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An Obligee's Failure To Comply With Conditions Precedent In The AIA A-312 Performance Bond Leads To Discharge Of The Surety

by CharCretia V. Di Bartolo, Partner

On June 30, 2020, the Rhode Island Superior Court issued a decision, *Providence Builders, LLC v. Costa Brothers Masonry, Inc. and Travelers Casualty and Surety Company of America*, PC-2019-7689 (R.I. Super June 30, 2020), in which it fully discharged an A312 performance bond, declaring the bond to be null and void due to an obligee's failure to comply fully with Sections 3.2 and 3.3 of the Bond. In doing so, the court followed the overwhelming precedent in other jurisdictions, which have held that the obligee's obligations outlined in Section 3 of the Bond are conditions precedent that must occur before the surety is obligated to respond and that actions taken by the obligee which deprive the surety of its right to participate in and choose how the surety will satisfy its obligations under the bond discharge the surety "*in toto*."

In *Providence Builders*, the plaintiff/obligee, Providence Builders LLC ("PBLLC"), was the construction manager for a project known as The Commons at PVD Station located in Providence, Rhode Island ("Project"). PBLLC subcontracted with the defendant/principal, Costa Brothers Masonry, Inc. ("Costa"), to perform certain masonry work on the Project. Travelers Casualty & Surety Company ("Travelers") issued an A312 performance bond (2010 form) with Costa as principal and PBLLC as obligee.

PBLLC notified Costa and Travelers of a potential default pursuant to paragraph 16.2 of the Subcontract and requested a conference pursuant to Section 3.1 of the Bond. At the Section 3.1 meeting, both PBLLC and Costa complained about each other's performance on the Project. Nevertheless, both PBLLC and Costa agreed to continue to work together to complete the Project. After the Section 3.1 meeting, conflicts continued between PBLLC and Costa. There were numerous communications between PBLLC and Costa regarding project issues, on which the parties copied Travelers, and PBLLC issued several 24-hour notice letters to Costa. PBLLC, however, did not terminate Costa and instead hired a replacement subcontractor to complete Costa's work. PBLCC finally defaulted and terminated Costa but only after the replacement mason had completed Costa's work. PBLLC filed suit against both Costa and Travelers two days after terminating Costa.

On cross motions for summary judgment, the court agreed with Travelers that the obligations stated in Sections 3.2 and 3.3 of the Bond, which require default, termination, notice of termination and a pledge by the obligee to pay the contract balance to the surety, were clear and unambiguous conditions precedent to Travelers' obligation to act. Although PBLLC complied with Section 3.1, the court held that it failed to comply with Sections 3.2 and 3.3, thus fully discharging Travelers. Although PBLLC did eventually terminate Costa, it did so only after Costa's work was completed by a replacement contractor and, therefore "far too late" for Travelers to exercise its rights under the Bond. By failing to default and terminate Costa and "deciding to go it alone in hiring Lighthouse to complete the masonry work, the plaintiff extinguished Travelers' contract rights and eliminated its options to protect itself." With respect to Section 3.3, the court noted that the obligee's half-hearted attempt to offer to pay the contract balance for the first time in its objection to Travelers' motion for summary judgment was "insufficient compliance" with this paragraph. The court went on to state that "the bond is, therefore, crystal clear that only when [PBLLC] has satisfied all of the conditions of Section 3 is the surety – that is Travelers – required to take action." The court discharged the Bond "*in toto*."

In rendering its decision, the court found PBLLC's counterarguments "unavailing and unpersuasive." First, the court dismissed PBLCC's argument that it had merely hired the replacement mason to supplement Costa's work, not to replace Costa. The court reviewed the various potential contract provisions in detail that would have allowed PBLLC to supplement Costa's work and found that either those provisions did not apply or that Costa failed to invoke them. In the end, the court held that it was clear based on the facts that PBLLC had in fact hired the replacement mason to complete Costa's work and cited to a concession by PBLLC's counsel during oral argument to that effect to support her conclusion.

The court also quickly disposed of PBLLC's suggestion that Travelers was required to show prejudice resulting from its own failure to comply with Section 3.2. The court noted that the Bond itself, in Section 4, clearly states otherwise, finding again that the Bond was "crystal clear that no prejudice is required for a failure to comply with Section 3.2."

Finally, the court noted that there was insufficient evidence that Travelers even knew that a replacement contractor had been hired, as PBLLC argued. More significantly, the court held that "even if Travelers had the knowledge that plaintiff claims, that would not excuse plaintiff's strict compliance with Section 3 before Travelers' obligations would ripen."

The court also denied plaintiff's cross motion for summary judgment. In its motion, PBLLC argued that certain alleged conduct of Travelers breached the covenant of good faith and fair dealing. According to its motion, this conduct included recommending attorneys to Costa, providing advice to Costa on plaintiff's breach of the subcontract and discussing Costa's plan to file a mechanics' lien. PBLLC urged the court to find that Travelers had colluded with its principal to undermine its efforts to complete the work and that Travelers had never truly intended to comply with its obligations under the Bond.

Citing to Travelers own brief and argument, the court held that it is "not improper for Travelers to communicate or even to coordinate with its principal - that is, Costa. Moreover, nothing overrides the clear and unambiguous terms of the contract. Intent is not an issue here. And this case rises and falls on the parties' clear and unambiguous contract terms." The court went on to hold that the plaintiff's cross motion failed because the claim for breach of the covenant of good faith and fair dealing is not an independent cause of action and requires a breach of the underlying contract. Here, because PBLLC failed to comply with the conditions precedent, PBLLC and not Travelers breached the Bond.

The court's decision in *Providence Builders* strongly affirms the clear and unambiguous language of the A312 Bond that the surety's obligations arise only after the obligee complies with the conditions precedent stated in Section 3. The decision also confirms that the obligee must strictly comply with these conditions before the surety is required to take any action. Obligees should take note that any actions that deprive the surety of its right to choose how it will respond under the Bond will result in a discharge of the surety.

Will A Downturn In the Economy Lead To Increased Bond Claims In Certain Sectors?

by Paula Lee Chambers, Partner

Used Car Dealer Bonds or Motor Vehicle Dealer Bonds are mandated in all fifty states by statute to protect consumers from unscrupulous used car dealers. More often, the dealer fails to rectify a number of enumerated statutory conditions leaving the consumer paying thousands of dollars with a clunker left in the driveway or returns the car for repair only to never have it returned. Will the downturn in the economy lead to more consumers turning to used cars from a "pop-up" dealer with perceived lower cost options available to the consumer? Moreover, will well-established used car dealers with no prior claims now experiencing financial hardship result in claims because the dealer cannot repair the cars under the used car warranty? The experience in Massachusetts to these questions has been "yes." There has been an increase in claims. Not all is lost, however. A surety faced with a cascade of claims can reduce its risk by taking certain legal actions to limit its liability in defending what may be multiple claims on one or more bonds.

What Defines A "Triggering Event"

As always, a careful reading of the bond to determine who is a proper claimant, the statutory conditions contained in the statute,

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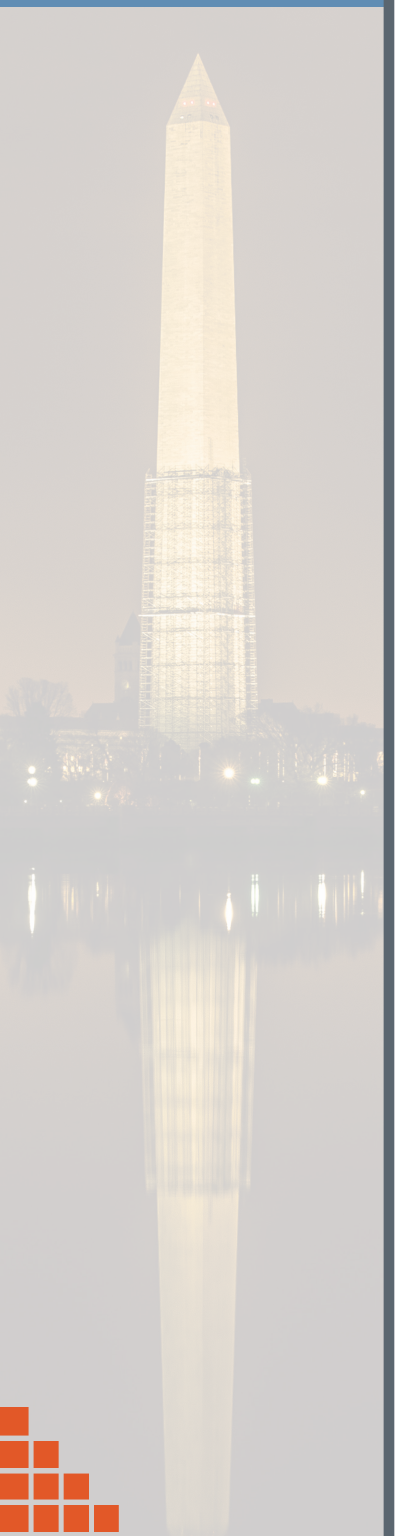

and the 'triggering event" for a claim on the bond is the starting point. The term "event" may very well be challenged by a claimant to obtain the benefit of the bond.

In one Massachusetts case, the claimant filed a small claims action for breach of contract, breach of warranty, and deceptive acts and practices against the used car dealer. Two years prior to the small claims action, the claimant had returned the vehicle for repairs based on the check engine light under the warranty and never took possession of the vehicle again. Based on a review by the surety, the surety issued its denial letter on the grounds that the claim was time barred by the specific language contained in the bond and in compliance with the Massachusetts Motor Vehicle Dealer Statute, M.G.L. c. 140, § 58.

Specifically, the bond at issue read in part:

> NOW, THEREFORE, the condition of this obligation is such that if the said Principal shall faithfully observe the provisions of Chapter 140, Section 58, then this obligation shall be void and of no effect; otherwise it shall remain in full force and virtue. The aggregate liability of the Surety shall in no event exceed the amount of this bond regardless of the number of claims against the bond or the number of years remains in force.

The bond further stated:

> Section 1. Recovery against this bond may be made by any natural person who obtains a final judgment in court against the Dealer for an act or omission on which the bond is conditioned if the act or omission occurred during the term of the bond. No suit may be maintained to enforce any liability on the bond unless brought within one (1) year after the event giving rise to the cause of action.
>
> Section 2. Notice of any suit under this bond must be made in writing to the obligee (written acknowledgement of receipt of said notice by the obligee is prima facie evidence of compliance with this requirement of notice).

In this case, the surety denied the claim based on the language contained in the bond which read in part: "No suit may be maintained to enforce any liability on this bond unless brought within one (1) year after the event giving rise to the cause of action." (emphasis added). The "event," the surety argued, giving rise to the cause of action was either at the earliest the sale by the used car dealer two years prior and at the latest when the claimant returned the vehicle because of the check engine light - the breach of warranty three weeks later. Based on those timelines, the claimant had missed the one-year suit limitation contained in the bond.

Undaunted, the claimant took the position that there was a new event arising from the deceptive acts and practices claim against the used car dealer for his failure to pay her claim as a new event. For the surety's part, the surety reiterated its position that the unfair acts of the used car dealer was not a new event. It was a subsequent cause of action arising from the failure on the part of the dealer to repair her vehicle two years prior. Alternatively, if it was a new event, the bond would not pay for unfair and deceptive acts of the principal as extra-contractual damages.

Extracontractual Damages Are Not Covered Under the Bond In Massachusetts

Extracontractual damages obtained by the claimant are not recoverable under the bond which sometimes doubles or triples the claimant's damages with an entitlement to attorney's fees. In the example above, the claimant received a $7,000 judgment, which the court doubled pursuant to the consumer statute ($14,000), and included $150 in costs, and $4500 in attorney's fees, totaling $25,650.

The judgment amount, however, is not the amount the claimant would be entitled to under the bond. M.G.L. c. 140, § 58 sets forth the limits of a surety's liability under a motor vehicle dealer bond. There is no provision within that statute that allows for recovery of attorney's fees against a surety, nor is there any provision that allows a claimant to recover from a surety bad faith damages that have been assessed against its principal. The Massachusetts Court of Appeals also issued a decision fully supporting this proposition. In *C&J Steel, Inc. v. Travelers Casualty and Surety Company of America*, 70 Mass. App. Ct. 653, 876 N.E.2d 442 (2007), the plaintiff obtained bad faith damages against the surety's principal. The claimant then attempted to recover those damages against the surety, even though the surety itself did not engage in any bad faith conduct. The court of appeals held that the bad faith statute, Chapter 93A, only applies to the offending conduct of the principal. Accordingly, the *C&I* court held that the surety could not be held liable for the bad faith conduct of its principal.

Pursuant to these decisions, M.G.L. c. 140, § 58 does not provide for an award of damages against a surety for bad faith damages. Similarly, the statute does not allow for a recovery of attorney's fees from a surety.

Determining Whether An Interpleader Action To Deposit the Penal Sum Is Appropriate

When a used car dealer closes abruptly, there are often times multiple claimants that will more than likely exceed the penal sum of the bond. The dilemma for a surety is whether to follow the "first in line, first in time" approach until the bond is exhausted or whether an interpleader action to deposit the penal sum is more of a safeguard for the surety to limit the potential liability for unfair claims practices and attorney's fees. Pursuant to Massachusetts law, it is more of a two part process of interpleader and a request to deposit the penal limits of its bonds. Additionally, a surety is entitled to its attorney's fees and costs if there are any bond proceeds remaining. Importantly, if there are multiple claims on the bond, a request for injunctive relief upon the depositing of the bond proceeds is essential for the surety.

Under Massachusetts law, Mass. R. Civ. P. 67 provides, in pertinent part:

> In an action in which any part of the relief sought is a judgment for a sum of money or the disposition of a sum of money or the disposition of any other thing capable of delivery, a party, upon notice to every other party, and by leave of court, may deposit with the court all or any part of such sum or thing. Money paid into court under this rule shall be deposited and withdrawn in accordance with the provisions of any applicable statute or rule.

A Rule 67 motion is proper "where the depositor is a mere stakeholder or does not contest liability to at least someone among two or more claimants." *Tarpey v. Crescent Ridge Dairy, Inc.*, 47 Mass. App. Ct. 380, 393 (1999). The surety on a used car deal bond is a "pure stakeholder" and would be seeking nothing beyond a discharge from further liability.

Moreover, "[i]nterpleader lies only when the party is exposed to several actions for the same demand, while he is ready and willing to satisfy that demand in favor of the claimant who establishes his right thereto, and he himself claims no personal interest in the subject-matter of the litigation." *Gonia v. O'Brion*, 223 Mass. 177, 178 (1916). "In an interpleader the issues made and tried are treated as issues between the rival claimants only." *Savage v. McCauley*, 301 Mass. 162, 164-65 (1938)(and cases cited). "It follows that, in an interpleader action in which the stakeholder does not assert a claim to the stake, the stakeholder should be dismissed immediately following its deposit of the stake into the registry of the court…without awaiting an adjudication of the defendants' competing claims." *Hudson Sav. Bank v. Austin*, 479 F.3d 102, 107 (1st Cir. 2007)(interpreting cognate federal rule).

The Surety's Attorney's Fees And Injunctive Relief

In an interpleader action in Massachusetts, the court has the discretion to award attorney's fees to a disinterested stakeholder to be paid from the disputed fund. *John Hancock Life Ins. Co. v. Flaherty*, 81 Mass. App. Ct. 1120 (2012) (holding that the argument that the "American Rule" prohibits an award of attorney's fees in an interpleader action is "simply wrong," and that award of attorney's fees is within the discretion of the judge).

The courts in Massachusetts are also willing to grant a permanent injunction on future claims arising from the same bond. "In a true interpleader, the cause of action is founded upon the right of the stakeholder to avoid multiple suits against him." *Savage v. McCauley*, 301 Mass. 162, 165, 16 N.E.2d 639, 640 (1938). "[W]here a stakeholder, faced with rival claims to [a] fund itself, acknowledges…his liability to one or the other of the claimants…[the] fund itself is the target of the claimants…. It is, therefore, reasonable and sensible that interpleader, in discharge of its office to protect the fund, should also protect the stakeholder from vexatious and multiple litigation." *State Farm Fire & Cas. Co. v. Tashire*, 386 U.S. 523, 534, 87 S. Ct. 1199, 1205, 18 L. Ed. 2d 270 (1967). "In such situations, an injunction against overlapping lawsuits is desirable to [e]nsure the effectiveness of the interpleader remedy, as such an injunction prevents the multiplicity of actions and reduces the possibility of inconsistent determinations." *Guardian Life Ins. Co. v. Gilmore*, 45 F. Supp. 3d 310, 319-20 (S.D.N.Y. 2014).

Conclusion

Claims on these Used Car Dealer Bonds should be treated cautiously to ensure that the claims attorney or analyst is addressing the scope and breadth of the possible claims on the bond. Contacting the agent and more importantly, the obligee on the bond- most often the town or city politic, may be the best practices to determine whether it is a one-off claim or whether a flood of claimants will be forthcoming. Additionally, the Massachusetts statute incorporated into the bond requires a judgment and has strict statute of limitation and notice timelines. Reducing the risk for the surety and potential unfair settlement practices are key in handling such claims.

"Too Much Notice" Of A Payment Bond Claim May Be No Notice At All Under The Miller Act

by Brian C. Padove, Associate

While courts generally give liberal construction to the Miller Act, 40 U.S.C. §§ 3131 *et seq.*, with regard to its remedial provisions, courts have repeatedly determined that the notice provisions and requirements of the Miller Act are stringent requirements that compel strict compliance therewith in order to properly bring a claim against a bond. The Seventh Circuit recently confirmed this long-standing precedent in *A&C Constr. & Installation, Co., WLL v. Zurich Am. Ins. Co.*, 963 F.3d 705 (7th Cir. June 30, 2020) ("*A&C Construction*"). In *A&C Construction*, the Seventh Circuit affirmed the U.S. District Court for the Northern District of Illinois's (the "District Court") holding on summary judgment that the sub-subcontractor missed its Miller Act notice requirement deadlines thereby eliminating its ability to bring a cause of action on a payment bond against the surety because the sub-subcontractor provided notice of its claim well before 90-days from its last date of work.

The Miller Act And Its Notice Requirements

Section 3133 of the Miller Act sets forth the requirements that claimants must follow in order to bring a civil action on a payment bond. For sub-subcontractors/material suppliers, section 3133 provides two express timing requirements necessary in order to maintain and bring an action on a payment bond under the Miller Act: (1) notice of its payment bond claim within 90 days to the prime contractor, and (2) a one-year limitation period in which a lawsuit must be brought.

With regard to the notice requirement, in order to bring a civil action on the payment bond, a sub-subcontractor/material supplier must provide "written notice to the contractor within 90 days from the date on which the person did or performed the last of the labor or furnished or supplied the last of the material for which the claim is made." Likewise, if payment it still not made to the claimant after the required notice is given, then the claimant has one-year after the day on which the last of the labor was performed or material was supplied by the claimant to bring a cause of action under the bond.

While the statutes are relatively unambiguous, issues often arise, such as what constitutes "last" performance of work, whether the content of the notice was sufficient, and whether the notice was timely. The latter issue was addressed in *A&C Construction*.

Case Background

A&C Construction involved a federal construction project for the construction of two billets in the Blatchford-Preston Complex at Al-Udeid Air Base in Qatar (the "Project"). AMEC Foster Wheeler Environment & Infrastructure, Inc. ("AMEC") entered into a contract with the Army Corps of Engineers to serve as the prime contractor on the Project, and in accordance with the Miller Act, AMEC, as principal, and Zurich American Insurance Company and The Insurance Company of the State of Pennsylvania (the "Sureties") executed and delivered a payment bond for the Project (the "Payment Bond"). Thereafter, AMEC subcontracted certain mechanical work to Black Cat Engineering & Construction ("Black Cat") who subsequently subcontracted with Plaintiff, A&C Construction & Installation, WLL ("A&C").

After some time, the relationship between Black Cat and A&C deteriorated to a point where Black Cat eventually terminated A&C in late 2015, but A&C continued to perform its own actual work on the Project until May 16, 2016. On August 16, 2016, A&C provided a Miller Act notice of non-payment alleging that, as of that date, it was owed $8,449,710. A&C, however, allegedly continued to provide work and equipment to the Project because: (1) its equipment remained on the Project site for Black Cat's use; and (2) A&C provided supervision of one of its subcontractors through the Project's completion date of February 28, 2017. Thereafter, A&C filed its lawsuit in the District Court on June 7, 2017 for recovery of damages under the Payment Bond.

Northern District of Illinois Decision

After filing suit, the Sureties moved for summary judgment arguing that A&C was barred from bringing a Miller Act claim because A&C failed to

comply with the Miller Act timing requirements. Specifically, the Sureties argued, among other things, that: (1) the time between A&C's last date of its own actual work, which the Sureties argued was May 16, 2016, and the date upon which the notice was served (August 16, 2016), totaled 91 days and thus was untimely; (2) the lawsuit was filed on June 7, 2017 – one year and 22 days after May 16, 2016; and (3) to the extent the District Court agreed that A&C continued providing equipment and/or work through February 28, 2017, then A&C's August 16, 2016 notice was not within 90-days of February 28, 2017. In response, A&C argued that the lawsuit was timely because the last date it worked and/or furnished equipment was February 28, 2017. A&C also argued that even though the August 16, 2016 notice was served well more than 90-days prior to the last provision of work, it placed the prime contractor and Sureties on notice of A&C's claim of unpaid labor and materials - in essence, A&C argued it provided "too much notice" of its claims.

The District Court rejected A&C's arguments and granted summary judgment in favor of the Sureties. In ruling in the Sureties' favor, the District Court relied, in part, on a strict view of the Miller Act's time provisions. First, with regard to May 16, 2016 as the date on which A&C last provided labor or materials, the court noted that even if the notice provided on August 16, 2016 was timely, A&C failed to file its lawsuit within one year of May 16, 2016. Second, the court held that even if it assumed that February 28, 2017 was the last date of work, the Miller Act required A&C to provide notice within 90-days of that date (by May 29, 2017), which A&C failed to do. As such, in addressing A&C's final "too much notice" argument, the District Court found that while the prime contractor and Sureties may have been on notice of potential claims by A&C, the August 16, 2016 notice did not meet the strictly construed notice requirements under the Miller Act, which are conditions precedent to filing a suit against the Sureties.

Seventh Circuit Decision

A&C appealed the District Court's ruling to the Seventh Circuit. Relying, in part, on its "too much notice" argument, A&C asserted that the District Court erred in granting summary judgment in the Sureties favor because, among other things: (1) its August 16, 2016 notice was timely given; (2) it performed work through February 28, 2017; and (3) the lawsuit filed on June 7, 2017 was timely.

Although the Seventh Circuit noted that the Sureties and A&C disputed the correct date of the last work performed, the Seventh Circuit found that it was not necessary to determine the final date for appellate purposes. Instead, it assumed (just as the District Court had done) that A&C's last date of work, for purposes of the bond claim, was February 28, 2017. Following this assumption, the Seventh Circuit held that there was no dispute that A&C served its Miller Act notice on August 16, 2016. The Seventh Circuit then took a strict view of the "unambiguous" nature of the Miller Act's notice requirement and found that the Miller Act notice must be given "within 90 days" of the assumed last date of work, February 28, 2017. Accordingly, the Seventh Circuit rejected A&C's "too much notice" argument and held that the August 16, 2016 notice was not technically within 90 days of the February 28, 2017 date. As such, A&C failed to timely serve its Miller Act notice, and thus, could not maintain an action against the Sureties on the Payment Bond.

In its conclusion, the Seventh Circuit noted that the Miller Act aims to protect subcontractors against nonpayment. The Seventh Circuit went on to note, however, that the Miller Act "demands strict compliance with certain conditions precedent to the right to recover." Consequently, given the facts at hand, the Seventh Circuit stated that it was left with the "straightforward" question of whether A&C could sue on the bond if A&C did not comply with the requirement to provide notice within 90-days of the date that A&C said it completed its work (February 28, 2017). Since the undisputed facts were that A&C did not provide such notice within 90-days of February 28, 2017, the answer was clear: no, A&C could not sue on the payment bond. As such, the court affirmed the District Court's ruling and emphasized that the Miller Act's timing requirements relating to notice must be strictly adhered to.

Conclusion

The *A&C Construction* decision addressed the peculiar issue of a contractor providing its notice more than 90-days prior to the last date on which it performed work and furnished material on a project. Thus, given that the contractor provided notice "too early" (rather than giving notice too late and/or not at all) the contractor argued that, in taking a liberal construction of the Miller Act, the notice was proper because the sureties were still on notice of the claim well-before the 90-day post-work deadline had passed. The Seventh Circuit, however, was unpersuaded by the contractor's "too much notice" argument and found that "too much notice" was no notice at all under the Miller Act. This decision highlights a key exception to the

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Miller Act's general rule of liberal construction – namely, one must have strict compliance with the notice and statute of limitations provisions of the Miller Act.

Accordingly, the key concepts to take away from this ruling are two-fold. For contractors, while it is important to provide notice under the Miller Act when payments are not received, contractors must still comply with the Miller Act's unambiguous requirements by providing subsequent notice within 90-days of it last performing work or furnishing materials to the project. For sureties, when a bond claim notice is received, it is prudent (as it always is) to obtain precise information about the date the claimant last performed work and/or furnished material. If the notice date is not within the 90-day timeframe, then the surety may be able to take a strict view of the Miller Act provisions and deny any such claim as being untimely.

Crosno Construction, Inc. v. Travelers Casualty And Surety Company Of America: A New Twist On An Old Tale

by Rebecca S. Glos, Partner

Just when the issue of the enforceability of pay-*if*-paid clauses and pay-*when*-paid clauses seemed to be well-settled, a recent decision by the California Fourth District Court of Appeal in *Crosno Construction, Inc. v. Travelers Casualty and Surety Company of America* has added a new wrinkle, keeping contractors and sureties alike on their toes. 47 Cal.App.5th 940 (2020).

Historical Framework For Pay-If-Paid And Pay-When-Paid Provisions In Subcontracts

Prior to the *Crosno* holding, the California Supreme Court, in a seminal construction payment decision, held that a pay-*if*-paid provision in a California construction contract was not an enforceable defense to a payment claim by a subcontractor, because it was against public policy. *William R. Clark Corp. v. Safeco Insurance Co.*, 115 Cal.4th 882 (1997). Consequently, the *Wm. R. Clarke* court held that a prime contractor must pay the subcontractor regardless of whether the prime contractor was paid by the owner.

Notwithstanding the decision in *Wm. R. Clarke*, courts have generally distinguished "pay-***when***-paid" clauses and found that they may be enforceable as long as the time affixed for payment to the subcontractor is a "reasonable" time. *Id.* at 885. The issue faced by many subcontractors is "what exactly constitutes a 'reasonable time'?" Even if the subcontract in question includes a definition of "reasonable" time (often it does not), will it be considered reasonable as a matter of law? While subcontractors would like to have the question of reasonableness quantified more precisely (for instance, whether 60 days, 180 days, or even one year could be considered reasonable), the answer often depends upon the factual situation particular to each given case.

***Crosno*: An Indefinite Amount Of Time Is Not "Reasonable"**

The issue addressed in *Crosno* was whether a pay-when-paid provision that allows the contractor to withhold payment from the subcontractor until the contractor has concluded its pursuit of legal remedies against the owner is a "reasonable" timeframe for payment to the subcontractor. In *Crosno*, the general contractor, Clark Bros., Inc. ("Clark"), was hired by the North Edwards Water District ("District") as its general contractor to build an arsenic removal water treatment plant. Clark, in turn, hired subcontractor Crosno Construction, Inc. ("Crosno") to build and coat two steel reservoir tanks. The subcontract included a "pay-when-paid" provision allowing Clark to pay Crosno within a reasonable time of receiving payments from the District, but "in no event shall be less than the time [Clark] and [Crosno] require to pursue *to conclusion* their legal remedies against the [District] or other responsible party to obtain payment…." *Crosno Construction, Inc. v. Travelers Casualty and Surety Company, supra*, 47 Cal.App. at 945 (emphasis added). After it had supplied and fabricated labor and materials in excess of $500,000, Crosno was ordered to stop work because a dispute had arisen between Clark and the District. *Id.* at 947. The District subsequently terminated Clark and a lawsuit arose thereafter.

Crosno filed its own lawsuit against Clark and its surety, Travelers Casualty and Surety Company of America ("Travelers"), to receive payment for its work under Clark's public works payment bond. Travelers argued it was entitled to rely upon the pay-when-paid provision which allowed Clark to withhold payment from Crosno until litigation between Clark and the District had concluded. The trial court granted Crosno's motion for summary judgment on the basis that the pay-when-paid provision was unenforceable because it violated the policies underlying California *Civil Code* § 8122, which requires a waiver and release before a subcontractor's payment bond claims can be "waive[d], affect[ed], or impair[ed]." Travelers appealed on the issue of whether it was liable for prejudgment interest and attorneys' fees under the payment bond (the District had interpleaded funds to satisfy the outstanding principal judgment in favor of Crosno on its payment bond claim). *Id.* at 949.

Having acknowledged the constitutional and statutory basis for payment bonds, the court of appeals agreed with the trial judge's finding that the pay-when-paid provision, which set a potentially lengthy and uncertain period during which a subcontractor would not be permitted to enforce its statutory right to recover the value of its work and materials, was void as a violation of the public policy underlying *Civil Code* § 8122. *Id.* at 950. The court determined that, while explicitly providing for payment to be delayed for an "unspecified and undefined" period after completion of the work, the provision conflicted with the purpose behind the payment bond of providing subcontractors with an expedient means of recovery. *Id.* at 956-57. For this reason, the court held that Travelers was precluded from relying upon this provision as a defense to a subcontractor's claim under Travelers' payment bond. In the same manner, Travelers was precluded from inserting a condition in its bond limiting a subcontractor's bond recovery for claims where litigation against the owner had concluded. *Id.* at 957.

The court equally rejected Travelers' argument that its obligation on the bond was coextensive with Clark's obligation, thereby entitling it to assert the same defenses as Clark. *Id.* at 962. The court found that Travelers' obligation as the bond surety was independent of the pay-when-paid provision in the subcontract. *Id.* at 963. Because a public works payment bond is statutory in nature, the court held that specific statutory protections applied, including those under *Civil Code* § 8122. *Id.*

Crosno's Impact On Enforceability Of Pay-When-Paid Provision

The holding in *Crosno* may be the first in a long line of cases defining permissible terms to include within a pay-when-paid provision. Along these lines, it is important to note that the decisive issue in *Crosno* was not the enforceability of pay-when-paid provisions, but rather what is considered a reasonable – and, therefore, permissible – amount of time a subcontractor may be required to wait to be paid. Indeed, the court in *Crosno* emphatically stated that not "***all*** pay-when-paid provisions are unenforceable against a payment bond claim – just that [the one in the subcontract between Clark and Crosno] is." *Id.* at 958 (emphasis added). Specifically, the court rejected the expansive language in the provision allowing Clark to defer payment to Crosno for an indefinite period of time while the former litigated its claims against the District. While it did not set a maximum time period a subcontractor could be made to wait, the court seemed to suggest that the statute of limitations for initiating an action against a surety on a payment bond (ie. within six months of when a stop notice may be filed) should serve as the outer limits of a reasonable period.

Based upon this reasoning, the court may have ruled differently had: (1) the pay-when-paid provision specified the maximum amount of time payment to Crosno could be deferred while Clark litigated its claims against the District; and (2) such period did not extend beyond the statute of limitations to initiate an action against a payment bond surety. Unfortunately, the court offered no insight one way or another.

Pay-when-paid clauses remain enforceable as long as the language contained within does not set an indefinite duration of time before the subcontractor may be compensated, or conditions payment to the subcontractor on an event that takes place in the indefinite future (ie. conclusion of litigation between the general contractor and owner). As pay-when-paid provisions become more fine-tuned, we anticipate this issue becoming the subject of future judicial authority. Until then, general contractors should review the pay-when-paid clauses in their subcontracts and revise where necessary. For subcontracts where the work is ongoing, general contractors may wish to negotiate a "reasonable" duration to include

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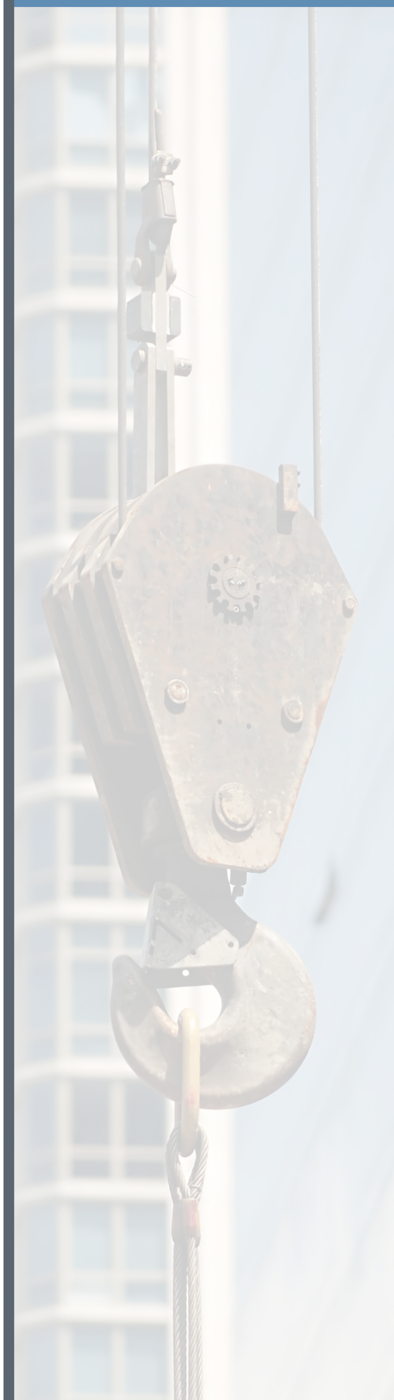
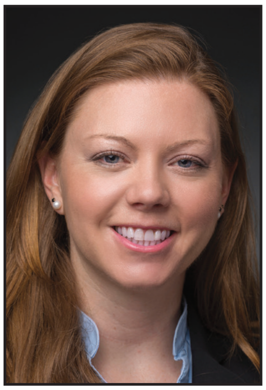


within such provisions to avoid complications which may arise in the future.

Although parties are permitted to contract and negotiate terms as they see fit, to the extent the enforcement of any provisions interfere with longstanding rights, such provisions may be deemed to violate public policy and, therefore, may be declared void. The *Crosno* decision is a good reminder for general contractors and sureties to understand and protect themselves from owner actions that could potentially result in the general contractor, or its surety, funding change orders and other subcontractor costs while the owner wrongfully withholds payment. Knowing the risk that a pay-when-paid provision may potentially be unenforceable should influence how general contractors and their sureties react to an owner's non-payment for base contract work or reluctance to commit to payment for extra work.

Marguerite DeVoll Named Partner



Watt, Tieder, Hoffar & Fitzgerald, LLP is proud to announce that **Marguerite DeVoll** has been named a Partner of the firm. This achievement reflects Marguerite's hard work and dedication to the area of bankruptcy and creditors' rights.

Marguerite has passionately pursued the area of bankruptcy and creditors' rights throughout her legal career. During law school, she served as the Editor-in-Chief of the Emory Bankruptcy Developments Journal. Following law school, she clerked for the Honorable William R. Sawyer of the United States Bankruptcy Court for the Middle District of Alabama for two years.

Marguerite takes great pride in the work that she does and is committed both to her clients and the legal community. She regularly appears in bankruptcy courts throughout the country, including Texas, Georgia, Delaware, Wisconsin, Maryland, Virginia, D.C., New York, Illinois, and Kentucky. She has represented secured and unsecured creditors, asset purchasers, trustees and other court-appointed fiduciaries, debtors, and other interested parties in chapters 7, 11, and 13. She also routinely appears in the Virginia and Maryland state courts representing and protecting the rights of landlords, banks, contractors, sureties, and other creditors.

Marguerite is an active writer and regularly presents CLEs on bankruptcy and creditors' rights issues to bankruptcy and nonbankruptcy associations, including the Walter Chandler Inn of Court, the Maryland Bankruptcy Bar Association, the Northern Virginia Bankruptcy Bar Association and the Virginia State Bar's Construction Law and Public Contracts Section.

Marguerite is also very involved in the legal community. She currently serves as an at-large director for the Bankruptcy Bar Association for the District of Maryland and plans to continue service on the board of directors for this organization next year. Since 2011, she has been a member of the International Women's Insolvency and Restructuring Confederation ("IWIRC") and served in numerous leadership roles with IWIRC. In addition, Marguerite is a member of the American Bankruptcy Institute, the Northern Virginia Bankruptcy Bar Association, and the Tort Trial & Insurance Practice Section of the America Bar Association.

FIRM NEWS

Recent And Upcoming Virtual Events

COVID-19 Impacts on Northeast Construction and Mitigation, May 6, 2020. **Jonathan C. Burwood** presented to the claim and underwriting teams for Frankenmuth Surety.

Virginia Bar Association's 5th Annual Federal Government Contracting Seminar, September 16, 2020; **Scott P. Fitzsimmons** and **Jonathan Wright** will present on FAR Class Deviations, how they are approved, when they are issued, and the Class Deviations issued in the Federal Government's response to COVID-19.

31st Annual Northeast Surety & Fidelity Claims Conference, September 24, 2020; **Christopher J. Brasco** and **Matthew D. Baker** will present on "Concurrent Events & Other Scheduling News."

Construction Management Association of America ("CMAA") National Conference and Trade Show, October 15, 2020; **Christopher J. Brasco** and **Kathleen O. Barnes** to speak on "Project Success Through Effective Leadership and Risk Management."

ABA Tort, Trial and Insurance Section's Fidelity and Surety Law Committee and the Fidelity Law Association's Annual Fall Fidelity Insurance Program, November 4 and 5, 2020; **CharCretia DiBartolo** will co-chair. The virtual program will cover the "who, what, where, when and how" of modern fidelity insurance claims in two webinars.

Virginia State Bar's 41st Annual Construction and Public Contracts Seminar, December 4, 2020; **Kathleen O. Barnes** to speak on "Swimming with Sharks: Litigating a Construction Case to a Jury."

35TH Annual Construction SuperConference, December 9, 2020; **Christopher J. Brasco**, **Vivian Katsantonis** and **Kathleen O. Barnes** to speak on "Concurrent Events and Other Breaking News Affecting the Recovery of Delay Damages."

2021 ABA Construction Forum Midwinter Meeting, January 2021; **Kathleen O. Barnes** will give a presentation entitled "All About the Benjamins, Where Tomorrow's Construction Dollars Will Come From and Where Are They Headed?"

Watt Tieder newsletters are posted on our website, www.watttieder.com, under the Resources Tab. If you would like to receive an electronic copy of our newsletter, please contact Peggy Groscup at: **pgroscup@watttieder.com**

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The Watt, Tieder, Hoffar & Fitzgerald newsletter is published quarterly and is designed to provide information on general legal issues that are of interest to our friends and clients. For specific questions and concerns, the advice of legal counsel should be obtained. Any opinions expressed herein are solely those of the individual author.

Special Thanks to Editors, **Robert G. Barbour**, **William Groscup**, **Christopher M. Harris** and **Marguerite Lee DeVoll**.

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