

Bonding Company Hit Hard for Failing to Meet Deadlines

by Eric Travers, Esq.

In a case that represents another in a series of victories for subcontractors and suppliers with bond rights, the principle that bonding companies, like bond claimants, have to strictly comply with their respective obligations under the rules set forth in the payment bonds was applied by the U.S. District Court for the Eastern District of Virginia, in the case *Casey Industrial, Inc. v. Seaboard Surety Co.*¹ Though suppliers and subcontractors tend to be wary of the good faith with which sureties investigate claims on their bonds, there have been several noteworthy decisions affirming the welcome and common-sense principle that “what’s good for the goose is good for the gander.”

In *Casey*, a subcontractor properly submitted a bond claim for increased costs, delays, and extra work and did so within the time limit set by the payment bond on the project in question. The bond was posted by the Seaboard Surety Company and contained language identical to that in the American Institute of Architects’ (AIA) A312-1984 bond form by requiring the bonding company to “[s]end an answer to the Claimant ... within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.”

Within the 45-day period after receiving the claim, the bonding company wrote the subcontractor and denied the claim. The surety stated in its letter that it disputed: (1) the subcontractor’s right to payment for delays that the owner had not paid; (2) the amounts claimed with respect to deductive change orders and alleged payments; and (3) entitlement to interest and attorneys’ fees.

Almost one year later, in separate litigation between the owner and general contractor for the project in question, the judge presiding over that case issued 107 pages of factual finding and conclusions of law. The judge in that case found that the subcontractor’s work suffered “numerous quality problems” and that the subcontractor wrongfully delayed performing certain work and incorrectly installed other work. When the surety got wind of these findings, it attempted to use them as a basis to have the subcontractor’s bond claim dismissed.

But the Eastern District of Virginia Court rebuffed this attempt.

It is generally accepted that surety bonds establish a three-party contractual relationship. In the typical construction context, this three-party relationship is between: (1) the surety that issues the bond, (2) the general contractor that pays for the bond (the “bond principal”), and (3) the individual creditors who are entitled to rely on the bond (the “subcontractor” or “supplier”). Because of this, courts interpret payment bonds as if the bonds were ordinary contracts, and the Eastern District of Virginia was no exception.²

The court interpreted the bond as a contract that imposed on the contracting parties certain rights and duties. The court

held that Seaboard Surety could *only* rely on the reasons it had identified in the 45-day period because all “other bases for challenging the amount in question are waived.” As such, the bonding company was not allowed to raise defective work as a basis for denying the claim. The court explained that because the bond was a contract to which ordinary rules of construction apply, the bonding company was required to honor its contractual obligation when disputing a claim to describe in writing, within 45 days of receiving the claim, which portions of the claim were disputed, and the reasons for the dispute.

Though the bonding company did write the subcontractor to inform it that its claim was disputed, the court held that the bonding company could not raise new reasons for denying the claim after the 45-day period expired.

The court explained that its holding did not mean that the bonding company was prohibited from raising legal defenses or facts that supported or defended the original reasons the claim was rejected. It did mean, however, that the bonding company was “precluded ... from developing new bases for dispute outside the 45-day contractual period.” In other words, because the plain language of the bond “contract” required the bonding company to list in its response letter (1) the amounts disputed and (2) the bases for challenging the claim, the subcontractor’s claims could be disputed only on the grounds given for nonpayment in the original 45-day period. All other bases for challenging the claim were waived.

This decision builds and expands upon the reasoning in the 2005 decision of Maryland’s highest court in *National Union Fire Insurance Company of Pittsburgh, Pa. v. Wadsworth Golf Construction Company of the Midwest*. In that case, the Maryland Court of Appeals held that a bonding company had waived its right to dispute any of a claim when it did not specify — within the 45-day period — what portions of a claim it intended to contest. The Maryland Court of Appeals in *National Union* explained that this result was necessary because the express language in the bond required the bonding company to respond to the claim by clearly stating what was disputed and why it was disputed. When the bonding company in *National Union* had not given any reason for not paying the bond claim within the 45-day period, the Maryland Court of Appeals held that the bond claimant was entitled to view the claim as undisputed, and that any other finding would render the bond language meaningless.

¹ *Casey Industrial, Inc. v. Seaboard Surety Co.*, 2006 U.S. Dist. LEXIS 74589 (E.D. Va. Oct. 2, 2006), clarified by, 2006 U.S. Dist. LEXIS 78416.

² *Nat’l Union Fire Ins. Co. of Pittsburgh v. Bramble*, 388 Md. App. 257, 863 A.2d 347 (Md.App. 2004).



The *Casey Industrial* court cited the *National Union* decision, noting that the case says, quite clearly:

A Surety is not allowed to delay raising reasons why it should not have to pay a surety bond as a lawsuit progresses. This Court remains persuaded by the language of *National Union*, which stated that ... the surety contract did not "simply require that the sureties state which portions of the claim are disputed and which are not; they must also delineate the grounds underlying the dispute."

Like *National Union*, the *Casey Industrial* case is a very favorable decision for subcontractors and material suppliers seeking payment under a payment bond. The decision is, thus, a welcome development to bond claimants because it confirms that bonding companies have the same obligation that claimants do to strictly follow the rules set by the payment bond form regarding the parties' respective duties in making and defending claims. In doing so, *Casey Industrial* represents a useful tool subcontractors and suppliers can wield when faced with a bonding company that does not take seriously its obligations under the bond to promptly investigate and pay legitimate claims.

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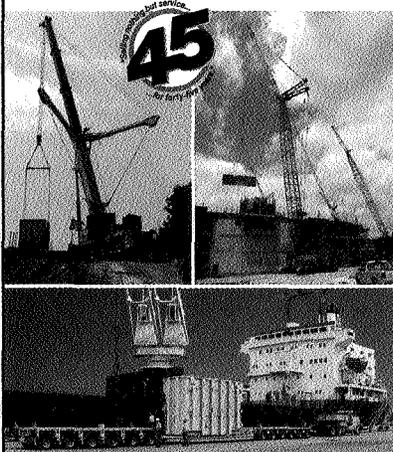
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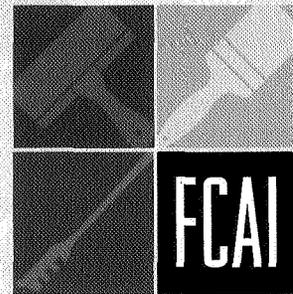
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