 (Ct. Cl. 1972). The CPC is intended "to ensure the fair and equitable treatment of all persons who deal with the procurement system," not just the parties in privity of contract with the state. S.C. Code Ann. § 11-35-20 (f) (for emphasis). The result of the state engineer's decision is, therefore, unsupported by federal case precedent. The result of *In Re: Graduate Science Research Facility* could not reasonably have been anticipated by the

practicing members of the South Carolina construction bar.

In Re: Graduate Science Research Facility has been appealed to the Procurement Review Board and may be in the court system for some time to come. Pending a final resolution of the issues, subcontractors and their counsel need to exercise extreme caution in drafting liquidating agreements, releases or claims pass-through clauses. Until the law on this issue is settled, no subcontractor can rely on being a "real party in interest" under § 11-35-4230.

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those interested to contact Nick regarding authoring an article. It is easy to call on the same folks again and again, but we would all benefit from a wider range of participation.

Thanks for your help and support this year. I look forward to seeing you at Wild Dunes in September.

If you would like to have an article published in the construction law newsletter, please send your submissions to Nick Nicholson via e-mail at nnicholson@hsblawfirm.com.

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