

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

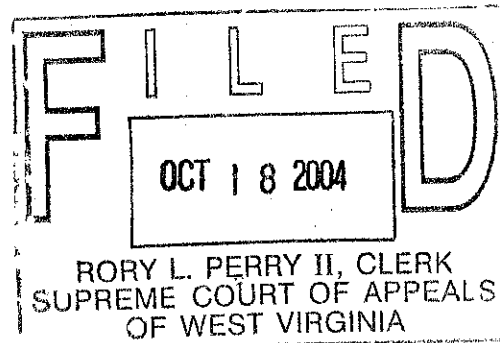
Nos. 31869 and ~~31870~~

WELLINGTON POWER CORPORATION
Plaintiff Below, Petitioner

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE
Defendant Below, Respondent.

Case No.:03-C-52



Consolidated with:

W.G. TOMKO, INCORPORATED
Plaintiff Below, Petitioner

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE
Defendant Below, Respondent.

Case No.: 03-C-94

**BRIEF OF PETITIONERS WELLINGTON POWER CORPORATION AND W.G.
TOMKO, INCORPORATED IN SUPPORT OF THEIR POSITION ON CERTIFIED
QUESTION**

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TOMKO, INCORPORATED IN SUPPORT OF THEIR POSITION ON CERTIFIED
QUESTION**

Pursuant to Rule 13 of the West Virginia Rules of Appellate Procedure, Petitioners,
Wellington Power Corporation ("Wellington") and W.G. Tomko, Incorporated ("Tomko")
hereby submit their brief in support of their position on the certified question from the Honorable

Robert B. Stone, presiding in the Circuit Court of Monongalia County, West Virginia.

I. THE KIND OF PROCEEDING AND NATURE OF THE RULING BELOW

The case presents a novel and important issue regarding a subcontractor's ability to proceed with a claim against a contractor's surety bond on a public building project where the subcontract contains a "pay if paid" condition precedent clause.

This matter arises from the work of Wellington and Tomko as subcontractors on a construction project at the Life Sciences Building of West Virginia University in Morgantown, West Virginia ("the Project"). Upon information and belief, Dick was the construction manager on the Project pursuant to a contract with the Owner of the Project, West Virginia University ("WVU" or the "University"). On or about October 25, 2000, Wellington entered into an agreement with Dick to provide labor, material and supervision for certain electrical work on the Project ("Wellington's Subcontract"). Tomko entered into a similar agreement with Dick for certain plumbing work on the same day ("Tomko's Subcontract"). A portion of both Wellington's Subcontract and Tomko's Subcontract is attached to their Complaints as Exhibit "1."

CNA, through National Fire Insurance Company of Hartford ("National Fire") and as surety for Dick Corporation, provided a Labor and Material Payment Bond naming Dick as principal and WVU as obligee. A copy of the Payment Bond ("Bond") is attached to the Complaints as Exhibit "2." Pursuant to the terms of the Bond, National Fire and Dick bound themselves jointly and severally to assure the payment by Dick of the claims of certain persons supplying labor and materials used or reasonably required for use in the performance of the Subcontract.

During the course of the Project, Wellington's and Tomko's work was delayed and

disrupted due to, among other things, Dick's mismanagement of the Project. As a result, Wellington and Tomko were forced to expend significant additional time and money on the Project to complete its work. Furthermore, at the conclusion of the Project, Dick owed Wellington and Tomko their contract balance and retainage and costs associated with directed overtime and authorized change orders.

Because Dick refused to pay Wellington and Tomko for the above damages, both contractors made demands upon National Fire and its Bond to recover the money owed to them by Dick. National Fire, however, has refused to make payment to Wellington or Tomko on their claims. Because of this nonpayment, Wellington and Tomko filed separate suits against National Fire pursuant to the Labor and Material Payment Bond issued by National Fire in the Circuit Court of Monongalia County, West Virginia.

On or about April 16, 2003, National Fire filed a Motion to Dismiss the Complaints of both Wellington and Tomko or, in the alternative, to stay these matters. In its Motions to Dismiss, National Fire took the position that, as Dick's surety, it could invoke as a complete defense to liability an alleged condition precedent in Dick's subcontract with Wellington and Tomko that indicates that payment is not due from Dick until Dick has been paid by WVU for the monies sought by Wellington and Tomko. Importantly, this so-called "pay if paid" clause that National Fire sought to invoke was never incorporated into the Payment Bond.

In response to the Motions, Wellington and Tomko argued that the "pay if paid" clause as an absolute condition precedent in the subcontracts undermines the very purpose of requiring a payment bond and, thus, violates public policy. In a case of first impression, the Circuit Court agreed with Wellington and Tomko and denied National Fire's Motions to Dismiss, ruling that a "pay if paid" clause under a public contract scenario is unenforceable by a surety on a public

project as against the public policy of West Virginia. A true and correct copy of a transcript of a portion of the proceedings before Honorable Judge Robert B. Stone is attached hereto as Exhibit "A."

Upon later motion by National Fire, the Circuit Court agreed to certify the following novel question of law to this Court:

In a public building project in West Virginia, does a "pay if paid" condition precedent clause violate West Virginia public policy, as articulated in the West Virginia Public Bond Statute (W.Va. Code § 38-2-39), so as to entitle a subcontractor to proceed with a claim against a contractor's surety bond, despite the terms of its subcontract that the contractor itself is not liable for payment to the subcontractor because of the failure of the same "pay if paid" condition precedent clause?

A true and correct copy of the Order of Certification to the West Virginia Supreme Court of Appeals is attached hereto and incorporated herein by reference as Exhibit "B." The two cases were consolidated for purposes of certifying this question to the Supreme Court of Appeals and all further proceedings were stayed pending receipt of a certified answer from this Court. Both sides then filed Petitions to Docket the certified question with the Court, which were granted on September 16, 2004. A copy of the Court's Order of September 16, 2004 is attached hereto as Exhibit "C." It is Petitioners' position that, in light of other courts' interpretations of the law on the enforceability of "pay if paid" clauses, the Circuit Court was correct in finding the clauses invalid as against public policy. As such, Petitioners respectfully request that the Court answer the certified question in the affirmative.

II. STATEMENT OF FACTS

A. Contract Balance and Retainage

As noted, Wellington and Tomko contracted with Dick to provide various construction

services on the Project. Wellington agreed to provide electrical contracting services on the Project for \$4,607,700.00. Due to a series of Change Orders totaling \$200,819.57 and payments for overtime totaling \$114,830.00, the Subcontract amount was adjusted to \$4,923,349.57. Dick forwarded payments to Wellington totaling \$4,623,440.90, leaving an outstanding contract balance of \$299,908.67, including retainage. Wellington further incurred \$442,802.00 in authorized and directed overtime premiums, \$327,972.00 of which Dick has refused and failed to pay.

In addition, Wellington performed extra work pursuant to field changes in the scope of the Project in the amount of \$101,610.00, which Dick has refused and failed to pay as well. Furthermore, Wellington performed work pursuant to pending Change Orders, for which it has not received payment. These total an additional \$200,423.00. Taken together, Wellington is currently owed \$929,913.67 in outstanding contract balance and retainage, directed overtime, authorized and requested field changes and pending change order requests.

Pursuant to its subcontract, Tomko agreed to provide plumbing contracting services on the Project for \$1,824,444.00. Due to a series of Change Orders totaling \$231,689.46, the Subcontract amount was adjusted to \$2,056,133.46. Dick forwarded payments to Tomko totaling \$1,949,551.80, leaving an outstanding contract balance of \$209,163.32 including retainage. Tomko further incurred \$95,468.00 in authorized and directed overtime premiums, all of which Dick has refused and failed to pay. Taken together, Tomko is currently owed \$304,631.32 in outstanding contract balance and retainage, directed overtime, and authorized change orders. Despite repeated demands, both National Fire and Dick have failed and refused to remit any of this outstanding money due to Wellington and Tomko.

B. Compensable Delays on Project

In addition, due to numerous delays on the Project, Wellington and Tomko were forced to expend significant additional time and money of the Project. The cause of these delays and impacts included:

- WVU's need to rebid the steel portion of the Project;
- design problems with Stairwell #4 in the east wing;
- delays in steel fabrication, delivery and erection in the west wing
- access problems in the main switch gear room due to the redesign ordered by WVU;
- Dick's improper scheduling of the drywall contractor;
- The lack of a material hoist and the inability to stock pile materials on site; and
- Dick's poor construction management skills.

Specifically, Dick (1) failed to properly plan, schedule and coordinate the work on the Project as a whole; (2) failed to obtain and effectuate design and engineering changes and clarifications in an timely and coordinated manner so as not to impede or disrupt the progress of Wellington's and Tomko's work; and (3) directly interfered with the scheduling and performance of Wellington's and Tomko's work by causing changes and disruptions to their planned methods and sequences of work.

Due to Dick's poor construction management skills, Wellington and Tomko were forced to work in conditions where there was:

- Stacking of trades;
- Out of sequence work;
- Denial of access;
- Vacillating crew sizes;
- Dedication of additional supervision to deal with larger crews; and
- Working in multiple areas simultaneously.

As a result, Wellington and Tomko experienced numerous delays, disruptions and inefficiencies in their attempts to complete their work in a timely manner under their respective Subcontracts.

They also completed their work significantly later than the dates set forth in the Project

Schedule.

As a result of the aforementioned breaches of contract, Wellington has suffered damages in an amount in excess of \$3,600,000.00, all of which resulted from Wellington's increased labor and material costs, including but not limited to directed acceleration and additional supervision, as a result of the aforementioned delays, disruptions and inefficiencies on the Project, all in excess of the costs contemplated under the Subcontract. For the same reasons, Tomko has incurred damages in excess of \$1,500,000.00.

C. Dick's Payment Bond

In accordance with Dick's contract with WVU, Dick procured a Payment Bond from CNA, naming Dick as principal and WVU as obligee. Pursuant to the terms of the Bond, National Fire and Dick bound themselves jointly and severally to assure the payment by Dick of the claims of certain persons supplying labor and materials used or reasonably required for use in the performance of the Subcontract. There is no "pay-if-paid" language contained within the Payment Bond itself or incorporated therein.

Wellington and Tomko have sued National Fire under the Bond because of Dick's failure to pay them for the above damages. National Fire has attempted to avoid liability for payment to Wellington and Tomko by arguing that there has been a complete failure of an absolute condition precedent specified in the subcontracts to the obligation of Dick, and consequently its own, to pay Petitioners. However, the lower court found that this condition precedent, a "pay if paid" clause, would violate the public policy of West Virginia if enforced.

III. DISCUSSION OF LAW

Under section 58-5-2 of the West Virginia Code, any question of law arising upon a challenge to the sufficiency of a pleading may be certified by the circuit court in which it arises

to the Supreme Court of Appeals for its decision. W. Va. Code § 58-5-2. The question before this Court comes as the result of the Circuit Court's denial of National Fire's motions to dismiss Petitioners' complaints for failure of an absolute condition precedent and, thus, was properly certified to this Court. The facts necessary to resolve this question of law are not in dispute: (1) Petitioners entered into subcontracts with Dick to perform work on the Project; (2) Petitioners performed all work required in their subcontracts; (3) Petitioners have not been paid by Dick for all the work performed under their subcontracts; (4) Dick procured a payment bond to guarantee payment of its subcontractors; (5) National Fire, as Dick's surety, subcontractors; (6) the project is a publicly funded project; and (7) the bond itself does not include a "pay if paid" clause or incorporate Petitioners' subcontracts. Petitioners seek to enforce the Payment Bond against National Fire as a result of Dick's nonpayment and have not made any claims under the Subcontract.

A. STANDARD OF REVIEW

The standard of review of questions of law answered and certified by a circuit court is de novo. *See, e.g.,* Syl. Pt. 2, Keplinger v. Virginia Elec. and Power Co., 208 W. Va. 11, 537 S.E.2d 632 (2000); Syl. Pt. 1, Gallapoo v. Wal-Mart Stores, Inc., 197 W. Va. 172, 475 S.E.2d 172 (1996). Under the de novo standard of review, Petitioners, Wellington and Tomko, respectfully submit that the circuit court's decision that a "pay if paid" clause violates public policy when contained in a contract for public building projects in West Virginia was correct as supported by similar decisions in other jurisdictions.

B. ARGUMENT

Although West Virginia law is silent on the issue before this Court, Petitioners urge this Court to follow the case law of other jurisdictions as the court did below and affirm Judge

Stone's ruling that a "pay-if-paid" clause is unenforceable under the laws of the State of West Virginia, and as a consequence, a surety may not rely upon a "pay-if-paid" clause not contained within the bond itself or incorporated therein.

1. West Virginia would consider a "pay-if-paid" clause to be in violation of public policy

The purpose of a "pay-if-paid" clause in a subcontract on a construction project is to shift the risk of owner nonpayment from the general contractor, whom has a contract directly with the owner, to a subcontractor, who does not. Many courts around the nation have struggled with the question of whether such a clause creates an absolute condition precedent to payment to a subcontractor or whether it simply creates a timing mechanism that would require the contractor to pay the subcontractor within a reasonable period of time even without payment from the owner. See, i.e., West-Fair Electric Contractors v. Aetna Casualty & Surety Co., 638 N.Y.S.2d 394, 661 N.E.2d 967 (N.Y. 1995); OBS Co. v. Case Construction Corp., 558 So.2d 404 (Fla. 1990); Wm. R. Clarke Corp. v. Safeco Insurance Co., 64 Cal. Rptr.2d 578, 938 P.2d 372 (Cal. 1997); R&L Acoustics v. Liberty Mutual Insurance Co., 2001 WL 1249658 (Conn. Sup. Ct. 2001); Brown & Kerr Inc. v. St. Paul Fire and Marine Insurance Co., 940 F. Supp. 1245 (N.D. Ill. 1996). The majority view is that such clauses are unenforceable as absolute condition precedents. Statesville Roofing & Heating Co. v. Duncan, 702 F. Supp. 118, 119 (WDNC 1988) ("The trend now in most States is that, absent special circumstances, such language is given no weight.")

The West-Fair case is illustrative of why courts have found that "pay-if-paid" clauses, which are an absolute condition precedent, are against public policy. In West-Fair, the highest court in the State of New York was faced with a situation similar to the one at hand in that a subcontractor had brought suit against a surety for payments not made by the latter's principal

and the surety raised the defense of a “pay-if-paid” clause. The West-Fair court ruled that such a clause does not create a timing mechanism but, instead, creates an absolute condition precedent to payment. West-Fair, 661 N.E.2d at 970. The court, however, then undertook an analysis of New York’s Lien Law and opined that the Lien Law “is remedial in nature and intended to protect those who have directly expended labor and materials to improve real property at the direction of the owner or general contractor.” Id. Consequently, the court reasoned that, if the court were to make the “pay-if-paid” clause an absolute condition precedent, a subcontractor could not file a lien in the event of nonpayment from the owner. Id. at 971. The court held that:

a pay-when-paid provision which forces the subcontractor to assume the risk that the owner will fail to pay the general contractor is void and unenforceable as contrary to public policy set forth in the Lien Law . . .

Id. The court then ruled that the surety could not rely upon the “pay-if-paid” clause defense since such a defense did not exist. Id. at 972. See also Shearman & Associates, Inc. v. Continental Casualty Co., 901 F. Supp. 199, 203 (D.V.I. 1995) (holding that a surety cannot rely upon a “pay-if-paid” clause in that such a clause is in violation of public policy as expressed in the Virgin Islands Construction Lien Statute) and Brown & Kerr Inc., 940 F. Supp. at 1250 (holding that a conditional payment clause in a subcontract is in violation of Illinois public policy as expressed in that state’s Mechanics Lien Act and would not preclude payment under a payment bond to a subcontractor).

Courts have used similar logic even on public projects on which the subcontractor would not have statutory lien rights. In the case of Chapman v. EI Constructors, Inc., 1995 WL 91391 (Conn. Super. 1995), a subcontractor, whose subcontract contained a conditional payment clause, filed suit against the general contractor’s surety bond. The bonding company raised a “pay when paid” defense. Id. at *5. The court found such a defense “unavailing” and held that

“to allow the City’s nonpayment to prevent plaintiff’s recovery under both the subcontract and the payment bond would entirely frustrate the public policy of [the Connecticut Public Bond Statute].” Id. at *5-6.

Another case that discusses the invalidity of a pay-if-paid clause on a public project is Capital Steel Fabricators, Inc. v. Mega Construction Co., Inc., 58 Cal. App. 4th 1049, 68 Cal. Rptr. 2d. 672 (1997). In Capital Steel, the plaintiff was a subcontractor on a School District project in California. The subcontract contained a pay-if-paid clause, which the Court stated unambiguously permitted the general contractor to not pay its subcontractors until payment was received from the owner. Id. at 158. The Supreme Court of California in the case of Wm. R. Clarke Corp. v. Safeco Insurance Co., 64 Cal. Rptr.2d 578, 938 P.2d 372 (1997), had previously ruled that such clauses, however, were unenforceable as a violation of public policy on private construction projects, and the question before the Capital Steel court was whether that holding would apply to public projects as well. Id. The arguments made by the contractor and its bonding company was that the basis of the court’s opinion in Wm. R. Clarke was the inability of the subcontractor to file a mechanics’ lien on a private project thereby robbing the subcontractor of a remedy to its nonpayment and that, since their matter involved a public project, no mechanic’s lien could be filed thereby rendering Wm. R. Clarke inapplicable. Id. at 1060. The Capital Steel court, however, disagreed with the general contractor and its surety and held:

Because the mechanics lien, the stop notice, and payment bond statutes are remedial in nature . . . and are meant to protect the subcontractors from defaulting contractors, there is no reason to conclude that a true pay when paid condition precedent clause is enforceable in a public works subcontract but not a private sector project. Accordingly, we conclude the general contractor’s liability to its subcontractor for work performed on a public works projects may not be made contingent on the governmental entity payment to the general contractor in a factual scenario such as is present in this case. [The general contractor] was liable to [the subcontractor] for the work it performed on the project as was the surety, Fidelity.

Id. at 1062.

As can be seen from the chart below, when faced with the question of the enforceability of a pay-if-paid clause against a subcontractor and especially when a surety seeks to enforce such a clause, many jurisdictions have ruled in the subcontractors favor.¹ These jurisdictions include California, Connecticut, Florida, Illinois, New York, the Virgin Islands and Virginia. In addition, Federal courts in the 9th Circuit, the 5th Circuit and the District of Colorado when faced with this exact question involving the Federal bonding statute, The Miller Act, have similarly ruled that the surety may not avoid liability due to a pay-if-paid clause.

Jurisdiction	Case	Holding
California	<u>Capital Steel Fabricators, Inc. v. Mega Construction Co., Inc.</u> , 58 Cal. App. 4th 149, 68 Cal. Rptr. 2d 672, 678-80 (1997)	Applies the ruling in the <u>Clarke</u> case to public works project even though lien statute is not applicable.
California	<u>Wm. R. Clarke Corp. v. Safeco Insurance Co.</u> , 64 Cal. Rptr. 2d 578, 584-85, 938 P.2d 372, 378-79 (Cal. 1997)	Court rejects surety's argument that its principal is not in default because the condition precedent for payment has not occurred and, instead, follows the <u>West-Fair</u> Court in ruling that the pay-if-paid clause is against public policy.
Connecticut	<u>R&L Acoustics v. Liberty Mutual Insurance Co.</u> , 2001 W.L. 1249658, *8 (Conn. Super. 2001)	In dicta, Court lays out argument that surety cannot rely upon pay-when-paid provisions.

¹ It is important for the Court to note that the case of Blandford Land Clearing Corp. v. National Union Fire Insurance Co., 260 A.D.2d 86, 698, N.Y.S.2d 237 (1999) discussed in the chart below involves the defendant in this matter National Union Fire Insurance Company. In that matter, National Fire - unsuccessfully raised the same defenses that they are attempting to raise in this matter.

Connecticut	<u>Chapman v. E.I. Constructors, Inc.</u> , 1995 W.L. 91391, *6 (Conn. Super. 1995)	"To allow the City's nonpayment to prevent plaintiff's recovery under both the subcontract and the payment bond would entirely frustrate the public policy of Conn. Gen. Stat. 49-41 and 49-42 [the Connecticut Bond Statute]."
Federal Government (9 th Circuit)	<u>United States f/u/b/o Walton Technology, Inc. v. Weststar Engineering, Inc.</u> , 290 F.3d 1199, 1208 (9 th Cir. 2002)	A pay-when-paid clause would not stop a subcontractor from making a claim against the Federal Miller Act Bond in part due to the purpose behind the Miller Act to protect all persons supplying labor and material in the prosecution of the work.
Federal Government (District of Colorado)	<u>United States f/u/b/o DDC Interiors, Inc. v. Dawson Construction Co.</u> , 895 F. Supp. 270, 273-4 (D. Colo. 1995)	"The risk of nonpayment for goods and services provided for a government project should be borne by the surety - not the laborers or materialmen" and that a "pay-upon-payment" clause would not allow a surety to circumvent its responsibilities under the Public Payment Bond.
Federal Government (5 th Cir.)	<u>United States f/u/b/o T.M.S. Mechanical Contractors, Inc. v. Millers Mutual Fire Ins. Co.</u> , 942 F.2d 946, 949, n. 6 (5 th Cir. 1991)	Pay when paid clause in subcontract does not preclude recovery under the Miller Act "despite non-payment by the government to the contractor."

Florida	<u>Everett Painting Co. v. Padula & Wadsworth Construction, Inc.</u> , 856 So. 2d 1059, 1062 (Fla. App. 2003)	A surety cannot make payment conditional on payment by the public project owner because the purpose of the bond statute is to “protect subcontractors and suppliers by providing them with an alternative remedy to mechanics’ liens on public projects.”
Florida	<u>OBS Co. v. Case Construction Corp.</u> , 558 So. 2d 404, 408 (Fl. 1990).	“To allow nonpayment by the owner to prevent recovery both under the subcontract and the payment bond would thwart the entire purpose and scheme of the mechanics’ lien law and statutes allowing a bond in lieu of exposure to liens.”
Illinois	<u>Brown & Kerr, Inc. v. Saint Paul Fire & Marine Insurance Co.</u> , 940 F. Supp. 1245, 1249 (N.D. Ill. 1996)	“We do not believe the Bond contemplates that payment of subcontractors should await the determination of an extended legal dispute between the owner and general contractor concerning his work which is completely unrelated to [the subcontractor] particularly since the underlying purpose of the bond is to assure the payment of subcontractors and when, as here, [the subcontractor] has completed performance under the subcontracts.”
New York	<u>Blandford Land Clearing Corp. v. National Union Fire Insurance Co.</u> , 260 A.D.2d 86, 698 N.Y.S.2d 237 (1999)	Applies <u>West-Fair</u> to a payment bond situation in which lien rights still exist and rules that the surety still cannot rely upon a pay-if-paid clause.

New York	<u>West-Fair Electric Contractors v. Aetna Casualty and Surety</u> , 638 N.Y.S.2d 394, 398, 661 N.E.2d 967, 971 (NY 1995)	A pay-if-paid clause “which forces the subcontractor to assume the risk that the owner will fail to pay the general contractor is void and unenforceable as contrary to public policy set forth in the Lien Law . . .”
Virgin Islands	<u>Shearman & Associates, Inc. v. Connecticut Casualty Co.</u> , 901 F. Supp. 199, 203 (D.V.I. 1995)	A surety cannot rely upon a “pay-if-paid” clause in that such a clause is in violation of public policy as expressed in the Virgin Island Construction Lien Statute
Virginia	<u>In re: M&T Electrical Contractors, Inc.</u> , 267 B.R. 434, 448-49 (Bankr. DC 2001)(applying Virginia Law).	Surety cannot assert, as a defense to a claim, a condition precedent payment provision unless the bond explicitly gives the surety the right to rely upon the defenses provided in that Subcontract. “To hold otherwise would run counter to the purpose of the bond.”
Virginia	<u>Moore Bros. Co. v. Brown & Root, Inc.</u> , 707 F.3d Cir. 717, 723-24 (4th Cir. 2000).	Holding that the bond and subcontract are two separate and distinct agreements, and a surety who did not include an express pay-when-paid condition precedent in the contract payment bond cannot rely upon such language in the subcontract.

As stated above, the courts of West Virginia have yet to opine on the question of the validity and meaning of a “pay-if-paid” clause. Petitioners, however, urge this Court to affirm the lower court’s ruling that such a clause violates the public policy of West Virginia as set forth

in the West Virginia Bond Statute. That statute provides:

§38-2-39. Public building; bond of contractor; recordation of bond; no lien in such case.

It shall be the duty of the state commissioner of public institutions, and of all county courts, boards of education, boards of trustees, and other legal bodies having authority to contract for the erection, construction, improvement, alteration or repair of any public building or other structure, or any building or other structure used or to be used for public purposes, to require of every person to whom it shall award, and with whom it shall enter into, any contract for the erection, construction, improvement, alteration or repair of any such public building or other structure used or to be used for public purposes, that such contractor shall cause to be executed and delivered to the secretary of such commissioner or other legal body, or other proper and designated custodian of the papers and records thereof, a good, valid, solvent and sufficient bond, in a penal sum equal at the least to the reasonable cost of the materials, machinery, equipment and labor required for the completion of such contract, and conditioned that in the event such contractor shall fail to pay in full for all such materials, machinery, equipment and labor delivered to him for use in the erection, construction, improvement, alteration or repair of such public building or other structure, or building or other structure used or to be used for public purposes, then such bond and the sureties thereon shall be responsible to such materialman, furnisher of machinery or equipment, and furnisher or performer of such labor, or their assigns, for the full payment of the full value thereof.

* * *

Nothing in this article shall be construed to give a lien upon such a public building or improvement as is mentioned in this section, or upon the land upon which such public building or improvement is situated.

W. VA. CODE §38-2-39 (2002)(emphasis not in original).

As clearly set forth in the statute, the purpose of requiring a bond is for the protection and security of suppliers of labor and material to public construction projects in the state of West Virginia. The purpose is also to give subcontractors and suppliers a remedy other than a

mechanics' lien, which cannot attach to government property. Consequently, the logic of the courts set forth in the West-Fair opinion and the opinions of the Courts set forth in the above chart would apply here. Given that National Fire's argument with regard to the "pay-if-paid" clause would remove a remedy provided by the West Virginia Legislature, a remedy provided for the stated purpose of protecting subcontractors like Wellington and Tomko, this court must not countenance such a position. The "pay-if-paid" clause must be found to be against the public policy of West Virginia.

2. **Even if the Court was to find that the "pay-if-paid" clause does not violate public policy, National Fire does not have the right to rely upon such a clause.**

National Fire took the position below that it has the right to rely upon the defenses of its principal and that, since the owner has yet to pay Dick, the surety has no obligation to pay Wellington or Tomko. Such a position, however, flies in the face of the language of the Public Bond Statute set forth above.

While there is no case law in West Virginia on this issue, other jurisdictions have addressed this question on point. The United States Court of Appeals for the Fourth Circuit recently decided the case of Moore Bros. Co. v. Brown & Root, Inc., 207 F.3d 717 (4th Cir. 2000). In Moore Bros., a construction manager hired subcontractors to build the Dulles Toll Road Extension in northern Virginia. The subcontract used by the construction manager contained "pay-if-paid" language similar to the case at bar. Id. at 720. Pursuant to Virginia state law, the construction manager was required to furnish a payment bond. When the subcontractors were not paid, they filed suit against the surety, who raised the defense of the "pay-if-paid" clause. The Fourth Circuit summarized the question before it as "whether a surety can assert the principal's defense based on 'pay when paid' language in the subcontract, where the surety did

not expressly incorporate the 'pay when paid' language into the contract payment bond." Id. at 722.

In ruling in favor of the subcontractors, the court stated:

The question is whether, in light of the "pay when paid" condition precedent contained in the subcontract with [the construction manager] Brown & Root, the money is nonetheless "justly due" the plaintiffs. We think the only sensible answer to this question is yes. [The surety] Highlands, unlike Brown & Root, did not include an express "pay when paid" condition precedent in its surety bond contract. Highlands' attempt to bootstrap its own defense to the "pay when paid" defense asserted by the principal is not persuasive for two reasons.

First, there is no indication that the parties intended the phrase "sums justly due" to incorporate the contingency of payment by the Owners. On the contrary, the very purpose of securing a surety bond contract is to insure that claimants who perform work are paid for their work in the event that the principal does not pay. To suggest that non-payment by the Owners absolves the surety of its obligation is nonsensical, for it defeats the very purpose of a payment bond.

Second, our conclusion that the Virginia Supreme Court would not allow a surety to invoke the "pay when paid" defense available to a principal is supported by decisions in other jurisdictions. At least three other courts have rejected attempts by sureties to invoke a "pay when paid" defense that is available to a principal. See OBS Co. v. Pace Constr. Corp., 558 So.2d 404 (Fla.1990); Brown & Kerr, Inc. v. St. Paul Fire and Marine Ins. Co., 940 F. Supp. 1245 (N.D.Ill.1996); Shearman & Assoc., Inc. v. Continental Cas. Co., 901 F.Supp. 199 (D.V.I.1995). In Brown & Kerr the court stated:

[The subcontractor] is suing under the Bond and not the subcontract. The two are separate agreements. [The surety] has neither cited, nor have we discovered, any authority for the proposition that the inability to proceed against the general contractor because of a "pay when paid" clause in the subcontract necessarily prevents recovery against the surety under the payment Bond. Indeed, such an argument runs counter to the underlying purpose of the payment Bond, i.e. the assurance of payment to subcontractors.

940 F. Supp. at 1249.

Moore Bros., 207 F.3d at 723. See also United States f/u/b/o DDC Interiors, Inc. v. Dawson Construction Co., 895 F. Supp. 270, 273-4 (D. Colo. 1995)(opining that “[t]he risk of nonpayment for goods and services provided for a government project should be borne by the surety - -not the laborers or materialmen” and that a “pay upon payment” clause would not allow a surety to circumvent its responsibilities under a public payment bond).²

Here, the Payment Bond does not incorporate the language of the Subcontract. See Exhibit “2” to the complaint of both Wellington and Tomko. The Bond has no language that would constitute a “pay-if-paid” clause. Its terms are clear and unambiguous. As such, like the

² In its Motions to Dismiss, Respondent cited to three cases in support of its position that a surety has the right to rely upon a “pay-if-paid” clause: Sasser & Company v. Griffin, 210 S.E.2d 34 (Ga. App. 1974), Jerome Distributors, Inc. v. B.L.I Construction Co., Inc., 237 S.E.2d 13 (Ga. App. 1977) and C.M. Eichenlaub Co., Inc. v. Fidelity & Deposit Company, 437 A.2d 965 (Pa. Super. Ct. 1981). The two cases from Georgia, however, really address the question of the enforceability of a “pay-if-paid” clause by a general contractor against a subcontractor and not the surety’s ability to rely upon one. In fact, the Jerome Distributors case does not involve a surety at all, and the Sasser case discusses the surety in *dicta* only. It should also be noted that these cases do not involve public projects. Moreover, Georgia is a minority view state on the issue of the enforceability of pay if paid clauses. See Statesville Roofing, 702 F. Supp., at 121 (“Georgia has a long line of cases holding that pay-when-paid clauses in written contracts must be taken literally; . . . [h]owever, Georgia is a minority view state . . .”).

The Eichenlaub case from Pennsylvania does involve a surety and a “pay-if-paid” clause. That case, however, has been thrown into question by the Pennsylvania Supreme Court decision of Centre Concrete Co. v. Insurance Co. North America, 559 A.2d 516 (Pa. 1989), which looked to the last day of work performed as opposed to when payment was made by the owner to the contract in determining when the statute of limitations began to run. As pointed out by the United States District Court for the Eastern District of Pennsylvania, the Eichenlaub opinion was faulty in failing to make any reference to the bond statute of the Commonwealth of Pennsylvania. Walker Diving Contractors, Inc. vs. Travelers Indemnity Co., 1989 WL 46091, *3-4 (E.D. Pa. 1989). See also R.E. Monks Construction Co. v. Aetna Casualty & Surety Co., 189 Ariz. 575, 578, 944 P.2d 517, 520 (1997) (distinguishing Eichenlaub by stating that claims against a payment bond on a public project arise even before the principal defaults in that “the surety bond provides an additional remedy for unpaid subcontractors on public projects similar to a mechanic’s lien available as a remedy in private contracts”).

sureties in the Moore Bros. and Brown & Kerr cases cited above, National Fire is simply attempting to bootstrap the “pay-if-paid” clause into the surety Bond.

Wellington and Tomko are suing under the Bond and not the subcontract. The two are separate agreements. Given the underlying purpose of the Bond as set forth in the West Virginia Bond Statute and the fact that Wellington and Tomko have completed their performance under the subcontracts, National Fire should not have the right to rely upon the alleged “pay-if-paid” clause in the subcontracts.

IV. CONCLUSION

For all of the foregoing arguments and authorities, Petitioners, Wellington Power Corporation and W.G. Tomko, Incorporated, respectfully request that this Court grant their petition for certified question review and affirm the decision of the Circuit Court of Monongalia County.

Respectfully submitted,

**COHEN, SEGLIAS, PALLAS,
GREENHALL & FURMAN, P.C.**

BY: 

ROY S. COHEN, ESQUIRE

Local Counsel:

J. Bryan Edwards, Esquire
(W. Va. State Bar ID No. 6886)
CRANSTON & EDWARDS PLLC
Dorsey Avenue Professional Building
1200 Dorsey Avenue, Suite II
Morgantown, West Virginia 26501
Attorneys for Petitioners,
Wellington Power Corporation
and W.G. Tomko, Incorporated
Dated: October 15, 2004

EXHIBIT "A"

1. IN THE CIRCUIT COURT OF MONONGALIA COUNTY, WEST VIRGINIA
2. WELLINGTON POWER CORPORATION,
3. a Pennsylvania corporation,
4. Plaintiff,

4. vs.

CASE NO. 03-C-52

5. CNA SURETY CORPORATION d/b/a
6. CNA COMMERCIAL INSURANCE,
7. a Delaware corporation,
8. Defendant.

9. W.G. TOMKO, INCORPORATED,
10. a Pennsylvania Corporation,
11. Plaintiff,

11. vs.

CASE NO. 03-C-94

12. CNA SURETY CORPORATION d/b/a
13. CNA COMMERCIAL INSURANCE,
14. a Delaware Corporation,
15. Defendant.

16. Transcript of a portion of the proceedings in the
17. above-styled action before Honorable Robert B. Stone,
18. Judge, on May 19, 2003.

19. APPEARANCES:
20. On behalf of the Plaintiffs:
21. Roy S. Cohen, Esquire
22. John A. Greenhall, Esquire
23. J. Bryan Edwards, Esquire
24. On behalf of the Defendants:
25. Kevin P. Lucas, Esquire
26. Billy Atkins, Esquire

GINNY L. ARMISTEAD, RPR
OFFICIAL COURT REPORTER



1 THE COURT: Well, I want to make two rulings. I may
2 not go far enough, but that's all I am going to do here
3 today because I think that's all I have to do.

4 We have finally, I think, kind of boiled this down to a
5 focused argument on enforceability of the "pay when paid"
6 provision or its condition precedent value, the law of the
7 State of West Virginia, versus briefs that have been
8 submitted, and Mr. Cohen has submitted a very long brief and
9 cited a lot of cases from different jurisdictions not
10 recognizing that provision.

11 And from some of the questions I asked, I think counsel
12 can easily see where I was coming from and what my concern
13 is in this whole thing.

14 But, the language cited in the Moore brothers case in
15 the Fourth Circuit certainly caught my attention -- I wanted
16 to say that -- certainly caught my attention. I read it
17 several times, tried to think about that applicability to
18 our case here. And just as in Moore brothers -- they said
19 it was their conclusion that the Virginia Supreme Court
20 would not allow a surety to invoke the "pay when paid"
21 defense available to a principal, and that's supported by
22 decisions in other jurisdictions -- that was my own thought
23 and prediction about the Supreme Court of West Virginia. If
24 this case were to immediately go down there in front of

1 them, I don't believe they would recognize that and enforce
2 it.

3 Under the facts of this case, public contract cases,
4 what I am trying to limit this to, I don't know that I agree
5 with the case that somebody cited that said there are some
6 jurisdictions that find this void as against public policy
7 in all cases because they believe that if you apply this
8 that it defeats the entire mechanic's lien statutory scheme
9 even in private contracts.

10 I don't know that I understand that or follow that or
11 believe that's true, but it goes so far to stop mechanic's
12 liens in private suits against an owner.

13 You know, I can see that gets very involved, but I am
14 not so sure I agree with that decision. But in public
15 contracts where the right to file mechanic's liens is
16 distinguished by statutory scheme, this just seems to be the
17 important part of the whole scheme in public building
18 contracts, and that is to have a payment bond that protects
19 subcontractors.

20 It just seems to me that this provision of don't have
21 to pay until you are paid defeats the whole purpose of the
22 payment clause. That's how I saw that.

23 And Mr. Lucas argued persuasively. You all know so
24 much more about this law than I will ever know because

1 obviously you have practiced in this area. Your briefs were
 2 excellent. I appreciate that or I wouldn't have had any
 3 idea what these issues were about. I don't know how it
 4 could be presented better in an argument than it was
 5 presented here today for about an hour and a half, which I
 6 would have never have had that much time if another hearing
 7 hadn't been cancelled.

8 I struggled to keep up with the arguments. I don't
 9 believe I am a lightweight intellectually, but still I
 10 struggled to keep up with some of these arguments because,
 11 well, I think you would understand me, the circuit court of
 12 general jurisdiction doesn't deal with this kind of stuff
 13 very often, and it's pretty complex.

14 But, I think to get to what I am going to rule, one of
 15 the two rulings I am going to make is that under the public
 16 contract scheme that it's not enforceable as against, at
 17 least under the public contract scheme, as against the
 18 public policy of West Virginia.

19 And I know there is no case law to that effect. But I
 20 disagree with Mr. Lucas. I don't think it throws prior case
 21 law in this state on its head. I don't think it does that
 22 at all. I think it's very limited to these facts, this kind
 23 of a provision under this kind of a case.

24 MR. LUCAS: Your Honor, before you make a final ruling

1 on that, can I have an opportunity to brief that specific
2 point since I didn't have a chance to brief more of the
3 cases?

4 THE COURT: The second ruling I am going to make is
5 that yes, some of the issues raised about matters outside
6 the pleadings involved issues of what's in the pleadings --
7 I'm sorry -- what are in the contracts. And that could be
8 certainly provided to me. But I thought I heard a number of
9 other places where there is some discussion about efforts of
10 resolving outstanding claims.

11 You know, we have got this obviously disputed, hotly
12 disputed issue as to whether Dick has been paid any amounts
13 that Wellington or Tomco are seeking in their complaints.
14 And those aren't matters within contract documents. We have
15 got discussions about who is making decisions about whether
16 claims that arise are related to actions of West Virginia
17 and its architect.

18 I know Mr. Lucas has argued the plaintiff says that
19 because that's what it says in their complaint, but I am
20 concerned that there are at this point factual issues also
21 that aren't as clear as need to be if I am going to make a
22 ruling that throws a case out.

23 Our Court is very strict and stern with that rule and
24 reversing cases all the time saying it's premature what you

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have done. So that's the procedural part that you all argued, and I recognize that. And that's part of the decision.

But I wanted to make that other decision, also, because I think it's important to make it at this time. And you all, I don't think that you can brief it or argue it any more or give me or any more information than I already have here today.

MR. LUCAS: May I make a request? I really would like the opportunity -- this is an important ruling that you are making, of potential broad significance. And, among other things, I may very well want to ask you to consider, if you make that ruling, the former ruling on the "pay when paid" clause, to certify that for immediate appeal particularly because you are making a ruling in the area of public contracts. And, so all I would ask, if I could, at this point would be if you allow me a short period of time, whatever you choose, to brief this one specific issue. You have all the other issues.

And then at the time, so you can see, because we haven't responded to any of these, including the Moore case which the Court seems to be impressed with or impressed with the reasoning of, I would like to address that. And I also may at that point want to ask the Court whether the

1 that is a first impression in this state as far as I am
2 concerned, and that certainly this case and these two cases
3 and other cases may depend on that, so I might look very
4 favorably to that.

5 MR. LUCAS: Thank you, Your Honor.

6 MR. COHEN: Thank you, Your Honor.

7 THE COURT: I need an order prepared out of this
8 hearing.

9 MR. COHEN: Can we get it to you tomorrow morning?

10 THE COURT: You don't have to have it that fast. I
11 just need to have someone -- I want to ask one side to
12 prepare it and then send it to the other side.

13 MR. LUCAS: I would like to see it. Would there be a
14 possibility for us to see the transcript, particularly the
15 last part where the Court's reasoning was discussed?

16 THE COURT: If you would like to order a transcript,
17 you can do that.

18 MR. LUCAS: That's fine, I can do that.

19 THE COURT: You can talk with her after this. I don't
20 know if it was that well stated. I am not sure you can get
21 a lot out of it, but you're certainly welcome to it.
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23
24

CERTIFICATE

I, Ginny L. Armistead, Registered Professional Reporter, do hereby certify that the foregoing is a true and correct transcript of a portion of the proceedings in the above-styled action on May 19, 2003.

Given under my hand this 20th day of May, 2003.

Ginny L. Armistead

Registered Professional Reporter

GINNY L. ARMISTEAD, RPR

REGISTERED PROFESSIONAL REPORTER

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EXHIBIT "B"

IN THE CIRCUIT COURT OF MONONGALIA COUNTY, WEST VIRGINIA
DIVISION NO. 1

WELLINGTON POWER CORPORATION
a Pennsylvania Corporation,
Plaintiff

Case No. 03-C-52

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE,
a Delaware Corporation,
Defendant.

and

W.G. TOMKO, INCORPORATED,
a Pennsylvania Corporation,
Plaintiff,

Case No. 03-C-94

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE,
a Delaware Corporation,
Defendant.

Order of Certification to the
West Virginia Supreme Court of Appeals

These actions arise out of the construction of the Life Sciences Building located on the Downtown Campus of West Virginia University in Morgantown, West Virginia. The plaintiffs in the two (2) cases are subcontractors who each entered into written agreements with the defendants to provide various work on the building project. The enforceability of a "pay if paid" condition precedent is critical to a number of issues in these cases. In both cases, the defendant filed a Motion to Dismiss based on this provision which were both denied.¹ Both parties also

¹ Although defendant's motions were both styled motions to dismiss, the motions focused on the contract provision as well as matters outside the pleadings. Accordingly, this



filed separate Motions for Certification.

Pursuant to the provisions of West Virginia Code § 58-5-2, the Circuit Court of Monongalia County, West Virginia certifies that following question to the West Virginia Supreme Court of Appeals:

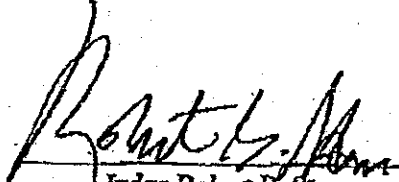
Question: In a public building project in West Virginia, does a "pay if paid" condition precedent clause violate West Virginia public policy, as articulated in the West Virginia Public Bond Statute (W. Va. Code § 38-2-39), so as to entitle a subcontractor to proceed with a claim against a contractor's surety bond, despite the terms of its subcontract that the contractor itself is not liable for payment to the subcontractor because of the failure of the same "pay if paid" condition precedent clause?

Answer by the Circuit Court: Yes.

It is ORDERED that the above-styled cases shall be consolidated for purposes of certifying these questions to the West Virginia Supreme Court of Appeals and that all further proceedings in this action are STAYED, pending receipt from the Supreme Court of Appeals of a certified answer to the above question.

It is FURTHER ORDERED that a certified copy of the case file in this action and a transcript of the hearing held on May 30, 2003 shall be forwarded to the West Virginia Supreme Court of Appeals upon request. Counsel shall take such steps as are necessary to present this matter to the West Virginia Supreme Court of Appeals.

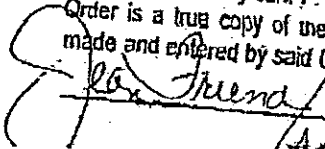
Entered this 23rd day of January, 2004.


Judge Robert B. Stone
Circuit Court of Monongalia County

Court construed the motions as motions for summary judgment.

STATE OF WEST VIRGINIA SS:

I, Jean Friend, Clerk of the Circuit Court and Family Court of Monongalia County State aforesaid do hereby certify that the attached Order is a true copy of the original Order made and entered by said Court.


Jean Friend
Circuit Clerk

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Wellington Power Corporation and W.G. Tomko, Incorporated's *PETITION FOR DOCKETING OF CERTIFIED QUESTION* was served upon the following via Regular First Class Mail, postage prepaid on March 2, 2004:

Billy Atkins, Esquire
Atkins & Oblak, PLLC
5000 Hampton Center, Suite 4
Morgantown, West Virginia 26505

Kevin P. Lucas, Esquire
Manion McDonough & Lucas, P.C.
600 Grant Street, Suite 1414
Pittsburgh, PA 15219


J. BRYAN EDWARDS, ESQUIRE

EXHIBIT "C"

STATE OF WEST VIRGINIA

At a Regular Term of the Supreme Court of Appeals continued and held at Charleston, Kanawha County, on the 16th of September, 2004, the following order was made and entered:

Wellington Power Corporation, a
Pennsylvania corporation, Plaintiff

vs.) Nos. 31869 and 31870

CNA Surety Corporation, d/b/a CNA
Commercial Insurance, a Delaware
corporation, Defendant

and

W.G. Tomko, Incorporated, a
Pennsylvania corporation, Plaintiff

v.

CNA Surety Corporation, d/b/a CNA
Commercial Insurance, a Delaware
corporation, Defendant

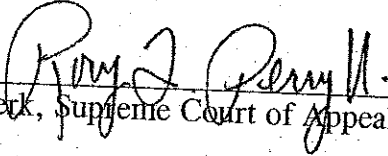
The Court, having seen and inspected the certificate of the Circuit Court of Mononalia County, together with the order entered therein on the 23rd day of January, 2004, the record and memorandum of authorities by counsel in this action, is of opinion that the ruling of the said circuit court upon the question certified to this Court should be reviewed, and that the Court doth hereby docket said cause for hearing, and doth hereby consolidate the two petitions filed for purposes of briefing, consideration and decision.

It is hereby ordered that this proceeding be submitted, heard and determined upon the original record, briefs of counsel and oral argument if requested by the parties. It is further ordered that the plaintiff, Wellington Power Corporation, file an original and nine copies of

a brief within thirty days of receipt of this order; the defendant, CNA Surety Corporation, file a like number of briefs within thirty days of the plaintiff's brief, with any reply brief deemed necessary to be filed by the plaintiff within fifteen days of receipt of the defendant's brief.

A True Copy

Attest:


Clerk, Supreme Court of Appeals