



Legal Corner

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PAYMENT BOND RECOVERIES

A recent decision from the Massachusetts Appeals Court pertaining to a public school construction project has helped to clarify the scope of liability of a surety on a payment bond claim involving a subcontractor. The subcontractor had initially filed a complaint in the Superior Court with claims against the general contractor, the architect, and the payment bond surety... The counts against the general contractor were for a breach of contract, quantum meruit, i.e. payment for the fair value of the services rendered, and allegations that the general contractor had breached the good faith obligations required pursuant to M.G.L. c. 93A, §11. The claims against the surety were for payment pursuant to the payment bond issued under M.G.L. c. 149, §29 and also alleged that the surety also had committed acts of bad faith pursuant to M.G.L. c. 93A for which it would be liable for punitive damages. The subcontractor was seeking hundreds of thousands of dollars in recoveries. The general contractor stayed the court action and required the subcontractor to proceed with the arbitration required within the general contract.

Accordingly, the subcontractor filed a demand for arbitration against the general contractor making the same allegations that it had within the complaint. After two days of hearings (which is unusually short for a construction dispute involving hundreds of thousands of dollars in damages), the evidence phase was closed. The arbitrator subsequently issued a decision against the general contractor for a total amount in excess of \$1.2 million which consisted of breach of contract damages of over \$310,000 together with violations of M.G.L. c. 93A in the amount of \$625,000 plus interest and attorneys' fees of \$270,000.

The subcontractor then sought to confirm the award against both the surety and the general contractor. The surety contested the punitive damages and the attorneys' fees aspect of the award. The surety's position was that the bond covers only labor, materials and equipment which are furnished to the project and not punitive damages. The surety also pointed out that the subcontractor had not filed a demand for arbitration against the surety but only against the general contractor.

While the surety was aware that arbitration was proceeding on the various issues, it had never been the subject of a demand for arbitration and did not participate. The subcontractor sought to hold it liable on the basis that it was responsible for the actions of its principal, i.e. the general contractor. The court disagreed and said that the failure to participate in an arbitration in which it was not a party did not make it liable. It claimed also that the scope of coverage of the insurance,

continued on page 20

i.e. the payment bond was a question for the court and not for the arbitrator as to whether there was a requirement on the part of the surety to arbitrate.

The only liability which would therefore be sustainable against the surety would be for the contract damages plus the interest. As the general contractor was, in essence, out of business and insolvent, the subcontractor was, therefore, going to be limited to recovery of only its breach of contract damages plus interest and none of the hundreds of thousands in punitive damages which it had been awarded recovery by the arbitrator and Superior Court Judge.

The holding of this case illustrates the importance of making sure that if you are going to be proceeding in arbitration, you must be certain to include all of the players from whom you may be seeking relief and avoid a potential problem such as developed in this case. While a party may challenge whether it has the obligation to participate in an arbitration, if one doesn't make the demand and assert the right, you could waive it and, therefore, miss the opportunity to get payments for portions of your damages. ■

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