

SEND THE CLAIM NOTICE! Payment Bond Held as *Exclusive Remedy*:
Scoggins Construction Co. v. Dealers Electrical Supply Co.

By Charles W. Getman¹

In a well-familiar transaction for construction projects, a materials vendor (“Vendor”) entered into a three-way joint check agreement to secure its sale of materials to a subcontractor (“Sub”), and with the Sub’s general contractor (“General”), by which the General agreed to make progress payments owed to the Sub through checks jointly payable to both the Sub and the Vendor. The particular project at issue happened to be a public work for a local school district, for which the General also obtained a payment bond for the benefit of all vendors and subcontractors. In this not atypical case, after the Vendor supplied valuable materials to the Sub, the Sub defaulted on its payment obligations to the Vendor, and in fact abandoned the project and removed substantial materials. The Vendor then sued the Sub and obtained an agreed interlocutory judgment, but the Sub apparently was judgment-proof. The Vendor also concurrently sued the General in the same lawsuit for breach of the joint check agreement and also under the Trust Fund Doctrine.² After a bench trial, the Vendor obtained final judgment against the General for the full principal amount of its claim, with interest and attorney’s fees. The General appealed on four points, and the Corpus Christi Court of Appeals reversed the judgment and rendered that the Vendor take nothing,³ holding all common law and statutory claims asserted by the Vendor against the General were wholly superseded by the General’s payment bond issued under the McGregor Act, which the Court held thereby became the Vendor’s exclusive remedy; and the Vendor’s failure to comply with the notice requirements under the Act precluded any other means of recovery against the General.⁴

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²Tex. Prop. Code §§ 162.001, *et seq.*

³*Scoggins Constr. Co. v. Dealers Elec. Supply Co.*, 2007 WL 4442544 (Tex. App.—Corpus Christi Dec. 20, 2007, pet. denied).

⁴Tex. Prop. Code §§ 2253.001, *et seq.* In addition to asserting the McGregor Act’s claimed exclusivity, the General also asserted on appeal that there was no evidence and/or insufficient evidence of any breach of the joint check agreement, nor violation of the Trust Fund Act, nor any personal liability for the General’s principal owner. These latter three appeal points were not the basis of the Corpus Christi court’s decision and are not addressed herein.

The Texas Supreme Court denied the Vendor's petition for review on June 20, 2008, and this now constitutes the law in the twenty counties of Texas's Thirteenth Judicial District,⁵ resulting in this article.

The McGregor Act⁶

Once a project is designed, there usually are at least four sets of parties involved in constructing a project: (i) vendors who supply materials to (ii) subcontractors, who install materials for the (iii) general contractor, who works for the (iv) owner.⁷ Vendors and subcontractors typically do not have direct contractual privity with the project owner, but do have the statutory right in a *private* project to file liens against the owner's property.⁸ Conversely, vendors and subcontractors may not lien a public work project.⁹ Therefore, most *public* work projects require the general contractor to post a payment bond for the benefit of such vendors and subcontractors.¹⁰

To assert a claim against a public project payment bond, those parties in direct privity with a general contractor (i.e., first-tier subcontractors and first-tier vendors) must provide written notice to the general contractor and its surety no later than the fifteenth day of the *third* month after each month in which any claimed labor was performed, or any claimed material was delivered.¹¹ The notice must include a sworn statement of account and describe the basis of the claim.¹² Retainage claims have additional notice requirements.¹³

⁵Aransas, Bee, Calhoun, Cameron, Dewitt, Goliad, Gonzales, Hidalgo, Jackson, Kennedy, Kleburg, Lavaca, Live Oak, Matagorda, Nueces, Refugio, San Patricio, Victoria, Wharton, and Willacy.

⁶Tex. Gov't Code §§ 2253.001, *et seq.* This paper is not an exhaustive review of Texas's lien and payment bond laws, but is only a general overview.

⁷Many projects have lower-tier subcontractors, and sometimes additional general contractors.

⁸Tex. Prop. Code §§ 53.001, *et seq.* See also Tex. Const. art. 16, § 37.

⁹Tex. Const. art. 11, § 9; *Featherlite Bldg. Prod. Corp. v. Constructors Unlimited, Inc.*, 714 S.W.2d 68, 69 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.). However, they may lien *money* due to the general contractor from the government. Tex. Gov't Code § 2253.027.

¹⁰Tex. Gov't Code § 2253.021. Such bonds are not required for public work projects that do not exceed \$25,000. Claimants may seek a lien against the monies owed to the general contractor in such projects. Tex. Prop. Code §§ 53.231, *et seq.*

¹¹Tex. Gov't Code § 2253.041.

¹²*Id.*

¹³Tex. Gov't Code § 2253.046.

Even more onerous, any claimant without direct privity with the general contractor (e.g., vendors to subcontractors and lower-tier subcontractors to first-tier subcontractors), must submit similar written notice no later than the fifteenth day of the *second* month after the labor was performed or the materials provided; and also send a second notice no later than the fifteenth day of the third month after the labor was performed or the materials provided.¹⁴

The statute allows an unpaid claimant to sue the payment bond principal (i.e., the general contractor) and/or its surety, jointly or severally, commencing 61 days after the notice was mailed, and expressly allows for recovery of attorney's fees to the extent same are equitable.¹⁵ Importantly, any lawsuit seeking recovery against the payment bond has a relatively short one-year statute of limitations, commencing on the date of mailing the original claim notice.¹⁶

Application of McGregor Act

Many cases have held that the purpose of the McGregor Act's public project payment bond is remedial, and the Act should be provided a liberal interpretation for the protection of vendors and subcontractors.¹⁷ However, that stated liberality has been applied only to the *sufficiency* of the notice and will authorize claims that are in "substantial" compliance with the required content.¹⁸ No such liberality has been allowed for the *timing* of a claimant's notice, regardless of whether it is a public or private project.¹⁹

¹⁴Tex. Gov't Code § 2253.047.

¹⁵Tex. Gov't Code §§ 2253.073 - .074.

¹⁶Tex. Gov't Code § 2253.078(b).

¹⁷See, e.g., *Texas Dept. of Mental Health and Mental Retardation v. Newbasis Central, L.P.*, 58 S.W.3d 278, 280 (Tex. App.—Fort Worth 2001, no pet.) (citing *Ramex Constr. Co. v. Tamcon Serv., Inc.*, 29 S.W.3d 135, 139 (Tex. App.—Houston [14th Dist.] 2000, no pet.)).

¹⁸See, e.g., *Sims v. Williams Baker, Inc.*, 568 S.W.2d 725, 730 (Tex. Civ. App.—Texarkana 1978, writ ref'd n.r.e.) and *United States Fidelity & Guaranty Co. v. Parker Brothers & Co.*, 437 S.W.2d 880 (Tex. Civ. App.—Houston [1st Dist.] 1969, writ ref'd n.r.e.).

¹⁹See, e.g., *Wesco Distribution, Inc. v. Westport Group, Inc.*, 150 S.W.3d 553, 557-58 (Tex. App.—Austin 2004, no pet.) (timely notice returned for lack of full postage; private project lien denied and attorney's fees awarded against claimant); *S. A. Maxwell Co. v. R. C. Small & Assoc., Inc.*, 873 S.W.2d 447, 453-56 (Tex. App.—Dallas 1994, writ denied) (McGregor Act claim denied; first notice 11 days late; second notice timely but insufficient); *Suretec Ins. Co. v. Myrex Indus.*, 232 S.W.3d 811, 815-16 (Tex. App.—Beaumont 2007, pet. denied) (McGregor Act claim denied when 15th day of month was a Sunday; notice was dated on the 15th but not mailed until following day); and *St. Paul Travelers Ins. Co. v. Century Asphalt Materials, LLC*, 529 F.3d 313 (5th Cir. 2008).

The *Century Asphalt* case (cited in the foregoing footnote) is a prime example of the strict timing requirement for public project claims. There, the subcontractor received payments from the general contractor prior to the time that any statutory notices would have been required, and therefore did not serve any statutory notices under the McGregor Act. Unfortunately, the general contractor also declared bankruptcy before the checks cleared, and its trustee subsequently recovered the pre-petition payments to the subcontractor as preferences. The bankruptcy court held the subcontractor's notice requirements were equitably tolled until it was required to return the payments, and thereafter allowed the subcontractor to submit notice to the surety, and ultimately awarded summary judgment against the surety. But the district court reversed, and the Fifth Circuit affirmed, finding timely notice was a "substantive condition precedent to the existence of the cause of action" and that "equitable tolling does not apply to a 'jurisdictional statutory prerequisite.'"²⁰ Of course, the general contractor was bankrupt, and the subcontractor had no other remedy to pursue.

Is the McGregor Act an *Exclusive* Remedy?

Considering the strictness of the statutory timing deadlines, and the holding that even timely paid claims may nonetheless result in the forced return of the payment while concurrently resulting in the loss of the statutory remedy, it is apparent that the McGregor Act is not as "remedial" or "liberally construed" as purported. But now the Corpus Christi Court of Appeals has extended this strict construction with the even more Draconian holding that the McGregor Act is the "exclusive" remedy for vendors and subcontractors.

Although the Corpus Christi opinion fails to provide any insight into why that particular vendor, Dealers Electrical Supply Co., failed to provide timely notice of its claim to the project's general contractor, Scoggins Construction Company, it is presumed that the materials vendor felt secure upon its common law contract claim arising from its joint check agreement and other statutory claims in lieu of pursuing the payment bond. Nonetheless, the Corpus Christi Court of Appeals has barred the vendor's other common law and statutory rights, finding all of them to have been superseded by the Court's conclusion that "[t]he provisions of the McGregor Act are mandatory and provide the exclusive means to establish the existence of a cause of action by laborers or suppliers on a public project."²¹

The Legal Basis and Logic of the Corpus Christi Court of Appeals is Flawed.

Legal Basis. For its conclusion that the McGregor Act is the mandatory and exclusive remedy for a vendor's claim, the Corpus Christi Court of Appeals relied solely upon the case of

²⁰*Id.* at 321 (citing *Bunch Elec. Co. v. Tex-Craft Builders, Inc.*, 480 S.W.2d 42, 45 (Tex. Civ. App.—Tyler 1972, no writ) and *Heart Hosp. IV, LP v. King*, 116 S.W.3d 831, 836 (Tex. App.—Austin 2003, pet. denied) (denying timely unemployment appeal that was filed in wrong court)).

²¹*Scoggins*, 2007 WL 4442544 at * 5.

Commercial Union Ins. Co. v. Spaw-Glass Corp.,²² which relied solely upon the case of *Bunch Elec. Co. v. Tex-Craft Builders, Inc.*²³ However, the actual holding of the *Commercial Union* case was that a surety, as subrogee to a subcontractor for which it unilaterally had made payments to its vendors, could not assert a bond claim against the general contractor without complying with the bond statute, which it did not. Only in dicta did the *Commercial Union* court further hold that the Act is an exclusive remedy, relying solely upon *Bunch Electric*. That case similarly held that claims against the payment bond must comply with the statute that required the bond. A review of the McGregor Act and its legislative history finds no basis for the Corpus Christi court's conclusion that it is the exclusive remedy not only for claims against the payment bond (which is logical), but simultaneously supersedes all other common law and statutory claims, and possibly as against all claimed defendants.²⁴ Surely, claims against the bond must comply with the statute that requires the bond's issuance and details the claims process. But there is no legal basis for the conclusion that a claimant's other common law and statutory claims should be precluded when the claims do not seek recovery against the statutory bond.

Logic. In the usual course, whether a public or private project, vendors and subcontractors usually have no direct privity with the owner, yet Texas statutes allow vendors and subcontractors to place liens against the owner's property (private project only).²⁵ To effect the same purpose of protection to vendors and subcontractors not in privity with the owner, the McGregor Act requires general contractors in most public projects to post a payment bond to secure payments owed to vendors and subcontractors in lieu of lien rights.

In a private project, we have found no cases holding that the posting of a bond to secure an owner from the vendor's or subcontractor's lien simultaneously precludes the vendor/subcontractor from concurrently suing each other and/or the general contractor. Posting of the bond does not mandate an exclusive remedy for all claims.

A public project payment bond is required at commencement of the project because the vendors and subcontractors do not have statutory lien rights against public property.²⁶ Logic suggests

²²877 S.W.2d 538, 540 (Tex. App.—Austin 1994, writ denied).

²³480 S.W.2d 42, 45 (Tex. Civ. App.—Tyler 1972, no writ).

²⁴As noted above, the Vendor's breach of contract claim against the Sub in the *Scoggins Construction* case resulted in the Vendor's judgment against the Sub, which was not appealed. However, taking to its logical conclusion the Corpus Christi court's holding that the McGregor Act provides "the exclusive means to establish the existence of a cause of action by laborers or suppliers," the Vendor's breach of contract claim against the Sub to whom it sold the materials might also be barred by the McGregor Act's "exclusive" remedy.

²⁵Such liens also may be superseded by a payment bond: Tex. Prop. Code §§ 53.201, *et seq.*

²⁶See footnote 9, *supra*.

that the posting of the bond should not abrogate the vendor/subcontractor's other common law and statutory rights against each other and/or the general contractor any more than they do in private projects, which is none. Moreover, the General's argument in the *Scoggins Electric* case that the McGregor Act should be an exclusive remedy so as to shield the General from having to possibly pay twice for the same materials (both to its subcontractor and again to its subcontractor's vendor) is not persuasive. The General had a separate duty to comply with its separate three-party joint check agreement. If the General performed under that agreement, it should be protected from any possible double payment.

Interpretation of Similar Federal Statute ²⁷

The Texas McGregor Act is substantially similar to the federal Miller Act.²⁸ Most federal public work projects similarly require the general contractor to issue a payment bond to protect the vendors and subcontractors because the vendors and subcontractors are not allowed to lien the federal property.²⁹ However, many federal appellate courts have held that the Miller Act is *not* an exclusive remedy:

- (a) "The Miller Act was designed to provide an *alternative remedy* to the mechanic's liens ordinarily available on private construction projects . . . [b]ecause a lien cannot attach to government property."³⁰
- (b) The Miller Act is "an alternative means of recovery, not a replacement of state law causes of action."³¹

²⁷40 U.S.C. §§ 3131, *et seq.* ("Miller Act"). Much of the following argument is credited to the amicus curiae brief filed at the Texas Supreme Court on May 14, 2008, by J. Brett Busby, counsel for The American Subcontractors Association, Inc.

²⁸"The material portions of the Texas statute . . . has [sic] been taken from the Miller Act." *Ferrier Brothers v. Brown*, 362 S.W.2d 181, 188 (Tex. Civ. App.—Eastland 1962, writ ref'd n.r.e.).

²⁹*See F. D. Rich Co. v. U.S. ex rel. Industrial Lumber Co.*, 417 U.S. 116, 945 S. Ct. 2157 (1974); *Johnson Service Co. v. Climate Control Contractors, Inc.*, 478 S.W.2d 643, 645-46 (Tex. Civ. App.—Austin 1972, no writ).

³⁰*J. W. Bateson Co. v. Board of Trustees of the Nat'l Automatic Sprinkler Industry Pension Fund*, 434 U.S. 586, 589, 98 S. Ct. 873 (1978) (emphasis added).

³¹*United States ex rel. Varco Pruden Buildings v. Reid & Gary Strickland Co.*, 161 F.3d 915, 918-19 (5th Cir. 1998) (awarding damages under Miller Act and also attorney's fees under concurrent state law breach of contract claims).

- (c) “Nothing in the Miller Act evinces a legislative intent to limit remedies available to subcontractors. To the contrary, the Act *expands* upon the remedies previously available to government subcontractors.”³²
- (d) “The Miller Act simply provides the equivalent of a mechanic’s lien; it does not supplant any other remedies the supplier may have against any party involved in a federal construction project.”³³
- (e) “[T]he Miller Act is not an exclusive remedy.”³⁴
- (f) “Recovery under the Miller Act is not a supplier’s exclusive remedy against a general contractor.”³⁵

Conclusion

The Corpus Christi Court of Appeals held:

We conclude that the “joint check” agreement does not provide grounds for Dealers to circumvent the remedy provided by the payment bond provision of the McGregor Act. Based on the foregoing, the “joint check” agreement does not provide an alternate remedy for Dealers considering [Scoggins] executed a valid payment bond.³⁶

The resulting non-enforceability of joint check agreements will cause most materials vendors to choose between terminating credit sales to subcontractors with questionable credit, or to otherwise hire a new back-office staff capable of preparing and delivering proper and timely notices to general contractors and sureties, often in as little as 45 days after the sale. This result is inconsistent with the remedial intent of the McGregor Act, substantially limits claimants’ rights, is based on a fundamental misapplication of Texas law, and is expressly contrary to federal court decisions interpreting the federal statute upon which the Texas statute is patterned. This decision, along with the recent federal Fifth Circuit *Century Asphalt* decision, strongly suggests all counsel should advise

³²*Wright v. U.S. Postal Service*, 29 F.3d 1426, 1430-31 (9th Cir. 1994) (emphasis in original).

³³*K-W Industries v. National Surety Corp.*, 855 F.2d 640, 643 (9th Cir. 1988).

³⁴*Active Fire Sprinkler Corp. v. U.S. Postal Service*, 811 F.2d 747, 754 (2d Cir. 1987) (allowed state law breach of contract claim despite failure to timely notice Miller Act claim).

³⁵*United States ex rel. Sunworks Div. of Sun Collector Corp. v. Insurance Co. of North America*, 695 F.2d 455, 457 (10th Cir. 1982) (explaining that a payment bond provides security for a claim, but should not preclude a claimant’s other non-secured claims).

³⁶*Scoggins*, 2007 WL 4442544 at p. 11.

their vendor and subcontractor clients to fully comply with the written claim requirements in any public or private construction project for which a payment bond has been posted, even if the vendor/subcontractor client has already been paid. *Seller beware.*

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