



# Legal Corner

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## Court Decision Limits Sureties' Exposure

*A case which was decided by the Massachusetts Appeals Court just recently held that a surety is not liable for the punitive damages which may be attributable to the conduct of its principal (a general contractor) arising from its actions on a public construction project. The matter arose from a dispute between a subcontractor and a general contractor on a school construction project within Massachusetts. The subcontractor, a non-filed sub-bidder, had claimed that the general contractor owed it a substantial amount for contract balances plus additional work. The general contractor had disputed that the subcontractor had performed its work in a satisfactory and timely manner. It also disputed the extra work claims by the subcontractor.*

The subcontractor subsequently filed a lawsuit against the general contractor, the payment bond surety and the architect. The contractor moved to stay the litigation and required the subcontractor to initiate arbitration since that was a specified means of dispute resolution for the project. The subcontractor then initiated arbitration against the general contractor. The arbitration sought not only payment for the contract balances and extra work, but also damages arising from M.G.L. c. 93A violations for unfair practices and not proceeding in good faith. Subsequently, the arbitration hearings were commenced and lasted a mere two days...very unusual

Subsequently the arbitrator found in favor of the subcontractor and awarded damages consisting not only of the contract balance and extra work, but also punitive damages of two times the actual damages and attorneys' fees. The overall damages which were awarded against the general contractor exceeded \$1 million. The subcontractor was then able to

confirm and receive a judgment against the general contractor for the amount of its award including the punitive damages and attorneys' fees.

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However, the general contractor was in essence insolvent and the subcontractor sought to collect the entire amount due from the contractor on the basis of the arbitration award. The surety resisted and claimed that it was not bound by the arbitration award with respect to the punitive damages and attorneys' fees. It acknowledged responsibility for the underlying contract balance, which represented about 30% of the total award.

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which the surety would pay suppliers and subcontractors in the event that the general contractor did not.

A further reason was that the subcontractor had never commenced the arbitration against the surety but proceeded solely against the general contractor. The opinion did, however, note that the surety was also represented by the same attorney who represented the general contractor but that this was not something that would be sufficient to hold the surety responsible.

Thus, the rationale of the Appeals Court was based on not only a substantive basis, i.e. the surety should not be liable for damages of this type, but also the procedural issue in that the subcontractor had never attempted to join the surety in the arbitration. One thing that the court did make clear was that the surety would be responsible for any unfair or deceptive practices that it may have created during its administration and responses to claims filed by payment bond claimants. It would be anticipated that the court would follow the same rationale in future cases, i.e. that this is not a type of damage for which the surety should be responsible.

There's certain to be other actions by subcontractors against a surety in which the subcontractor will attempt to join the surety within the arbitration and ultimately seek to have any punitive damage issues against the general contractor also made a part of the arbitration proceeding in which the surety is obligated to participate. ■

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