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Rocky Waters Ahead: Pennsylvania Commonwealth Court Eliminates Safe Harbor Defense For Payment Bonds

A recent decision handed down by the Pennsylvania Commonwealth Court has changed the landscape of surety law in Pennsylvania. The Court's decision in *Berks Products Corp. v. Arch Insurance Co.*, undeniably increases the financial risk to sureties writing bonds in the Commonwealth.

The Pennsylvania Public Prompt Pay Act contains a provision which provides protection for sureties when the bonded contractor pays its subcontractors in full for their work. Specifically, the statute states that when "a contractor has made payment to the subcontractor according to the provisions of this Act, future claims for payment against the contractor or the contractor's surety by parties owed payment from the subcontractor which has been paid in full shall be barred". In other words, once a contractor has paid a subcontractor, claims made by 2nd and 3rd tier claimants against the contractor or the contractor's surety are improper.

The *Berks Products* case changes that by effectively eliminating this "safe harbor" provision. In short, the court held that the language of a typical payment bond, as stated below, takes priority over the statutory safe harbor protection afforded contractors and their sureties:

The terms and conditions of this Bond are and shall be that if the Principal and any subcontractor of the Principal to whom any portion of the work under the Agreement shall be subcontracted, and if all assignees of the Principal and of any such subcontractor, promptly shall pay or shall cause to be paid, in full, all money which may be due any claimant supplying labor or materials in the protection and performance of the work in accordance with the Agreement and in accordance with the Contract Documents ... for material furnished or labor supplies or labor performed, then this Bond shall be void; otherwise the Bond shall be and shall remain in full force and effect.

By way of background, the general contractor in the *Berks Products* case argued that it paid its subcontractor in full for the labor and material the subcontractor provided to the project. No other party disputed that the subcontractor, which went bankrupt, did not pay its material supplier – more specifically Berks Products – in full. When Berks Products made its claim against the payment bond issued by Arch, the surety maintained it was protected by the safe harbor provision in the statute. In contrast, Berks Products argued that this statutory protection was waived by the language in the Arch bond. The Commonwealth Court determined that the above quoted language went further than the bond law required and did in fact waive the "safe harbor" protection afforded to the surety. Specifically, by committing to have the bond stay in effect until the claimants were paid in full, the surety waived its right to assert the safe harbor protection otherwise afforded to it.

This decision seems to run contrary to the Court's prior holding in *Trumbull Corp. v. Boss Construction*. The same Commonwealth Court held that the Prompt Pay Statute takes priority over rights afforded to claimants under Pennsylvania's Little Miller Act in *Trumbull*. In that case, the Court reasoned that the Prompt Pay Statute enacted well after the inception of the Little Miller Act expressed the intention of the legislature to provide a safe harbor and, to the extent there is a contradiction between the two statutes, the most recently enacted legislation controls. Thus, the surety was able to assert the "safe harbor" provisions of the statute as a defense to a payment bond claim.

The *Berks Products* decision is a metaphorical "game changer" for surety law in Pennsylvania. While some are predicting an end to the safe harbor provision, the more likely outcome is a less drastic outcome driven by a more prudent approach. Sureties will likely begin reviewing their bond forms to consider language revisions that will better protect the bonding company. Those in the construction industry should be aware of this decision and the changes that are likely over the horizon as a result.