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MESSAGE FROM THE EDITOR-IN-CHIEF

The Summer of 2000 is now upon us and we are nearing the height of the construction season. Indeed, with all the highway and roadway construction, office building erection, the construction of many new sports-related facilities and the development of numerous commercial, industrial and residential projects, it is likely that the trend of activity will continue well into next year. Likewise, the construction industry will be faced with legal issues which will undoubtedly impact in one way or another all of these projects being undertaken. In this, our second issue of The Critical Path, we have focused on a number of areas of which all members of the construction industry should take note.

From the ever-developing law of affirmative action to pay-when-paid clauses and their relationship to surety bonds, to the recent guidance from the National Labor Relations Board on “salting” and, finally, to the two very recent decisions discussing the timing for filing claims against public labor and material payment bonds, we have strived to increase the industry’s awareness of these issues and their possible impact on your respective businesses. We trust that you will find this issue’s articles to be both enjoyable and informative. Also, if you should desire that a particular topic be addressed in an upcoming issue of The Critical Path, we encourage you to contact myself, any of our Regional Editors or any of the Construction Group Steering Committee members.

Edward B. Gentilcore
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Introduction
This article provides an overview and update on race and ethnic-conscious affirmative action programs in federal procurement with a particular focus on federally subsidized highway construction projects. It might be asked why, after thirty years of national debate and litigation over affirmative action programs, an update is necessary. Isn’t the law well settled?

Few things in the law are ever well settled and that is particularly so in the arena of affirmative action. With the possible exception of abortion, no other area of current dialogue in the law touches so many hot-button issues of philosophy, psychology, ethics, business, economics, sociology, politics, and constitutional law. After thirty years of national debate and litigation over affirmative action programs, an update is necessary. Isn’t the law well settled?

Few things in the law are ever well settled and that is particularly so in the arena of affirmative action. With the possible exception of abortion, no other area of current dialogue in the law touches so many hot-button issues of philosophy, psychology, ethics, business, economics, sociology, politics, and constitutional law. Affirmative action policies reach into some of the most important corners of our lives—education, employment, professions, commerce, to mention a few. And no other issue contains within it such logical contradictions. That is why in the last decade attempts by the Supreme Court to bring some resolution to the dispute inevitably produce passionate and highly fragmented points of view, leaving the pervading impression that things remain in flux.

“That all men are created equal” is, of course, the bedrock principle of American government, but it took a civil war and many decades of subsequent upheaval to give it real meaning. Today, equal opportunity laws are accepted, core elements of the American social compact. The debate today is whether and under what circumstances it is permissible in the pursuit of equality to give certain people an edge. Therein lies the explosive seeds of contradiction with which our courts have been required to struggle in the framework of affirmative action.

For now at least, albeit by fragile majority rulings, the fundamental constitutional questions are resolved, but only in the abstract. The present state of the law under the current Supreme Court can perhaps best be expressed in the negative: Race/ethnic-conscious affirmative action by the government, while disfavored by this Court, is not per se unconstitutional. Whether a particular program passes constitutional muster depends on a variety of factors which are discussed below in the context of federal construction projects.¹

For now, there remains on the Court, as throughout society at large, a great philosophical divide on the merits of affirmative action generally. Proponents do not view affirmative action as creating “preferences.” They see it as...
necessary to the creation of a “level playing field” and thus as indispensable to furthering the government’s “compelling interest” in eliminating or mitigating the roadblocks to equal opportunity. Opponents say that the first and necessary principle of affirmative action is to discriminate. It is, they say, impossible to remedy past discrimination by engaging in present discrimination. Moreover, opponents believe that the end result of affirmative action, at least in the long term, actually hurts those it is intended to help. In their view, rather than eradicating the effects of past discrimination, affirmative action perpetuates those effects by attaching a badge of inferiority to the genuine achievements of minority groups. The full compass of these issues has been explored in the context of minority “set-aside” programs in the construction industry and it is those cases and related legislation and regulations to which we now turn.

Affirmative Action on Federally Subsidized Construction Projects


In May 1977, Congress enacted the Public Works Employment Act (the “Act”) which authorized an additional four billion dollars for federal grants to state and local governments for use in local public works projects. The Act included a “minority business enterprise” (“MBE”) provision which (subject to special waivers) prohibited grants for projects unless it could be shown that at least 10% of the grant amount would be spent for the employment of MBEs (50% owned and controlled by minorities or, in the case of a public corporation, 51%).

Several petitioners, including associations of contractors, challenged the MBE portion of the Act as a violation of the equal protection clauses of the Fifth and Fourteenth Amendments to the United States Constitution and other anti-discrimination statutes. In a 6-3 decision written by Chief Justice Burger, the Court found the

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MBE provision to be constitutional. Specifically, it found that the record showed an abundant historical basis to conclude that minorities had been excluded from participating in public contracting opportunities because of discrimination and that it was a legitimate congressional objective to remedy that situation. The Court held that the Constitution’s Commerce Clause allowed Congress to regulate the actions of private contractors in this respect and that the Fourteenth Amendment allowed Congress to regulate the actions of state and local governments.

The Court acknowledged that “innocent” non-minority firms may be disadvantaged because of the MBE program but stated that Congress need not in this context be wholly “color-blind.” It found that the MBE remedial program was properly “tailored” to cure the effects of discrimination and, for that reason, “a sharing of the burden” by innocent parties is not impermissible. Insofar as the bottom-line constitutional principle is concerned, *Fullilove* remains the law of the land. Affirmative action, as an abstract principle, remains constitutional. However, and importantly, in applying this principle to particular programs, succeeding courts have been less expansive.


In this case, the Supreme Court invalidated the City of Richmond’s Minority Business Utilization Plan which had a 30% set-aside for MBEs. The Court did not disturb *Fullilove*’s holding that affirmative action is not *per se* invalid, but it articulated conditions which could make them invalid. The case generated six separate opinions from the nine Justices, but in the end seven Justices joined in the view that the 30% set-aside was a constitutional overreach.

It is far beyond the scope of this paper to analyze the reasoning in each of the separate opinions. Nevertheless, certain common principles emerge from those opinions which concurred in the majority result.

First, the majority made it clear that, although state and federal governments have a compelling interest in assuring that its tax dollars not be spent to further unlawful discrimination,2 race/ethnic-conscious affirmative action programs of the government are “suspicious” on their face and are

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to be given “strict scrutiny” by the reviewing courts.

Second, the necessary “compelling government interest” in remediying discrimination cannot be demonstrated by proof of general historic or societal discrimination. Nor can it be shown on the mere basis of a statistical disparity between the minority population of the community and the percentage of MBEs awarded contracts. Rather, the evidence of discrimination must be specific and must involve the particular governmental entity sponsoring the affirmative action program at issue. Moreover, the correct “disparity” measure would compare the percentage of qualified MBEs in the relevant market with the percentage of total city construction dollars currently awarded to MBEs.

Third, the remedy must be “narrowly tailored” to remedy the proven discrimination. A rigid 30% quota is not so tailored since it entitles a minority to an absolute preference irrespective of actual discrimination.


This case involved a challenge to the "subcontractor compensation clause" in federal procurement contracts which give prime contractors additional compensation to hire subcontractors certified as being owned and controlled by “socially and economically disadvantaged” individuals. Using regulations applied by the Small Business Administration under its so-called 8(a) or 8(d) programs, contractors are required to “presume” that certain minorities (African Americans, Hispanic Americans, Asian/Pacific Americans, Native Americans, women) are so disadvantaged.

Adarand, which was not certified as an eligible small disadvantaged business (“SDB”), was low bidder for a guard rail subcontract on a highway project. It lost the job to a certified SDB. Adarand sued, arguing that the government’s use of race-based presumptions under the subcontractor compensation clause violated the Equal Protection Clause of the Fifth Amendment to the United States Constitution. The set-aside program was upheld by the United States District Court for Colorado and by the 10th Circuit Court of Appeals. On certiorari, the Supreme Court reversed and remanded the case back to the District Court for further consideration.

The Court’s rationales were as fragmented in Adarand as they were in the Croson case. Six separate opinions were published. This time, a majority of five coalesced around the “strict” and “narrow” principles of interpretation enunciated in Croson.3 First, the majority said that any governmental classification involving race must be viewed with “skepticism.”
Second, the majority squarely reinforced the “strict scrutiny” standard applied in \textit{Croson}, overruling to that extent an intervening 1990 decision by the Court which used an “intermediate scrutiny” standard.\footnote{In fact, the majority ruled that “any person, of whatever race, has the right to demand that any governmental actor subject to the Constitution justify any racial classification subjecting that person to unequal treatment under the strictest judicial scrutiny.” (emphasis added)} Third, the majority made it explicit that in order to withstand such scrutiny the particular plan must serve a “compelling governmental interest” and must be “narrowly tailored” to further that interest. The \textit{Adarand} ruling did not change the basic holding of \textit{Fullilove} that race/ethnic affirmative action programs can serve a compelling governmental interest in eradicating the effects of discrimination. However, \textit{Adarand} makes clear that to the extent \textit{Fullilove} permitted racial classifications to be subject to a standard of review less rigorous than strict scrutiny, “it is no longer controlling.”

Having established the ground rules, the Court in \textit{Adarand} then found that the Court of Appeals had not sufficiently analyzed whether the subcontractor compensation clause at issue passed these tests. It therefore vacated the judgment and remanded the case for further proceedings consistent with its opinion.

### The Aftermath of \textit{Croson} and \textit{Adarand I}

What has occurred since \textit{Adarand I} reflects the ongoing tension and dissonance between the enabling holdings of \textit{Croson} and \textit{Adarand} on the one hand (affirmative action is not per se unconstitutional) and, on the other hand, the “strict” and “skeptical” language within which the holdings are couched.

Traditional battle lines have formed on the Hill with certain conservative forces pushing for elimination of all set-aside programs. The Administration has promised to “mend, not end” these programs. The \textit{Adarand} case has been retried and re-appealed all the way back to the Supreme Court. Courts around the country continue to hear challenges to affirmative action programs. The upshot to date is that:

- Legislation proposed in Congress to end the programs has been “tabled” indefinitely.
- The Department of Justice (“DOJ”) and the Department of Transportation (“DOT”) reaffirmed the validity of Disadvantaged Business Enterprise (“DBE”) programs but modified their regulations for implementing them.
- The President has signed a new Transportation Act for the 21st Century which maintained the DBE program requiring a 10% set-aside to be applied consistent with the new agency rules and regulations.
- The \textit{Adarand} challenge to the “subcontractor compensation clause” remains alive after the Supreme Court reversed the 10th Circuit’s “mootness” ruling on remand.

### Regulatory Changes

In the wake of \textit{Adarand}, DOJ and DOT have attempted to modify their affirmative action regulations to address the Supreme Court’s insistence that such programs be narrowly tailored to address a demonstrable, compelling government interest in remedying specific discrimination. The changes focus on:

- The replacement of rigid “quotas” with good faith “goals” such that a low bidder who makes a good faith effort to meet the goals, but fails, nevertheless allegedly gets the contract;
- Conducting industry “disparity studies” to establish “benchmarks” for the availability of “ready, willing and able” DBEs; tailoring the availability data to the relevant local markets;

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- Greater emphasis on using “race-neutral” criteria for facilitating the bidding process and opportunities for smaller businesses in general.

Critics are not persuaded that the regulatory changes are meaningful. They regard them as ground cover for the continuation of race-conscious bidding preferences in the vast federal procurement system. Particular criticism is aimed at the “disparity studies” and “benchmark limits” which can be manipulated to support presuppositions of discrimination.⁶

**“Adarand II”**

In January of this year, the Supreme Court revisited Adarand’s challenge to the DBE program, this time in the context of reviewing the decision of the Court of Appeals on the remand from “Adarand I.” Once again, the Court showed its reluctance to endorse race-conscious affirmative action programs.

The *Adarand* remand took an interesting twist. The case was initially reheard at the Federal District Court of Colorado which, in a June 1997 decision, ruled for Adarand and invalidated the subcontractor compensation clause. The District Court found that the clause was not “narrowly tailored” because the presumption that all minorities are disadvantaged includes people who are not disadvantaged and excludes people who are. The Government appealed to the 10th Circuit Court of Appeals.

While the appeal was pending, Adarand filed suit challenging the State of Colorado’s use of the Federal guidelines which contained the presumption of DBE eligibility for minorities. Colorado then modified its procurement regulations by eliminating the presumption. Adarand then applied for and was certified by Colorado as an eligible DBE. The 10th Circuit Court of Appeals learned about Adarand’s new DBE status and dismissed the appeal as moot because, as a certified DBE, Adarand could not claim injury. Adarand successfully petitioned the Supreme Court for review.

The Supreme Court reversed the Court of Appeals again. It found that because DOT had not yet accepted Colorado’s certification policy (which had eliminated the presumption for minorities, a presumption which remained in DOT’s regulations) it was possible that Adarand’s DBE certification might be withdrawn in the future. For that reason, in the opinion of the Court, the case was not moot and it was therefore remanded for consideration on the merits.
So, after 11 years of wrangling,7 Adarand’s challenge to the DBE program with its reliance on minority presumptions of eligibility has not yet been finally resolved on the merits. The challenge remains very much alive.

Other Grounds for Challenges

Aside from the broad constitutional questions discussed above, many narrower bases for challenging set-aside programs exist. Generally, the most fertile areas of potential challenge lie first in the quality of proof of actual discrimination and, second, in the scope and flexibility of the proposed remedial quota or goal.

Hard proof of actual discrimination by the governmental entity sponsoring the program which specifically affects the covered parties is a necessary predicate to the program’s validity. Typically, this is the area which forms the battleground in litigation over such programs. Expert witnesses (statisticians, social demographers, etc.) are called to support or attack the “disparity studies” or the “benchmarks” of availability upon which the program is based.

The key questions all involve the “relevance” of the statistical pool from which the conclusions of “adverse impact” are drawn. The industry, market, particular qualifications, and availability data taken into account must fairly and specifically describe and apply to the location and nature of, and the participants in, the particular project involved in the dispute. Beyond that, the studies must be sophisticated enough to factor out alternative, non-discriminatory explanations for any disparities which might be shown.8

As for proposed remedies, one principle emerges loud and clear from the Supreme Court rulings: rigid, inflexible quotas (even if described as “goals”) will not be countenanced. Remedies of this kind are inherently suspect; they will be reviewed with a flint-eyed predisposition to contract, not expand; they must not be formulaic but, rather, thought out in detail to address the specific proof of discrimination at issue in the particular project.

Conclusion

Affirmative action, even with its reverse discrimination consequences, is a tolerated part of our constitutional fabric. Having said that, the limits of tolerance are exquisitely narrow and the potential for challenge remains great.

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1This article concentrates on three United States Supreme Court cases involving affirmative action programs affecting federally subsidized construction projects. However, the principles covered in those cases also arise in and inform court decisions involving affirmative action in other spheres of society. See, e.g., University of California Regents v. Bakke, 438 U.S. 265 (1978) (admission quotas in higher education); Wygant v. Jackson Board of Education, 476 U.S. 267 (1986) (employee layoffs).

2“It is beyond dispute that any public entity, state or federal, has a compelling interest in assuring that public dollars drawn from tax contributions of all citizens, do not serve to finance the evil of private prejudice.” Id. at 492.

3Again, it is beyond the scope of this article to synthesize the individual views expressed in the varying opinions.


5In fact, the majority opinion expressly recognized that, “[t]he unhappy persistence of both the practice and the lingering effects of racial discrimination against minority groups in this country is an unfortunate reality, and government is not disqualified from acting in response to it.”


7The controversial contract underlying the Adarand case was awarded in 1989.

8E.g., past societal discrimination, individual career and entrepreneurial choices, etc.
Moore Bros. Co. v. Brown & Root, Inc., 207 F.3d 717 (4th Cir. 2000), held that a surety cannot raise as a defense to a claim against a payment bond the “pay-when-paid” clause in the underlying subcontract. This decision creates a situation in which the surety is liable under the payment bond even though the general contractor has no liability by virtue of the pay-when-paid clause. Of course, the contractor will be liable to the surety for any sums paid under the bond through the typical indemnity agreement underlying the contractor/surety relationship. This article discusses the Moore Brothers decision and its implications for sureties and contractors.

The Fourth Circuit rejected Highlands’ argument and held that Highlands could not rely upon the pay-when-paid clause in the underlying subcontract as a defense to Moore Brothers’ claim against the bond. In reaching this conclusion, the court first determined that the underlying contract and the payment bond were distinct agreements that required separate interpretation.

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The Decision
The Moore Brothers case arose from a project in Loudoun County, Virginia, known as the Dulles Toll Road Extension (“DTRE”), a fourteen-mile long, private toll road. Brown & Root was the general contractor. Brown & Root entered into a subcontract with Moore Brothers for construction of a portion of the road. The subcontract

between Brown & Root and Moore Brothers contained the following pay-when-paid clause: “Notwithstanding any other provision hereof, payment by Owner to General Contractor is a condition precedent to any obligation of General Contractor to make payment hereunder; General Contractor shall have no obligation to make payment to Subcontractor for any portion of the sublet work for which General Contractor has not received payment from the Owner.” This standard pay-when-paid language has been enforced by the Supreme Court of Virginia.¹

Brown & Root, as the general contractor, posted a payment bond with Highlands Insurance Company (“Highlands”) as surety. The bond contained standard language describing when a claim could be made against the bond. This language stated in part: “Principal and surety hereby jointly and severally agree with the obligees that every claimant herein defined who has not been paid in full before the expiration of a period of 90 days . . . may sue on the bond for the use of such claimant, prosecute the suit to final judgment for such sum or sums as may be justly due claimant, and have execution thereon.” (emphasis added)

During the project, the thickness of the sub-base for the road was found insufficient. Therefore, Brown & Root directed Moore Brothers to
perform additional work to increase its thickness. Moore Brothers performed this work and claimed increased costs of $2.1 million.

After Moore Brothers completed the additional work, Brown & Root commenced arbitration against the project owner to recover the costs for the work. Brown & Root succeeded in the arbitration and obtained an award against the owner for the full amount claimed by Moore Brothers. However, since the owner's lender for the project had not approved the additional work, the lender refused to fund payment for Moore Brothers' additional work. The owner could not and did not pay Brown & Root for Moore Brothers' additional work. Since Brown & Root was not paid by the owner, it refused to pay Moore Brothers, citing the pay-when-paid clause in their subcontract.

Moore Brothers subsequently sued Brown & Root for breach of contract and sued Highlands under the payment bond. Since neither Brown & Root nor Highlands contested the validity of the work performed by Moore Brothers or the amount claimed for the work, both relied upon the pay-when-paid clause in the subcontract between Brown & Root and Moore Brothers as their primary defense. Highlands contended that, as a result of this clause, no sums were “justly due” Moore Brothers as required by the bond. Rather, the court held that the bond must be construed based solely upon the language set forth in the bond.

The court then determined that the bond did not incorporate the terms of the underlying subcontract and, specifically, did not incorporate the pay-when-paid clause. Accordingly, the court held that Highlands could not “bootstrap its own defense to the pay-when-paid defense asserted by Brown & Root.” Thus, while the court held that the pay-when-paid clause was enforceable under Virginia law, it concluded that Highlands had no right or basis to assert this clause as a defense to Moore Brothers’ claim because the bond contained no language referencing or incorporating this clause.

The Fourth Circuit rejected Highlands’ argument and held that Highlands could not rely upon the pay-when-paid clause in the underlying subcontract as a defense to Moore Brothers’ claim against the bond. In reaching this conclusion, the court first determined that the underlying contract and the payment bond were distinct agreements that required separate interpretation. In other words, the court rejected Highlands’ argument that the bond’s “sums justly due” language was to be interpreted by reference to the subcontract between Moore Brothers and Brown & Root.

In short, the court held that the pay-when-paid clause, while a procedural impediment to Moore Brothers’ claim against Brown & Root, had no effect upon Moore Brothers’ claim against the bond.

The court next turned to interpreting the phrase “sums as may be justly due claimant,” based solely upon the language contained in the bond. Not surprisingly, the court then held that, since there was no dispute that Moore Brothers had completed the work and had not been paid for it, the sums it claimed were “justly due.” In reaching this conclusion, the court characterized the pay-when-paid clause as a “condition precedent” to payment by Brown & Root, but held that it did not mean that sums were not justly due and owing to Moore Brothers under the bond.

In short, the court held that the pay-when-paid clause, while a procedural impediment to Moore Brothers’ claim against Brown & Root, had no effect upon Moore Brothers’ claim against the bond. In making this determination, the court appeared to rely heavily upon a decision by the Florida Supreme Court, OBS Company, Inc. v. Pace Construction Corporation, 558 So.2d 404 (Fla. 1990). In that case, the Florida Supreme Court addressed the very issue presented in the Moore Brothers case, the use of a pay-when-paid clause in the underlying contract to defeat a claim against a payment bond. Just as the Fourth Circuit did, the Florida Supreme Court rejected this defense and held that the pay-when-paid clause does not mean that the contractor does not owe the debt, but that “it simply cannot be enforced” until the contractor is paid by the owner. The Fourth Circuit

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likewise concluded that sums are justly due under the bond when there is no dispute as to the performance of the work and that the pay-when-paid clause is merely a condition precedent that forestalls payment by the contractor of a debt that is due and owing.

Finally, the court concluded that to allow Highlands to use the pay-when-paid clause to avoid liability under the bond would defeat the very purpose of the bond. The court stated: “To suggest that nonpayment by the owners absolves the surety of its obligation is nonsensical, for it defeats the very purpose of a payment bond.” Accordingly, the court concluded “as a surety who did not include an express pay-when-paid condition precedent in the contract payment bond, Highlands may not assert the pay-when-paid clause contained in the subcontract… as a defense to its liability to pay on the bond.”

The lesson for sureties from the Moore Brothers case is clear—if the surety intends to rely upon any provision in the underlying contract, the bond must specifically incorporate the underlying contract, or the particular language, into the bond.

very purpose of the bond. The court interpreted by the court is fairly standard in the industry. Therefore, the court's interpretation may be deemed persuasive in interpreting the same language in another court, particularly where the issue has not been previously addressed. Indeed, the Fourth Circuit relied on a decision from the Florida Supreme Court because the pay-when-paid language and bond language in both cases were nearly identical. The court also noted that it found no cases that supported Highlands' use of the pay-when-paid clause as a defense to a claim against the bond. Second, the court's rejection of the pay-when-paid defense asserted by Highland was based upon a “plain meaning” interpretation of the bond. Courts in most jurisdictions, as in Virginia, in interpreting contracts, such as the payment bond, will give the words in the contract their plain and ordinary meaning to determine the parties’ obligations. The premise of the plain-meaning rule is that the court will not look outside the contract to give meaning to it. The Fourth Circuit pointedly noted that the bond simply contained no language incorporating the subcontract as a whole or the pay-when-paid clause in particular. This left the term “sums justly due” to be interpreted without reference to the pay-when-paid language.

The Fourth Circuit's approach in construing the language in the bond is not unique to Virginia and further supports application of the Moore Brothers decision outside Virginia.

Finally, the Fourth Circuit concluded its decision by making broad statements concerning the general purpose of payment bonds.
The court concluded that it would be “nonsensical” for nonpayment by the owner to defeat a claim against the bond because “the very purpose of securing a surety bond contract is to insure that claimants who perform work are paid for their work in the event that the principal does not pay.” Again, the Fourth Circuit’s statement as to the purpose of a payment bond is not based upon any peculiarity of Virginia law.

**Implications for The Surety**

The Moore Brothers decision is particularly disturbing for sureties for several reasons. First, and foremost, it undermines the basic premise of the surety relationship that the principal must first be liable before a claim can be asserted against the surety. The decision in Moore Brothers allowed Brown & Root to escape liability based upon the pay-when-paid clause, but found Highlands liable for Moore Brothers’ claim. In fact, the Fourth Circuit held that the purpose of a payment bond is to provide payment to the subcontractor if “the principal does not pay” regardless of whether the principal is obligated to pay. The liability of the principal and the surety, according to the Fourth Circuit, are treated as separate and distinct issues.

Second, reliance by a surety upon a pay-when-paid clause in the underlying contract is now highly suspect. This is obviously true in Virginia, but it is true for other jurisdictions as well because the critical language in the payment bond at issue in Moore Brothers is identical or quite similar to language found in most payment bonds.

Finally, the court’s conclusion that the bond is a stand-alone agreement unaffected by the underlying contract has implications beyond simply the pay-when-paid scenario addressed in the case. In essence, the court held that, absent express language incorporating the underlying contract, that contract’s terms are not incorporated into the bond and are not to be referred to in determining the surety’s obligations under the bond. Therefore, just as the Fourth Circuit determined that the pay-when-paid clause was merely a “condition precedent to payment under the contract” that had no bearing in determining whether payments were “justly due” under the bond, other conditions precedent may also be unavailing as defenses to claims against the bond.

The lesson for sureties from the Moore Brothers case is clear—if the surety intends to rely upon any provision in the underlying contract, the bond must specifically incorporate the underlying contract, or the particular language, into the bond.

**Implications For The General Contractor**

The ultimate loser in the Moore Brothers case is, of course, Brown & Root, who will be called upon to indemnify and repay to Highlands any sums it pays under the payment bond under the general indemnity agreement that underlies the typical contractor/surety relationship. Brown & Root successfully negotiated a contract with Moore Brothers in which Moore Brothers agreed to accept the risk of nonpayment by the owner by agreeing to the pay-when-paid clause. The Fourth Circuit’s decision, however, essentially writes this provision out of the contract and places back on Brown & Root the risk of the owner’s nonpayment. Therefore, it is in the interest of the general contractor to be sure that all conditions for payment under its contracts are incorporated into the payment bond so that these conditions are not circumvented as happened in Moore Brothers.

**Conclusion**

The Moore Brothers case requires sureties and contractors alike to closely review the language and terms of their payment bonds to ensure that claims under the bond are predicated upon the same conditions and requirements for payment as set forth in the underlying contract. Otherwise, both the surety and the general contractor may lose important defenses to claims by subcontractors.

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2. The Fourth Circuit ultimately held that Brown & Root was responsible for or caused the owner’s inability to pay for the additional work, and, therefore, could not rely upon the pay-when-paid clause for that reason. The court did affirm, however, that but for Brown & Root’s alleged involvement in causing the owner’s inability to pay, the clause provided a good defense for Brown & Root.
"Salting" is a union organizing strategy common in the construction industry in which union organizers seek employment with non-union employers. Salting presents a "damned if you do, damned if you don’t" dilemma for employers: (1) if the organizer is hired, he may try to organize the employer from within; and (2) if the organizer is not hired, he may claim that the failure to hire was discriminatory and file an unfair labor practice ("ULP") charge against the employer with the National Labor Relations Board ("Board" or "NLRB").

Non-union employers have tried to combat salting by arguing that "salts" are not "employees" within the meaning of the National Labor Relations Act. However, the Board has consistently held, and the United States Supreme Court has agreed, that they are employees entitled to the Act’s protections. The litigation that has ensued over ULP charges brought on behalf of salts has resulted in different opinions about the NLRB General Counsel’s burden to prove the employer violated the Act in refusal-to-consider and refusal-to-hire cases and the remedies that are appropriate for sustained violations.

The Board recently addressed these contested issues in FES, A Division of Thermo Power, 331 NLRB No. 20 (May 11, 2000). The Board recognized explicitly that salting cases produce the possibility of two distinct types of Section 8(a)(3) violations of the Act. Acknowledging that “there has been some confusion over the elements of 8(a)(3) violations concerning refusals to hire and refusals to consider applicants for employment and the stage at which the employer may present its defense in these cases,” a panel majority of the Board clarified the elements of the violation, the respective burdens of the parties, the stage at which the issues are to be litigated and the appropriate remedies for proven violations.

**Refusal-To-Hire Claims**

To establish a discriminatory refusal to hire, the Board explained that the Board’s General Counsel must show at the hearing on the merits:

1. that the employer was hiring, or had concrete plans to hire, at the time of the alleged unlawful conduct;
2. that the applicants had experience or training relevant to the announced or generally known requirements of the positions for hire, or in the alternative, that the employer did not adhere uniformly to such requirements, or that the requirements were themselves pretextual or were applied as a pretext for discrimination; and
With regard to the second prong, the General Counsel must make an initial showing that applicants have "experience or training relevant to the announced or generally known objective requirements of the positions for hire." Thus, if the posted qualifications are suggested ("preferred" versus "required") or subjective ("good" or "superior"), the General Counsel does not have to prove that the applicants met those criteria. The General Counsel may alternatively make the required showing by demonstrating that the employer did not uniformly adhere to the announced requirements or that the requirements were pretextual or disparately applied.

If the General Counsel meets its burden by establishing the above three elements, the burden then shifts to the employer to show that it would not have hired the applicants even in the absence of union activity or affiliation. The employer can do this by demonstrating the applicant did not possess the necessary skills or that those hired had superior skills. Thus, the Board instructed that the issue of why the applicants were not hired has to be litigated on the merits at the hearing.

If the General Counsel meets its burden and the employer fails to meet its burden, a Section 8(a)(3) violation has been established. Once a violation is proven, the Board explained that the appropriate remedy is an order:

1. to cease and desist;
2. to offer the discriminatees immediate instatement to the positions for which they applied; or, if the positions no longer exist, to substantially equivalent positions; and
3. to make the discriminatees whole for losses they sustained because of the discrimination.

In cases involving numerous applicants, the Board held that the General Counsel "need only show that one applicant was discriminated against to establish a refusal-to-hire violation warranting a cease-and-desist order." To get back pay or instatement, however, the General Counsel must produce evidence at the hearing that there were job openings and evidence of the number of openings. Further, if the number of applicants discriminated against exceeds the number of established job openings, the compliance proceeding may be used to determine which applicants would have been hired for the openings and only those applicants will be instated with back pay. Any remaining applicants do not have to be instated because the Board will not require the employer to instate more applicants than it has available positions. Rather, the Board will provide the remaining applicants with refusal-to-consider remedies, which are discussed more fully below.

Refusal-To-Consider Cases

The General Counsel's burden in discriminatory refusal-to-consider cases is similar to his burden in refusal-to-hire cases in that the Board's General Counsel must show:

1. that the employer excluded applicants from the hiring process; and
2. that anti-union sentiments contributed to the decision to not consider the applicants for employment.

If the General Counsel meets this burden, then the employer must show that it would not have considered the applicants even in the absence of their union activity or affiliation. If a violation is established, the employer will receive a cease and desist order and an order to place the discriminatees in the position they would have been in for consideration for future job openings, absent the discrimination, and to notify the discriminatees of future openings in the jobs for which they applied or substantially equivalent positions.

Significantly, the Board held that a discriminatory refusal-to-consider may violate Section 8(a)(3) of the Act's ban on discrimination "in regard to hire" even when the

In FES, the Board clarified previously blurred lines on each party's respective burdens and defenses in refusal-to-hire and refusal-to-consider cases. It also broadened the permissible scope of salting charges by recognizing a valid refusal-to-consider claim even if the employer is not hiring when the salt applies for a job.

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employer is not hiring any new employees. In so holding, the Board rejected the employer's argument that there can be no Section 8(a)(3) violation when there are no jobs available. Instead the Board reasoned that, even if no jobs are available, the refusal-to-consider discourages future applicants and deters employees' efforts to self-organize, thereby violating the Act.

**Conclusion**

In *FES*, the Board clarified previously blurred lines on each party's respective burdens and defenses in refusal-to-hire and refusal-to-consider cases. It also broadened the permissible scope of salting charges by recognizing a valid refusal-to-consider claim even if the employer is not hiring when the salt applies for a job. What *FES* has not changed, however, is an employer's ability to refuse to hire salts for *bona fide* reasons. Indeed, an employer can refuse to hire a salt for any legitimate reason other than the salt's union status and objective, including falsification of employment application information, failing to follow proper application procedures and violating work rules. Accordingly, and in light of *FES*, employers can reduce the likelihood of ULP charges by taking some simple measures:

- Require all applicants to complete applications.
- State on applications that falsification of application information is grounds for immediate discharge.
- Train interviewers not to ask about union affiliation in interviews.
- Maintain and enforce a valid no-solicitation policy.
- Treat salts the same as all other applicants.

Observing these practical steps as an employer will not only reduce the chances of facing unfair labor practice charges, but also will help to promote legitimate business interests.

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*This remedy necessarily will involve an inquiry into the likelihood that the discriminatees would have been transferred to other worksites upon completion of the project on which the alleged unlawful conduct occurred or whether their employment would have ceased at the termination of the project. See Dean General Contractors, 285 NLRB 573 (1987).*

*The Board also instructed that the compliance proceeding on a refusal-to-consider violation is the appropriate forum for determining whether there was an actual job loss as a result of the discriminatory refusal to consider. Because the fundamental purpose of Board remedies is to "undo the effects of violations of the Act," the Board held that the General Counsel should have the opportunity at the compliance hearing to show that the applicant would have been hired for a job that became available. Further, the Board stated that if the requisite showing was made, the job must be offered to the applicant as part of the make-whole remedy.*
A subcontractor has been performing its work on the project and has been awaiting payment under the terms of its subcontract. The contractor has refused to pay invoices based upon an assertion that either the time of payment has not yet arisen under the subcontract or the contractor has identified certain corrective work which is necessary before payment will be issued. The subcontractor, recognizing its subcontractual duties, either awaits a determination that payment is due or proceeds to undertake the necessary remedial work before pursuing formal legal avenues to enforce its right to payment. However, taking these courses of conduct in relationship to statutorily required labor and material payment bonds may prove to be fatal decisions under a pair of very recent decisions interpreting the statutory limitations on commencement of actions against payment bond sureties.

In the first case, *Windsor Metal Fabrications, Ltd. v. General Accident Insurance Company of America*, 94 N.Y. 2d 124 (Ct. App. N.Y. 1999), a subcontractor on a public improvement project had initiated suit against a surety to recover on the statutorily required payment bond. Plaintiff, Windsor, a subcontractor engaged by the general contractor to provide and erect all structural steel for the project, had been terminated as a result of the State of New York’s termination of its prime contract with the general contractor on or about March 28, 1995. Promptly after this termination, Windsor corresponded with both the general contractor and General Accident, indicating its entitlement to payment in the amount of approximately $200,000.00. Both the general contractor and General Accident denied owing Windsor any additional compensation and rejected Windsor’s payment demands. Shortly thereafter, Windsor initiated a demand for arbitration against only the general contractor seeking payment in the requested amount. Windsor also notified General Accident of the arbitration and General Accident participated in the proceedings to the extent that it joined the general contractor in an attempt to prove Windsor had breached its subcontract and was not entitled to payment.

In April 1996, Windsor was awarded its claims against the general contractor and a confirmation of award was entered. At that time, however, the general contractor had become insolvent and was unable to pay on the judgment.

Having hit this significant financial obstacle, Windsor initiated action against General Accident in the amount of the judgment entered against the general contractor. General Accident interposed a defense under the statute of limitations as contained in New York’s State Finance Law § 137(4)(b).

State Finance Law § 137(4)(b) provides:

> No action on a payment bond furnished pursuant to this section shall be commenced after the expiration of one year from the date on which final payment under the claimant’s subcontract became due.

A related statute, Section 137(3) of the State Finance Law, provides that anyone who had furnished labor or materials pursuant to a subcontract made directly with the contractor and who is not paid within ninety...
Accordingly, despite the arguably reasonable interpretation that payment was not yet due under the subcontract, the court concluded that because the subcontractor had a stated belief payment was due, the bond claim limitations period began to run, albeit prior to any arbitration award against the contractor/principal.

of the State Finance Law begins to run when the subcontractor who has directly contracted with the general contractor has “submitted an invoice for final payment (or given the functional equivalent thereof) and 90 days have passed since the subcontractor has ceased to work on the project.” See Windsor, 94 N.Y. 2d at 131. Indeed, the court added in its holding that “[c]ontractual provisions between the subcontractor and general contractor cannot modify this . . . date.” Id.

The court viewed as significant the payment bond’s incorporation of the one year limitations period from the State Finance Law and the payment bond’s specific reference to the statute on the face of the bond. Id. at 134. Following generally accepted surety interpretation principles, the court refused “to look beyond the face and terms of the bond to the contract provisions.” Id. The court then also stated there were “strong policy reasons for not reading contractual clauses to interject an open durational set of events into the statute . . . [, noting] [t]hat practice would undermine the essential purpose of the limitations period and would effectively circumvent the intent of the Legislature in this respect . . . .” Windsor, 94 N.Y. 2d at 135.

Accordingly, despite the arguably reasonable interpretation that payment was not yet due under the subcontract, the court concluded that because the subcontractor had a stated belief payment was due, the bond claim limitations period began to run, albeit prior to any arbitration award against the contractor/principal.

In the second case, United States v. International Fidelity Insurance Company, 200 F.3d 456 (6th Cir. 2000), the court was called upon to evaluate the issue of commencement of the one year statute of limitation period on the labor and material payment bond juxtaposed with the question of when labor was last performed or material was last supplied in accordance with the requirements of the Miller Act, 40 U.S.C.A. § 270b(b). In particular, the Court of Appeals for the Sixth Circuit was evaluating, for the first time in that circuit, what work constituted a triggering event for commencement of the statute of limitation.
The plaintiff in *International* was Interstate Mechanical Contractors, Inc. ("Interstate"), a subcontractor performing HVAC work at a U.S. Department of Commerce facility located in Tennessee. Pursuant to Section 270a of the Miller Act, the general contractor, as principal, posted a bond to guarantee payment under the contract with International as the payment bond surety. As a part of its subcontract, Interstate agreed to, among other things, install electric duct heaters, coordinate the heaters' installation with other work, and test operate the heaters to demonstrate compliance with the contractual requirements. While Interstate completed its construction of the heaters in June of 1994, and although the government took beneficial occupancy of the facility shortly thereafter, the requisite testing and trouble-shooting of the heaters did not occur until October of 1994. In fact, in October of 1994, additional work was undertaken in the form of replacement of the heaters and re-testing of them on or about October 18, 1994. Exactly one year after this last testing date, Interstate filed suit against International under the provisions of the Miller Act.

Despite the fact that the Miller Act requires that suits to recover against a payment bond be initiated no more than "one year after the day on which the last of the labor was performed . . .", 40 U.S.C.A. § 270(b), the Sixth Circuit rejected Interstate’s contention that the work performed in October of 1994 qualified for purposes of the starting point for calculation of the Miller Act payment bond claims limitation period. Consistent with the liberal interpretation and reading which is to be given to the Miller Act as a remedial statute, the Sixth Circuit agreed “with the majority of courts that have interpreted the phrase [above-quoted] and have concluded it connotes more than mere substantial completion or substantial performance of the plaintiff’s obligations under its contract.” See *International*, 200 F.3d at 459.

However, the court quickly noted it also agreed “that work done at the request of the government and pursuant to a warranty, subsequent to final inspection and acceptance of the project, falls outside of the meaning of labor performed as set forth in § 270b(b)." *International*, 200 F.3d at 459. As such, the issue framed before the court was whether Interstate’s work, performed between substantial completion of the project and final completion of the project, was included within the operative definition of the Miller Act versus whether such work was more appropriately considered warranty work and excluded from an analysis of the Miller Act payment bond limitation triggering event.

In *International*, the Sixth Circuit adopted the “majority rule” which “requires the trier of fact to distinguish ‘whether the work was performed . . . as a part of the original contract or for the purpose of correcting defects, or making repairs following inspection of the project.’” *International*, 200 F.3d at 460. Although the court recognized that this line of inquiry had received some criticism, it chose to adopt this test as the law of the Sixth Circuit when addressing the commencement of the statute of limitation of claims against labor and material payment bond sureties under the Miller Act.

Having adopted this standard, the court then turned to the question of whether Interstate’s work, which was arguably required under the contract, was by its nature remedial versus work required under the original contract. Because the court observed that the last tests performed were of corrective work

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performed by Interstate and “were not tests required by the original contract,” those tests of remedial or corrective work did not qualify as the supply of labor for purposes of the Miller Act. International, 200 F.3d at 460.

The court held:

Because the correction—or—repair versus original contract test first enunciated in United States ex rel. Austin v. Western Elec. Co. offers predictability and administrability when applying the Miller Act’s statute of limitation, we adopt it for our Circuits. Under this majority rule, tests of remedial work, or tests performed to replacement materials do not constitute labor under § 270b(b) for purposes of the Miller Act. The Act’s inquiry focuses on the nature of the work performed, not its cause. Hence, under § 270b(b), neither repairs necessitated by work improperly performed by the contractor nor repairs necessitated by defective materials supplied by a manufacturer qualify as 'labor performed' or 'materials supplied.' For those reasons stated above, we AFFIRM the Order of the district court granting summary judgment to [International].


Reading the rationale of these cases together, their underlying instructions are resoundingly clear. In order to avail oneself of the protections provided by statutorily mandated labor and material payment bonds, a claimant must be extremely diligent in taking adequate steps to enforce those rights. In each of the situations identified, the adverse consequences of these decisions could have been avoided by the subcontractor’s initiations of actions against the payment bond sureties prior to the outer limit dates on which the claims were actually commenced. For example, the plaintiff in Windsor could have very well avoided problems with the payment bond statute of limitation by joining General Accident in its claim in arbitration made against the general contractor/principal. Also, had the surety raised the absence of an arbitration provision as a defense to its joinder, Windsor could have then initiated a parallel proceeding to enforce its rights.

Admittedly, the situation confronting Interstate was far more complicated. From the facts of that case, it is hard to determine whether Interstate

Reading the rationale of these cases together, their underlying instructions are resoundingly clear. In order to avail oneself of the protections provided by statutorily mandated labor and material payment bonds, a claimant must be extremely diligent in taking adequate steps to enforce those rights.
should have used the June 1994 completion date as the starting point for its statute of limitation analysis or some date between June of 1994 and the date in October of 1994 that it ultimately and unfortunately chose to utilize in calculating its timeframe in which to assert claims against International. Nevertheless, with the benefit of the International decision, Interstate, as well as other subcontractors on projects protected by Miller Act bonds,¹ should be far more conservative in calculating the starting point for the statute of limitation governing payment bond claim rights in the future.

So, in order to take advantage of the valuable protections offered by statutorily required labor and material payment bonds, it is extremely important to obtain a copy of the payment bond, evaluate its terms, evaluate the statutorily established limitation period, and conservatively identify the triggering date for initiation of claims against the payment bond surety. Following this approach, a claimant’s rights to recovery will be enhanced, its entitlement to payment will be protected to a greater degree, and that claimant will be able to keep building for the future! ■

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¹Most states, including Pennsylvania and Virginia, have so-called “Little Miller Acts” which impose requirements for payment bonds on state and local public projects similar to those imposed under the Federal Miller Act. As such, subcontractors on state projects should also heed the decision of the Sixth Circuit in International.
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