



REMEDIES FOR NON-PAYMENT ON PUBLIC-WORK PROJECT

A recent decision by the Supreme Court of Texas establishes that subcontractors and materialmen may have more than just a claim on a payment bond on public work projects. See *Dealers Electrical Supply Co. v. Scoggins Construction Co., Inc.*, 2009 WL 1901638 (Texas).

For prime contracts exceeding \$25,000.00, the Texas Government Code, historically called the McGregor Act, requires the prime contractor on a public-work contract to execute a payment bond to protect laborers and materialmen who work on or supply materials to the project. See Tex. Gov't. Code § 2253.021(a)(2). The statute was enacted to protect public-work laborers and materialmen, since a lien cannot be asserted against a public improvement.

In order to properly file a claim on a payment bond, notices and a sworn statement of account must be given within specified time frames, depending on one's relation to the prime contractor. Failure to timely comply with the notice requirements invalidates a claim against the surety and means no payment by the surety to the claimant.

Prior to the recent Texas Supreme Court Case, *Dealer Electrical*, some courts held that the McGregor Act claim against the surety was the "ONLY" available remedy of an unpaid subcontractor or materialman.

In *Dealers Electrical*, an electrical parts supplier furnished electrical equipment to Diamond Industries who had been hired by

the prime contractor, Scoggins Construction Co., to do work on a project for the Mercedes Independent School District. In trying to recover for the value of materials it had furnished to Diamond Industries, who abandoned the project, *Dealers Electrical* sued the surety and Scoggins (along with Diamond Industries) for violating a joint check agreement it had with the general contractor and for violating Chapter 162 of the Texas Property Code, generally known as the Texas Construction Trust Fund Act:

*Under the Trust Fund Act, payments made to a **contractor** or subcontractor under a construction contract for the improvement of real property are considered to be trust funds. Tex. Prop. Code § 162.001(a). Subcontractors or **suppliers** who furnish labor or **material** for the construction project are considered beneficiaries of any trust funds paid or received in connection with the improvement. *Id.* at § 162.003. A trustee misapplies trust funds if it "intentionally or knowingly or with intent to defraud, directly or indirectly retains, uses, disburses, or otherwise diverts trust funds without first fully paying all current or past due obligations incurred by the trustee to the beneficiaries of the trust fund. *Id.* at § 162.031(a). A party who misapplies trust*

funds under the Trust Fund Act is subject to civil liability to trust-fund beneficiaries whom the Act was designed to protect. See C & G Inc. v. Jones, 165 S.W.3d 450, 453 (Tex. App.—Dallas 2005, pet denied).

In its lawsuit, *Dealers* included, but later dropped, a claim against the surety bond, due to the fact it *failed* to comply with the McGregor Act's mandatory notice requirements. *Dealers* also asserted a claim under its Joint Check Agreement and for violation of the Trust Fund Act. The prime contractor, Scoggins, argued that the "ONLY" remedy available to the subcontractor, *Dealers Electric*, was against the bond, under the McGregor Act. This argument would preclude any recovery by *Dealers* since it had not properly perfected its McGregor Act claim. The trial court found in favor of *Dealers*, but the appellate court reversed the verdict, finding that the McGregor Act was

Dealers' "ONLY" remedy as to anyone other than Diamond Industries, to whom it had actually furnished product. The court rendered a take-nothing judgment against Dealers. The Texas Supreme Court reversed and declined to follow the general contractor's argument that the McGregor Act was the subcontractor's "ONLY" remedy.

The Texas Supreme Court's ruling opens the door for unpaid subcontractors, laborers and materialmen to pursue alternative remedies against the prime contractor. Thus, other causes of action may be asserted to assist the subcontractors or materialmen in recovery. For example, breach of a third-party check agreement, quantum meruit, fraud, or a trust fund claim. Suppliers should also file their claims against the bonds. It is still a better tactic to file your claim and try to recover against the bond than resorting to litigation to prove up your claim. Watch your deadlines carefully and consult with an attorney if you have any questions about filing your claim.

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