ARMED SERVICES BOARD OF CONTRACT APPEALS

Appeal of --	)	
	)	
Security Insurance Company of Hartford	)	ASBCA No. 51759
	)	
Under Contract No. N68378-94-C-5830	)	

APPEARANCE FOR THE APPELLANT: James D. Curran, Esq.
Wolkin & Timpane, LLP
San Francisco, CA

APPEARANCES FOR THE GOVERNMENT: Arthur H. Hildebrandt, Esq.
Navy Chief Trial Attorney
Stephen R. O'Neil, Esq.
Assistant Director
Navy Litigation Office

OPINION BY ADMINISTRATIVE JUDGE JAMES
ON RESPONDENT'S MOTION TO DISMISS
FOR LACK OF JURISDICTION

Respondent moves to dismiss for lack of jurisdiction appellant's claim that allegedly arose prior to the execution of a takeover agreement between the Government and appellant, the original contractor's surety. Alternatively, respondent argues that appellant elected to sue at the Court of Federal Claims (COFC) under the doctrine of equitable subrogation before appealing to the ASBCA, thereby barring our jurisdiction. Appellant argues that it has standing to appeal pursuant to the Contract Disputes Act of 1978 (CDA), 41 U.S.C. § 607, and that its ASBCA claim is separate and distinct from the COFC claims.

STATEMENT OF FACTS (SOF) FOR PURPOSES OF THE MOTION

1. In December 1992, the Navy awarded Martech USA, Inc. ("Martech") Contract No. N68378-93-C-8677 (contract 8677) for construction of privacy fencing and garbage enclosures for Capehart Housing Units at Novato, California, for the firm-fixed price of $1,969,345 (R4, tab 1).

2. Security Insurance Company of Hartford (Security) provided performance and payment bonds, executed on 30 December 1992, for contract 8677 in the respective amounts of $1,969,345 and $787,738 (Gov't Attach. B). Contract 8677 was modified by

change orders which increased the contract price to $2,116,109. There is no evidence that the amounts of the original performance or payment bonds were altered. (R4, tabs 3, 6)

3. Contract 8677 provided in pertinent part:

> 1.12.1 Payment for Materials Offsite
>
> . . . payments may be made to the contractor for materials stored off construction sites. However, the following conditions must be met:
>
> a. The conditions described in the paragraph entitled "Payments to the Contractor."
>
> b. The material must be within a distance of 50 miles by streets and road of the county of the construction site.
>
> c. The materials shall be adequately insured and protected from theft and exposure.
>
> d. The materials shall not be susceptible to deterioration or physical damage in storage or in transit to the jobsite. Payments will not be made for materials in transit to the jobsite or storage site.
>
> 1.12.2 Obligation of Government Payments
>
> The obligation of the Government to make any of the payments required under any of the provisions of this contract shall, in the discretion of the Officer in Charge of Construction, be subject to:
>
> a. reasonable deductions on account of defects in material or workmanship; and
>
> b. any claims which the Government may have against the contractor under or in connection with this contract. Any overpayments to the Contractor shall, unless otherwise adjusted, be repaid to the Government upon demand.

(R4, tab 1)

4. Respondent paid in full Martech's first invoice, dated 28 February 1993 in the amount of $39,387, on 16 April 1993, and its second invoice, dated 30 July 1993, in the amount of $549,521, on 1 September 1993 (R4, tabs 12, 19).

5. Martech commenced site work on contract 8677 on about 13 August 1993. On 22 September 1993 respondent paid Martech's third invoice, dated 31 August 1993, in the amount of $841,547, except for a 10% retention of $84,155, and on 2 November 1993 paid Martech's fourth invoice, dated 4 October 1993, in the amount of $55,366, except for a 10% retention of $5,537, because the work was behind schedule. (R4, tabs 13, 19; complaint, ¶ 12)

6. A letter dated 14 December 1993 of Channel Lumber Company (Channel), Martech's lumber supplier, informed respondent that Martech's payment to Channel of $474,695 for supplies previously delivered was several weeks overdue (R4, tab 15).

7. On 23 December 1993, Martech filed a petition in bankruptcy under Chapter 11 in the United States Bankruptcy Court for the District of Alaska. On 24 February 1994, the Bankruptcy Court granted Martech's motion to reject contract 8677. (Comp. ¶ 13) On 3 March 1994, the contracting officer terminated contract 8677 for default (R4, tab 20). At the time of default, 64% of the contract period had elapsed, 17% of the work was complete (R4, tab 16), and 65.98% of the contract price had been paid.

8. On 15 September 1994, the Government and Security entered into a takeover agreement, identified by the parties as Contract No. N68378-94-C-5830, with respect to contract 8677. Martech was not a signatory or party to the takeover agreement. The takeover agreement did not mention assignment of any Martech claim to Security. The takeover agreement provided in pertinent part:

> NOW THEREFORE, in consideration of their mutual promises, the parties agree as follows:
>
> 1. The surety will perform or procure the performance of all the work and other obligations of the defaulted Contract not presently completed or fulfilled, including the correction and repair of all defective workmanship. The provisions and clauses of the defaulted Contract, and the plans and specifications, are incorporated into this Agreement.
>
> 2. The Government and the Surety agree that $719,980.00 is the unpaid contract balance, including retainages. The Surety shall be paid in accordance with

> and in the manner provided by the defaulted Contract, subject to the following conditions: . . .
>
> b. Any unpaid amounts earned by the defaulted Contractor, including retained percentages and progress estimates for work accomplished prior to termination, shall be subject to claims by the Government against the defaulted Contractor under the defaulted Contract except to the extent that such unpaid earnings may be required to permit payment to the Surety of its actual costs and expenses incurred in the completion of the work exclusive of its payments and obligations under the payment bonds under the Contract.
>
> . . . .
>
> 9. The Surety and the Government reserve any and all rights each may have with respect to the assertion of or defense to any claims and/or requests for equitable adjustment, whether such claims and/or requests arise under the original Contract, this Takeover Agreement, the completion contract of the Surety's performance bond, and whether such claims or requests have been asserted to date or not.

(R4, tab 25)

9. Security hired Summit Builders to complete the project for an agreed price of $1,381,000. The project completion date was set for 1 March 1995. (R4, tab 25)

10. On 1 February 1995, Security and other sureties sued the United States in the COFC, in a suit designated No. 95-74 C, with respect to various Government contracts with Martech, including contract 8677. Security alleged its "priority right of equitable subrogation to recover the contract balances existing under each bonded Government contract" (¶ 5); as payment and performance bond surety of Martech, Security had "executed Takeover . . . Agreements with the Government" (¶ 10); and as a result of satisfying its bond obligations under contract 8677, Security "has suffered substantial bond losses and is equitably subrogated to the rights of the Government, Martech, and Martech's subcontractors and suppliers to recover its bond losses" (¶ 12). The complaint also alleged in ¶ 32:

> In addition, certain claims for equitable adjustment or the recovery of contract funds exist under the contracts identified

> herein. To the extent [Martech] or the Sureties recover any affirmative claims against the Government related to the contracts identified herein, or the Government issues any change orders or equitable adjustments to the contracts, the Sureties have a priority right to recover such funds.

The complaint also alleged in ¶ 33 that –

> the Sureties have made demand upon the Government for the payment of the contract balances existing under Martech's contracts with the Government for which the Government has failed and refused to issue payment.

The sureties did not allege that such "demand" sought a contracting officer's (CO) final decision on a CDA claim. The record shows no CO's final decision prior to the COFC suit No. 95-74 C. The sureties alleged Tucker Act jurisdiction of their COFC suit, citing 28 U.S.C. § 1491(a)(1). The plaintiffs prayed for judgment "in the amount to be determined at trial, plus interest, costs and attorney fees." (Gov't Rebuttal, Attach. A)

11. In discovery in COFC No. 95-74 C, the sureties requested the Government to identify all reviews, investigations, analyses, inspections and quality assurance measures it made prior to issuing payment to Martech, and all facts upon which it relied in rejecting any equitable adjustment claim, under contract 8677 (Gov't Attach. C at 167, 169).

12. Sometime in late June or early July 1995, the work under the takeover agreement was completed and accepted by respondent (R4, tabs 26, 31).

13. Security's 31 October 1995 letter to respondent submitted an "amended certified claim," with a certification dated 28 November 1995. (The discrepancy between these dates is not explained in the record.) Security alleged that as the takeover contractor and as a third party beneficiary to the payment provisions of contract 8677, it was entitled to "payment of the sums improperly disbursed to Martech in violation of the Contract terms and conditions." Security alleged that respondent made wrongful payments to Martech for off-site lumber because respondent did not: (1) properly inspect, approve or accept, (2) pay the proper amount, (3) verify Martech's title to the materials, and (4) confirm proper storage of the materials. Security requested $997,445 for such improper payments and $8,066.50 for costs for preparing the submission, for a total of $1,005,511.50. It alleged further that as a result of the foregoing, it might be deemed to be released *pro tanto* from its bond obligations to the Government. Security's claim also alleged a breach of the takeover agreement itself on the basis of those prior payments to Martech. (R4, tab 29)

14. The CO's 22 June 1998 decision denied Security's claim in its entirety (R4, tab 33).

15. On 30 July 1998, the COFC issued an "Order Directing Entry of Judgment" on Case No. 95-74 C which stated:

> This order addresses plaintiffs' motion filed July 24, 1998 to dismiss this civil action in its entirety without prejudice. Government counsel has advised that no response to said motion will be filed.
>
> Plaintiffs' motion is GRANTED. Accordingly, it is ORDERED that judgment shall be entered dismissing this case WITHOUT PREJUDICE. Each party shall bear its own costs.

(Gov't Rebuttal, Attach. D)

16. On 18 September 1998 Security timely appealed to the Board from the CO's 22 June 1998 decision.

17. Security's 31 October 1995 claim did not state that it had advised the CO of any overpayment or impropriety in progress payments 1-4 to Martech before those payments were made on 16 April, 1 September, 22 September and 2 November 1993, respectively (see SOFs 4-5), but stated: "Relief is appropriate even in the absence of the Surety's notice to the Government to protect the Surety's interest" (R4, tab 29 at 10). Security's 25 January 1999 complaint in ASBCA No. 51759 did not allege it notified the CO of any improprieties before respondent paid progress payments 1-4 to Martech. Security's complaint alleged that respondent's payments to Martech for off-site lumber violated the terms of contract 8677 "and the takeover agreement." Security's attorney's 16 June 1994 letter (which is not in the appeal record) apparently first advised the CO of an alleged Government "overpayment" for off-site lumber in progress payments to Martech (R4, tab 23). We assume, therefore, for purposes of this decision, that Security did not give notice of its principal's default prior to the payments.

Parties' Contentions

Movant argues that Security: (1) does not qualify as a "contractor" under the CDA because Security's claim is based on respondent's alleged violation of the payment terms of the defaulted contract, rather than on the takeover agreement to which it was a party; and (2) elected to pursue this claim at the COFC, thereby barring it from bringing the claim at the ASBCA.

Appellant argues that it has standing to prosecute this claim under the terms of its takeover agreement because the Government's failure to ensure that payments for materials made to Martech conformed with the defaulted contract terms was a breach of the takeover contract, and so improper payments to Martech are due to Security under the takeover contract. As to the movant's second ground, Security argues that its ASBCA claim for the allegedly improper materials payment is separate and distinct from the claims it brought in the COFC.

DECISION

The burden of establishing the Board's jurisdiction is on the appellant. *See McNutt v. General Motors Acceptance Corp.*, 298 U.S. 178, 189 (1936).

This motion presents two issues: (1) Does Security have standing to pursue this appeal at the ASBCA? (2) Was the surety's appeal of the denial of its 31 October 1995 claim precluded by the "election of forum" doctrine?

I.

Security based its claim for wrongful payment for off-site lumber -- and hence its standing to appeal to the Board -- on four grounds. (1) It was entitled to recover for Government violations of the payments provisions of contract 8677 as a third party beneficiary thereof, citing *National Surety Corp. v. United States*, 31 Fed. Cl. 565 (1994). (2) It was entitled to an equitable adjustment of its takeover agreement because of such Government payments to Martech for off-site lumber in alleged violation of contract 8677, whose terms were incorporated into the takeover agreement, citing *Travelers Indemnity Co. v. United States*, 16 Cl. Ct. 142 (1988). (3) It was entitled to damages resulting from alleged violations of contract 8677 which resulted in a *pro tanto* release or discharge of its performance bond obligations to the Government, citing *Fireman's Fund Ins. Co. v. United States*, 909 F.2d 495 (Fed. Cir. 1990). (4) It was entitled to damages for breach of the takeover agreement.

A. Security's first ground, the "third party beneficiary" premise for recovery by a surety, was rejected in *National Surety Corp. v. United States*, 118 F.3d 1542, 1544-45 (Fed. Cir. 1997), which said:

> The view that the surety is a third party beneficiary of the contract whose performance it assures is not the usual premise of surety claims against an obligee . . . .
>
> . . . .
>
> The surety's rights and obligations are not based on third-party beneficiary concepts, but on principles of suretyship law.

Accordingly, we find no basis in third party beneficiary concepts for standing of Security to bring this claim to the ASBCA.

B. Security's second ground, violation of contract 8677's payment terms, which were incorporated by reference into the takeover agreement, is supported by *Travelers Indemnity*. The Claims Court's derivation of "a tripartite agreement" concept as the basis for its holding (16 Cl. Ct. at 152) was the statement in *Balboa Ins. Co. v. United States*, 775 F.2d 1158, 1160 (Fed. Cir. 1985): "a surety, as bondholder, is as much a party to a Government contract as the contractor." Such statement was disparaged as *dicta* in *Admiralty Const., Inc. by National American Ins. v. Dalton*, 156 F.3d 1217, 1221 (Fed. Cir. 1998), which stated:

> In *Ransom v. United States*, 900 F.2d 242 (Fed. Cir. 1990), this court explained:
>
> > *Balboa* did not hold a surety has contractual rights against the government . . . . [Rather] this court merely held that the government becomes a "stakeholder" for remaining contract proceeds when a payment and performance bond surety notifies the government that the surety's interest is in jeopardy because of default by the contractor.
>
> *Id*. at 245. In other words, this court clarified that the *Balboa* dicta addresses [sic] the surety's "stakeholder" status under equitable subrogation principles, not its contractor status under the CDA.

The Claims Court did not cite any other Federal Circuit decision or other persuasive precedent in holding in *Travelers* that an alleged Government violation prior to default of the terms of the defaulted contract, that are incorporated in a surety's takeover agreement,

provides standing for the surety to appeal a CDA claim to a Board of Contract Appeals or to the COFC. *Cf. Fireman's Fund Ins. Co.*, ASBCA No. 50657, 00-1 BCA ¶ 30,802 at 152,070, *recon. den.*, 00-1 BCA ¶ 30,905, on appeal *sub nom. Fireman's Fund Ins. Co. v. Danzig*, CAFC No. 00-1420 (without defaulted contractor's assignment or novation of pre-takeover claims, surety lacks standing to prosecute pre-takeover CDA claims for affirmative relief, because there is no privity of contract). We need not, however, decide this incorporation by reference issue in light of the third ground for standing.

C. Security's third ground, *pro tanto* release or discharge of its performance bond obligations, finds support in *National Surety Corp.*, *supra*, which stated that:

> any material change in the bonded contract, that increases the surety's risk or obligation without the surety's consent . . . [entitles the surety] to relief against the obligee based on impairment of suretyship status. *See* Restatement (Third) of Suretyship & Guaranty § 37 (1996). Extensive precedent illustrates the discharge or pro tanto deduction of the surety's obligation . . . .

118 F.3d at 1544. *National Surety* held that the Government's failure to withhold the ten percent retainage despite the defaulted contractor's failure to provide a required "project arrow diagram," was a material departure from the contract terms which *pro tanto* discharged the surety, and the surety had no duty to notify the Government that the original contractor had defaulted. 118 F.3d at 1547.

The Federal Circuit did not discuss the jurisdictional basis for National's lawsuit. However, the lower court decision under review – 31 Fed. Cl. 565, 569 (1994) – stated that the appeal was taken from a deemed denial of the contractor's "properly certified claim" pursuant to 41 U.S.C. § 605(c)(5). At an earlier procedural juncture, the contractor alleged COFC jurisdiction under the CDA, 41 U.S.C. §§ 601 *et seq.* 20 Cl. Ct. 407, 409 (1990).

For the purposes of this motion, we construe Security's claim of improper progress payments for off-site lumber as an allegation of a material departure from the terms of contract 8677. Accordingly, we hold that Security has standing to bring this ASBCA appeal on the ground of *pro tanto* discharge.

D. Security's fourth ground, breach of the takeover agreement, is not an added basis to find CDA standing to adjudicate this appeal, since, based upon the present record, all the operative, causal facts with respect to liability for off-site lumber payments appear to have occurred before the execution of Security's takeover agreement. *Cf. Insurance Co. of the West*, ASBCA No. 35253, 88-3 BCA ¶ 21,056 at 106,347.

II.

Respondent argues that Security's ASBCA claim is precluded because it first filed suit in the COFC in February 1995 on the same claim. Once a contractor knowingly elects under the CDA to appeal a CO's adverse decision to an appeals board or to the COFC, and that forum has jurisdiction over the proceeding, the contractor cannot pursue that same claim in the alternate forum. *See National Neighbors, Inc.*, 839 F.2d 1539, 1542 (Fed. Cir. 1988) (election to appeal to HUD BCA would be non-binding if the Board did not have jurisdiction); *Tuttle/White Constructors, Inc. v. United States*, 656 F.2d 644, 647, 228 Ct. Cl. 354, 358 (1981) (binding election to appeal to ASBCA); *Omaha Tank & Equipment Co.*, ASBCA Nos. 36235, 37905, 89-1 BCA ¶ 21,404 at 107,891 (binding election to sue in Claims Court); *Admiralty Const., Inc. by National American Ins. v. Dalton*, 156 F.3d 1217, 1221 (Fed. Cir. 1998) (*Tuttle/White* forbade "simultaneous identical claims").

Respondent has failed to establish the elements of a binding election of forum. There was no CO's final decision prior to COFC suit No. 95-74 C. The complaint in COFC No. 95-74 C, ¶ 33, alleged that –

> the Sureties have made demand upon the Government for the payment of the contract balances existing under Martech's contracts with the Government for which the Government has failed and refused to issue payment.

The sureties did not allege that such "demand" sought a CO's final decision on a CDA claim. The sureties alleged Tucker Act jurisdiction of their COFC suit under 28 U.S.C. § 1491(a)(1). (SOF ¶ 10) Thus, the record does not establish that the COFC suit was based on a CO's final decision or deemed denial of a CDA claim under 28 U.S.C. § 1491(a)(2). Furthermore, the record does not establish that the February 1995 COFC demand for payment of contract 8677's balance was identical to the October 1995 ASBCA claim of allegedly improper progress payments to Martech for off-site

lumber. Therefore, movant's argument that Security elected to pursue the allegedly improper off-site lumber payment claim at the COFC is unsound. We hold that the doctrine of election of forum does not bar Security from taking this appeal to the ASBCA.

We deny the motion to dismiss.

Dated: 11 July 2000

DAVID W. JAMES, JR.
Administrative Judge
Armed Services Board
of Contract Appeals

I concur

MARK N. STEMPLER
Administrative Judge
Acting Chairman
Armed Services Board
of Contract Appeals

I concur

EUNICE W. THOMAS
Administrative Judge
Acting Vice Chairman
Armed Services Board
of Contract Appeals

I certify that the foregoing is a true copy of the Opinion and Decision of the Armed Services Board of Contract Appeals in ASBCA No. 51759, Appeal of Security Insurance Company of Hartford, rendered in conformance with the Board's Charter.

Dated:

EDWARD S. ADAMKEWICZ
Recorder, Armed Services
Board of Contract Appeals