

Payment Bond Claim Partially Paid

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Labor and material payment bonds on public improvement projects are mandated by statute and promote the public policy of New York State that all entities and individuals that perform work and/or furnish materials on the public project should be paid for the work performed or materials furnished. A payment bond claim on a public project may be the most cost effective method for a subcontractor and/or materialman to obtain payment and, in some instances, the payment bond claim may be the only option for a subcontractor and/or materialman to be paid.

On a payment bond claim, the general contractor's surety is obligated to ensure payment to a proper payment bond claimant for the reasonable value of the work, labor and services and materials furnished under the subcontract. The surety is entitled to certain defenses on such payment bond claims, including, but not limited to, untimely claims, improper claimants, non-recoverable elements of a claim and/or back charges/offsets due to the adequacy and completeness of the work and/or materials. As explained by a recent court decision, these defenses, however, must be properly preserved by the payment bond principal (general contractor) in order to defeat a motion for summary judgment.

After a subcontractor was not fully compensated for work and materials it provided on a public project, it filed a payment bond claim and commenced an action against the general contractor's surety seeking payment under the payment bond. The subcontractor made a motion for summary judgment alleging that that even though the public owner had paid the general contractor in full for its work, the general contractor failed to make corresponding payments to the subcontractor. As proof of the owner's full payment, the subcontractor submitted a payment application that listed all of the line items covering the subcontractor's work had been paid in fully by the owner.

In opposition to the subcontractor's motion, on behalf of the surety, a representative from the general contractor submitted an affidavit asserting defenses to the subcontractor's claim for payment. Among other defenses asserted, the general contractor's representative stated: (i) that the general contractor had no obligation to pay the subcontractor until the public owner paid the general contractor; (ii) the subcontractor's demand for payment of retainage is not due and owing because the general contractor had not received retainage payments from the public owner; (iii) payment from the owner was subject to a pending contractually-mandated dispute resolution proceeding; (iv) certain back charges/offsets were assessed against the subcontractor because the subcontractor failed to complete its work, improperly performed certain work and the subcontractor caused damages to other contractors' work; (v) the subcontractor delayed the project; and (vi) the owner threatened potential liquidated damages to be assessed against the general contractor, which proportionate share of liquidated damages would flow down to the subcontractor.

The court analyzed the general contractor/surety's defenses to payment and addressed

each defense. First, the court determined that the subcontract language that payment from the owner was a condition precedent to payment to the subcontractor was an impermissible pay-if-paid clause that was void as against public policy. The court held, held, that the general contractor was entitled to withhold retainage because a contract provision allows retainage to be withheld until a project is completed and accepted by the owner merely fixes the time for payment and is not an improper pay-if-paid provision. With regard to the general contractor's defense of back charges/offsets, the court analyzed the subcontract provisions governing back charges. The subcontract required the general contractor to provide written notice of any potential back charges/offsets to payment. The surety offered some emails from the general contractor to the subcontractor regarding certain work that was allegedly improperly performed and/or unperformed. The court held that these emails constituted written notice under the subcontract. The court, however, held that other emails that questioned the adequacy of the subcontractor's work that were not sent to the subcontractor did not constitute proper notice under the subcontract. The court then assessed the defense that the subcontractor caused delays to the project. The court determined that there was little evidence that the subcontractor was notified that it was inadequately staffing the project or otherwise causing unacceptable delays. Indeed, the court noted that the general contractor had alleged in its alternative dispute resolution proceeding with the owner that any alleged delays on part of the subcontractor were excusable. The final defense asserted by the surety was that the public owner has threatened to assess liquidated damages. The court held that an unrealized, admittedly potential claim for liquidated damages that the owner may or may not assert against the general contractor does not constitute a claim for liquidated damages against a subcontractor by which a surety or the general contractor may offset payment to the subcontractor.

Ultimately, the court partially granted and partially denied the subcontractor's motion for summary judgment. The court held that there were issues of fact with regard to certain back charges/offsets asserted by the general contractor and whether payment for retainage was due and owing. The court further held that the other surety defenses were unavailing and, therefore, the subcontractor was entitled to judgment for approximately half of the amount sought in its complaint, plus 9% interest.

Commentary

This case is illustrative of how a court will analyze a bond claim and the defenses asserted by a general contractor/surety. The court will review the subcontract provisions to determine processes and procedures for payment as well as any notice provisions required to assert back charges or offsets against such demands for payment. As shown in this case, the court may even determine whether the payment provisions of the subcontract are impermissible pay-if-paid provisions and, are therefore, void as against public policy. The court will then look to the project correspondence and records submitted by the parties to determine whether the subcontract provisions have been followed by both the subcontractor/payment bond claimant and the general contractor/surety seeking to avoid such payment.

From the general contractor's perspective, it should make sure that the carefully drafted provisions of the subcontract are followed, including any required notice provisions. A failure to insist on strict compliance with the notice requirements may result in a waiver of a defense to a payment bond claim and/or result in a payment bond claimant obtaining rights to which it would not have been entitled. The general contractor should also be cognizant of the positions it has taken in different dispute resolution forums. Here, the court specifically noted that general contractor took inconsistent positions regarding the subcontractor's alleged delays. Ultimately, that inconsistency resulted in the court discrediting the general contractor's defense that the subcontractor caused delays. Without defenses, the surety will be obligated to tender payments on a payment bond claim. The surety will then require the general contractor and/or the indemnitors under the General Indemnity Agreement to satisfy any amounts paid by the surety, including the surety's defense costs.

From the subcontractor's perspective, it must diligently comply with all notice and recordkeeping requirements of the subcontract and timely and adequately provide notice of its bond claim to the surety. Failure to comply with any precondition to payment may prevent the subcontractor from obtaining full payment. The subcontractor can also use the subcontract as a shield to defend its claim against untimely and/or inappropriate attempts by the general contractor and/or surety to avoid payments.

Feel free to contact me to discuss filing or defending bond claims.