



2. The AGC adopts and incorporates by reference the arguments made by Defendants' Beck-Ford Construction, L.P. and Beck-Ford Construction Management L.L.C. ("Beck-Ford") and International Fidelity Insurance Co. ("IFIC") in their Response to Motion for Summary Judgment, filed June 1, 2009, their counsel in the Post-Hearing Letter Brief, filed on June 11, 2009 and IFIC in its Motion for Reconsideration, filed on June 24, 2009.

3. This Court's July 7, 2009 Order, granting summary judgment against surety, IFIC and in favor of subcontractor, ESP Mechanical, LLC ("ESP"), is inconsistent with construction and surety industry standards. Specifically, sureties are traditionally entitled to rely on all defenses of their principals as to the debt owed to a bond obligee. Thus, if a contract between the bond principal and bond obligee contains a contingent payment, or pay-if-paid clause, the surety is entitled to rely on this defense and, traditionally, will withhold payment. Furthermore, the Texas legislature has already addressed sureties' rights to enforce contingent payment clauses in the contingent payment statute, Chapter 35.521 of the Texas Business and Commerce Code, *recodified at* Sections 56.051-.057 of the Texas Civil Practice and Remedies Code ("Contingent Payment Statute"), and this Court's Order is contrary to the language of that statute. Finally, because this Court's Order is inconsistent with industry standards, the decision has the potential to cause significant disruption in the manner in which construction companies and their sureties handle payment issues and payment bond claims. Therefore, the AGC requests the Court reconsider its July 7, 2009 order, grant IFIC's Motion for Reconsideration, and deny ESP's Motion for Summary Judgment.

## II.

### DISCUSSION

#### A. *A Surety's Liability is Only As Extensive As the Bond Principal's*

4. This Court's order granting ESP's Motion for Summary Judgment as to IFIC is in contravention of well-established surety law. "Surety" is defined as "[a] person who is primarily liable for the payment of another's debt or the performance of another's obligation." BLACK'S LAW DICTIONARY 682 (2<sup>nd</sup> pocket ed.). The Texas Supreme Court has noted a "significant distinction between sureties and an insurer is that sureties traditionally are entitled to rely upon **all defenses** available to their principal as to the debt owed to the bond obligee." *Great American Ins. Co. v. North Austin Mun. Utility Dist. No. 1*, 908 S.W.2d 415, 418-19 (Tex. 1995). As the *Great American* Court pointed out, "the Texas Business and Commerce Code expressly allows a surety to require a bond obligee to sue upon a written contract before the surety is liable." *Id.* (emphasis in original) (citing former TEX. BUS. & COM. CODE § 34.02, now codified at TEX. CIV. PRAC. & REM. CODE § 43.0002, effective April 1, 2009). The AGC is not aware of any Texas courts recognizing exceptions to this fundamental tenet of surety law.

#### B. *The Texas Legislature Addressed Sureties' Rights to Enforce Contingent Payment Clauses*

Additionally, unlike in most other states, the Texas legislature has specifically addressed enforceability of contingent payment clauses in Section 35.521 of the Texas Business and Commerce Code ("Contingent Payment Statute").<sup>1</sup> The Contingent Payment Statute specifically provides: "[t]he assertion of a contingent payment clause is an affirmative defense to a civil action for payment under a contract." TEX. BUS. & COM. CODE § 35.521(q). This language is

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<sup>1</sup> This provision has been recodified at TEX. CIV. PRAC. & REM. CODE §§ 56.051-.057.

broad enough to include assertion of this affirmative defense by both contingent payors and their sureties.

Furthermore, the legislature specifically considered and addressed enforcement of contingent payment clauses by sureties in the Contingent Payment Statute. *See id.* § 35.521. Specifically, the following subsections reference a surety's ability to enforce contingent payment clauses:

(b) A **contingent payor or its surety** may not enforce a contingent payment clause to the extent that the obligor's nonpayment to the contingent payor is the result of the contractual obligations of the contingent payor not being met, unless the nonpayment is the result of the contingent payee's failure to meet the contingent payee's contractual requirements.

(c) Except as provided by Subsection (f), a **contingent payor or its surety** may not enforce a contingent payment clause as to work performed or materials delivered after the contingent payor receives written notice from the contingent payee objecting to the further enforceability of the contingent payment clause as provided by this section and the notice becomes effective as provided by Subsection (d). The contingent payee may send written notice only after the 45th day after the date the contingent payee submits a written request for payment to the contingent payor that is in a form substantially in accordance with the contingent payee's contract requirements for the contents of a regular progress payment request or an invoice.

(h) A **contingent payor or its surety** may not enforce a contingent payment clause if the contingent payor is in a sham relationship with the obligor, as described by the sham relationships in Section 53.026, Property Code.

(j) A **contingent payor or its surety** may not enforce a contingent payment clause if the enforcement would be unconscionable. The party asserting that a contingent payment clause is unconscionable has the burden of proving that the clause is unconscionable.

*Id.* § 35.521(b), (c), (h), (j). “[T]he legislature is never presumed to do a useless act.” *City of Rockwall v. Hughes*, 246 S.W.3d 621, 636 (Tex. 2008). As such, because the legislature specified when a surety may not enforce a contingent payment clause, it must be presumed a surety may enforce such a clause absent those specified circumstances.

**C. *A Surety's Right of Indemnity Against Bond Principal Allows Recovery Against the Unpaid Contractor***

5. Further, to the extent this Court desired to hold *someone* other than the unpaid contractors responsible for the owner's non-payment, its granting of summary judgment against IFIC is not a means to that end. Traditionally, **a surety enjoys a full right of indemnity against the bond principal.** *Great American Ins. Co.*, 908 S.W.2d at 424. Thus, in this case, IFIC will likely attempt to seek recovery from Beck-Ford to the extent of the Court's judgment. As such, holding the surety liable where the principal cannot be held liable because of a valid contingent payment, pay-if-paid clause merely increases litigation costs for the parties involved, which, in turn, further taxes the Texas court system.

**D. *Effects of this Court's Ruling***

6. This Court's entry of summary judgment against IFIC effectively imposes a strict liability standard on payment bond sureties in the state of Texas. Texas Courts have recognized the legitimate nature of risk-shifting negotiations and contract terms, such as the pay-if-paid clause in the Beck-Ford/ESP contracts. However, as discussed above, this Court's ruling essentially creates an end-run around those arms-length negotiated terms, by holding a payment bond surety liable when the principal on the bond is not so liable. Because of this Court's judgment, sureties may decline to write payment bonds in Texas and general contractors will likely avoid procuring payment bonds because doing so will necessarily result in additional liability, when the general contractor itself would not be directly liable for a claim.

WHEREFORE, PREMISES CONSIDERED, the Associated General Contractors - Texas Building Branch requests that this Court reconsider its July 7, 2009 Order, grant International Fidelity Insurance Co.'s Motion for Reconsideration, and deny ESP Mechanical, LLC's Motion for Summary Judgment.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I certify that a copy of the foregoing was served pursuant to Rules 21 and 21a of the Texas Rules of Civil Procedure on the 8<sup>th</sup> day of September, 2009.

Corbin Van Arsdale

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