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MEMORANDUM

TO: **RPPTL Construction Law Committee**

FROM: **Ty G. Thompson**
Surety & Insurance Subcommittee

DATE: **February 13, 2012**

RE: **Case Law Update**

Cardinal Change

On November 18, 2011, the United States District Court for the Southern District of Florida in *Hartford Cas. Ins. Co. v. City of Marathon* - 2011 WL 5825503 (S.D. Fla.), held that a performance bond surety would not be responsible for a cardinal change in the bonded contract, notwithstanding language in the contract where the surety consented to changes. A copy of the decision is attached. A summary of the facts and law are:

The Plaintiff, Hartford Casualty Insurance Company's and Defendant City of Marathon's cross motions for summary judgment… Court finds that Plaintiff Hartford Casualty Insurance Company is entitled to summary judgment….

Defendant Intrastate Construction Corp. ("Intrastate"), a construction company incorporated under the laws of Florida, submitted its bid for the **Area 3 Project**….Intrastate's $2,061,000.00 construction bid was recommended and determined to be the lowest responsive and responsible bidder for the **Area 3 Project**….The project consists of constructing tanks, buildings, and installing wastewater treatment and plumbing facilities, complete, in place, all in accordance with the construction drawings and technical specifications."…

…On or about June 3, 2009, Plaintiff Hartford Casualty Insurance Company ("Hartford") issued statutory **performance and payment bonds for the Area 3 Project** under bond

number 35 BCSFD 6127 (the "Bonds"). Hartford executed …**The Area 3 Performance Bond**, issued in favor of Marathon, guaranteed Intrastate's performance on the contract entitled, City of Marathon Service Area 3 Wastewater and Stormwater Project. The Area 3 Payment Bond guaranteed payment to Intrastate's subcontractors, sub-subcontractors, laborers, and materialmen on the contract entitled, City of Marathon Service Area 3 Wastewater and Stormwater Project.

…On or about April 27, 2010, Intrastate and Marathon executed a document entitled Change Order No. 1 to "provide the same type of services to build another treatment plant," known as the **Area 7 Wastewater Treatment Facility Project**…5.5 miles away from the **Area 3 Project**…Hartford informed Marathon by letter that it had not and would not bond the **Area 7 Change Order** and thereby extend the value of its bond from $2,061,000.00 to $5,045,487.00.

…Upon review of the plain language of the contracts, the Court finds that Hartford consented to changes, including "additions, deletions, or revisions in the Work," as well as "change affecting the general scope of the Work." The Court rejects, however, Marathon's proposition that Marathon had the unlimited, unilateral right to change the price and scope of the underlying contract.…Although Hartford consented to change orders through the change provisions of the underlying construction contract, if the nature and magnitude of the change order is far beyond what the parties anticipated when they entered into the contract, it may nevertheless qualify as a ***cardinal change*** to relieve Hartford of liability…turns on the extent to which the undisputed material facts indicate that the Area 7 Change Order was a significant enough deviation from the scope of the underlying construction contract to relieve Hartford of its liability under the performance bond.

The undisputed facts reveal that the Area 7 Change Order obligated Intrastate to build "another treatment plant," based on separate plans and specifications, 5.5 miles away. ***This was not a change order that merely extended or altered the specifications, timeline, or cost of the original treatment plant—this was a change order that ordered the building of a second treatment plant***…The Court finds the fact that the Area 3 Project and the Area 7 Project were both part of an expansive overhaul of the water treatment system in City of Marathon to be insufficient, standing alone, to prove that the addition of the Area 7 Project (or any of the other seven treatment areas) was contemplated at the time Marathon, Intrastate, and Hartford executed the construction and bond contracts for the Area 3 Project.…The Area 7 Change Order came at an **additional cost of $2,984,487.00—an increase of over 144 percent** of the original contract sum. Therefore, the Court finds that the undisputed facts show that the change "greatly exceed[ed] the original contract cost" so as to satisfy the third factor.

Miller Act

In *U.S. for the use of McAllister Construction Co., LLC v. Diversified Maintenance Systems Inc.*, 2011 WL 6112903 (N.D. Fla. December 8, 2011) a subcontractor on a federal project sued the Miller Act surety for the prime contractor, and the contractor intervened. The subcontract included an arbitration provision requiring that all disputes be settled by arbitration in Utah. The prime contractor demanded arbitration, but the subcontractor did not participate in the arbitration and claimed that it was invalid. The intervening prime contractor and surety moved for summary judgment. The subcontractor argued that by intervening in the Miller Act suit the prime contractor waived the right to have the dispute resolved by arbitration. The court noted that the petition to intervene cited the arbitration provision and sought to enforce it. The court rejected the subcontractor's waiver argument, granted the motions, and dismissed the case with prejudice.

In *U.S. for the use of Capital Computer Group, LLC v. The Gray Insurance Co.*, Case No. 10-15519 (11th Cir. December 21, 2011) the claimant alleged that it was an unpaid first tier subcontractor on a Miller Act project. The prime contractor had approached another contractor (Code 4 Systems, Inc.) about the work, but Code 4 could not qualify for financing. Code 4 and the claimant then arranged for the claimant to enter into the "subcontract" and sub-subcontract the work to Code 4. The claimant financed the work via a factoring arrangement. The work had been performed and the prime contractor had not paid for it, but the surety argued that the claimant was simply providing financing and thus was not within the coverage of the Miller Act payment bond. The Court looked to the subcontract, which obligated the claimant to perform the work including maintaining insurance for the prime contractor's benefit and indemnifying the prime contractor. The fact that the claimant "performed" by hiring Code 4 to do the actual work did not make it any less of a subcontractor. The Court looked to the written documents and concluded that the claimant was a subcontractor within the coverage of the bond. The Court affirmed summary judgment for the claimant.

Offer of Judgment

In *Southeast Floating Docks, Inc. v. Auto-Owners Insurance Co.*, 2012 WL 301029 (Fla. February 2, 2012) the Florida Supreme Court answered one of the three questions of Florida law certified by the U.S. Court of Appeals for the Eleventh Circuit at 632 F.3d 1195 (11th Cir. February 8, 2011). The surety settled with the obligee and sued the principal and an indemnitor. At the first trial, the jury thought that the surety settled in bad faith and returned a judgment for the defendants. The trial court granted a new trial. After the new trial was granted but more than 45 days before the scheduled date for the second trial, the principal made an offer of judgment of $300,000 conditioned on release of it and the individual indemnitor. The surety rejected the offer and recovered

over $1.1 million at the second trial. On appeal, the Eleventh Circuit reversed grant of the second trial and reinstated the first jury verdict for the defendants. The principal then claimed attorneys fees pursuant to the Florida offer of judgment statute and court rule because the surety recovered less than the offer. The trial court denied the principal's request and the principal appealed. The Eleventh Circuit certified three dispositive questions of Florida law to the Florida Supreme Court: (1) does the Florida statute allow offers of judgment before a second trial, and if so may they be deemed valid if the result of the first trial is reinstated; (2) did the condition of the offer on dismissal of claims against the individual indemnitor make the offer an invalid "joint offer;" and (3) does the Florida offer of judgment statute and regulation apply in a case in which a contractual agreement called for application of another state's law.

The Florida Supreme Court answered the third question. It found that the Florida offer of judgment statute was substantive, as opposed to procedural, and did not apply because the indemnity agreement provided that Michigan law would govern all disputes arising under the agreement. The Court did not reach the other two questions, which were rendered moot by the answer to the third, and remanded the case to the Eleventh Circuit.