

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

Nos. 31869 and 31870

WELLINGTON POWER CORPORATION

Plaintiff Below, Petitioner Herein

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE
Defendant Below, Cross-Petitioner Herein.

Case No.: 03-C-52

Consolidated with:

W.G. TOMKO, INCORPORATED
Plaintiff Below, Petitioner Herein

v.

CNA SURETY CORPORATION d/b/a
CNA COMMERCIAL INSURANCE
Defendant Below, Cross-Petitioner Herein.

Case No.: 03-C-94

BRIEF OF CROSS-PETITIONER CNA SURETY CORPORATION
IN SUPPORT OF ITS POSITION ON CERTIFIED QUESTION

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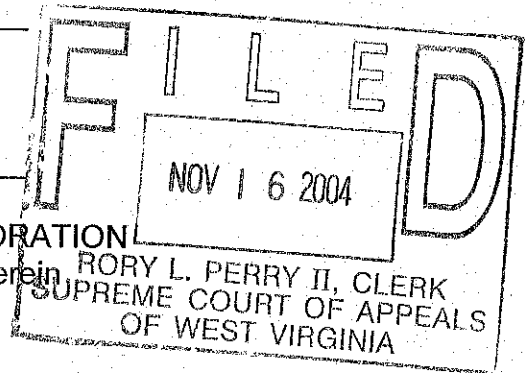


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I. KIND OF PROCEEDING AND NATURE OF THE TRIAL COURT'S RULING

This appeal stems from two consolidated civil actions pending in the Circuit Court of Monongalia County. The disputes arise from a public project for construction of the Life Sciences Building located on the Downtown Campus of West Virginia University in Morgantown, West Virginia (the "Project"). Dick Corporation ("Dick") provided certain construction management services for the Project under a Construction Management Agreement with West Virginia University ("WVU"), the Project owner. Plaintiffs Wellington Power Corporation ("Wellington") and W.G. Tomko, Incorporated ("Tomko") entered into Contractor Agreements (the "Subcontracts") with Dick for the providing of electrical and mechanical/plumbing work, respectively, on the Project.

In their Complaints, Plaintiffs allege that their work on the Project was significantly disrupted and delayed when WVU and its architect substantially redesigned various major elements and rebid the structural steel portion of the Project. (Record in W. G. Tomko, Inc. v. CNA Sur. Corp., No. 03-C-94 ("Tomko R.") at 3; Record in Wellington Power Corp. v. CNA Sur. Corp., No. 03-C-52 ("Wellington R.") at 6.) Plaintiffs contend that these circumstances caused them damages for which they are entitled to recover in this action. The suit does not name Dick as a defendant. Instead, Plaintiffs have opted to sue only Dick's surety on the Project, named in the Complaint as CNA Surety Corporation d/b/a CNA Commercial Insurance ("CNA").¹

¹ Dick actually obtained its Labor and Material Payment Bond from National Fire Insurance Company of Hartford, but Plaintiffs have improperly named CNA, a related company, as the Defendant. To avoid confusion, the Defendant surety is nonetheless referred to as "CNA" in this Brief.

CNA filed motions to dismiss the Wellington and Tomko Complaints on April 16, 2003. The motions relied in material part on pay-if-paid provisions in the Subcontracts. These provisions expressly state that Wellington and Tomko would not be entitled to payments on the Project until Dick had received payment from WVU. Adopting the Plaintiffs' argument on this issue, the Circuit Court issued what it acknowledged was a completely novel ruling in West Virginia, predicting that this Court would hold that enforcement of such pay-if-paid contract provisions by Dick's surety on the Project would contravene the public policy of West Virginia.

Upon a subsequent motion filed by CNA, which was joined in by the Plaintiffs, the Circuit Court agreed to certify for appeal to this Court the following question of first impression under West Virginia law:

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 copy of the Circuit Court's Certification Order dated January 23, 2004 is attached as Exhibit 1 to this Brief. The two cases were consolidated for purposes of certifying the question to this Court, and all further proceedings in the Circuit Court were stayed pending the answer of the potentially dispositive certified question. Both the Plaintiffs and CNA filed Petitions for Docketing of Certified Question, which were granted by this Court on September 16, 2004. A copy of this Court's Order of September 16, 2004 is attached hereto as Exhibit 2.

II. STATEMENT OF FACTS

A. Project Background

The Project from which these disputes arise was for the construction of the Life Sciences Building located on WVU's Downtown Campus in Morgantown, West Virginia. On or about June 22, 1998, WVU entered into the Construction Management Agreement with Dick. Dick obtained a Labor and Material Payment Bond as security for its obligation to make certain payments for labor and materials supplied to the Project (the "CNA Bond"). The CNA Bond was issued to Dick, as principal, and identifies WVU as obligee.

On or about October 25, 2000, Dick entered into the Subcontract with Plaintiff Wellington for electrical work on the Project. Also on or about October 25, 2000, Dick entered into the Subcontract with Plaintiff Tomko for mechanical/plumbing work on the Project. Wellington and Tomko subsequently commenced their work. In the interim, however, WVU and its architect substantially redesigned various major elements and rebid the structural steel portion of the Project. As alleged in Plaintiffs' Complaints, WVU's redesign activities and rebidding significantly disrupted and delayed the Project. (Tomko R. at 3; Wellington R. at 6.) As further alleged by Plaintiffs, WVU's activities created additional delays in steel fabrication, delivery and erection and negatively impacted the Project and Project scheduling. (Tomko R. at 4; Wellington R. at 6.) Plaintiffs also allege that their work on the Project was delayed and disrupted due to mismanagement on the part of Dick.²

² CNA disputes many of the facts recited in Plaintiffs' Brief, including the Plaintiffs' allegation that Dick mismanaged the Project, as well as Plaintiffs' allegations regarding their entitlement to and the amount of

As a result of the aforementioned alleged delays and disruptions to the Project, Plaintiffs claim that they experienced inefficiencies and increased costs for which they contend that Dick, as construction manager, is liable. In addition, Plaintiffs claim that Dick is obligated to pay various other amounts allegedly due under their Subcontracts. Because Dick allegedly has refused to pay the amounts that Plaintiffs claim are due, Plaintiffs filed this action -- against CNA only as Defendant -- seeking recovery under the CNA Bond.

B. Pertinent Contractual Provisions

The Wellington and Tomko Subcontracts specifically and unequivocally provide that receipt by Dick of payment from WVU shall be an absolute condition precedent to Dick's obligation to make any payment to Wellington or Tomko:

Contractor [Wellington and Tomko] agrees and acknowledges that payment of the Contract Sum shall be made only from [sic.] funds which are due from [WVU] that [Dick] has actually received in hand from [WVU] and designated by [WVU] for disbursement to Contractor. Contractor agrees to look solely to such funds for payment. Contractor understands and agrees that [Dick] shall have no liability or responsibility for any reason whatsoever for any amounts due or claimed to be due to Contractor except to the extent [Dick] has actually received funds from [WVU] that are due from [WVU] specifically designated for disbursement to Contractor.

(Tomko R. at 10 (emphasis added); Wellington R. at 320 (emphasis added).)

The Subcontracts also incorporate by reference various other Project-related documents and materials, including the Bid Package General Conditions.

(Tomko R. at 11; Wellington R. at 321.) These General Conditions also provide that

any outstanding balances, retainage, overtime and change orders. The truth of these allegations, however, is irrelevant to the resolution of the Certified Question. For present purposes, it is enough that the allegations have been made.

receipt of payment from WVU is an absolute condition precedent to Dick's obligations to pay any amounts to any subcontractors on the Project:

Timing. Progress payments will be made within thirty (30) days after receipt by [Dick] of **payment from [WVU] for Contractor's work.** It is agreed that [WVU's] payment to [Dick] of amounts owed to Contractor is a condition precedent to [Dick's] obligation to pay Contractor for work performed.

(Tomko R. at 36; Wellington R. at 66 (bold type in original; additional emphasis added).)

At § 42.13, the General Conditions also mandate as follows:

Pay if Paid. [Dick] shall have no liability or responsibility for any amounts due or claimed to be due Contractor for any reason whatsoever except to the extent that [Dick] has actually received funds from [WVU] specifically designated for disbursement to Contractor. Receipt of these funds by [Dick] shall be a condition precedent to Contractor's right to receive payment. Contractor acknowledges that the Contract Price must be paid from funds to be received by [Dick] from [WVU].

* * *

Contractor agrees that this Section does not merely relate to timing of payment but rather establishes a contingency upon which payment to Contractor (or any **Subcontractors**) shall rely.

(Tomko R. at 37; Wellington R. at 70 (bold type in original; additional emphasis added).)

In addition to these express pay-if-paid provisions, Article 50 of the General Conditions requires that any dispute or claim that is related in any manner to the actions or decisions of WVU or its architect—which is what Wellington and Tomko allege in their Complaints—must be prosecuted and resolved in accordance with the dispute resolution procedures set forth in Dick's Construction Management Agreement with WVU.³ (Tomko R. at 39; Wellington R. at 85.)

³ Pursuant to Article 50, Dick has the sole and exclusive right to determine whether any claim by a subcontractor arises out of or relates to the actions or decisions of WVU or its architect. (Tomko R. at 39; Wellington R. at 85.) Nevertheless, in the present lawsuits, Plaintiffs' Complaints expressly allege culpable conduct by WVU or its architect. (Tomko R. at 3-4; Wellington R. at 6.)

Pursuant to the sections 4.4.4 and 4.5.1 of the Supplementary General Conditions applicable to the Construction Management Agreement between Dick and WVU, any and all claims against WVU must be filed in the West Virginia Court of Claims. (Tomko R. at 41; Wellington R. at 117.) Accordingly, the Plaintiffs expressly agreed to prosecute and resolve claims on this public Project, such as those set forth in the Complaints which are alleged to have resulted from the redesign and rebidding ordered by WVU, in accordance with the procedures set forth in Dick's Construction Management Agreement with WVU, including submission of such claims for resolution by the West Virginia Court of Claims.

III. ASSIGNMENT OF ERROR

The Certified Question to be answered by this Court is:

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?

The Circuit Court answered the question in the affirmative and, for all the reasons cited herein, this Court should reverse the decision below and answer the Certified Question in the negative.

IV. DISCUSSION OF THE LAW

A. Public Policy Supports Enforcing a Pay-If-Paid Provision That Establishes a Clear Condition Precedent to Payment of a Subcontractor.

"[I]f there is one thing which more than another public policy requires it is that men of full age and competent

understanding shall have the utmost liberty of contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred, and shall be enforced by courts of justice. Therefore, you have this paramount public policy to consider,—that you are not lightly to interfere with this freedom of contract.”

State v. Memorial Gardens Dev. Corp., 143 W. Va. 182, 190, 101 S.E.2d 425, 430 (1958), quoting, Baltimore & O. S. W. Ry. Co. v. Voigt, 176 U.S. 498, 505-06 (1900).

The public policy on which this Court should rely in answering the certified question is the principle of freedom of contract. It has been stated that “the sanctity of a contract is a fundamental concept of our entire legal structure.” Chambers Development Co., Inc. v. Passaic County Utility Authority, 62 F.3d 582, 589 (3rd Cir. 1995). “[P]arties ought to be able to rely on the agreements they form with one another. That is *the* central premise of contract law.” Blasland, Bouck & Lee, Inc. v. City of North Miami, 96 F. Supp. 2d 1375, 1382 (S.D. Fla. 2000). Consistent with this fundamental principle, the goal of the courts of West Virginia in contract cases such as the one now before this Court should be to determine the intention of the parties to the contract and to enforce that contractual intent accordingly.

Not surprisingly, that is the manner in which the vast majority of courts around the nation have interpreted and enforced pay-if-paid provisions in construction contracts. Decisions in the many cases that have considered the enforceability of pay-if-paid provisions have turned on an inquiry as to the parties’ intent. If a pay-if-paid provision is clearly intended by the parties to establish that the general contractor’s receipt of payment from the owner is a condition precedent to recovery by the subcontractor, then that intention is enforced by the courts. If, on the other hand, no

clear intention to create a condition precedent can be found from the contractual language used or from extrinsic evidence in the case of ambiguity, then the courts frequently have interpreted pay-if-paid language simply to establish a general time for payment (i.e. at the time of receipt of actual payment by the general contractor or at a reasonable time even if such payment has not been received) and not as a strict condition precedent to payment of the subcontractor.

1. The Dyer Case Sets Forth the Majority View, Which Properly Turns On Contractual Intent.

Thomas J. Dyer Company v. Bishop International Engineering Co., 303 F.2d 655 (6th Cir. 1962) is the seminal case. In Dyer, the Court of Appeals carefully analyzed a contract between a general contractor and a subcontractor on a construction project in Kentucky to determine the intention of the parties in adopting a pay-if-paid provision. Based on the Court's analysis, its ultimate holding was that the pay-if-paid language included in the subcontract in that case was not meant to impose a strict condition precedent to payment of the subcontractor. Rather, the Court interpreted the language used in that subcontract only as establishing that the time of payment of the subcontractor would be receipt of payment by the general contractor or at a "reasonable . . . time if it develops that such an event does not take place." 303 F.2d at 659. In its discussion of the relevant cases, the Dyer Court noted that courts demand clear evidence of intention to establish a condition precedent through use of pay-if-paid language, but pointed out that "it is the intention of the parties which is the controlling factor in each particular case." Id. at 660.

Plaintiffs inaccurately contend that the majority view is that pay-if-paid clauses are not enforceable. A survey of cases nationwide shows that the majority of jurisdictions have followed Dyer's more reasoned approach of looking to the intention of the parties to determine whether a pay-if-paid provision should be construed as an express condition precedent to payment or simply as a timing provision.⁴ In applying this approach, courts have required clear evidence of an intention to create a condition precedent before one will be found to exist. As predicted in Dyer, the cases have turned on the particular language used by the parties in their agreement and variations in contract language have caused results to differ. However, in those cases where intention to create a condition precedent was readily discernable in the contract language, courts have upheld and enforced that intention.

For example, L. Harvey Concrete, Inc. v. Agro Construction & Supply Company, 189 Ariz. 178, 939 P.2d 811 (1997) considered a pay-if-paid provision that stated expressly that receipt of payment by the general contractor was a "condition precedent" to payment of the subcontractor.⁵ The court cited to Dyer and fully acknowledged "the general rule that conditions precedent are not favored in the law and that courts are not inclined to construe a contractual provision as a condition precedent unless such construction is plainly and unambiguously required by the language of the

⁴ A number of Law Review articles have collected and analyzed cases from around the nation and found Dyer to be the case followed in the majority of jurisdictions. See, e.g., Hendrick, Spangler and Wedge, Battling for the Bucks: The Great Contingency Payment Clause Debate, 16-JUL Construction Law 12 (1996); Comment, Show Me the Money: A Comment on the Enforceability of "Pay-If-Paid" Clauses in Contracts for Personal Services, 33 U.S.F. L. Rev. 99 (1999); see also R.N. Robinson & Son, Inc. v. Ground Improvement Techniques, 31 F.Supp.2d 881, 886 n.3 (D.Colo.1998) ("[T]he majority of courts carve out an exception to the general rule regarding pay-when-paid clauses when the parties expressly contemplate shifting the burden of forfeiture under a subcontract to the subcontractor by promising payment only if the primary contractor is paid, not when.").

⁵ The contract expressly used the term "condition precedent" in providing "that payment for either progress payments or final payment is not due and owing to the subcontractor . . . until the owner has made such payment to the contractor." 939 P.2d at 813

contract.” 939 P.2d at 814. In view of the express contractual language in that case, the court had no difficulty in finding that the language did create an express condition prohibiting recovery by the subcontractor until the general contractor had received payment from the owner.

Similarly, in Berkel & Co. Contractors v. Christman Co., 210 Mich. App. 416, 533 N.W. 2d 838 (1995), the Court held that a pay-if-paid provision was an enforceable condition to payment which prevented the subcontractor from bringing a cause of action against the general contractor. The contractual provision in that case also expressly stated that the general contractor’s receipt of payment from the owner was a “condition precedent” to an obligation to pay the subcontractor. Likewise, in DEC Electric, Inc. v. Raphael Construction Corp., 558 So. 2d 427, 428 (Fla. 1990), a contractual provision stated that “[n]o funds will be owed to the subcontractor unless the general contractor is paid by the owner.” This language, too, was held to create an explicit condition precedent to payment of the subcontractor.

Many additional examples exist where courts have expressly cited Dyer or adopted similar reasoning in finding that pay-if-paid language created a condition precedent to payment. Such cases include:

Star Contracting Corp. v. Manway Constr. Co., 337 A.2d 669, 670-71 (Conn. Super. Ct. 1973) (contract provided that “payment will not be made by the Contractor to the Subcontractor until the Owner has made payment to the Contractor for the work”);

Robert F. Wilson, Inc. v. Post-Tensioned Structures, Inc., 522 So.2d 79, 79-80 (Fla. Dist. Ct. App. 1988) (contract provided that “final payment is contingent upon payment to the Contractor” and that “no compensation . . . shall be due the Subcontractor from the Contractor until payment . . . is received by the Contractor”);

St. Paul Fire & Marine Ins. Co. v. Georgia Interstate Elec. Co., 370 S.E.2d 829, 830-31 (Ga. Ct. App. 1988) (contract provided that “no payment shall be due Subcontractor . . . until Contractor has received payment from the Owner”);

New Amsterdam Cas. Co. v. Allen Co., 446 S.W.2d 278, 279 (Ky. Ct. App. 1969) (contract provided that the contractor "shall pay [the subcontractor] each month, within two days after first party has received payment from the [Owner]");

Gilbane Bldg. Co. v. Brisk Waterproofing Co., 585 A.2d 248, 249-52 (Md. Ct. Spec. App. 1991) (contract provided that "[i]t is specifically understood and agreed that the payment to the trade contractor is dependent, as a condition precedent, upon the construction manager receiving contract payments, including retainer from the owner");

Mascioni v. I.B. Miller, Inc., 184 N.E. 473, 473-74 (N.Y. 1933) (contract stated "payments to be made as received from the Owner");

North Harris County Junior Coll. Dist. v. Fleetwood Constr. Co., 604 S.W.2d 247, 255 (Tex. Civ. App. 1980) (contract provided that "final payment shall be made after . . . full payment therefore by Owner").

The parties have found no reported West Virginia case that has considered the interpretation and enforcement of a pay-if-paid provision. But the cases from other jurisdictions which have interpreted such provisions using the same mode of analysis employed in Dyer are fully in accord with the existing law of West Virginia, as established by this Court, concerning the interpretation of contractual conditions generally. In Adams v. Guyandotte Valley Railroad Company, 61 S.E. 341, 344-45 (1908), this Court provided the following helpful observations concerning contractual conditions:

"Conditions have no idiom. Whether they be precedent or subsequent is a question purely of intent, and the intention must be determined by considering, not only the words of the particular clause, but also the language of the whole contract as well as the nature of the act required to the subject matter to which it relates.

* * *

Under the practically unlimited right and power of parties to make such contracts as they see fit to make, and bind themselves to such extent and in such manner as they please, they may make performance of any covenant or condition, however unimportant or trivial in character, a condition precedent. Though time of

performance may be comparatively or really unimportant in a practical sense, they have the power to stipulate with one another that failure to observe it shall be fatal and put an end to the contract. They may make the entire transaction turn upon that as a condition precedent. In Bettini v. Gye, cited, Blackburn, Judge, said: "Parties may think some matter apparently of little importance essential, and, if they sufficiently express an intention to make the literal fulfillment of such a thing a condition precedent, it will be one."

Thus, this Court itself has analyzed and enforced contractual conditions in a manner very similar to that used in Dyer, albeit not in the specific context of a pay-if-paid provision in a construction contract.

2. The Cases Cited by the Plaintiffs Actually Demonstrate Why West Virginia Should Follow the Majority Rule in Answering the Certified Question.

The cases cited above have considered the enforceability of pay-if-paid provisions using an analysis that is fully consistent with the overriding public policy considerations in such cases: upholding freedom of contract and enforcing a contract between two parties according to its clear written terms. Contrary to these important public policy goals, the Plaintiffs here advocate that West Virginia should adopt a blanket position holding void as against public policy any agreement to make the owner's payment of the general contractor a condition precedent to a subcontractor's entitlement to payment on a construction project. According to the Plaintiffs, this policy should void such provisions even where, as in this case, they are specifically negotiated and clearly intended by the parties. In support of their argument, Plaintiffs point to a handful of cases where, because of idiosyncrasies in the mechanics lien and public contract bonding statutes of the states involved, courts have held that pay-if-paid provisions are violative of the public policy of those other states.

Plaintiffs place primary reliance on West-Fair Electric Contractors v. Aetna Casualty & Surety Co., 638 N.Y.S.2d 394, 661 N.E.2d 967 (N.Y. 1995), a case that did not even involve a public contract. There, the Court held that the particular features of New York's Mechanics Lien Law established a public policy in New York disallowing enforcement of a pay-if-paid condition precedent by the general contractor and his surety. The West-Fair case perfectly illustrates the following two primary factors which have caused some courts to refuse enforcement of pay-if-paid provisions, either through strict interpretation of the contractual provisions or, in rare instances, by declaring them unenforceable as against the particular state's public policy. First, some courts dislike provisions that operate to transfer of the risk of owner insolvency to the subcontractor. Second, courts dislike provisions that may, depending on other features of the state's law, leave the subcontractor without any remedy whatsoever. **Importantly**, neither of these factors is present in a bonded public construction project such as the present WVU Life Services Building Project.

The result in West-Fair is easily explained by the considerations mentioned above. First, the private owner of the project in that case had become insolvent and the Court noted that "lack of future payments by the owner is virtually certain." 638 N.Y.S.2d at 398, 661 N.E.2d at 971. Thus, enforcement of the pay-if-paid provision in the circumstances of that case would have operated to transfer totally the risk of owner insolvency and nonpayment from the general contractor to the subcontractor. Second, the subcontractor's normal remedy of pursuing a mechanics' lien claim was foreclosed under the peculiar language of New York's Lien Law. The New York Court observed:

"Plaintiff's right to receive payment has been indefinitely postponed, and Plaintiff has effectively waived its right to enforce its mechanics liens. The waiver has occurred by operation of the pay-when-paid provision because mechanics' liens may not be enforced until a debt becomes due and payable.⁶

Id. Third, and perhaps most significantly, New York's Lien Law contains an express provision stating that "any contract, agreement or understanding whereby the right to file or enforce any lien created under this [statute] is waived, shall be void as against public policy and wholly unenforceable." N.Y.S.2d at 397, 661 N.E.2d at 970, quoting, New York Lien Law, §34. These were the circumstances that motivated the West-Fair Court to declare a pay-if-paid provision unenforceable as against New York public policy.

Similarly, in Capital Steel Fabricators, Inc. v. Mega Constr. Co., 58 Cal. App. 4th 1049 (Cal. Ct. App. 1997), and Wm. R. Clarke Corp. v. Safeco Ins. Co., 15 Cal. 4th 882 (Cal. 1997), upon which Plaintiffs rely, the California courts based their decisions primarily on California Civil Code section 3262, which expressly renders null and void any contract terms whose effect is to waive claims or liens arising under California's mechanics lien and public bonding statute. See Wm. R. Clarke Corp., 15 Cal. 4th at 889-90; Capital Steel Fabricators, Inc., 58 Cal. App. 4th at 1060-62.

In contrast, the present cases present completely different circumstances. None of the three factors relied upon in West-Fair for refusing to enforce a pay-if-paid provision is present here. The Project owner in this case is the State of West Virginia,

⁶ Plaintiffs' suggestion that Blandford Land Clearing Corp. v. National Union Fire Insurance Co., 698 N.Y.S.2d 237, 260 A.D.2d 86 (N.Y. App. Div. 1999) applied West-Fair in a situation where the plaintiff's lien rights still existed is erroneous. Although the defendant in Blandford Land had argued that plaintiff's mechanics lien rights had not been extinguished by the particular clause at issue, the court held otherwise. See Blandford Land Clearing Corp., 260 A.D.2d at 95.

Equally unwarranted is plaintiffs' suggestion that National Fire Insurance Company of Hartford ("National Fire"), the defendant in the instant case, was also the defendant in Blandford Land. The defendant in Blandford Land was National Union Fire Insurance Company, an entirely different company that is in no way affiliated with National Fire or CNA.

which is not insolvent and will not become insolvent. Therefore, in this case neither the general contractor nor the Plaintiffs is presented with a risk of owner insolvency.

Furthermore, as required by West Virginia law, a bond has been issued by a surety, and the bond secures ultimate payment to parties performing work on the Project in the event the general contractor might fail, i.e., wrongfully refuse, to pay despite receipt of payment from WVU. Thus, this definitely is not a case where the Court should consider declining to enforce a pay-if-paid provision because doing so would transfer a risk of owner insolvency to the subcontractor.

Similarly, this is not a case where the subcontractor will by virtue of enforcement of a pay-if-paid provision lose rights under the mechanics lien law. This is a public contract and therefore a mechanics lien is not available to the Plaintiffs. Tug River Lumber Co. v. Smithey, 107 W. Va. 482, 148 S.E. 850, 853 (1929). Instead, a bond exists which fully protects ultimate payment to any subcontractor of amounts the general contractor might fail to pay after having received from WVU those sums justly due to the subcontractor. Furthermore, the contracts on the Project, including both the Construction Management Agreement between WVU and Dick and the Subcontracts between Dick and the Plaintiffs, contain remedial provisions through which subcontractors can assert claims (such as those being raised by the Plaintiffs) for additional payment on the Project. Indeed, express contractual provisions require adherence to a claims resolution system, including ultimate resolution in the West Virginia Court of Claims, through which subcontractors like the Plaintiffs can assert claims for additional payment.

Finally, unlike the lien laws of New York and California, there is no express statutory provision providing that a subcontractor cannot waive rights under the West Virginia Mechanics Lien Statute. In any event and as noted, this case involves a public project where no mechanics lien rights exist.

3. The Language Used in the Contract in This Case Clearly Supports Enforcement of the Pay-If-Paid Provisions.

Under the analysis adopted in the Dyer case and used by the majority of jurisdictions, there is no question whatsoever that the language used in the present Subcontracts requires enforcement of the pay-if-paid provisions as creating an express condition precedent to payment of Wellington and Tomko. The Subcontracts could not be clearer in establishing the parties' intent that payment to the subcontractor (i.e., Wellington and Tomko) is due **if and only if** the general contractor (i.e., Dick) has received payment from the owner (i.e., WVU). In fact, the language contained in the Subcontracts closely tracks the analysis of Dyer and the other existing case law and justifies enforcement of the present pay-if-paid agreements even under a rigorous analysis of contractual intent.

For example, section 42.4 of the General Conditions agreed to by the Plaintiff subcontractors in this case expressly uses condition precedent language: "It is agreed that [WVU's] payment to [Dick] of amounts owed to the subcontractor is a condition precedent to [Dick's] obligation to pay the subcontractor for work performed." (Tomko R. at 36; Wellington R. at 66.) Numerous cases have found the use of such language to expressly create a condition precedent. See, e.g., Berkel & Co.

Contractors v. Christman Co., 210 Mich. App. 416, 533 N.W. 2d 838 (1995); Gilbane Bldg. Co. v. Brisk Waterproofing Co., 585 A.2d 248, 249-52 (Md. Ct. Spec. App. 1991).

While some cases following Dyer have interpreted unclear or ambiguous pay-if-paid language to create a time of payment provision, see, e.g., Mecos Systems, Inc. v. Dancing Bear Entertainment, Inc., 42 S.W.3d 794 (Mo. App. 2001); Koch v. Construction Technology, Inc., 924 S.W.2d 68 (Tenn. 1996), the present Subcontracts (General Conditions section 42.13) expressly disclaim that the pay-if-paid language is intended to relate to timing of payment: "The subcontractor agrees that this section does not merely relate to timing of payment but rather establishes a contingency upon which payment to the subcontractor (or any subcontractors) shall rely." (Tomko R. at 37; Wellington R. at 70.)

Other decisions enforcing pay-if-paid provisions have turned on language indicating that payment to the subcontractor is intended to come "only from" and or "exclusively from" funds received by the general contractor from the owner. See, e.g., Campisano v. Phillips, 547 P.2d 26 (Ariz. App. 1976). The Subcontracts in this case also expressly include that language:

"Contractor agrees and acknowledges that payment of the Contract Sum shall be made only from (sic.) funds which are due from [WVA] that [Dick] has actually received in hand from [WVU] and designated by [WVU] for distribution to the subcontractor. The subcontractor agrees to look solely to such funds for payment."

(Tomko R. at 10; Wellington R. at 320.)

In short, language that more clearly establishes that payment by the owner to the general contractor is a condition precedent to recovery by the subcontractor is impossible to imagine. Even more clearly than in any of the cases

discussed above, the language to which these Plaintiffs expressly agreed in their Subcontracts demonstrates an unmistakable contractual intent to create a condition precedent to payment by use of pay-if-paid language. As shown above, in the great majority of jurisdictions in the United States the language of the Subcontracts would be held to create an enforceable condition precedent and that is what this Court's holding should be as well.

B. The Pay-If-Paid Clause Precludes Liability on CNA's Payment Bond.

1. CNA's Liability as Surety Cannot Exceed the Liability of the Principal, Dick.

Given that the pay-if-paid clauses in the Subcontracts at issue operate as a condition precedent and thus preclude any liability to Plaintiffs on the part of Dick, the principal on the bond, it necessarily follows that there can be no liability on the part of CNA, the surety. It is hornbook law that a surety's liability cannot exceed that of its principal. See, e.g., Gateway Communications, Inc. v. John R. Hess, Inc., 208 W. Va. 505, 508-09, 541 S.E.2d 595, 598-99 (2001); Robinson v. Fidelity & Deposit Co., 181 W. Va. 463, 467, 383 S.E.2d 95, 99 (1989); State ex rel. Mayle v. Aetna Cas. & Sur. Co., 152 W. Va. 683, 685-86, 166 S.E.2d 133, 135 (1969). Thus, a surety can be held liable only upon a default by the principal sufficient to subject the principal to liability. See Gateway Communications, Inc., 208 W. Va. at 508-09, 541 S.E.2d at 598-99; State ex rel. Mayle, 152 W. Va. at 685, 166 S.E.2d at 135. "Should there be no default [by the principal], no liability is incurred by the surety." State ex rel. Mayle, 152 W. Va. at 685, 166 S.E.2d at 135.

This Court has held that the causes of action brought under a performance bond mirror the causes of action that could be brought against the general

contractor for its default under a construction contract. See Gateway Communications, Inc., 208 W. Va. at 508, 541 S.E.2d at 598; accord Lindsey Masonry Co. v. Jenkins & Assocs., 897 S.W.2d 6, 16 (Mo. Ct. App. 1995) (verdict in favor of general contractor precludes liability under payment bond); Restatement (Third) of Suretyship & Guaranty §§ 19, 34 (1996) (stating that a surety may raise any defense available to the principal except the defenses of discharge in bankruptcy and lack of capacity). Indeed, West Virginia Code § 45-1-3 provides that notwithstanding the fact that a judgment has been obtained against the principal, a surety is entitled to assert any defense which could have been made in that underlying suit. See W. Va. Code § 45-1-3.

Applying these principles here, it is plain that CNA cannot have liability under the CNA Bond where the pay-if-paid clauses in Plaintiffs' Subcontracts create conditions precedent and thus preclude any liability on the part of Dick for breach of those Subcontracts. See supra Part A. Under the terms of the Subcontracts, where Dick has not yet received payment from WVU, Dick has no obligation to make payment to Plaintiffs. Where Dick is not in default and therefore has no liability to Plaintiffs, CNA likewise has no liability.

2. The Requirement of Default by the Principal Is Incorporated in West Virginia Code Section 38-2-39 and Therefore in the CNA Bond.
 - a. *Section 38-2-39 Requires a Bond Conditioned upon the Contractor's Default.*

Section 38-2-39 of the West Virginia Code provides in relevant part:

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.

W. Va. Code § 38-2-39 (emphasis added).

In interpreting a statutory provision, this Court applies the statute's plain language. See Taylor v. Nationwide Mut. Ins. Co., 214 W. Va. 324, 328, 589 S.E.2d 55, 59 (Nov. 21, 2003). The statute here expressly requires a bond "conditioned" upon the existence of "fail to pay" conduct by the contractor principal. The term "fail" or "failure" connotes some degree of fault or dereliction of duty. See Smith v. Godby, 154 W. Va. 190, 199, 174 S.E.2d 165, 171 (1970) (the word "failure" implies inattention, inaction or inadvertence in the discharge of a duty"); accord Williams v. Taylor, 529 U.S. 420, 431-32 (2000); see also In re Faircloth, 588 S.E.2d 561, 564 (N.C. Ct. App. 2003) (excusable nonpayment does not constitute a "failure to pay").

As the Supreme Court of the United States recently explained in the course of interpreting the word "failed" as used in statutory language:

In its customary and preferred sense, "fail" connotes some omission, fault, or negligence on the part of the person who has failed to do something. See, e.g., Webster's New International Dictionary 910 (2d ed.1939) (defining "fail" as "to be wanting; to fall short; to be or become deficient in any measure or degree," and "failure" as "a falling short," "a deficiency or *432 lack," and an "[o]mission to perform"); Webster's New International Dictionary 814 (3d ed.1993) ("to leave some possible or expected action unperformed or some condition unachieved").

See also Black's Law Dictionary 594 (6th ed. 1990) (defining "fail" as "[f]ault, negligence, or refusal"). To say a person has failed in a duty implies he did not take the necessary steps to fulfill it. He is, as a consequence, at fault and bears responsibility for the failure. In this sense, a person is not at fault when his diligent efforts to perform an act are thwarted, for example, by the conduct of another or by happenstance. Fault lies, in those circumstances, either with the person who interfered with the accomplishment of the act or with no one at all. We conclude Congress used the word "failed" in the sense just described. Had Congress intended a no-fault standard, it would have had no difficulty in making its intent plain. It would have had to do no more than use, in lieu of the phrase "has failed to," the phrase "did not."

Williams, 529 U.S. at 431-32 (emphasis added).

This reasoning is equally applicable in this case. The West Virginia Legislature could easily have required a bond conditioned to make the surety liable in the event the contractor "does not pay" had that been its intent. Instead, it limited liability on the bond to those instances where the contractor "shall fail to pay," thereby incorporating into the bonding statute the fundamental tenet of surety law that a surety becomes liable only upon a default of the principal.

To date, Plaintiffs' only response to this argument based upon the specific language of West Virginia's statute has been to close their eyes, despite the fact that CNA made this argument in its Petition for Docketing of Certified Question. Plaintiffs have not addressed the specific language of the West Virginia statute requiring a bond conditioned upon failure to pay. Plaintiffs have ignored the cases by this Court and others interpreting the word "failure." Rather, despite this Court's admonishment that, because public contract bonding statutes differ in the various jurisdictions, decisions by foreign courts are of little use in interpreting West Virginia's statute, see Rhodes v. Riley, 113 W. Va. 679, 169 S.E. 525, 526 (1933), Plaintiffs continue to rely wholly on

cases interpreting statutes from other jurisdictions containing radically different language.

b. *The Statutory Condition of the Contractor's Failure to Pay Is Read Into the CNA Bond.*

It is well-established under West Virginia law that in construing a surety's obligations under a statutory bond, the terms of the statute requiring the bond are read into the bond and define the scope of the surety's obligations. See e.g., State Road Comm'n v. Curry, 155 W. Va. 819, 824, 187 S.E.2d 632, 635-36 (1972); Rhodes v. Riley, 113 W. Va. 679, 169 S.E. 525, 526 (1933); Tug River Lumber Co. v. Smithey, 107 W. Va. 482, 148 S.E. 850, 853 (1929); accord Coating Specialists, Inc. v. PAT Caffey Contractor, Inc., 194 So.2d 380, 384 (La. Ct. App. 1967) (liability of surety should not be expanded beyond the terms of public works statute); Charles City v. Rasmussen, 232 N.W. 137, 139 (Iowa 1930) ("[A]ny additions to such [statutory] bond will be treated as surplusage, and any omission of the provisions of the statute will be read into the bond.").

As this Court stated in the seminal case of Tug River Lumber Company, "if a bond is given under the authority of the law, that which is not expressed, but should have been incorporated, is included in the bond, while that which is not required by law is excluded." Tug River Lumber Co., 107 W. Va. 482, 148 S.E. at 853. Thus, where the statute sets forth an express condition of the bond, the law writes that condition into the bond. County Court v. Morrison, 115 W. Va. 18, 174 S.E. 562, 563 (1934).

Plaintiffs here do not dispute that the CNA Bond is a statutory bond issued to comply with the requirements of section 38-2-39. Indeed, their entire public policy argument is premised on the applicability of that statute. (See Plaintiffs' Brief, at 16-17.)

Accordingly, the statutory language conditioning liability upon the contractor's "failure to pay," is read into the CNA Bond.

Plainly, Dick cannot be deemed to have "failed to pay" where it has no obligation or duty to do so under the terms of Plaintiffs' Subcontracts. Dick has not paid because its duty to do so has not yet arisen, where it has not itself been paid by WVU. Dick is in no way at fault in regards to its nonpayment, and thus has not "failed to pay." Therefore, the condition of the bond has not been satisfied, and CNA cannot be held liable at this time.

3. Enforcing the Pay If Paid Clause Here Does Not Contravene Public Policy.

The Circuit Court viewed a result allowing CNA to assert as a defense the pay-if-paid clauses in the Subcontracts to violate West Virginia's public policy as articulated in section 38-2-39. However, this Court has repeatedly cautioned that contracts themselves "present . . . a conflicting public policy in favor of the traditional right of freedom of contract and that courts ought not lightly interfere with this right." Hensley v. Erie Ins. Co., 168 W. Va. 172, 182, 283 S.E.2d 227, 232 (1981); accord State v. Memorial Gardens (quoted at the beginning of Part B of the Argument herein).

Certainly, where a subcontractor has freely and voluntarily agreed to assume the risk of owner nonpayment, or, in the case of a public contract, delay in payment pending completion of an agreed-upon claims resolution mechanism, through a pay-if-paid clause in its subcontract, it does not contravene public policy to allow a surety to assert this provision as a defense to liability. To do anything else would be to contravene the public policy holding sureties liable only for their principals' defaults,

which policy is well-established in the common law and expressly reflected in West Virginia's bonding statute itself.

Indeed, this case illustrates how such pay-if-paid provisions in public contracts further the State's interests and are thus in accord with public policy. The Construction Management Agreement between Dick and WVU is a "guaranteed maximum price" contract, under which any cost savings in the construction of the Life Sciences Building get passed on to WVU, the State, and ultimately, the taxpayers. (Tomko R. at 169, 181, 188-89; Wellington R. at 248, 160, 269-70.) Under such a contract, the State has a substantial interest in maintaining control over subcontractor costs, and that is just what it did by virtue of various provisions in WVU's Construction Management Agreement with Dick, including the provisions requiring Dick to pay its subcontractors only upon WVU approval of such costs and Dick's receipt of payment allocated for such costs from WVU. (Tomko R. at 190-91, 208-09, 214-16; Wellington R. at 269-70, 289-90, 293-95.) The State's interest in containing costs on such public projects, however, would be entirely defeated if subcontractors were free to make an end-run around this process and obtain payment from the contractor's surety. If such an end-run is possible, it will have the effect of driving up bonding costs on public contracts (or reducing the number of interested contractors) to the detriment of taxpayers.

In addition, the Project contract documents contain explicit dispute resolution procedures mandated by WVU, and the Plaintiffs agreed that these procedures would apply to claims that they now assert. Article 50 of the General Conditions to the Subcontracts signed by the Plaintiffs expressly acknowledges the

dispute resolution procedures set forth in the Construction Management Agreement between WVU and Dick and expressly states that if a dispute or claim involving the subcontractor's work is determined to be one arising out of the actions or decisions of WVU or its architect then the subcontractor "agrees that its dispute or claim would be prosecuted and resolved in accordance with the dispute [resolution] procedure set forth in the [owner contract]." (Tomko R. at 39; Wellington R. at 85.) That Construction Management Agreement in turn provides that all such claims should be filed in the West Virginia Court of Claims and resolved in that forum. (Tomko R. at 228; Wellington R. at 307.)

Thus, the Project contract documents set forth a specific procedure for resolving claims such as those being raised by the Plaintiffs. Although the Plaintiffs freely agreed to these conditions as part of their Subcontracts, through their present suits they are attempting to totally ignore their contractual commitments. Here, not only is it bad public policy to allow parties to avoid their express agreements, but if Plaintiffs are permitted to proceed with these suits there is a real probability that the parties will be faced with multiple, simultaneous litigation in the Circuit Court and in the Court of Claims concerning the same Project and the same claims by the Plaintiffs. Under that scenario, the likelihood of unnecessary expense and inconsistent results is clear and is clearly against good public policy.⁷

⁷ While the surety is the ostensible defendant in the present cases, it is common knowledge and industry practice that the general contractor is obligated to indemnify its surety. Thus, the ultimate responsibility for the Plaintiffs' claims will fall upon the general contractor. Accordingly, through the simple expedient of suing the surety alone, Plaintiffs will be able to circumvent entirely the extensively negotiated and drafted contractual dispute resolution procedures to which they had expressly agreed. Obviously, West Virginia's public policy should not favor a result under which form triumphs over substance in such a manner and a party is rewarded for violating its written agreements.

Moreover, the burden of litigating multiple lawsuits and risking inconsistent judgments does not fall on the defendant alone. Rather, if the Plaintiffs' claims are permitted to proceed in the Circuit Court, there is the risk that WVU or its agents will be made a party to those proceedings. See, e.g., State v. Madden, 192 W. Va. 497, 409-500, 453 S.E.2d 331 (1994) (discussing exception to sovereign immunity). Such a result would jeopardize the specific statutory and contractual scheme by which the State has attempted to ensure that all claims affecting the public purse are efficiently handled in a single, streamlined proceeding in the Court of Claims.

In accord with the established public policy of West Virginia, numerous courts have held that a pay-if-paid clause in a subcontract precludes liability on a statutory payment bond, where the contractor has not been paid by the owner. See, e.g., St. Paul Fire & Marine Ins. Co. v. Georgia Interstate Elec. Co., 370 S.E.2d 829, 830-31 (Ga. Ct. App. 1988); Star Contracting Corp. v. Manway Constr. Co., 337 A.2d 669, 670-71 (Conn. Super. Ct. 1973); Pace Constr. Corp. v. OBS Co., 531 So.2d 737, 739 (Fla. App. Ct. 1988), quashed, 558 So.2d 404 (Fla. 1990); see also Pacific Lining Co. v. Algernon-Blair Const. Co., 812 F.2d 237, 241-42 (5th Cir. 1987) (holding that a surety can assert a pay-if-paid defense to the same extent that the contractor could, but certifying to the state court the question of the general enforceability of pay-if-paid clauses); United States f/u/b/o Woodington Elec. Co. v. United Pacific Ins. Co., 545 F.2d 1381, 1383 (4th Cir. 1976) (recognizes enforceability by Miller Act surety of condition precedent to payment in subcontract); United States f/u/b/o Harrington v. Trione, 97 F. Supp. 522, 526-27 (D. Colo. 1951) (non-occurrence of condition precedent in subcontract, namely, a showing of profit, precluded surety liability on a payment bond);

Philip L. Bruner & Patrick J. O'Connor, Jr., Bruner & O'Connor on Construction Law § 8:50 (criticizing certain courts for forgetting fundamental principles of suretyship in barring sureties from asserting defenses based upon pay-if-paid provisions).

In Star Contracting Corporation, for example, the court held that a pay-if-paid clause in a subcontract precludes liability on a statutory payment bond even though there is no corresponding limitation in the bond. Star Contr. Corp., 337 A.2d at 670-71. The court relied on "the fundamental precept of suretyship law that the liability of the surety is conditioned on accrual of some obligation on the part of the principal." Id. at 670. Notably, the court expressly rejected a public policy argument grounded on the statute requiring a bond on public contracts, such as the argument advanced by Plaintiffs here. See id. at 671. The court explained that "construing the liability of the surety as coextensive with that of the principal does not subvert the public policy effected by [the applicable state statute] because that statute was not intended to afford legal recourse against a surety when no such recourse existed against the principal, i.e., the statute does not give the subcontractor something that he is not entitled to under his primary contract." Id.; see also Rashid v. United States Fid. & Guar. Co., No. Civ.A.No. 2:91-0141, 1992 WL 565341, at *12 (S.D.W. Va. Sept. 28, 1992) ("[I]n enacting [statutory provisions relating to effect on surety of judgment against principal], the legislature did not intend to impair the right to contract." (citing State v. Myers, 82 S.E. 270 (W. Va. 1914)).

The cases to the contrary cited by Plaintiffs apply the law of other states, and, significantly, rely on bonding statutes containing radically different language than West Virginia's section 38-2-39. See Rhodes v. Riley, 113 W. Va. 679, 169 S.E. 525,

526 (1933) (public contract bonding statutes differ in the various jurisdictions, and therefore decisions by foreign courts are of little use in interpreting West Virginia's statute). Not one of the cases cited by Plaintiffs for the proposition that allowing a surety to enforce a pay-if-paid provision would violate public policy as reflected in a state's mechanic's lien or bonding statute involved a statute like West Virginia's that expressly requires a bond conditioned upon the contractor's failure to pay. To the contrary, most of the cases rely on statutes that condition the bond on payment or receipt of payment, most often within a certain time period, without any consideration of contractor fault, or on statutes that expressly void contractual waivers of claims thereunder. To illustrate, consider the following cases cited by Plaintiffs:

| Jurisdiction | Case | Statute Applied |
|-----------------------------------|---|--|
| California | <u>Capital Steel Fabricators, Inc. v. Mega Constr. Co.</u> , 68 Cal. Rptr. 2d 672, 58 Cal. App. 4 th 149, 1060-62 (Cal. Ct. App. 1997) | Cal. Civil Code § 3262 (voids contractual provisions that effect a waiver of claims or liens arising under mechanics lien and public bonding statute) |
| California | <u>Wm. R. Clarke Corp. v. Safeco Ins. Co.</u> , 938 P.2d 372, 376-77 (Cal. 1997) | Same |
| Connecticut | <u>Chapman v. El Constructors, Inc.</u> , No. CV 0040938, 1995 WL 91391, at *6 (Conn. Super. Ct. Feb. 21, 1995), <u>aff'd</u> , 687 A.2d 506 (Conn. 1997) | Conn. Gen. Stat. § 49-42(a) (right to payment under bond arises when the subcontractor has not received payment within 60 days) |
| Connecticut | <u>R&L Acoustics v. Liberty Mut. Ins. Co.</u> , 2001 WL 1249658, at *8 (Conn. Super. Ct. Sept. 27, 2001) (unpublished opinion) | Does not apply any statute but merely notes in dicta that some courts in other jurisdictions have held that sureties may not invoke pay-if-paid clause |
| Federal (9 th Circuit) | <u>United States f/u/b/o Walton Tech., Inc. v. Weststar Eng'g, Inc.</u> , 290 F.3d 1199, 1208-09 (9 th Cir. 2002) | 40 U.S.C § 3133(b)(1), (4) (formerly 40 U.S.C. § 270b) (action on Miller Act bond accrues where subcontractor has not been paid within 90 days and must be brought within one year of the last day upon which work was performed or material supplied) |

| Jurisdiction | Case | Statute Applied |
|--------------------------------------|---|--|
| Federal (District of Colorado) | <u>United States f/u/b/o DDC Interiors, Inc. v. Dawson Constr. Co.</u> , 895 F. Supp. 270, 274 (D. Colo. 1995), <i>aff'd</i> , 82 F.3d 427 (10 th Cir. 1998) (table op.) | Same |
| Federal (5 th Circuit) | <u>United States f/u/b/o T.M.S. Mech. Contractors, Inc. v. Millers Mut. Fire Ins. Co.</u> , 942 F.2d 946, 949 n.6 (5 th Cir. 1991) | Same |
| Florida | <u>Everett Painting Co. v. Padula & Wadsworth Constr., Inc.</u> , 856 So.2d 1059, 1062 (Fla. App. 2003) | Fla. Stat. ch. 255.05(1)(a) (requiring bond conditioned upon prompt payment) |
| Florida | <u>OBS Co. v. Case Constr. Corp.</u> , 558 So.2d 404, 408 (Fla. 1990) | Fla. Stat. Ann. § 713.23(1)(a) (requiring bond conditioned upon prompt payment) ⁸ |
| Illinois | <u>Brown & Kerr Inc. v. St. Paul Fire & Marine Ins. Co.</u> , 940 F. Supp. 1245, 1249 (N.D. Ill. 1996) | 30 Ill. Comp. Stat. 550/1 (requiring bond conditioned on payment) |
| New York | <u>West-Fair Elec. Contractors v. Aetna Cas. & Sur.</u> , 661 N.E.2d 967, 970-72 (N.Y. 1995) | New York Lien Law § 34 (voiding any contractual provision that effects a waiver of mechanics lien) |
| New York | <u>Blandford Land Clearing Corp. v. National Union Fire Ins. Co.</u> , 698 N.Y.S.2d 237, 260 A.D.2d 86 (N.Y. App. Div. 1999) | Same |
| Virginia | <u>Moore Bros. Co. v. Brown & Root</u> , 207 F.3d 717, 723 (4 th Cir. 2000) | Va. Code Ann. § 2.2-4337(A)(2) (requiring bond conditioned upon prompt payment) |
| Virginia | <u>In re M & T Elec. Contractors</u> , 267 B.R. 434, 449 (Bankr. D.D.C. 2001) | Same |

⁸ It is noteworthy that, following the OBS decision, the Florida legislature felt compelled to enact § 713.235, authorizing "conditional payment bonds" under which, "[n]otwithstanding any provisions of §§ 713.23 and 713.24 to the contrary, if the contractor's written contractual obligation to pay lienors is expressly conditioned upon and limited to the payments made by the owner to the contractor, the duty of the surety to pay lienors will be coextensive with the duty of the contractor to pay." Fla. Stat. Ann. § 713.235.

Regardless of whether these cases are correct as to the public policy reflected in the statutes of other states which they apply, they have no application here where the proper result is controlled by West Virginia law.

Moreover, these cases are distinguishable on their facts. For example, the case upon which Plaintiffs rely most heavily, Moore Brothers Company, involved a situation where the pay-if-paid clause was not enforceable by the contractor because the contractor's wrongful and even fraudulent actions contributed to the owner's inadequate financing and non-payment. See Moore Bros. Co., 207 F.3d at 721, 724-25. Furthermore, the contract in that case was a private contract with private owners, who had become insolvent. In contrast to a public project, where the risk of owner insolvency is virtually non-existent, the bonding company in private projects may be the only available source of funds.

The statutory requirement of a payment bond in the case of public projects is intended to protect subcontractors and the State from the risk of insolvency of the general contractor or the general's possible misallocation of funds it receives from the governmental owner. It cannot seriously be argued that in enacting the public contract bonding statute, the Legislature was seeking to protect subcontractors from the risk that the State itself would be unable or unwilling to pay all sums justly due. As already noted, see supra Part A, Plaintiffs will not be denied a remedy if they are not able to pursue CNA as surety in these cases. In a public contract situation such as the one here, the question is not whether the subcontractors will be paid, but rather when and how much. Clearly, it is reasonable to expect that at the end of the state-mandated dispute resolution procedure, WVU will pay Dick for that portion of Plaintiffs' claims that

is found to be meritorious. At such time, the condition precedent to both Dick and CNA's liability will be satisfied, and Plaintiffs will be able to recover that to which they are entitled.

Additionally, the Moore court placed great weight on the fact that the bond at issue there did not itself expressly incorporate the pay-if-paid clause. See id. at 722-23. Relying on Moore, Plaintiffs make a similar argument here. However, under West Virginia law, the CNA Bond incorporates the statutory language conditioning the bond upon the contractor's default. See State Road Comm'n v. Curry, 155 W. Va. 819, 824, 187 S.E.2d 632, 635-36 (1972); Rhodes v. Riley, 113 W. Va. 679, 169 S.E. 525, 526 (1933); Tug River Lumber Co. v. Smithey, 107 W. Va. 482, 148 S.E. 850, 853 (1929); see also supra Part II.B.2. The West Virginia authorities on this issue were cited and discussed in CNA's Petition for Docketing of Certified Question, yet Plaintiffs in their Brief do not even address them, but inexplicably continue to rely on Moore despite the contrary decisions by this Court.⁹

Furthermore, the CNA Bond specifically incorporates the Construction Management Agreement between Dick and WVU as follows:

WHEREAS, Contractor [Dick] has by written agreement dated June 28, 1998 entered into a contract with Owner for Earthwork, Foundations and Footings with Construction Management Services provided for the Life Science Building in accordance with drawings and specifications prepared by Payette Associates which contract is by reference made a part hereof and is hereinafter referred to as the CONTRACT.

⁹ Plaintiffs' oversight is not limited to this one issue. Plaintiffs in their brief have not cited a single West Virginia case in support of their position, and have completely ignored the numerous West Virginia cases cited by CNA in its Petition for Docketing of Certified Question. Plaintiffs appear to believe that because the Certified Question is a novel one under West Virginia law, they are free to ignore completely all of the West Virginia cases cited by CNA which show that the proper resolution of this matter is in CNA's favor.

(Tomko R. at 13; Wellington R. at 94 (emphasis added).) Where the bond incorporates the contract by reference, the contract terms become part of the bond. See Tug River Lumber Co. v. Smithey, 107 W. Va. 482, 148 S.E. 850, 851-53 (1929); Rashid v. United States Fid. & Guar. Co., Civ.A.No. 2:91-0141, 1992 WL 565341, at *9-12 (S.D.W. Va. Sept. 28, 1992) (where bond incorporates the contract by reference, arbitration provisions of contract become part of the bond). In addition to the pay-if-paid clauses in Plaintiffs' Subcontracts, the Construction Management Agreement between Dick and WVU contains provisions designed to implement the pay-if-paid provisions in the Subcontracts:

The Contractor shall promptly pay each Subcontractor, upon receipt of payment from the Owner, out of the amount paid to the Contractor on account of such Subcontractor's portion of the Work, the amount to which said Subcontractor is entitled, reflecting percentages actually retained from payments to the Contractor on account of such Subcontractor's portion of the Work.

(Tomko R. at 216; Wellington R. at 295 (emphasis added).)

Thus Moore Brothers involved the application of different law to entirely different material facts and has no authoritative value here. Indeed, in other cases involving different facts and statutes, the United States Court of Appeals for the Fourth Circuit has recognized the enforceability by a payment bond surety of a condition precedent in the subcontract. See United States f/u/b/o Woodington Elec. Co. v. United Pacific Ins. Co., 545 F.2d 1381, 1383 (4th Cir. 1976).

In conclusion, it is well-established under West Virginia law that a surety becomes liable only upon the default of the principal. The plain language of the West Virginia payment bond statute pursuant to which the CNA Bond was issued reflects this fundamental tenet of the law of suretyship. This statutory language and the public

policy behind it are incorporated in the CNA Bond. The public policy of West Virginia is to be found in its statutes and common law, and not by reference to decisions of other courts interpreting statutes that do not expressly incorporate and affirm the rule that the principal's default is a condition precedent to liability on the bond at issue.

4. If the Rule Advocated by the Plaintiffs Is Adopted, It Should Be Applied Prospectively Only.

Finally, if this Court were to rule, in this case of first impression, that the pay-if-paid contractual protections that exist in the Subcontracts are not enforceable as against public policy, then that ruling should be applied prospectively only and should not affect the rights and liabilities of the parties in this case. State ex rel. Mitchem v. Kirkpatrick, 199 W. Va. 501, 485 S.E.2d 445 (1997)(new rule on forum of medical malpractice actions not applied retroactively); Daily Gazette Co., Inc. v. Committee on Legal Ethics, 176 W. Va. 550, 346 S.E.2d 341, 342-43 (1985) (ruling on right of access to attorney discipline hearings not applied retroactively).

This Court has considered the issue of prospective versus retrospective application of new legal rulings under the five part test set forth in Bradley v. Appalachian Power Co., 163 W. Va. 332, 351, 256 S.E.2d 879, 890 (1979). This Brief will not be extended for an in-depth analysis of each of the Bradley factors, but two factors are worthy of special note in supporting prospective application here. The first factor is that "[i]f the issue involves a traditionally settled area of law, such as contracts or property as distinguished from torts, and the new rule was not clearly foreshadowed, then retroactivity is less justified," and the fifth factor provides that "the more radically

the new decision departs from previous substantive law, the greater the need for limiting retroactivity.” Id.

To apply a new, unprecedented and “radically” different rule in this case to defeat the legitimate expectations of contracting parties who used especially clear language to manifest their intentions would be unfair in the extreme, and it would also be unwise as a matter of public policy. If contractors and sureties do not believe that the courts of West Virginia will enforce clear contractual provisions as written, they will be discouraged from becoming involved in public projects in the State or the price they charge for doing so will increase to reflect the extra risks associated with the uncertainty of contractual commitments and contractually-mandated dispute resolution mechanisms in West Virginia. Such a result would obviously be bad for West Virginia’s finances as well as its public policy.

V. RELIEF REQUESTED

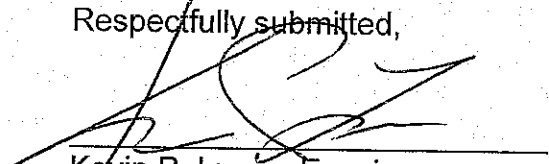
For all the reasons set forth, Cross-Petitioner CNA respectfully requests that this Honorable Court reverse the Circuit Court by answering the Certified Question in the negative.

Date: November 15, 2004

Respectfully submitted,

Local Counsel:

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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:

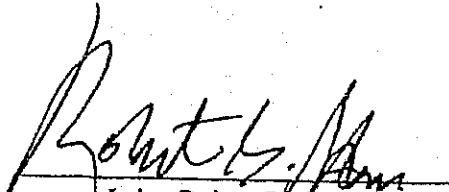
Question: In a public building project in West Virginia, does a "pay if paid" condition precedent clause violate West Virginia public policy, as articulated in the West Virginia Public Bond Statute (W.Va. Code § 38-2-39), so as to entitle a subcontractor to proceed with a claim against a contractor's 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.

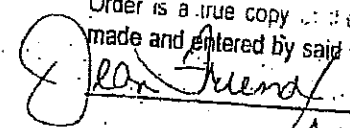
Entered this 23rd day of January, 2004.

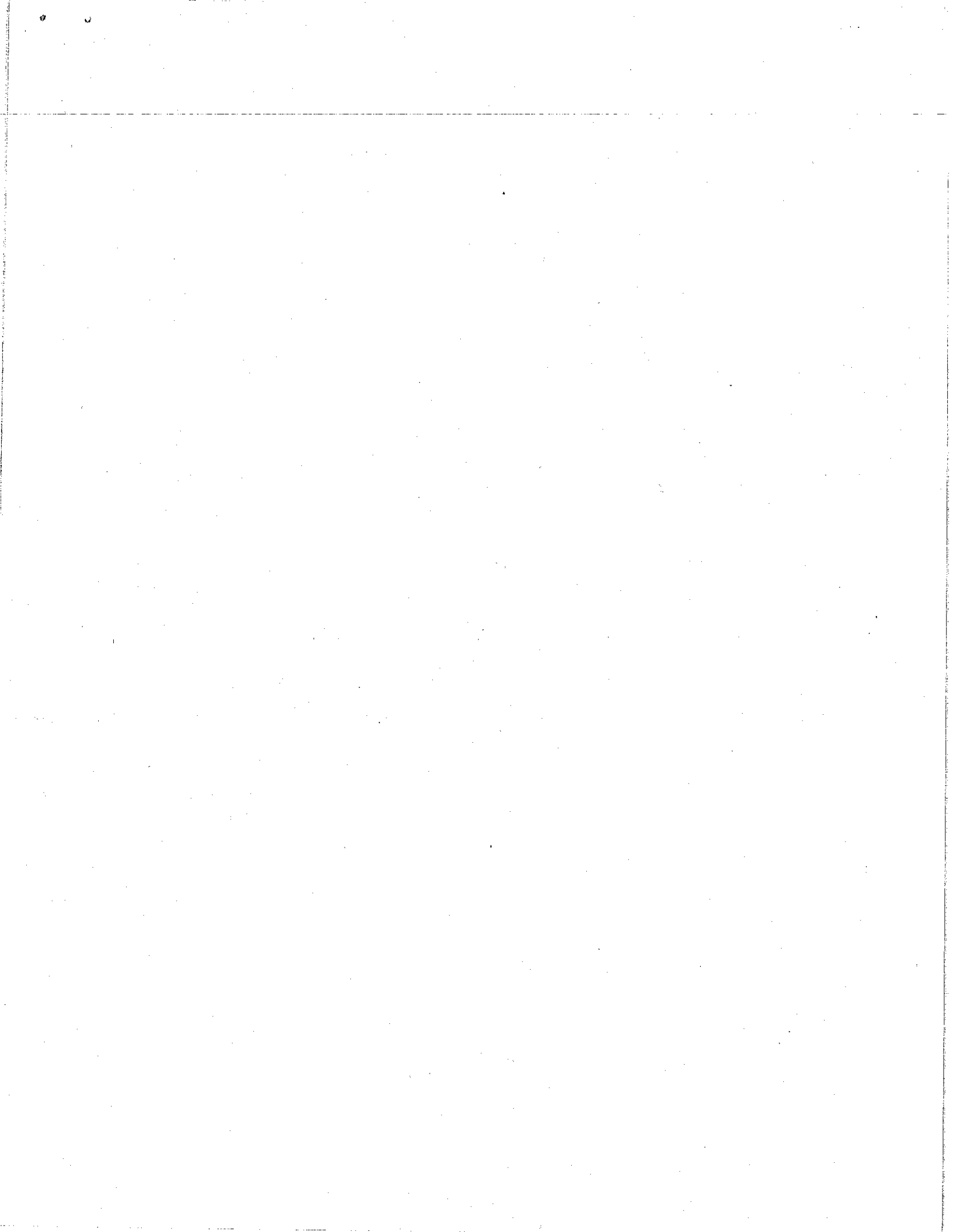

Judge Robert B. Stone
Circuit Court of Monongalia County

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, hereby certify that the attached Order is a true copy of the original Order made and entered by said Court.

2


Circuit Clerk



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.

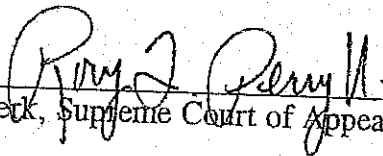
It is hereby ordered that this proceeding be submitted, heard and determined upon the original record, briefs of counsel and oral argument if requested by the parties. It is further ordered that the plaintiff, Wellington Power Corporation, file an original and nine copies of

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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:

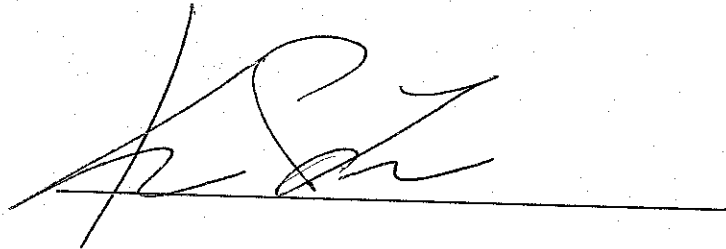

Clerk, Supreme Court of Appeals

CERTIFICATE OF SERVICE

I hereby certify that on this 15th day of November 2004, I caused a copy of the foregoing to be served by Federal Express upon the following:

J. Bryan Edwards, Esquire
Cranston & Edwards, PLLC
Dorsey Avenue Professional Building
1200 Dorsey Avenue, Suite II
Morgantown, West Virginia 26501

Roy S. Cohen, Esquire
John A. Greenhall, Esquire
Kimberly A. Gurchich, Esquire
Cohen, Seglias, Pallas, Greenhall & Furman, P.C.
1515 Market Street, 11th Floor
Philadelphia, Pennsylvania 19102

A handwritten signature in black ink, appearing to be "RSC", is written over a solid horizontal line.