ARMED SERVICES BOARD OF CONTRACT APPEALS

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

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

APPEARANCES FOR THE GOVERNMENT: Fred A. Phelps, Esq.
Navy Chief Trial Attorney
Stephen R. O'Neil, Esq.
Assistant Director
Anthony K. Hicks, Esq.
Trial Attorney

OPINION BY ADMINISTRATIVE JUDGE JAMES
ON RESPONDENT'S MOTION FOR PARTIAL SUMMARY JUDGMENT

On 11 July 2000, we held that appellant had standing to bring this appeal on the grounds of *pro tanto* discharge. 00-2 BCA ¶ 31,021. On 3 May 2001, respondent moved for summary judgment. Movant contends that *Insurance Co. of the West v. United States*, 243 F.3d 1367 (Fed. Cir. 2001), and *Department of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 142 L. Ed. 2d 718 (1999), require that in the instant appeal, appellant, the surety, must show that respondent made certain progress payments after the surety provided respondent notice of default on the bonds, but appellant provided such notice of default after the progress payments had been made, and respondent had no other notice of the original contractor's default prior to making such progress payments. Movant concludes that the surety cannot prevail in this appeal. Movant submitted 20 proposed findings of undisputed facts, and a supporting declaration by the Resident Engineer in Charge of Construction F. Wayne Coffer.

Appellant submitted a 31 May 2001 opposition to the motion. Appellant does not dispute any of movant's proposed findings of undisputed fact. Appellant contends that movant's legal authorities address equitable subrogation, not *pro tanto* discharge, and prior notice by the surety to the Government of the contractor's default is not required for *pro tanto* discharge.

STATEMENT OF UNDISPUTED MATERIAL FACTS

1. On 28 December, 1992 respondent awarded contract No. N68378-93-C-8677 (the 8677 contract) to Martech USA, Inc. (Martech) (R4, tab 1[*]; am. comp. ¶ 4).

2. On or about 30 December 1992, appellant (the surety) executed performance and payment bonds on the 8677 contract (R4, tab 3; am. comp. ¶ 5).

3. On or about 12 August 1993, respondent signed Martech's invoice 2, certifying thereby that it was correct and proper for payment in the amount of $549,521 (R4, tab 28).

4. On or about 1 September 1993, respondent made a progress payment to Martech on the 8677 contract in the amount of $550,121.90 ($549,521 plus $600.90 in interest) (R4, tab 31; am. comp. ¶ 9).

5. On or about 13 September 1993, respondent signed Martech's invoice 3, certifying thereby that it was correct and proper for payment in the amount of $757,392 (R4, tab 30).

6. On or about 22 September 1993, respondent made a progress payment to Martech for invoice 3 in the amount of $757,392 (R4, tab 36; am. comp. ¶ 10).

7. On or about 13 December 1993, Martech's lumber supplier (Channel Lumber) informed respondent for the first time that Martech had not paid it $475,000 for lumber utilized or to be utilized on the 8677 contract (R4, tab 41; Coffer decl. ¶ 6).

8. Prior to 13 December 1993 respondent had not been informed that Martech had not paid Channel Lumber or any other party involved with the 8677 contract (Coffer decl. ¶ 7).

9. Prior to 13 December 1993 respondent had not been informed that Martech had abandoned or was going to abandon performance on the 8677 contract (Coffer decl. ¶ 8).

10. On or about 16 December 1993, the surety's "claims agent" (Viceroy Management, Inc.) wrote to respondent stating:

> Our client has received information that there are numerous claims against said bonds as a result of the failure of Martech . . . to pay suppliers and sub-contractors pursuant to the prompt payment requirements under the Federal Acquisition Regulations (FAR), which we are currently investigating . . . .

[*] All citations to the Rule 4 file refer to respondent's revised Rule 4 file submitted on 31 October 2000, which replaced the original Rule 4 file.

> Based upon the foregoing, our client demands that your department refrain from disbursing any further funds to Martech, whether or not they have already been approved for payment, including progress payments, retainage or any other monies that may be due for work performed under the subject bonds until you are notified by Surety in writing to the contrary.

(R4, tab 46; Coffer decl. ¶ 10)

11. Prior to receipt of the 16 December 1993 letter, neither the surety nor any other party had notified respondent that it should stop disbursing contract funds to Martech (Coffer decl. ¶ 11).

12. After receipt of the 13 December 1993 notice from Channel Lumber, respondent did not disburse contract funds to Martech (Coffer decl. ¶ 9).

13. The surety's "Amended Contract Disputes Act Claim" states: "[r]elief is appropriate even in the absence of the Surety's notice to the Government to protect the Surety's interest" (R4, tab 113 at 10).

14. On 25 January 1999, the surety filed its amended complaint alleging that respondent's progress payments 2 and 3 to Martech violated the contract's terms (am. comp. ¶ 20).

15. The surety does not allege in its amended complaint that, prior to receipt of the 16 December 1993 letter, the surety notified respondent that it should cease disbursing contract funds to Martech, or that respondent knew at the time it paid invoices 2 and 3 that Martech had abandoned or was going to abandon performance on the 8677 contract, or that, after receipt of the 16 December 1993 letter, respondent disbursed contract funds to Martech (am. comp. at 1-5).

DECISION

Summary judgment is appropriate when there is no genuine issue of material fact and the movant is entitled to judgment as a matter of law. *See Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1390 (Fed. Cir. 1987). Here, appellant says that it does not dispute any of movant's proposed findings of material fact. In other words, movant's proposed undisputed facts are essentially immaterial to, and it is not entitled to judgment as a matter of law on, the *pro tanto* discharge theory of liability on which the surety based its claim.

Movant mentions the Board's statement in our 11 July 2000 interlocutory ruling on its motion to dismiss, that—

> 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.

00-2 BCA at 153,212. Movant ignores our 18 September 2000 Scheduling Order, which stated that "the parties discussed with the Board the legal theories and their supporting facts that appellant may seek to prove at the hearing – pro tanto discharge and breach of the takeover agreement." The Board has advised the parties that appellant may seek to prove operative, causal facts that occurred after execution of the takeover agreement, in order to establish Government liability under the takeover agreement. Accordingly, we have recaptioned respondent's motion as a motion for partial summary judgment.

Our review of the principal legal authorities cited in the motion and opposition leads us to the conclusion that the motion is not well taken. In *Fireman's Fund Ins. Co. v. United States*, 909 F.2d 495, 498 (Fed. Cir. 1990), the court held that release of retainages under a construction contract was discretionary and was not a material departure from the contract's terms and conditions, and reversed the lower court's holding of a *pro tanto* discharge in favor of the surety. The court also stated that since the surety had not notified the Government of the contractor's default prior to the Government's permissive release of the withheld retainages, the surety could not recover as an equitable subrogee.

The Federal Circuit in *National Surety Corp. v. United States*, 118 F.3d 1542, 1546-47 (Fed. Cir. 1997), affirmed the COFC's judgment on the grounds of *pro tanto* discharge, holding that the Government had materially departed from the defaulted contract requirement for the contractor to submit a detailed critical path schedule before the Government was authorized to release any retainages from progress payments, which release increased the surety's risk without its consent, citing the RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY, § 37, and decisional precedents, *id*. at 1544-47, and of equitable subrogation, holding that since the contract gave the Government no discretion to release retainages, and the Government knew, and notified the surety, of the contractor's default, no additional surety notice to the Government of such default was required for subrogation. *Id*. at 1547. The court remanded to the COFC to redetermine damages in light of the degree of injury, loss or prejudice to the surety arising from impairment of the security, in accordance with the principles of *pro tanto* discharge. *Id*. at 1548. The dissent argued that the majority "confused" the rules of equitable subrogation and *pro tanto* discharge, the surety had not argued *pro tanto* discharge to the lower court, and such theory did not fit the facts of the case. *Id*. at 1551-53. The majority and dissent differed on whether the Government acceptance of a "progress curve" instead of the required "arrow diagram" critical path schedule was a "material" departure from contract terms. They did not disagree

that *pro tanto* discharge does not require the surety to give prior notice to the Government of default by the original contractor.

In *Blue Fox*, the prime contractor had not obtained any Miller Act payment bond, so a subcontractor sought an "equitable lien" against funds payable under the prime contract as compensation for its completed work. The Supreme Court held that such a lien was not relief "other than monetary damages" under the Administrative Procedure Act, 5 U.S.C. § 702. Thus the sovereign had not waived immunity from such a subcontractor suit, and reversed the lower court's holding of jurisdiction under the APA to entertain the subcontractor's claim. 142 L. Ed. 2d at 727.

Insurance Co. of the West was an equitable subrogation suit by a performance bond surety that funded completion of the bonded construction contract, to recover $174,000 the Government wrongfully paid to the contractor after receiving the surety's notice of the contractor's default. The Government argued that *Blue Fox* had "upset" the rules of waiver of sovereign immunity supposed to exist under *Prairie State Bank v. United States*, 164 U.S. 227 (1896), *Henningsen v. United States Fidelity & Guar. Co.*, 208 U.S. 404 (1908), and *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962), since the Supreme Court in *Blue Fox* had stated that none of those three cases involved a question of sovereign immunity. The Federal Circuit stated, "we agree . . . that, after *Blue Fox*, we can no longer rely on those three cases to find a waiver of sovereign immunity" and felt itself obliged to follow such Supreme Court *dicta*. 243 F.3d at 1372. The Federal Circuit, however, found waiver of sovereign immunity in suits brought by sureties as equitable subrogees under the Tucker Act, 28 U.S.C. § 1491(a)(1), citing *United States v. Atlantic Mutual Ins. Co.*, 298 U.S. 483 (1936). The Federal Circuit affirmed the COFC's decision in favor of the surety. Most importantly, *Insurance Co. of the West* did not discuss or disavow *National Surety*'s statements and holdings with respect to *pro tanto* discharge, or require the surety to notify the Government of the bonded contractor's default in order to establish a *pro tanto* discharge.

We deny the motion.

Dated: 17 July 2001

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

I concur

I concur

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

EUNICE W. THOMAS
Administrative Judge
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 Co. of Hartford, rendered in conformance with the Board's Charter.

Dated:

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