



The *Wadsworth* Rule Is Alive And Well

By: *Eli Robbins*

Payment bonds are the grease that keeps the wheels of the construction industry turning. They provide security for lower-tier contractors and materialmen, ensuring that they will be paid for the labor and materials rendered to the project, and they provide security for owners, providing protection from and/or recourse in the event that a mechanics' lien is filed against the owner's property.

While payment bonds come in many forms, the most prevalent payment bond form is the AIA form A312. This standardized payment bond form establishes the circumstances under which the surety will be liable to pay a claim arising under the bond and sets forth the steps a claimant is required to perform in order to properly assert a claim against the surety under the bond. Finally, the A312 payment bond establishes what the surety must do once it receives a payment bond claim.

The obligations of the surety with respect to sub-contractors and materialmen (called "Claimants") are set forth in the A312 bond in a counter-intuitive manner, as follows:

"With respect to Claimants, this obligation shall be null and void if the Contractor promptly makes payment, directly or indirectly, for all sums due."

What this provision really means is that the surety is liable to pay Claimants all sums due unless the Contractor (also called the "Principal") has paid the sums due to the Claimant, either directly or indirectly. Invariably, whether the sum is "due", thereby invoking the surety's liability under the bond, or not, is often the subject of much debate. But that discussion is best left for another day.

Having defined the scope of the surety's liability to Claimants under the bond, the bond establishes the procedure a Claimant seeking to file a claim against the surety must follow. The procedure depends on whether the Claimant is a first-tier contractor—meaning a contractor who has a direct contract with the Principal (the contractor who furnished the bond), or a lower-tier contractor—meaning a contractor whose contract is with someone other than the Principal. Contractors who have a direct contract with the Principal need only provide the surety with a notice stating, with substantial accuracy, the amount of the claim and provide the owner with a copy of the notice to the surety. Contractors who do not have a direct contract with the Principal need to first send a notice to the Principal (with a copy to the owner) stating, with substantial accuracy, (1) the amount of the claim and (2) the name of the party with whom they have a contract. This notice must be sent to the Principal and the owner within 90 days of the

last day that labor and materials were rendered to the project. In the event that the Claimant receives a rejection (in whole or in part) of its claim or no response within 30 days after having provided the notice, the Claimant must notify the surety (with copy to the owner) of its claim against the bond and include with its notice a copy of its notice to the Principal.

Once the surety receives a valid notice of claim, the surety must do two things within 45 days: (1) send an answer to the Claimant stating the amounts that are undisputed and the basis for challenging any amounts that are disputed and (2) pay or arrange for payment of any undisputed amounts.

What happens if the surety fails to respond as it is required under the bond? Enter the *Wadsworth* case.

In *Wadsworth*, a general contractor hired Wadsworth to perform site work on the Hyatt Regency Chesapeake Bay Resort in Cambridge, Maryland. Wadsworth's contract contained a "pay-when-paid" clause which the general contractor relied upon in refusing to pay Wadsworth for the work it performed. Accordingly, Wadsworth filed a claim against the general contractor's A312 payment bond.

Thirteen days after receiving Wadsworth's bond claim, the surety acknowledged receipt of the bond

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claim and requested documentation to support the claim. Notably, the surety did not state the amounts of the claim that were undisputed or the basis for challenging the amounts of the claim it was disputing. Given that the surety failed to comply with the terms of the bond which it issued, *Wadsworth* argued that the surety implicitly waived its right to contest the claim. Accordingly, *Wadsworth* sought, and was granted, summary judgment against the surety in the full amount of its claim.

The surety appealed the decision granting *Wadsworth* summary judgment to the Maryland Court of Special Appeals and, after losing there, to the Maryland Court of Appeals, the highest appellate court in the State. The Court of Appeals upheld the entry of judgment in *Wadsworth's* favor holding that the surety's obligations under the bond were substantive and that the surety's failure to state the amounts of the claim that were undisputed and the basis for challenging the amounts of the claim that were disputed rendered the entire claim undisputed. Needless to say, this decision, the first of its kind in the United States, shook the entire surety industry. However, the American Institute of Architects ("AIA"), the creator of the A312 payment bond form, refused to modify the requirements of the A312 payment bond despite pressure from the surety industry, and the A312 payment bond remains in popular use.

The *Wadsworth* rule is gaining traction in other jurisdictions across the country. In Florida, a court went a step further than the *Wadsworth* court did and held that, under the terms of the A312 bond, a Claimant is not required to substantiate its bond claim.

In that case, the Claimant properly submitted a bond claim and, like in *Wadsworth*, the surety's response failed to comply with the provisions of the bond. However, in the Florida case, the surety requested that the Claimant file a "proof of claim" and provide substantiation of its claim. The Claimant provided the requested information and, when the surety failed to respond in compliance with the terms of the bond, sued the surety. The Claimant sought to apply the *Wadsworth* rule to preclude the surety from disputing its claim. The surety attempted to argue that the provision of the proof of claim form and substantiation by the Claimant triggered the 45 day period, which had not expired prior to the Claimant filing suit. The Claimant argued, and the Florida court agreed, that the 45 day period is triggered once a proper notice of claim which complies with the provisions of the bond is received by the surety. Because the bond does not require Claimants to provide additional substantiation of their claims or complete a "proof of claim" form, voluntarily providing these items in response to the surety's request did not impact the running of the 45 day period at all.

Having failed to convince the AIA to modify the A312 bond, the surety industry is slowly adapting their practices to avoid getting banged by the *Wadsworth* rule. Some sureties are moving away from using A312 payment bond form altogether. Other sureties have modified the A312 bond form by deleting the paragraph which outlines the surety's responsibilities upon receipt of a bond claim (including the 45 day response requirement and the requirement that the surety set forth the basis for challenging the disputed amounts of the bond claim) and replacing that paragraph with one that shifts the burden back on to the Claimant. A modified A312 payment bond could require the Claimant to provide a "proof of claim" executed under oath, along with substantiation in support

of its bond claim. As such, the lack of substantiation can, itself, become a basis for denying the bond claim which, when one thinks about it, is disingenuous and bears no relation to the actual merits of the claim. Another modification could enlarge or delete the time period within which the surety may respond to the claim. Finally, the surety can insert a provision preserving its rights notwithstanding a non-timely response. All of these possible modifications are direct responses to the issues raised by the *Wadsworth* rule and its progeny. As always, it is crucial that a contractor who is considering filing a bond claim read the payment bond terms and conditions very carefully and consult with competent counsel to ensure that it, and the surety in its response, have satisfied all of the requirements of the bond

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