1964

Utah State Building Board et al v. George R. Romney et al : Brief of Appellants

Utah Supreme Court

Shirley P. Jones; Attorney for Respondent;
Elliott Lee Pratt; Clyde Mecham and Pratt; Attorney for Appellants;

IN THE SUPREME COURT OF THE STATE OF UTAH

UTAH STATE BUILDING BOARD, et al,

Plaintiffs,

vs.

GEORGE R. ROMNEY and M. WALLIS ROMNEY, d/b/a G. MAURICE ROMNEY COMPANY, a Partnership, et al,

Defendants, Third-Party Plaintiffs and Appellants.

vs.

INDUSTRIAL INDEMNITY COMPANY, a corporation,

Third-Party Defendant and Respondent.

Case No. 10143

BRIEF OF APPELLANTS

Appeal from a Judgment of the Third District Court
For Salt Lake County
Honorable A. H. Ellett, Judge

Elliott Lee Pratt, Esq.
CLYDE, MECHAM & PRATT
351 South State Street
Salt Lake City, Utah 84111
Attorneys for Appellants

Shirley P. Jones, Jr., Esq.
Continental Bank Building
Salt Lake City, Utah
Attorney for Third-Party Defendant and Respondent

INDEX

INDEX OF AUTHORITIES CITED

ENCYCLOPEDIAS CITED

STATUTES CITED

IN THE SUPREME COURT OF THE STATE OF UTAH

UTAH STATE BUILDING BOARD, et al,
Plaintiffs,

vs.

GEORGE R. ROMNEY and M. WALLIS ROMNEY, d/b/a G. MAURICE ROMNEY COMPANY, a Partnership, et al,
Defendants, Third-Party Plaintiffs and Appellants.

vs.

INDUSTRIAL INDEMNITY COMPANY, a corporation,
Third-Party Defendant and Respondent.

Case No. 10143

BRIEF OF APPELLANTS

STATEMENT OF THE KIND OF CASE

This is an action brought against the General Contractor, Romney Company, and its bonding company by creditors of a subcontractor, with a Third-Party Com-

plaint by the General Contractor over against said subcontractor's bonding company.

DISPOSITION IN LOWER COURT

At the Pre-Trial, the General Contractor's (Appellant) Third-Party Complaint over against the subcontractor's bonding company, Industrial Indemnity Company (Respondent), was ordered dismissed and a subsequent Judgment of Dismissal was filed. The balance of the case involving the creditors' claims against the General Contractor was tried and a judgment taken against the General Contractor. Most of the creditors' claims were compromised and paid by theGeneral Contractor, Romney, just prior to trial. However, Rocky Mountain Refrigeration Company, the original plaintiff, obtained said judgment, its claim not being settled.

RELIEF SOUGHT ON APPEAL

The General Contractor, Romney, appellant herein, seeks reversal of the Judgment dismissing its Third-Party Complaint against the subcontractor's bonding company, Industrial Indemnity Company, respondent herein, and seeks to remand the case to the trial court for trial of the Third-Party complaint legal and factual issues.

STATEMENT OF FACTS

Romney Company, General Contractor and appellant herein, entered into a contract with the Utah State Building Board to construct the Rehabilitation Center at the University of Utah (Exhibits D-17, (P-3) (R. 43). Romney furnished the bond required under Title 14-1-1, Utah Code Annotated (R. 170, 225), wherein the State of Utah was named as obligee, Romney was named as principal, and American Surety Company was named surety and obligor.

Subcontractor, Walsh Plumbing Company, had a subcontract with Romney to do the plumbing portion of the general contract work (Ex. D-16) (R. 43). Walsh furnished in connection with said subcontract a bond, wherein appellant was named as obligee and owner, Walsh was named as principal, and Industrial Indemnity Company, respondent herein, was named as surety and obligor (Pre-Trial Ex. 1).

During and after construction, Romney paid Walsh for the subcontract work in reliance upon Lien Waivers furnished by the Walsh creditors (R. 49, 50, 51 (Ex. P. 10). Walsh, however, either did not pay these creditors, or paid them by check, which checks were returned because of insufficient funds (R. 23, 26, 36, 44, 259) (Ex. P-9).

These individual creditors did not give the written notice as is specified in respondent's bond (R. 226). Said notice requirement of the bond in effect states

that the creditor or claimant must notify in writing within 90 days of completion of the creditor's work any two of the three parties to the bond, i.e., the obligee, Romney, the principal, Walsh, and the obligor, respondent.

The bond further defines a claimant under the bond as one furnishing labor and materials on the project (Pre-Trial Ex. 1).

The Walsh creditors thereafter brought this action against appellant and its bonding company, American Surety Company, under Section 14-1-1, Utah Code Annotated, 1953, but did not sue respondent, Walsh's bonding company. Romney answered the Complaints of the original plaintiff and intervening plaintiffs, denying liability upon various grounds (Pleadings, R. 6, 34, 46, 53, 63). Romney also by its Third-Party Complaint, complained over against respondent, third-party defendant Walsh's bonding company, upon said bond, (Pre-Trial Ex. 1) for any judgment obtained against Romney by the Walsh creditors (R. 8-10, 28-30).

The case came on for Pre-Trial before Judge A. H. Ellett on February 24, 1964 (R. 225-228). At the Pre-Trial, respondent claimed, "that the bond was not made for the benefit of the Romney Company, but was made for the benefit of materialmen, and since no materialmen had given notice as prescribed by Paragraph 3(a) of the Industrial Indemnity bond," Romney could not recover. The Court, in Paragraph 9 of the Pre-Trial Order, stated:

"The Court will hold as a matter of law that Romney cannot recover under Pre-Trial Exhibit 1." (R. 226).

At the Pre-Trial, issues between the plaintiffs and Romney involving various defenses were set forth and set down for subsequent trial (R. 225-228). The primary issue remaining for trial insofar as each of the plaintiffs were concerned involved the reasonableness of some of the plaintiffs' claims and the question as to whether or not the work was actually performed on the project (R. 226).

At the trial, appellant defended against the claim of Rocky Mountain Refrigeration Company, but was unsuccessful and a judgment was obtained against appellant. Rocky Mountain was one of the unpaid creditors of Walsh Plumbing Company which appellant contends gives it the right to recover over against respondent. Just prior to trial, appellant was able to compromise and settle all other creditors' claims (R. 262-264) (R. 241-249).

ARGUMENT

POINT I.

THE COURT ERRED IN DISMISSING THE THIRD-PARTY COMPLAINT AGAINST THE RESPONDENT.

A. THE FAILURE OF CLAIMANTS TO GIVE PROPER NOTICE DOES NOT BAR AN ACTION ON THE BOND BY THE APPELLANT OBLIGEE.

(1) THE BOND PROVISIONS DO NOT PRECLUDE RECOVERY BY THE OBLIGEE.

Appellant, Romney, is the Owner-Obligee under the bond. Romney required Walsh, the Subcontractor, to furnish a bond "for the satisfactory performance of this agreement" (the Subcontract). (Ex. D-16 and 2nd page of Pre-Trial Ex. 1). The bond itself provides in part, as follows:

> "Principal . . . and Surety are held and firmly bound unto . . . Romney . . . as Obligee, hereinafter called Owner, for the use and benefit of claimants as hereinbelow defined . . . "

Paragraph 1, page 2, of the bond defines a claimant as one furnishing labor and materials to the Principal. Paragraph 3, in requiring written notice be given to any two of the following: The Principal, the Owner (Romney), or the Surety (Respondent), only makes this requirement of a claimant. There is nothing in any of the conditions precedent set forth in the bond requiring the Obligee on the bond to give notice as a prerequisite to filing suit.

The Court, in its Pre-Trial Order, stated:

> "8. The parties agree that no one gave any notice to the Industrial Indemnity Company or

to Walsh Plumbing Company or to Romney Company as required in Paragraph 3(a) on Page 2 of the Industrial Indemnity Company bond.

"9. The Industrial Indemnity Company claims that the bond was not made for the benefit of the Romney Company, but was made for the benefit of materialmen, and since no materialmen have given notice as prescribed by paragraph 3(a) of the Industrial Indemnity bond, the Court will hold as a matter of law that Romney Company cannot recover under pre-trial Exhibit 1."

The court thus in effect held that the Obligee was barred from suing on the bond because the claimants had not given written notice. Obviously, the failure to give such a notice cannot affect the rights of the Obligee. Had the bonding company intended that the Obligee give notice, or be barred from any action because of a failure to give notice, then it could and should have so provided in the bond. In *Hartford Accident & Indemnity Company v. Orr*, 321 P. 2d 373 (Okla.) (1958), the bond requires the Obligee, as a condition precedent to any right of recovery, to furnish a written notice of default to the Surety. Bonds are construed against the Surety which draws them and it must be assumed that if such a notice was to be applied against an Obligee, the bond would so indicate. See *Chapman v. Hoage*, 296 U.S. 526; Stearns Law of Suretyship, 5th Edition, page 12; and *Corp. of Pres. of L.D.S. v. Hartford*, 98 Utah 297, 95 P.2d 736, wherein this Court said: "But sureties in building contracts are not entitled to any notice of default unless the agreement specifically provides therefor."

Furthermore ,the notice required in this bond leaves the Obligee completely uninformed and at the mercy of the claimant and Surety. For example, the provisions require the claimant to notify any two of the three parties to the bond, and thus a notice can be given to the Principal and Surety without being given to the Obligee. And as a converse to this, the Obligee would not know (and did not) whether or not notice had been given and would thus not be able to protect itself in order to preserve its right under the bond. Thus it is apparent that the notice required was not intended to relate in any way to the Obligee. In our case, it is evident that the failure of the claimant to give such a notice was not a failure of the Obligee. However, under the Court's interpretation of this provision, the Obligee is deprived of its right on the bond through a failure over which it had no control, or knowledge thereof.

Thus, it is manifestly inequitable, impractical and contrary to the provisions and intent of the bond to deprive the Obligee of its right on the bond because of the failure of a claimant to give written notice of its claim. Such a provision could bar the claimant, but certainly not the Obligee.

(2) APPELLANT ROMNEY'S RIGHTS AS OBLIGEE ARE SEPARATE FROM THE RIGHTS OF THE CLAIMANTS.

It is fundamental in these construction bonds that the Obligee's rights are separate and independent from the rights of the claimants. As stated in *Stearns Law*

of Suretyship, 5th Ed., Par. 8:13, p. 266, entitled, "Bonds to Secure Building Contracts":

> "The Surety's bond is of a dual nature and contains several undertakings running to the Owner, the Obligee on the bond: One for his own protection, and the other for the benefit of third persons who furnish labor or materials."

Traditionally, the Obligee has the right of action on the bond. This right has been extended by statute and by various provisions of constructoin bonds to also give a right of action on the bond to those furnishing labor and materials to the Principal. In *Hochevar v. Maryland Casualty Company,* 114 F.2d 948 (Maryland) (1940), the Court separated the Obligee's rights from those of the beneficiary's under the bond, stating:

> "However, the Obligee's premature payment of retained percentages cannot affect the rights of third-party beneficiaries against the Surety."

In other words, the failure of the Obligee to protect its right under the bond cannot affect the right of a third-party beneficiary under the bond. Just as surely, we must assume that the failure of a third-party beneficiary to protect its rights cannot affect the right of the Obligee.

In *Equitable Surety Company v. U.S., ex rel McMillan,* 234 U.S. 448, 454, the Surety claimed as a defense against the materialmen that the Principal and Obligee had changed the contract which the bond was intended to cover. The Court held that such a defense

could not be maintained against the materialmen, stating:

> " . . . The obligation (the bond) has a dual aspect, it being given in the first place to secure to the government the faithful performance of all obligations which a contractor may assume toward it; and, in the second place, to protect third persons from whom the contractor may obtain materials or labor; and, that these two agreements are as distinct as if contained in separate instruments."

See also *Griffith, et al v. Rundle, et al.,* 63 P. 199 (Wash.) (1900). In 50 *Am. Jur.,* p. 1025, it is stated:

> "The natural person to bring suit on the bond or other obligation of a surety is, of course, the obligee."

The principle that the Obligee and the creditors or beneficiaries have independent and separate causes of action or rights under the bond is set forth in the Utah cases and in the Contractor's Bonding Statutes, particularly *Section* 14-1-2, *Utah Code Annotated.* In *State, et al v. Campbell Building Company ,et al,* 94 Utah 326, 77 P. 2d 341, the Court discusses this statute, indicating that the Obligee does have a right under the bond separate from that of the creditors. The Court says with reference to this statute and the rights of the parties:

> "The restrictions are twofold: to give the Obligee a priority to determine and protect any claim it may have, and to fix a one-year limitation on the Surety's liability to other creditors. When, therefore, the Obligee has had an opportunity to

> determine if it has any claims against the Surety, and assert the same, there are no good reasons why other creditors of the contractor should not be permitted to enforce their claims . . . The Statute is not for the benefit of the contractor, but for the benefit of the Obligee, creditors, and Surety."

The wording of the statute itself provides for two separate actions: One by the Obligee, and one by the creditors or beneficiaries under the bond. The Obligee is given the first right of action under the bond, and only after a period of six months within which the Obligee has the right to bring its action, can the creditors thereupon intervene or bring their own action on the bond.

Admittedly, the bond in question here is not a statutory contractor's bond, such as is required under *Title* 14-1-1, *Utah Code Annotated,* and such as is discussed in the *Campbell* case, supra. However, the wording of the subject bond, wherein it provides that the bond is for the use and benefit of claimants, to-wit, those furnishing labor and materials to the Principal, is the same wording as is requried under said statute and in the bonds discussed in the *Campbell* case and other Utah cases cited below. There is no doubt but that the Obligee has a right of action on the bond, which is made for the benefit of those furnishing labor and materials. In *Utah State Building Commission v. Great American Indemnity Company,* 105 Utah 11, 140 P. 2d 763, the Court discussed the statutory bond and whether or not the Obligee had a right thereon even though it was defective in its

corporate status. The Court said, in giving the Obligee a right under such a bond:

> "The Utah State Building Commission was the only proper Obligee on the bond, and the only entity that could have properly brought this action."

Also, in *Johnson Service Company v. E. H. Monin,* 171 N.E. 692 (N.Y.) (1930), the court held that the Obligee under the bond had a cause of action thereon even though the bond was conditioned upon the payment by the contractor of laborers and materialmen. The court said:

> "For a valuable consideration, the Contractor and the Surety have covenanted with the municipality that payment shall be made to materialmen and laborers whether protected by a lien or not. If they are not paid, the promisee intervenes and collects for their use the payment that is due."

See also *Colorado Fuel & Iron Company v. Dodge,* 52 P. 637 (Colo.) (1898), and *Bristol v. Bostwick,* 240 S.W. 774 (Tenn.) (1917), wherein the Obligee is given a right to bring an action in its own right, as well as for the use and benefit of the Principal's creditors. In *Deluxe Glass Company v. Martin,* 116 Utah 144, 208 P. 2d 1127, the court holds that the Owner is entitled to sue on the bond, given to protect the Owner from failure of the Principal to pay for all labor and materials on the project.

B. ACTUAL NOTICE IN LIEU OF WRITTEN NOTICE IS SUFFICIENT.

The Court ruled in its Pre-Trial Order and Judgment, to the effect that written notice was not given and thus the Obligee's right was lost. It is well accepted that the notice provisions in a bond must be reasonable. Reasonable notice also consists of actual notice. The Court, however, ruled without permitting the case to go to trial to determine whether or not there was actual notice or waiver of notice. (R. 139, 229). See *Corp. of Pres. of L.D.S. v. Hartford,* supra; 50 *Am. Jur.* p. 934, 1115.

Furthermore, there was no showing, in determining whether or not the notice was reasonable, that the Surety Company was in any way prejudiced by the failure to give said notice. Again, this is a factual matter which should have been developed at the trial, but which was eliminated as a matter of law by the Court's ruling and Judgment.

The notice required by the bond, even assuming it has application to the Obligee, is not reasonable and is arbitrary in its ultimate result. The Obligee for whose benefit the bond is given, has no opporunity of knowing whether or not the condition precedent of written notice is being complied with. The notice requirements give the claimant an election to ignore the Obligee .Thus, if the Obligee is bound by this notice requirement, it can be and was arbitrarily cut off from its rights under the bond. Such a notice, if applied to the Obligee, is

arbitrary and capricious in its result, and is, therefore, an unreasonable, unconscionable and unenforceable provision of the bond. Courts will not uphold an arbitrary notice requirement. The Obligee should, therefore, not be bound by such an unreasonable contractual requirement. Courts interpret contracts, where possible, to give validity to individual contractual provisions. To give validity to this provision, the court cannot and should not apply it to the Obligee.

POINT II.

THE COURT ERRED IN ENTERING THE JUDGMENT OF DISMISSAL ON APRIL 2, 1964 AS A NUNC PRO TUNC JUDGMENT TO BE EFFECTIVE FEBRUARY 21, 1964.

The Pre-Trial Order entered February 21, 1964, was not a final judgment from which an appeal could be taken. The judgment entered April 2, 1964, was a final judgment from which an appeal could be taken. The April 2, 1964, judgment cannot be made nunc pro tunc to take away rights of appeal which otherwise would still be valid and effective. The filing of the judgment April 2, 1964, initiates the running of the time for appeal. *United States v. F. & M. Schaefer Brewing Co.*, 356 U.S. 227.

SUMMARY

It is clear that the court has failed to distinguish between the rights of an Obligee and the rights of claim-

ants under the bond. This bond was required by the Obligee as Owner to assure that the Principal (Subcontractor) would pay for its labor and material furnished under the Subcontract. The Subcontractor did not pay for said labor and materials, and as a result, the Obligee was sued not under the Subcontractor's bond, but under its own public contract bond. Obligee is thus without a remedy because of the court's ruling.

The court has now denied the Obligee its rights under the bond upon the theory that the claimants' failure to file the necessary written notice eliminates all causes of action on the bond. The default of the claimants, beyond the Obligee's control, cannot and should not prejudice the rights of the Obligee. This notice requirement is unreasonable and in no way applicable to Obligee. The case should be remanded for trial so that the rights of the Obligee-appellant against respondent under its bond may be determined.

Respectfully submitted,

ELLIOTT LEE PRATT
CLYDE, MECHAM & PRATT

Attorneys for Appellants