

No. A12-0370

IN THE SUPREME COURT OF MINNESOTA

SAFETY SIGNS, LLC,
Appellant,

v.

NILES-WIESE CONSTRUCTION, CO. INC.
Defendant

WESTFIELD INSURANCE CO.
Appellee.

On Appeal from the Court of Appeals, Minnesota
Cause No. A12-0370

AMICUS CURIAE BRIEF OF AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
SUPPORTING APPELLANT SAFETY SIGNS, LLC

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ISSUES PRESENTED

The Law. Minnesota's payment bond statute (Minn. Stat. §574.31 – the “Act” or “Payment Bond Act”) was drafted to protect subcontractors and suppliers on public works by requiring a bond as payment security on projects that lack mechanics’ lien rights. The Act states that giving written notice of its claim to the surety and bond principal at the address listed in the bond is sufficient for the purposes of conforming with the notice requirement of the Act.

The Facts. Here, Safety Signs had two payment bond claims on a public works project. In both cases it provided written notice to the general contractor and surety at their respective primary places of business. The first claim was paid. The general contractor (who had received payment from the Owner for all Safety Sign's work) did not pay Safety Signs. Even though there was no dispute that the surety and general contractor had actual notice of the bond claims the surety denied the second bond claim because Safety Signs had served the general contractor at its primary place of business, which was not the address listed on the bond.

The First Issue. Given the purpose of the Act does (or should) the substantial compliance doctrine apply to the Act's notice requirements?

The Second Issue. Is a technical defect in service of the bond claim waivable or excusable where a previous bond claim was paid with the same written notice given?

PRELIMINARY STATEMENT

The American Subcontractors Association, Inc. (“ASA”) submits this brief as *amicus curiae* to urge the Court to reverse the decision of the Appeals Court in *Safety Signs, LLC v. Niles-Wiese Constr. Co., and Westfield Insurance Co.*, Court of Appeals, A12-0370 (Sept. 17, 2012) and grant the relief requested by Appellant Safety Signs, LLC.¹

INTEREST OF *AMICUS CURIAE* AND DISCLOSURES PURSUANT TO MINN. R. APP. P. 129

ASA is a national trade association representing the interests of approximately 3,000 subcontractor and supplier member businesses the United States, including subcontractors in the State of Minnesota and neighboring states. ASA members engage in the construction of public and private improvements and provide labor and materials on private and public construction projects throughout Minnesota and the United States. ASA’s members construct not only the public and private buildings in which the nation lives and conducts business, but also build the public and private infrastructure that serves as a critical starting point for nearly all other economic activity, including highways, bridges, tunnels, power plants, utilities, clean and wastewater facilities, and airports.

Today, ASA is the recognized leader of the construction subcontracting industry in the United States. ASA’s primary focus is the equitable treatment of subcontractors on

¹In accordance with Minn. R. Civ. App. P. 129.03, ASA certifies that this brief was authored solely by Counsel for ASA and that no person or entity other than ASA made a monetary contribution to the preparation or submission of this brief.

private and public works in the United States. ASA furthers this goal by promoting legislative action and by appearing as *amicus curiae* in significant legal actions that affect the construction industry at large. Here, ASA seeks to further that mission by urging reversal of the Minnesota Court of Appeals' decision.

Subcontractors and suppliers (“subcontractors”) commonly perform approximately 80-90% of the work on major construction projects such as the airport runway Project at issue in this case. *See generally* Jimmie Hinze & Andrew Tracey, *The Contractor-Subcontractor Relationship: The Subcontractor’s View*, Vol. 120 J. Const. Eng’g & Mgmt. 274 (Issue 2 1994); Keisha Rutledge, *Subcontractors Building Recognition on the Job*, Tampa Bay Bus. J. (Mar. 12, 2001).²

If substantial compliance with the notice requirements of the Payment Bond Act is not sufficient to preserve a bond claim on public works projects, under facts such as exist in the instant case, then the uncertainty that would be created, and the troubling legal and equitable issues that would result, would cause severely negative legal, economic, and public policy implications which undermine the intent and purpose of the Payment Bond Act. Even if this Court determines that a surety has a right to force a subcontractor to follow strict compliance with regard to notice requirements, this Court should hold that such a right was waived by the surety in this case.

² Available at www.bizjournals.com/tampabay/stories/2001/03/12/focus6.html.

STATEMENT OF THE CASE AND FACTS

ASA concurs with the Appellant's Statement of the Case and Facts. From ASA's perspective the seven most pertinent facts in this case, all of which are cited by Appellant, are as follows:

1. Appellant Safety Signs, LLC properly and timely performed its work as a subcontractor to the Nile-Wiese Construction Company ("Nile-Wiese") on a public works project constructing an airport runway and taxiway for the City of Owatonna, Minnesota.

2. The City paid the General Contractor and later the Westfield Insurance Company ("Westfield") for Safety Signs' work, but the Nile-Wiese and Westfield refused to pay Safety Signs.

3. The address listed in the payment bond for Nile-Wiese was *not* Nile-Wiese's principal place of business, the address listed on its website, the address listed on the Subcontract, or the address used by Westfield or Safety Signs to conduct business with Nile-Wiese.

4. When Safety Signs made its first claim on the payment bond, at the conclusion of phase one of the Project, it served Nile-Wiese and Westfield at their primary places of business. That claim was paid.

5. When the Project was complete, Safety Signs again was unpaid. So it again made a second claim on the bond by serving notice to Westfield and Nile-Wiese at their respective primary places of business.

6. In response to the second bond claim, Westfield and Nile-Wiese entered into negotiations with Safety Signs over the amount of the claim. As a result of this, Safety Signs slightly reduced its claim to directly correspond to the amount that the City had paid Nile-Wiese for Safety Signs' work.

7. By now Nile-Wiese was in severe financial distress, leaving the bond as the only viable security for the unpaid sums due. Even though Westfield and Nile-Wiese had actual notice of the second bond claim, Westfield denied the second bond claim. The sole reason Westfield refused to pay an amount indisputably owed was that Safety Signs had sent its notice letter to Nile-Wiese at its primary places of business instead of the address listed on the bond.

STANDARD OF REVIEW

ASA concurs with the Appellant's statement of the standard of review.

ARGUMENT

This appeal concerns a dispute over a surety's right on a public project to deny an otherwise valid payment bond claim of an unpaid labor and materials subcontractor, Safety Signs. If the Court of Appeals decision in *Safety Signs, LLC v. Niles-Wiese Constr. Co., and Westfield Insurance Co.*, Court of Appeals, A12-0370 (Sept. 17, 2012) (the "Decision") is not reversed, then the result will establish deeply troubling precedent with lasting negative ramifications in Minnesota and beyond.

Here the trial court properly held that substantial compliance with the notice requirements of Minnesota's payment bond statute (Minn. Stat. § 574.31) was sufficient to preserve an unpaid subcontractors' payment bond rights on a public project where the

City had paid for the subcontractors' work and Nile-Wiese and Westfield had actual notice of the bond claim. In its reversal, the Court of Appeals relied upon its decision in *Spetz & Berg, Inc. v. Luckie Construction Co., Inc. v. Luckie Constr. Co.*, 353 N.W.2d 233 (Minn. App. 1984), *rev. denied* (Minn. Nov. 9, 1984). Importantly, in its reversal the Court of Appeals "reluctantly" held that strict compliance with the notice requirements of the bond statute was necessary, stating that "[a]lthough it appears that the substantial compliance doctrine **should be extended** to Section 574.31 and public project bonds, **that is for the Minnesota Supreme Court to decide**" Decision, at p.8-9 (citing *Spetz & Berg*, 353 N.W.2d at 235 (emphasis added)).

For the reasons that follow and those stated in the Appellant's brief, this Court should confirm for the State of Minnesota that the imposition of a strict compliance standard on the notice requirements of the Payment Bond Act undermines the purposes, intent and benefits of the Payment Bond Act where substantial compliance and actual notice has been achieved. Further, this Court should hold that strict compliance with the notice provisions inures only to the benefit of unscrupulous actors who wish to avoid proper contractual obligations, putting form over substance, and thus a strict compliance standard diminishes the safeguards which protect Minnesota subcontractors and would cause a chilling effect upon the Minnesota construction industry.

I. MINNESOTA'S PAYMENT BOND STATUTE IS A REMEDIAL STATUTE DESIGNED TO ENSURE THAT UNPAID SUBCONTRACTORS AND SUPPLIERS ARE PAID FOR PROPERLY PERFORMED WORK.

A. Payment Security is Essential.

Subcontractors are creditors. In the construction industry, subcontractors provide labor or materials to a project in exchange for the promise of future payment. Payment security for subcontractors is thus vitally important to their business. Among other things, a construction contractor who can bid a project secure in the knowledge that it will be paid for its work—and have a security interest in its labor or materials—can give its best price because it does not need to price the risk of non-payment into its bid.

Ensuring construction contractors have adequate payment security for their work is therefore a recognized public policy interest because among other things it both (a) reduces default of general contractors³ and (b) protects the greater public of Minnesota by keeping prices to the public low. By analogy, a comparison of mortgage and credit card interest provides a good illustration of why this is the case.

Mortgage rates are typically much lower than credit card interest rates. At a basic level, the business rationale is the security found in the mortgage is not present in credit cards and thus the risk is lower along with the credit rate. The same basic rationale applies to a construction contractor's bid price, and by extension, what the public pays for

³ As a general rule, sureties typically require owners, officers, and their spouses to agree to be personally obligated to indemnify the surety if it must pay any bond claim. This indemnification obligation is a primary distinction between contracts of insurance and suretyship, and strongly encourages solvent bond principals to pay their lower tiers.

a project. This is because when a contractor prepares its bid it must compute the lowest price it needs to win the job while still making a profit.

When determining a bid price, subcontractors must consider not only the hard costs of performing the work (e.g., the cost of labor, materials, overhead, etc.) but the risk of default and non-collection. Though subcontractors on public projects will usually have contractual and other legal remedies directly against the other party to the contract, those remedies may or may not have any actual value. In other words if, as apparently happened here, the general contractor is financially distressed or insolvent, the security of the bond is critical. Instead of a worthless contract, the bond provides a valuable guarantee of payment. The bond thus reduces the risk of non-collection, and its availability enables subcontractors to offer services and material in construction settings for less because they are not forced to price elevated risk into the bid. Thus, not only does reduced payment risk on public works project help grow and sustain a healthy business climate, but it ensures that the good actors in the market will not pay, in the form of elevated costs of subcontractors anticipating higher-risk contracts across the board, for the damage caused bad actors in the market. This reduced cost is passed down to the Minnesota public as a whole, and at the same time helps to stimulate the construction industry.

B. Minnesota's Legislature has recognized these policy interests, and the importance of security to contractors through the lien and bond statutes.

Given the above, it is well recognized that projects backed by security can be built for a lower price. The Minnesota legislature has responded to this reality by creating

mechanic's lien statutes (for private projects) and the Minnesota Public Payment Bond statutes ("Bond Laws") for public projects. The Bond Laws, found at Minnesota Stat. § 574.26 to 574.32, and Minnesota's lien statutes serve the same purpose: both ensure that contractors who provide labor and materials to a construction project have payment security larger than the solvency of their contracting partner.

On private projects, the security is the real property that was improved by the Project. Because mechanic's liens can generally only be filed on public property (otherwise government buildings and property would be subject to sale), the Bond Laws require that contracts on public construction projects in excess of \$75,000 will not be valid unless the general contractor supplies a payment bond or other security guaranteeing the payment of all just claims "of all persons furnishing labor and materials" to the public project. See Minn. Stat. § 574.26, subd. 2.⁴

It has long been established that the general purpose of Minnesota's Payment Bond statute "is to protect laborers and materialmen who perform labor or furnish material for the execution of a public work to which the mechanic's lien statute does not apply." *Ceco Steel Products Corp. v. Tapager*, 208 Minn. 367, 370, 294 N.W. 210, 212 (1940) (involving the substantially similar predecessor of Minn. Stat. § 574.31). Because the Payment Bond Act is remedial, it is similarly well-established that it should be liberally construed to effectuate its purpose. See *Wheeler Lumber Bridge & Supply Co. v. Seaboard Sur. Co.*, 218 Minn. 443, 449, 16 N.W.2d 519, 522 (1944). As such, this

⁴ Though not pertinent to this Appeal, the Bond Laws also require general contractors to post a performance bond for the protection of the public owner. Minn. Stat. § 574.26.

Court, should hold that the intent and purpose of the Act is best met though substantial compliance with the notice requirements of the Payment Bond Act.

II. THE OVERLY HARSH AND TECHNICAL APPEALS COURT DECISION UNNECESSARILY UNDERMINES THE REMEDIAL PURPOSE OF THE PAYMENT BOND ACT.

This Court should confirm for the lower courts of Minnesota that the substantial compliance doctrine applies to the notice requirements of the Payment Bond Act and public project bonds. This common sense holding will clarify the law and at once further the intent of the Payment Bond Act and correct the immediate wrong that would be perpetuated against Safety Signs by the Court of Appeals' overly harsh and technical construction of the bond statute. Even more importantly, affirming that substantial compliance with the Act's notice requirements is sufficient to preserve valid claims will act as a guard against future harms to subcontractors who would otherwise be taken advantage of by an unnecessary and counterproductive strict construction standard.

Moreover, applying the substantial compliance doctrine to the notice requirements of the Act is consistent with the established policy reasons not only for why payment bonds are required on public works, but with the well-established doctrine that sureties are not favorites of the law. "The trend of authority followed in a majority of States is that where a compensated surety has issued a standard form of bond, it is to be interpreted liberally, and all ambiguities are to be resolved in favor of those for whose benefit the bond is given." *McClare v. Massachusetts Bonding & Ins. Co.*, 266 N.Y. 371, 377 (1935) (citing Corbin, *Third Parties as Beneficiaries of Contractors' Surety Bonds*, 38 Yale Law Journal, 1); *U.S. Fid. & Guar. Co. v. Poelker*, 180 Ind. 255, 102 N.E. 372

(1913) (“the [bond] contract, when there is room for construction, is to be construed most strongly against the surety and in favor of the indemnity which the obligee had reasonable ground to expect.”)

In a similar vein, as this Court noted in *Reliance Ins. Co. v. St. Paul Ins. Cos.*, 307 Minn. 338, 342, 239 N.W.2d 922, 925, 84 A.L.R.3d 181 (1976) it “has long been the law in this state, requiring a showing of actual prejudice by the insurer to defeat liability. In [*Farrell v. Nebraska Ind. Co.*, 183 Minn. 65, 69, 235 N.W. 612, 614 (1931)] we said:

‘To hold that the [insurer] under the circumstances should be absolved from liability because of the failure to give earlier notice would be unreasonable, unwarranted, and a grave injustice. The record does not disclose that defendant was in any way prejudiced by the delay.’”

Reliance Ins. Co. v. St. Paul Ins. Cos., 307 Minn. 338, 342, 239 N.W.2d 922, 925, 84 A.L.R.3d 181 (1976).

Imposing a ‘strict construction’ standard relating to notice requirements for a subcontractor entering into a public works construction project puts form over substance and in the process undermines the vital protections the Act was meant to provide. If the Court of Appeals’ decision is not reversed, the ramifications will fall particularly harsh on the small and mid-sized businesses that cannot afford armies of lawyers and personnel to advise on each contract or bond, and who rely on that bond to guarantee payment for good work on public projects. This is especially so due to the fact that for smaller business especially, it can be difficult to obtain a copy of the bond in the first place. Administrative roadblocks and unequal bargaining power in the contract, as well as the fear of being fired from the construction job in the event a request for the bond is made,

already are an impediment to subcontractors substantially complying with the provisions of the Act. If yet another obstacle is put in their way, it is these small and mid-sized businesses that will suffer the most severe harm, some of whom may well be put out of business, if the Court of Appeals' decision is allowed to stand.

In addition to undermining the intent and purpose of the Payment Bond Act, the Court of Appeals' Decision actually creates an incentive for collusion between the surety and general contractor to, as was done here honestly or not, list one notice addresses for the general contractor in the subcontract and a different address in the bond. This danger is amply illustrated by the record here, which reflects that Niles-Wiese did not sign for and/or refused to accept certified mail service of the second bond notice claim **even though it was sent to the address at which Niles-Wiese was corresponding with Westfield about the bond claims.**

Here, there is no record that Westfield or Niles-Wiese was prejudiced by the fact that there was actual notice of the claims that were sent to their respective primary places of business. Westfield received the notices. Niles-Wiese received the first notice, and refused delivery of the second certified mail notice letter, but it and Westfield discussed the second bond claim and actually engaged in negotiations with Safety Signs over the claim.

The purpose of requiring notice of bond claims is to give the surety and bond principal an opportunity to timely investigate and evaluate the claim. Because they had such notice, the intent of the Act in requiring notice of claims was met. Moreover, here Westfield not only investigated but knew that Niles-Wiese had been paid by the City for

Safety Signs' work and had even received certain payments itself from the City. Under these circumstances, it is manifestly unjust to use strict construction notice standard as the sole basis to deprive an unpaid subcontractor of its right to a payment it is undeniably owed for work it indisputably performed on a public project.

It was similarly misguided for the Appeals Court to hold that Westfield had and could not waive, under any circumstances, the "right" to insist that Niles-Wiese receive notice at a particular address other than its principal place of business. The Supreme Court of Minnesota has explained that it is established in Minnesota that "[t]he general rule is that: 'Except as limited by public policy, a person may waive any legal right, constitutional or statutory.'... We are unable to discover any good reason why a defect in a notice required to be given as a condition precedent to suit under a contract may be waived and a similar defect in a notice required to be given as a condition precedent under a statutory remedy cannot be." *Standard Oil Co. v. Enebak*, 176 Minn. 113, 116-17, 222 N.W. 573, 574 (1928) (emphasis added) (internal citations omitted).

Given the above, even if this Court held that the notice requirement of the Act must be strictly construed and sets a condition precedent to recovery on the bond, in this case Westfield waived any such statutory requirement of service on a contractor at a particular address by making payment upon the first demand under the bond made by Safety Signs. Holding that Westfield waived any such right would be in harmony with the Payment Bond Act's public policy of favoring protecting unpaid subcontractors on public works project, and would also comport with Minnesota law liberally interpreting bonds in favor of coverage and against paid sureties. Conversely, the Court of Appeals'

Decision articulates a standard that goes against these principles, and instead protects paid sureties over the unpaid public works contractors even where there is no evidence of prejudice resulting to the surety from the allegedly defective service. Simply put, the remedial purpose of the Payment Bond Act is severely hampered if the courts of this State are unable, under any circumstances, to consider the facts that may justify a finding of waiver.

If the Appeals Court decision is affirmed, it will give free rein to general contractors and sureties to play games with the notice addresses on their bond, to refuse service of certified mail letters, and to deny deserving claimants the protections the Minnesota legislature required to promote a healthy business climate while keeping construction prices down and protecting the state treasury. As noted earlier, in the *Spetz & Berg* case, the Tenth Appellate District stated that it is “for the Minnesota Supreme Court to decide” whether substantial compliance doctrine applies to the Payment Bond Act. Given the damage to the legitimate interests and expectations of the numerous business interests who rely on the security of payment bonds and trust the common sense application of the law to preserve the goals of a law designed to protect them both current Minnesota law and sound public policy support the conclusion that the substantial compliance doctrine indeed applies to payment bond claims in Minnesota.

CONCLUSION

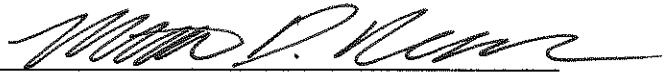
Neither law, nor public policy, nor equity, supports the Court of Appeal’s reversal of the well-reasoned decision of the District Court. Subcontractors, small construction businesses, those they employ, and the Minnesota public at large will pay the price if this

Court does not reverse the Minnesota Court of Appeals and reinstate the District Court's decision. Given the remedial purposes of the Payment Bond Act, there are compelling legal and equitable reasons why (1) the doctrine of substantial compliance should apply to the notice requirements of Minnesota Statute § 574.31 and public project payment bonds, and (2) that a surety or bond principal may waive any requirement for service of notice at a particular address and did so in this case.

For the foregoing reasons and the interest of justice and equity, *amicus curiae* the American Subcontractor's Association respectfully asks the Court to grant the relief sought in the Petition, *i.e.*, to reverse the decision of the Court of Appeals and reinstate the District Court's decision granting judgment to Appellant Safety Signs, LLC on its bond claims for its vitally important, yet still unpaid, work at the Owatonna Regional Airport.

Respectfully Submitted,

WAGNER, FALCONER, & JUDD, LTD.



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