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NO GOOD DEED GOES UNPUNISHED: WHY TRYING TO BE THE GOOD GUY IS SOMETIMES A BAD IDEA

By Sean M. Howley, Esquire

A recent decision out of the United States Court of Appeals for the Fourth Circuit (the appeals court for all of the federal courts in Maryland, Virginia, West Virginia, North Carolina and South Carolina)[1] affirmed the old adage that "no good deed goes unpunished" when it invalidated the Payment Bond claim of a material supplier on a U.S. Government Project because it tried to help the subcontractor it was working for stay in business.

Here is what happened: The general contractor ("GC") on a project for the U.S. Coast Guard provided a Payment Bond to secure the payment of its subcontractors and suppliers. Payment Bonds are required on most U.S. Government contracts in excess of $100,000 pursuant to a statute known as the Miller Act.[2] Subcontractor ("Sub") was hired to perform heating, ventilation and air conditioning ("HVAC") work, and in turn, contracted with a material supplier ("MS") to provide a significant portion of the HVAC materials.

GC made payments to Sub who affirmed, in the somewhat standardized release form it was required to provide with each application for payment, that Sub had paid all of its subcontractors and suppliers. The release stated, in pertinent part, as follows:

> I ..... certify that payments, less applicable retainage, have been made (through the period covered by previous payments received from General Contractor) to all my subcontractors and suppliers, for all materials and labor used in, or in connection with, the performance of this Subcontract.

The problem was that Sub was having significant financial difficulties and could not make its payments to MS. Despite the language contained in the releases, Sub had not in fact paid any money to MS as it was paying off debts from other projects just to stay in business. After almost two months without any payment, Sub and MS met and, after much deliberation, MS agreed to forego immediate payment of the monies that were owed. The two parties then negotiated an agreement whereby MS would receive monthly payments over time. Without such an agreement, the Sub claimed it would not be able to continue doing business.

1 Damuth Services, Inc. v. Western Surety Company, et al, Case No. 09-1170
2 The Miller Act can be found at Title 40 of the U.S. Code, Sections 3131 through 3134.

Such payment over time arrangements are common during difficult times. MS was willing to accommodate its customer because MS thought that if payment was ultimately not made by Sub, it could make a claim on the Payment Bond provided by the GC. In essence, MS thought (as many reasonable people would), "why make trouble for my customer (Sub) – as long as he makes payment before I need to make my claim on the Payment Bond, I should try and help him stay in business." It is important to note that a key part of the deal was that MS would not notify GC that it had not been paid by Sub.

Ultimately, Sub could not continue to make payments and went out of business. MS made a claim on the GC's Payment Bond and then sued the Payment Bond Surety seeking payment of the unpaid portions of its invoices. Unfortunately for MS, both the trial and appeals courts held that the conduct of MS in helping the Sub stay in business, and not informing the GC or Surety of the fact that it had not been paid by Sub, prejudiced the Surety and prevented MS from making a claim on the Payment Bond.

The Court specifically held that MS knew about the release language executed by Sub in the standard release form and also knew (in a general sense) about the obligations of Sub to make payment to all its material suppliers from the monies it received from GC. Despite this knowledge, MS did not make the GC aware of the Sub's failure to pay and instead remained knowingly silent. Because of this, the Court found that the combined actions of Sub and MS misled the GC into believing that the Sub had been making payments to MS all along. As a result of those actions, the Court held that the surety had no obligation to make any payment to MS.

What is the moral of this story? I wish it were that trying to help one of your customers "stay afloat" during tough economic times was a good thing, but this case goes to show that it is not. While the material supplier's heart was, in this writer's opinion, in the right place, the realities of payment on government projects (state or federal) is that if you are not getting paid, you should not remain silent or cut any deals – at least not without getting the consent of the GC and the Surety. Doing so may result in significant prejudice to your rights and, more importantly, your ability to get paid.

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