

**TWELFTH ANNUAL
NORTHEAST SURETY AND FIDELITY CLAIMS
CONFERENCE
SEPTEMBER 20 - 21, 2001**

**THE SURETY'S RIGHT TO PERFORM WITHOUT
ACCELERATING TO MEET THE CONTRACT COMPLETION
DATE AND WITH THE COMPLETION TEAM OF ITS
CHOOSING:
*ST. PAUL v. CITY OF GREEN RIVER***

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by Scott D. Baron, Esq.

“The surety steps into the shoes of the contractor.” This familiar maxim, upon which the surety has relied for decades in adopting its principal’s defenses and enforcing its subrogation rights, can be a double-edged sword. Consider the following scenario: A bonded contract has a stipulated completion date together with a “time is of the essence” clause. The bonded contractor is terminated for default after falling substantially behind schedule. The obligee/owner demands performance from the surety, and the surety demands payment of the contract balance pursuant to its subrogation rights. The surety also reminds the obligee/owner that it “steps into the shoes” of the contractor entitling it to adopt all of the contractor’s defenses under the bonded contract, including the contractor’s assertion that the default was improper. The obligee/owner, attempting to make the surety eat its own words, retorts as follows: “Since the surety steps into the shoes of the contractor, I guess you’ll agree that the surety is obligated to meet the contractor’s stipulated completion date, even if that means accelerating performance in order to get the project back on schedule.” While this argument may have some intellectual appeal, it has been rejected in the important case of *St. Paul Fire & Marine Insurance Company v. City of Green River*, 93 F.Supp.2d 1170 (D. Wyo. 2000), *aff’d*, ___ F.3d ___, 2001 WL 369831 (10th Cir. 2001). In fact, the surety in *Green River* was held to have been completely discharged from liability where the obligee/owner refused to allow the surety to perform because it did not commit to accelerate performance to meet the original completion date. The decision also stands for the important rule that a surety which opts to take over and complete a bonded project may do so with a completion team of its choosing.

The Facts of *Green River*

_____The material facts of *Green River* were relatively straightforward and not in dispute. On February 10, 1997, Westates Construction Company (“Westates”) entered into a \$28.6 million contract with the State of Wyoming Joint Powers Water Board (the “Board”) for the construction of a water treatment plant in Green River, Wyoming (the “Project”). The contract provided for a completion date of December 1, 1998 and stated that “time is of the essence.” Prior to construction, St. Paul Fire & Marine Insurance Company (“St. Paul”), as surety, had issued a performance bond on behalf of Westates, as principal, and in favor of the Board, as obligee, securing Westates’ performance of the contract. The bond form was the standard A312 form of the American Institute of Architects (AIA), which provided that upon the principal’s default, the surety may elect one of the following options:

- 3.1 Arrange for the Contractor, with consent of the Owner, to perform and complete the Construction Contract; or
- 3.2 Undertake to perform and complete the Construction Contract itself, through its agents or through independent contractors; or

- 3.3 Obtain bids or negotiated proposals from qualified contractors acceptable to the Owner for a contract for performance and completion of the Construction Contract, arrange for a contract to be prepared for execution by the Owner and the Contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract, and pay to the Owner the amount of damages as described in paragraph 6 in excess of the Balance of the Contract Price incurred by the Owner resulting from the Contractor's default; or
- 3.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances:
 1. After investigation, determine the amount for which it may be liable to the Owner and, as soon as practicable after the amount is determined, tender payment therefor to the Owner; or
 2. Deny liability in whole or in part and notify the Owner citing the reasons thereof.

Construction commenced on March 3, 1997. After the Project fell substantially behind schedule, the causes of which were in dispute, the Board, on January 16, 1998, terminated Westates for default and made demand against St. Paul under the performance bond. On that date, the Board also commenced an action against Westates in Wyoming state court alleging breach of contract. The Board's termination notice provided that, in the event it was ultimately determined that the termination was unlawful, the Board's termination for default would be converted to a termination for convenience.

Following a one-month due diligence investigation, the parties met on February 25, 1998 to discuss their respective positions. At this meeting, St. Paul delivered a letter to the Board which stated as follows:

As a result of the Notice of Termination dated January 16, 1998, St. Paul Fire & Marine Insurance Company has undertaken a due diligence review and investigation of the Project. . . .

At my direction, the due diligence investigation is being performed by Jerry Hainline and Hainline & Associates. The investigation commenced on or about January 26, 1998 and remains on-going. . . .

I have been advised by Mr. Hainline that his preliminary determination is that the Owner did not have sufficient grounds to warrant termination of the Contractor.

. . .

Notwithstanding a determination of wrongful termination, St. Paul intends to exercise its election to proceed with completion of the contract pursuant to

Paragraph 4.2 of the Performance Bond. In accordance with Paragraph 4.2, the Surety intends to “undertake to perform and to complete the construction contract itself, through its agents or through independent contractors”

St. Paul intends to complete construction utilizing the services of Jerry Hainline and Hainline & Associates as its agent and such independent contractors as are selected by Mr. Hainline and Hainline & Associates

Thus, although St. Paul’s preliminary conclusion was that the termination was improper, it offered to perform under a reservation of rights. St. Paul also provided the Board with the resumes of the principal project managers upon whom St. Paul intended to rely in managing and scheduling the project under Hainline. In addition, St. Paul provided the Board with a list of personnel whom Hainline intended to manage in completing the Project, which included certain Westates employees.

Separate and apart from St. Paul’s offer to perform under Paragraph 4.2, and prior to the meeting on February 25, 1998, St. Paul, Westates, and the Board had discussed and negotiated a possible settlement among the parties whereby St. Paul would complete the Contract on an “accelerated” basis (*i.e.* by May 14, 1999). In accordance with those settlement negotiations, St. Paul presented a second letter to the Board on February 25, 1998 which provided as follows:

. . . St. Paul has been asked to approve a compromise proposal outlined in the term sheets attached hereto and incorporated by reference. I am advised that the term sheets resulted from negotiations between Jerry Hainline, on behalf of the surety, Martin Becker on behalf of Westates Construction Company and Clark Stith, on behalf of the Joint Powers Water Board.

Subject to approval of final compromise language, St. Paul is prepared to construct the project in accordance with the conditions outlined in the term sheets. The presentation that Mr. Hainline is going to make this evening is illustrative of how St. Paul intends to proceed, based upon the compromise.

The terms of this compromise were set forth in a “Term Sheet” drafted by Clark Stith, counsel for the Board, who advised St. Paul that he would recommend that the Board accept the terms of the settlement. As part of this settlement, in addition to the substantial extra costs that would have been incurred through accelerated performance, such as substantial overtime payments, St. Paul and Westates also would have agreed to (a) release the Board from all claims, including their claim that the Board’s termination of Westates was improper; (b) abandon all claims of Westates for extra compensation due under the Contract; (c) negotiate and settle all non-pass-through claims of subcontractors; and (d) not use any Westates personnel for any management functions in connection with completing the Contract. In return, the Board would have agreed to (a) rescind its notice of termination of Westates; (b) dismiss the state court action against Westates with prejudice; (c) relieve Forsgren, the Project

engineer, of its authority pertaining to construction management;¹ and (d) assign its claims against Forsgren and its subconsultants to St. Paul and Westates. This settlement ultimately fell through and, thus, no settlement was ever reached among the parties.

At the February 25, 1998 meeting, the Board asked St. Paul when it expected to complete the Project if the settlement proposal were not accepted and St. Paul completed pursuant to its 4.2 proposal. St. Paul representatives responded by indicating that the surety's scheduling expert had estimated that the Project would be completed on or about September 24, 1999, which was more than nine months after the original completion date of December 1, 1998. This estimated completion date had been calculated considering the status of construction, assuming mobilization and full resumption of construction activities by April 1, 1998, and proceeding at the pace of construction contemplated by the underlying Contract and initially approved baseline schedule. Thus, while this estimated completion schedule did not provide for *acceleration* of performance, it also did not contemplate any *further delay* to the Project schedule.

On February 28, 1998, the Board sent St. Paul a letter stating as follows:

During the special meeting of the Joint Powers Water Board on Wednesday, February 25, 1998, St. Paul representatives stated that St. Paul would complete the . . . Project no sooner than September 24, 1999, despite a contract completion date for the Project of December 1, 1998. Accordingly, the Joint Powers Water Board is justifiably insecure that St. Paul will complete the Project in a timely manner.

In addition, St. Paul representatives have made clear St. Paul's intention to utilize the personnel employed by . . . Westates to complete the Project, the initial contractor for the Project, even though the Joint Powers Water Board does not consent to Westates or its personnel completing the Project. St. Paul's announced intention to use Westates to finish the Project without the consent of the Joint Powers Water Board is an anticipatory breach of the requirements of Section 4.1 of the Performance Bond.

Accordingly, please be advised that the Joint Powers Water Board refuses to allow St. Paul to complete the Green River water treatment plant Project under Section 4.2 of the Performance Bond.

On March 4, 1998, St. Paul responded to the Board's February 28, 1998 letter, stating as follows:

You have not only terminated the principal, but you have terminated the surety as well. This action has been taken before the surety has had any opportunity to complete pursuant to paragraph 4.2 of the performance bond. As this is an

¹ According to Hainline, Forsgren was the primary reason for the Project delays due to numerous unresolved defects in the plans and specifications and due to the inherent conflict in Forsgren having both design and construction management responsibilities. Hainline thus concluded that replacement of Forsgren as construction manager was essential if the Project was to be completed by the accelerated date of May 14, 1999.

extraordinary Board action, please advise immediately if my understanding of the Board's action is incorrect.

* * *

As was clearly stated to the Board, it was St. Paul's intention to complete the construction Project itself utilizing as its agent and/or independent contractor, Jerry Hainline and Hainline & Associates. Under 4.2, St. Paul intended to proceed to complete the Project with all due diligence. This does not obligate St. Paul to complete on or before the originally intended contract completion date. The terms and conditions of the construction contract provide for liquidated damages for late completion in the amount of \$2,500 per day. While St. Paul disagrees that these damages would be due, they certainly provide an adequate remedy at law and the owner selected the contractual remedy for late completion.

...

Under no circumstances has St. Paul proposed that Westates complete the construction contract. The Board was specifically advised that St. Paul intended to complete the construction contract pursuant to paragraph 4.2 of the bond "through its own agents or through independent contractors." Paragraphs 4.1 and 4.3 of the performance bond require the owner's consent. Paragraph 4.2 does not

_____ ...

St. Paul stands ready, willing and able to perform. The Board's refusal to allow St. Paul to proceed under paragraph 4.2 of the performance bond is a material breach by the Board of its obligations pursuant to the terms and conditions of the performance bond.

Notwithstanding St. Paul's offer to perform under Paragraph 4.2 and its reiteration that it stood "ready, willing and able to perform," on March 20, 1998, the Board's counsel confirmed that the Board had terminated St. Paul's right to perform and that it had retained another contractor to complete the Project.

Thereafter, St. Paul brought an action seeking a declaratory judgment that the Board's refusal to permit St. Paul to complete the Project constituted a material breach of the performance bond, thus discharging St. Paul from further obligation under the Bond. The Board filed a counterclaim alleging anticipatory breach of contract and seeking its excess completion costs which had totaled over \$10 million. The Board also filed a counterclaim alleging bad faith on the part of St. Paul. The parties thereafter filed cross-motions for summary judgment.

The District Court's Decision

The district court granted St. Paul's motion for summary judgment and ruled that it was discharged from liability under the Bond. The district court first addressed whether St. Paul

had committed an anticipatory breach when it announced that it would not meet the contract's initial completion date of December 1, 1998. The district court began its analysis by reciting the standard for anticipatory breach under Wyoming law, which is when a party to a contract "clearly and unequivocally announces its intention to refuse performance in the future." *J.B. Service Court v. Wharton*, 632 P.2d 943, 945 (Wyo. 1981). The court then indicated that whether St. Paul committed an anticipatory breach was a question of law for the court to decide. Based on the above standard, the court noted that St. Paul's announcement that it would not meet the December 1, 1998 completion date could not be an anticipatory breach unless St. Paul had an absolute duty to complete by December 1, 1998.

The court agreed with the Board that, as a general rule, a surety's liability is coextensive with that of its principal and, therefore, that St. Paul was bound by the "time is of the essence" clause in the contract. However, the court noted that both the contract and the Bond provided for liquidated damages in the event of late completion. Thus, the court reasoned that both the contract and the Bond expressly provided the remedy for delayed performance, and that remedy was liquidated damages, not accelerated completion and the substantial costs associated therewith. The court noted that the surety would have breached the bond if it failed or refused to pay liquidated damages. The court observed, however, that it is a "far leap" from this conclusion to reach the Board's position that St. Paul would be in breach if it did not complete the Project by the original completion date. To the contrary, the court found that Paragraph 5 of the Bond unambiguously set forth the surety's required pace of performance by stating as follows:

If the Surety does not proceed as provided in Paragraph 4 with reasonable promptness, the Surety shall be deemed in default on the Bond fifteen days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform its obligations under the Bond.

The court thus concluded that the surety's obligation was not to accelerate the work to make up for all lost time but, rather, to proceed "with reasonable promptness" and pay liquidated damages for delays attributed to Westates. The court concluded, therefore, that the Board had no basis to declare a material breach and terminate the surety.

The court further reasoned that a construction project is typically already in trouble and behind schedule by the time the surety's duty to perform is triggered. Under the circumstances, the court reasoned that "the Board's interpretation imposing an absolute duty of timely delivery would impermissibly require St. Paul to be 'superhuman.'" *Green River*, 93 F.Supp.2d at 1175.

Finally, the court reasoned that, even assuming St. Paul had an absolute duty to complete the Project by the original completion date, St. Paul's actions did not manifest the type of unequivocal renunciation necessary to constitute an anticipatory breach. In this regard, the court noted that St. Paul never renounced its intention to perform but, to the contrary, clearly indicated its intention to perform, albeit with an expected completion date which was beyond the original date.

The court next addressed whether St. Paul's announced intention to utilize Westates employees constituted an anticipatory breach. As the court noted, if St. Paul was within its rights to use Westates personnel, its announced plan to do so could not be an anticipatory breach. In this regard, the court distinguished Paragraph 4.1 of the Bond, which allows the surety to arrange for the principal to complete the project with the Owner's consent, from Paragraph 4.2 of the Bond, which allows the surety to complete the Project itself with its own agents, and has no requirement of Owner consent. As St. Paul elected to perform under Paragraph 4.2, the court rejected the Board's argument that the Bond prohibited St. Paul from using Westates' personnel without the Board's consent. The Court found that the Board's interpretation was "contrary to the unambiguous language of the performance bond, defie[d] common sense, and [was] unreasonable in light of industry practices." *Id.* at 1177.

The court observed that Paragraph 4.2, the option which St. Paul chose, has no limitations on whom the surety could utilize to complete the Project. The court found that by offering to perform under Paragraph 4.2, "St. Paul assumed primary responsibility to complete the project, and with that responsibility came the freedom to assemble the project team of its choosing." *Id.* The court went on to reason that the requirement of Owner consent in Paragraph 4.1 makes sense, in that it contemplates the Owner hiring the same contractor it had just defaulted. By contrast, under Paragraph 4.2, it is the surety with whom the Owner would have contractual privity and the party that would be directly responsible to finish the job. The court also noted that the performance options in the bond are standard in the industry, and that it is common practice for a completing surety to hire employees of the principal under the direction of a consultant. The court recognized that it would defy logic not to use any personnel familiar with the Project, and would likely only increase the cost of completion.

Having found that the surety satisfied its bond obligations, the court then addressed the ramifications of the Board's failure to allow St. Paul to perform and its hiring of another contractor to complete the Project. The court ruled that St. Paul was fully discharged from any and all liability under the bond, reasoning that "[t]he effect of the Board's termination of St. Paul was to divest St. Paul of its ability to minimize its liability by selecting the lowest cost option and by directing the construction or participating in the contractor selection process." *Id.* at 1178. The court further held that "an obligee's action that deprives a surety of its ability to protect itself pursuant to performance options granted under a performance bond constitutes a material breach, which renders the bond null and void." *Id.*

Having found that St. Paul had not committed an anticipatory breach and was discharged from liability, the district court dismissed all of the Board's counterclaims with prejudice, including its claims of bad faith.

The Tenth Circuit's Decision

_____ The Board filed an appeal with the United States Court of Appeals for the Tenth Circuit. After briefing and oral argument, the Tenth Circuit, on April 13, 2001, issued a two-page non-published decision affirming the district court's decision "substantially for the reasons stated by the district court." See *St. Paul Fire & Marine Insurance Company v. City of Green River, Wyoming*, 2001 WL 369831, ___ F.3d ___ (10th Cir. 2001), at *1.

The Tenth Circuit reasoned as follows:

We agree with the District Court's construction of the performance bond. There is no question that while the surety essentially steps into the shoes of the contractor upon the latter's default, it does not follow in this situation with this performance bond (an industry standard agreement) that the surety is bound by the original completion date, noting that while the Board would continue to be entitled to \$2,500 per day liquidated damages for lateness, the surety under the bond need only proceed with "reasonable promptness." *Id.*

The Tenth Circuit further reasoned that the Board's interpretation of the Bond that St. Paul was required to meet the December 1, 1998 completion date was wholly unreasonable. The court noted that had Westates defaulted one day before the original completion date, then surely the Board could not argue that the surety would be bound by the initial completion date.

Finally, with regard to the May 14, 1999 completion date offered by St. Paul as part of the compromise, the Tenth Circuit observed that this would have occasioned much greater expense and, therefore, it was not unreasonable for the surety to seek additional compensation for such accelerated performance beyond the "reasonable promptness" standard specified.

Reflections on *Green River*

_____The *Green River* decision should provide sureties with substantial comfort in knowing that, upon a contractor default, it has the right to discharge its obligations in the manner it sees fit. To the extent the obligee/owner interferes with that right, the surety will be discharged from liability. The decision confirms that it is the surety's decision, not the obligee's, to determine the method and manner in which to proceed upon a bonded contractor's default.

While the *Green River* decision is an excellent one for sureties, it is not without limitations. First, the court relied upon the specific language of the AIA A312 performance bond. This is an excellent bond form for sureties with respect to the issues in dispute in the *Green River* case because it spells out the surety's options and provides the pace of performance to which the surety is obligated (*i.e.* "with reasonable promptness"). A bond form which is silent on the required pace of performance and contains no specified remedy of liquidated damages for delayed performance by the principal might make it more difficult for the surety to argue that it should not be held to the original completion date.

Second, the bonded contract in *Green River* did not include an acceleration clause. A bond which incorporates a contract requiring the contractor to accelerate performance when it falls behind schedule arguably might require the surety to similarly accelerate in the event of a default. Even then, however, any obligation to finish the job by the original completion date must be subject to the limits of impossibility or economic waste.

Finally, the *Green River* decision certainly does not stand for the proposition that a surety cannot be terminated once it takes over to complete the bonded project. If the surety in *Green River* was not proceeding with reasonable promptness or otherwise was not complying with the terms of the bonded contract, it certainly could have been terminated for

its own breach. For example, in *State of Florida, Dep't of Insurance v. United States*, 81 F.3d 1093 (Fed. Cir. 1996), upon which the Board had relied, the owner terminated the completing surety "after months of [the surety's] inactivity" and where "all of [the surety's] efforts between October 1988 and May 1989 advanced the project by no more than 10 percent." 81 F.3d at 1097. Furthermore, the surety in that case had advised the owner "that it had no obligation to keep [the owner] informed of its progress and that there would probably be further slippage in the completion date for the project." *Id.* Under the circumstances the court found that the owner was "justifiably insecure" and therefore that its termination of the surety was not improper.

Notwithstanding the foregoing, any time the bonded contract has a liquidated damages clause and no acceleration clause, the surety should still be entitled to rely upon that clause as the measure of damages in the event of late completion. In such case, the risk associated with delayed performance that the surety assumed when it underwrote its bond was liquidated damages, not the substantial cost of acceleration. After all, if the owner had wished to provide the contractor and surety with an incentive to accelerate to make up for all lost time, then it could have provided that liquidated damages would be in an amount which would provide that incentive.