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In Court of Appeals

Minnesota Laborers Health and Welfare Fund, Minnesota Laborers Pension Fund, Minnesota Laborers Vacation Fund, Construction Laborers' Education, Training, and Apprenticeship Fund of Minnesota and North Dakota, Minnesota Laborers Employers Cooperation and Education Trust,

Appellants,

vs.

Granite Re, Inc.,

Respondent,

vs.

EnviroTech Remediation Services, Inc., David P. Sobaski, Karla P. Sobaski, Daniel Krause, Margaret Krause, Brent Krause, Jane Krause, William Sievers, Jill Sievers, Brent Anderson, and JoAnne M. Anderson,

Third-Party Respondents.

BRIEF AND APPENDIX OF RESPONDENT GRANITE RE, INC.

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The appendix to this brief is not available for online viewing as specified in the *Minnesota Rules of Public Access to the Records of the Judicial Branch*, Rule 8, Subd. 2(e)(2).

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STATEMENT OF LEGAL ISSUES

I. Is a third party that does not have a direct contract with the promisee entitled to sue on a private payment bond that provides that only a third party having a direct contract with the promisee may sue the promisor?

This issued was raised in the district court on cross-motions for summary judgment. Add. 1.[1]

The district court answered the question in the negative. It ruled that because appellants did not have a direct contract with the private payment bond principal, they were not entitled to sue the private payment bond surety. Add. 3-4 ¶¶ 1-2.

The Funds filed their appeal on June 15, 2012.

The most apposite cases on this issue are:

Hickman v. SAFECO Insurance Co. of America, 695 N.W.2d 365 (Minn. 2005).

Cretex Cos. v. Construction Leaders, Inc., 342 N.W.2d 135 (Minn. 1984).

Brix v. General Accident & Assurance Corp., 254 Minn. 21, 93 N.W.2d 542 (Minn. 1958).

Twin City Construction Co. v. ITT Industrial Credit Co., 358 N.W.2d 716 (Minn. Ct. App. 1984).

[1] "Add." refers to Appellants' Addendum.

II. Does the alleged fraudulent concealment of a principal obligor toll the limitation period and bar the innocent secondary obligor from asserting a limitations defense?

This issued was raised in the district court on cross-motions for summary judgment. Add. 1.

The district court answered the question in the negative. It ruled that because respondent did not engage in any fraudulent concealment, it was entitled to rely on the limitations period prescribed in its private payment bond. Add. 4 ¶¶ 3-4.

The Funds filed their appeal on June 15, 2012.

The most apposite cases on this issue are:

Schmucking v. Mayo, 183 Minn. 37, 235 N.W. 633 (1931).

Sletto v. Wesley Construction, Inc., 733 N.W.2d 838 (Minn. Ct. App. 2007).

STATEMENT OF THE CASE

On April 6, 2011, appellants Minnesota Laborers Health and Welfare Fund, Minnesota Laborers Pension Fund, Minnesota Laborers Vacation Fund, Construction Laborers' Education, Training, and Apprenticeship Fund of Minnesota and North Dakota, Minnesota Laborers Employers Cooperation and Education Trust (collectively, the "Funds") commenced this litigation by serving their Summons and Complaint on Respondent Granite Re, Inc. ("Granite"). Add. 3 ¶ 9. The Complaint stated a single count, seeking a declaratory judgment that the Funds' claim under Subcontract Labor and Material Payment Bond No. GRMN28376A (the "Bond") was timely. AA 6 ¶¶ 25-28.[2]

[2] "AA" refers to Appellants' Appendix.

Granite answered and joined several third-party defendants under an indemnity agreement. AA 10-AA 26.

The Funds and Granite brought cross-motions for summary judgment. AA 27-AA 30. On December 15, 2011, the district court (Hon. Shawn M. Moynihan) held a hearing on the motions. Add. 1. On March 6, 2012, the district court filed its Findings of Fact, Conclusions of Law, and Order for Judgment, accompanied by a memorandum, granting Granite's motion for summary judgment and denying the Funds' motion for summary judgment. Add. 1-11. The district court administrator entered judgment for Granite the same day. Add. 4. Granite dismissed its claims against the third-party defendants, with all judgments entered by May 31, 2012. AA 225-AA 237. This appeal follows.

STATEMENT OF FACTS

A. EnviroTech

EnviroTech Remediation Services, Inc. ("EnviroTech") was a contractor in the business of asbestos and lead remediation. *See* Add. 2 ¶ 2. EnviroTech entered into a series of Subcontract Agreements with Brandenburg Industrial Service Co. ("Brandenburg") to perform work related to a demolition project (the "Project"), specifically the demolition of the coal-fired High Bridge Generating Plant (the "Plant") operated by Xcel Energy ("Xcel"). Add. 2 ¶ 2; AA 64-AA 86; AA 94-AA 116; AA 119, AA 125-AA 146. The Subcontract Agreement Phase 3 Contract (the "Phase 3 Subcontract") was made on August 1, 2008 and effective the same day. AA 119, AA 125-AA 146. The Phase 3 Subcontract required EnviroTech to, among other things, provide a payment bond. AA 145 at ¶ 15.4. EnviroTech obtained the Bond, a private

payment bond, from Granite on August 29, 2008. AA 148. EnviroTech completed its work on the Project in May 2009. Add. 3 ¶ 7.

B. The Collective Bargaining Agreement and the Funds

EnviroTech was a member of the Minnesota Environmental Contractors Association (the "Association") and had agreed to be bound by the collective bargaining agreement (the "CBA") between the Association and the Laborers District Council of Minnesota and North Dakota (the "Union"). AA 46-AA 47. The CBA recites that it is an agreement between (1) the Association as the representative of several employers, contractors similar to EnviroTech, and (2) the Union as the representative of several local labor unions, whose members were employed by the employer-members of the Association. AA 51 at art. 2.

The CBA sets rates for wages and fringe-benefit contributions for laborers. AA 53-AA 55 at art. 8. The CBA requires employers to make monthly contributions to six fringe-benefit funds, five of which are the appellants in this matter. AA 58-AA 60 at art. 19. The CBA requires employers to provide, on demand, "all necessary employment and payroll records" to the Funds' trustees. AA 59 at para. 4(f). This access to employment and payroll records is recited as being necessary "to ensure the proper administration of [the Funds]." *Id.*

The Funds' trustees adopted an Amended and Restated Statement of Policy on Collection of Fringe Benefit Contributions for the Minnesota Laborers Fringe Benefit

Funds (the "Collection Policy"). RA 1-RA 22.[3] The Collection Policy provides that the administrator of the Funds will audit each employer's employment and payroll records "approximately every two years." RA 10. The Collection Policy permits audits to occur more frequently than every two years. *Id.* The Collection Policy also permits as many as three years to pass between audits of an employer. *Id.*

C. The Alleged Fraudulent Concealment

The Funds allege that EnviroTech engaged in fraudulent payroll practices by paying laborers with accounts-payable checks or cash instead of payroll checks. Add. 3 ¶ 6. The use of accounts-payable checks and cash payments is alleged to have concealed from the Funds hours of work performed by laborers who may have been members of unions covered by the CBA. *See id.*

EnviroTech completed its work on the Project in May 2009. Add. 3 ¶ 7. The Funds assert that they discovered these allegedly fraudulent payroll practices in or around December 2010, during the discovery process of ongoing federal litigation between the Funds' trustees and EnviroTech. Add. 3 ¶ 7; AA 4-AA 5 at ¶¶ 15-19.

The Funds calculated the amount of unpaid contributions they allege are owed by EnviroTech, and for which they assert Granite is liable under the Bond, by relying on sign-in/sign-out sheets, which anyone who entered the project site had to sign. AA 35-AA 36 at 92:13-93:4. The Funds' auditor assumed that everyone on the sign-in/sign-out sheets was performing covered work for which fringe benefit contributions were owed. AA 166-AA 169.

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[3] "RA" refers to Respondent's Appendix.

Granite had no knowledge of the allegedly fraudulent payroll practices before receiving the Funds' notice of claim in February 2011. RA 24 at ¶¶ 6-7.

D. The Bond

The Bond was issued by Granite as surety, on behalf of EnviroTech as principal. AA 148. The Bond recites that it is made in connection with the contractual obligations of EnviroTech under the Phase 3 Subcontract. *Id.* The Bond provides that "every claimant . . . who has not been paid in full" within 90 days after the last date the claimant performed work or labor, or furnished material, may sue on the bond. *Id.* at para. (2). The Bond further provides that "No suit or action shall be commenced hereunder by any claimant . . . [a]fter the expiration of one (1) year following the date on which [EnviroTech] ceased work on said subcontract." *Id.* at para. (3)(a). The Bond defines a "claimant" as "one having a direct contract with [EnviroTech] for labor, material, or both, used or reasonably required for use in the performance of [the Phase 3 Subcontract]." *Id.* at para. (1).

ARGUMENT

On appeal from summary judgment, this court's de novo review focuses on whether (1) there is any genuine issue of material fact and (2) the district court erred in its application of the law. *STAR Ctrs., Inc. v. Faegre & Benson, LLP*, 644 N.W.2d 72, 76-77 (Minn. 2002). Because no genuine issue of material fact precludes summary judgment in Granite's favor and the district court did not err in its application of the law, the summary judgment should be affirmed.

I. The Funds are not entitled to recover under the Bond.

The Funds argue that they are entitled to recover under the Bond as third-party beneficiaries. The district court concluded that the Funds are not intended third-party beneficiaries under the Bond, and are therefore not entitled to enforce its terms. Add. 3-4 at ¶¶ 1-2. Because there are no genuine issues of material fact to the contrary and the district court correctly interpreted and applied Minnesota contract law, this conclusion should be affirmed.

Under Minnesota law, a third party may enforce a contract only if it is an "intended" beneficiary of the contract. *Cretex Cos. v. Constr. Leaders, Inc.*, 342 N.W.2d 135, 139 (Minn. 1984). A party is an intended beneficiary under a contract only if such status is "'appropriate'" and the party has satisfied one of two tests: the "intent to benefit" test or the "duty owed" test. *Id.* Because the rights of an intended third-party beneficiary "depend upon, and are measured by, the terms of the contract," both tests require a careful examination of the "terms and promises" of the Bond. *Brix v. Gen. Accident & Assurance Corp.*, 254 Minn. 21, 24, 93 N.W.2d 542, 544 (1958). Because the Funds cannot satisfy either the intent-to-benefit test or the duty-owed test, and no alternative theories favor the Funds, they cannot enforce the Bond as intended third-party beneficiaries.

A. The Bond does not reflect an intent to benefit the Funds.

The intent-to-benefit test requires that the contract "express some intent by the parties to benefit the third party through contractual performance." *Cretex Cos.*, 342 N.W.2d at 138. The parties' objective manifestation of intent as expressed in the

contractual writing controls. *Hickman v. SAFECO Ins. Co. of Am.*, 695 N.W.2d 365, 370 n.7 (Minn. 2005). Where there is a written instrument, the intent of the parties is determined by the plain language of the written instrument. *Travertine Corp. v. Lexington-Sherwood*, 683 N.W.2d 267, 271 (Minn. 2004). When a contractual provision is clear and unambiguous, the court cannot rewrite the provision through strained construction. *Id.* Unambiguous contractual language must be enforced according to its plain and ordinary meaning, even if the result is harsh. *Denelsbeck v. Wells Fargo & Co.*, 666 N.W.2d 339, 347 (Minn. 2003). A contractual provision is ambiguous only when its language is "reasonably susceptible of more than one interpretation." *Art Goebel, Inc. v. N. Suburban Agencies, Inc.*, 567 N.W.2d 511, 515 (Minn. 1997).

An intended third-party beneficiary can be identified in a contract either individually or as a member of a defined class. *See Hickman*, 695 N.W.2d at 370 (stating that although Hickman was not identified by name, he was a member of the class of "borrowers" under the insurance contract at issue). But when there is no reference to the third party in the contract, there is no intent to benefit the third party. *614 Co. v. Minneapolis Cmty. Dev. Agency*, 547 N.W.2d 400, 410 (Minn. Ct. App. 1996).

The Bond identifies its intended third-party beneficiaries as a class, designated as "claimants." Under the Bond, a claimant is "one having a direct contract with [EnviroTech] for labor, material, or both, used or reasonably required for use in the performance of [the Phase 3 Subcontract]." AA 148. As the district court recognized, the Funds did not have a direct contract with EnviroTech. Add. 3-4 ¶ 1. The Funds were a third-party beneficiary of the CBA between the Association (to which EnviroTech

belonged) and the Union (to which the laborers may have belonged). The record before the district court reflects that there are several contractual steps between EnviroTech and the Funds, not a direct contract.

Because the Funds did not have a direct contract with EnviroTech, they are not claimants and therefore not intended third-party beneficiaries. The language of the Bond, plainly interpreted and applied, requires the result reached by the district court.

B. The Bond does not require Granite to discharge a duty owed by EnviroTech to the Funds.

The duty-owed test requires that Granite's "performance under the contract must discharge a duty otherwise owed [the Funds] by [EnviroTech]." *Cretex Cos.*, 342 N.W.2d at 138.

In *Twin City Construction*, a property owner obtained a rescue loan. *Twin City Constr. Co. v. ITT Indus. Credit Co.*, 358 N.W.2d 716, 717 (Minn. Ct. App. 1984). The lender (promisor) agreed to make a $3.45 million loan (the promise) to the property owner (promisee). *Id.* The lender specifically committed $2.9 million of the loan for construction costs, to be paid to the builder (third party). *Id.* Because the lender's specific promise discharged a duty owed by the owner to the builder, the builder was an intended third-party beneficiary of the loan agreement. *Id.* at 718.

The Funds ignore the specific contractual performance that was due from Granite under the terms of the Bond. Granite contracted to be liable to the defined class of *claimants* who had not been paid in full by EnviroTech within 90 days after last performing work. Granite's payment to any claimants would not satisfy a duty owed by

EnviroTech to the Funds. Granite's promise under the Bond requires it to discharge certain duties owed by EnviroTech, but not all duties owed by EnviroTech.

The Funds are not intended third-party beneficiaries of the Bond under the duty-owed test.

C. Alternative theories do not grant the Funds third-party beneficiary status.

Rather than accept that the traditional third-party-beneficiary tests do not favor them, the Funds attempt to require a strained construction of the Bond under two theories: (1) fringe benefit funds are third-party beneficiaries of private payment bonds as a matter of law, regardless of the language of the payment bond at issue; or (2) the Funds are the assignees of the laborers and are therefore claimants by assignment. Neither theory is availing.

1. Fringe benefit funds are not third-party beneficiaries of private payment bonds as a matter of law.

The Funds argue that, regardless of the plain language of the Bond, they are intended third-party beneficiaries of the Bond because fringe benefit funds are always intended third-party beneficiaries of various statutory and contractual devices prevalent in the construction industry. The Funds confuse these devices – mechanics liens, statutory payment bonds, and private payment bonds – each of which must be understood within its own context.

A mechanics lien is a lien on real property in favor of a person who contributes to the improvement of the real property by, among other things, "performing labor, or furnishing skill, material or machinery." Minn. Stat. § 514.01 (2010). Mechanics liens

arise not by contract, but are "purely creatures of statute." *London Constr. Co. v. Roseville Townhomes, Inc.*, 473 N.W.2d 917, 919 (Minn. Ct. App. 1991).

When a contractor has a "contract with a public body for the doing of any public work," the contractor must provide a statutory payment bond "for the use and benefit of all persons furnishing labor and materials engaged under, or to perform the contract, conditioned for the payment, as they become due, of all just claims for the labor and materials." Minn. Stat. § 574.26, subd. 2 (2010); *accord* 40 U.S.C. § 3131(b)(2) (2006) (stating similar requirement for federal public works projects).

A private payment bond is simply a contract between two parties, not a set of obligations imposed or arising under statute. While consideration of mechanics liens and statutory payment bonds involves statutory construction and legislative intent, consideration of private payment bonds involves only principles of contract law. *See Cretex Cos.*, 342 N.W.2d at 138-141 (applying only contract law, and not the law of public works bonds, to a private performance bond).[4]

The Funds cite a number of cases that hold that fringe benefit funds are entitled to bring either a mechanics lien action against real property or a bond claim against the surety of a statutory payment bond. Both lines of cases have their genesis in a single decision of the United States Supreme Court, *United States ex rel. Sherman v. Carter*. In *Sherman*, the Court concluded that the federal statutory phrase "person who has furnished

[4] Generally speaking, a performance bond runs to the owner of a project, while a payment bond runs to the subcontractors and suppliers. *Cretex Cos.*, 342 N.W.2d at 137-38. Performance bonds and payment bonds are both required by statute for public works, and are often sold together for private projects.

labor" in the federal payment bond act (commonly known as the Miller Act) includes trustees of fringe benefit funds. *United States ex rel. Sherman v. Carter*, 353 U.S. 210, 220-21, 77 S. Ct. 793, 799 (1957). The rationale of *Sherman* has since been adopted by many states in interpreting and applying their state payment bond acts. *E.g.*, *Dobbs v. Knudson, Inc.*, 292 N.W.2d 692, 695 (Iowa 1980). The rationale of *Sherman* has also been adopted by many states, including Minnesota, in interpreting and applying their mechanics lien statutes. *Twin City Pipe Trades Serv. Ass'n v. Peak Mech., Inc.*, 689 N.W.2d 549, 552-53 (Minn. Ct. App. 2004).

But the rationale of *Sherman* has not been universally adopted within these statutory contexts. Under New Jersey law, fringe benefit funds are not entitled to prosecute a claim on a statutory payment bond, where the public works payment bond statute "creates an obligation to ensure payment . . . 'for all labor performed or materials, provisions, provender or other supplies . . . used or consumed in, upon, for or about the construction, erection, alteration or repair of such buildings, works or improvements.'" *Laborers Local Union No. 779 Pension, Welfare & Annuity Funds v. Am. Cas. Co.*, 771 A.2d 712, 718 (N.J. Super. Ct. Law. Div. 2000) (quoting N.J. Stat. Ann. § 2A:44-143a(1)).

The question of whether fringe funds are entitled to sue on a private payment bond not governed by statute appears to have arisen only under New York law. The decisions there are in conflict. In 1958, the intermediate appellate court of New York concluded that a private payment bond providing that "the principal and sureties undertake to pay promptly all lawful claims for 'Wages and compensation for labor performed and

services rendered by all persons engaged in the prosecution of the Work under said Contract'" permitted fringe fund trustees to bring a claim. *Martin v. William Casey & Sons, Inc.*, 170 N.Y.S.2d 228, 230 (N.Y. App. Div. 1958). The court focused on what it determined the parties intended, beyond the express language of the bond. *Id.* at 232. Because the bond at issue in *Martin* did not include a "direct contract" definition, the opinion is not persuasive as to the interpretation of a bond that defines the class of its intended third-party beneficiaries with a "direct contract" definition.

The Southern District of New York, applying New York law, concluded that a private payment bond with a "direct contract" definition of "claimant" includes fringe benefit funds. *Mountbatten Sur. Co. v. Kips Bay Cinemas, Inc.*, No. 00 Civ. 0430 (NRB), 2000 U.S. Dist. LEXIS 17176, at *32 (S.D.N.Y. Nov. 28, 2000).[5] But the *Mountbatten* court relied extensively on *Martin* and *Sherman*, which are both distinguishable. *Id.* at *22-28. In addition, the *Mountbatten* court interpreted New York law as requiring that a bond be construed against a compensated surety, even in the definitions setting forth the obligation undertaken by the surety. *Id.* at *28-29.

Applying the plain language of the private payment bond at issue, which included a "direct contract" definition, a New York trial court concluded that fringe benefit funds are not "claimants" and therefore not entitled to enforce the bond. *Iron Workers District Council of W. N.Y. & Vicinity Welfare & Pension Funds v. D.R. Chamberlain Corp.*, 673 N.Y.S.2d 797, 801 (N.Y. Sup. Ct. 1997).

[5] This unpublished opinion appears in Granite's Appendix at pages RA 25 through RA 36.

Iron Workers comports with Minnesota law. The rule of construction against the surety, applied by the *Mountbatten* court, is contrary to Minnesota law. Under Minnesota law, a compensated surety "is entitled to stand on the contract and to have it construed reasonably." *Lamberton Bldg. & Loan Ass'n v. Nat'l Sur. Co.*, 177 Minn. 575, 576, 225 N.W. 724, 724-25 (1929); *accord Neb. Beef Ltd. v. Universal Sur. Co.*, 607 N.W.2d 227, 233 (Neb. Ct. App. 2000) (stating that a compensated surety "cannot be held beyond the precise terms of his contract" and that the surety's liability "is measured by, and will not be extended beyond, the strict terms of his contract" (quotation omitted)). The plain language of a "direct contract" definition, as recognized by the *Iron Workers* court, does not include fringe benefit funds that are the third-party beneficiaries of a collective bargaining agreement.

In this case, the Funds did not have a direct contract with EnviroTech. Therefore, they are not claimants and are not entitled to sue under the Bond.

2. The Funds are not the assignees of the laborers.

The Funds argue that they are the assignees of the laborers. But they identify no facts to support this argument. There are none. The Funds sued Granite in their own names, not pleading any assignment by the laborers. AA 1-AA 9. The CBA does not make the Funds or their trustees the assignees of the laborers. AA 49-AA 62. The CBA contemplates the Funds suing to enforce their own rights as third-party beneficiaries to the CBA, not as assignees of the laborers. AA 58-AA 60 at art. 19.

The Funds may argue that they are constructive assignees. But this theory is premised on *Sherman*, which is inapposite. The *Sherman* Court avoided the question of whether or not the funds were assignees of the laborers:

> Whether the trustees of the fund are, *in a technical sense*, assignees of the employees' rights to the contributions need not be decided. Suffice it to say that the trustees' relationship to the employees, as established by the master labor agreements and the trust agreement, is *closely analogous* to that of an assignment.

Sherman, 353 U.S. at 219-20, 77 S. Ct. at 798 (emphases added). This approach is grounded in the liberal interpretation accorded to statutory payment bonds; no such liberal interpretation is afforded private contracts under Minnesota law. Whether the Funds are "in a technical sense" the assignees of the laborers is a crucial matter. The relationship either is or is not an assignment, "closely analogous" does not suffice for a private contract.

Because the Funds are not the assignees of the laborers, they are not entitled to enforce the provisions of the Bond.

D. Public policy does not require treating the Funds as claimants.

The Funds argue on policy grounds that they must be third-party beneficiaries of the Bond, lest laborers' rights go unenforced. Notably, these policy arguments require completely ignoring the language of the Bond itself and imposing upon Granite an obligation it did not knowingly and willingly undertake. But even on policy grounds alone, these arguments are unsupported.

First, the Funds argue that individual claimants could not afford to enforce their rights under the Bond or, if they chose to, would strain judicial resources. The Funds

ignore that individual claimants would likely have sufficient factual commonalities to form a class. A class-action lawsuit against the surety would spread any burdens of litigation across the plaintiff-claimants and would minimize the judicial caseload.

Second, the Funds argue that it would defeat the purported purpose of payment bonds to enforce the "direct contract" definition as written. But private payment bonds are not required. Because private payment bonds are a matter of contractual choice, the purpose of each private payment bond is set forth within the bond itself. *See Travertine Corp.*, 683 N.W.2d at 271 (stating that intent of contract is found in its language). If parties choose to narrowly define the class of persons who may recover under a private payment bond, they are free to do so. Further, if the courts embrace an expansive interpretation of private payment bonds, sureties will respond by either increasing the premiums for private payment bonds (thereby increasing the cost of contracts and reducing funds available for labor) or cease writing private payment bonds altogether (thereby depriving of a remedy those who would have recovered had a bond been in place).

Third, fringe benefit funds are not helpless to protect themselves. Fringe benefit funds can protect themselves by filing a mechanics lien claim. Additionally, fringe benefit bonds (also called "wage and welfare bonds" or "collective bargaining bonds") exist precisely to provide a secondary source from which a fringe benefit fund can obtain the payments owed by an employer. David C. Olson, et al., *Fringe Benefit Bonds* in *The Law of Commercial Surety and Miscellaneous Bonds* 367, 367 (Bruce Charles King, et al., eds., 2d ed. 2012). In this case, the CBA permits the Funds to compel an employer to

post a fringe benefit bond if the Funds deem themselves insecure in the payment or collection of fringe benefit contributions. AA 59 (first full paragraph on page 18). Having already sued EnviroTech twice for deficient contributions, the Funds could have required the very employer at issue in this litigation to post such a bond designed precisely for the Funds' benefit. On a larger scale, the Funds could instead ask the parties to the CBA to permit more flexibility in their ability to require fringe benefit bonds be posted.

Because the district court correctly concluded that the Funds are not intended third-party beneficiaries of the Bond, the summary judgment should be affirmed.

II. The statute of limitations was not tolled as to Granite by EnviroTech's alleged fraudulent concealment.

The Funds argue that the one-year limitations period prescribed by the Bond cannot be enforced by Granite because EnviroTech allegedly fraudulently concealed the Funds' claims. Because the district court correctly interpreted Minnesota law and correctly applied it to the undisputed facts, its contrary conclusion and summary judgment in favor of Granite should be affirmed.

A. Minnesota precedents require the party against whom tolling will apply to have been the party engaging in fraudulent concealment.

Limitations periods, and the tolling of them, are familiar to Minnesota law. Long-standing precedents of the Minnesota Supreme Court and the Minnesota Court of Appeals make clear that the rule the Funds propose is incompatible with the doctrinal foundations of limitations periods and tolling.

Limitations periods are based "on the proposition that, if one person has a claim against another, . . . it would be inequitable for him to assert such claim after an unreasonable lapse of time during which such other has been permitted to rest in the belief that no such claim existed." *Finley v. Erickson*, 122 Minn. 235, 239, 142 N.W. 198, 199 (1913). The fraudulent concealment doctrine recognizes that a party should not be able to shield itself by affirmatively and fraudulently concealing the existence of a potential claim. *Schmucking v. Mayo*, 183 Minn. 37, 40, 235 N.W. 633, 634 (1931).

The fraudulent concealment doctrine, adopted by the Minnesota Supreme Court in *Schmucking*, permits a limitations period to be tolled if the defendant who asserts the protection of the limitations period has fraudulent concealed the plaintiff's cause of action. *Id.* at 38-39, 235 N.W. at 633. The *Schmucking* court stated two "moral and equitable principles" supporting its adoption of the doctrine:

> There is no reason, resting on general principles, why ignorance that is the result of defendant's actual fraud and not the stupidity or lack of diligence of plaintiff should not prevent the running of the statute in favor of the wrongdoer. Secondly, a person should not be permitted to shield himself behind the statute of limitations where his own fraud has placed him. He should not be permitted to profit by his own wrong, and it would strike the moral sense strangely to permit him to do so.

Id. at 40, 235 N.W. at 634. In a more recent case, the Minnesota Supreme Court identified two reasons for its adoption of the fraudulent concealment doctrine. *Buller v. A.O. Smith Harvestore Prods.*, 518 N.W.2d 537, 542 (Minn. 1994). First, "the plaintiff who does not assert his or her right because of the defendant's fraudulent concealment is not within the mischief sought to be remedied by a statute of limitations." *Id.* (quotation omitted). Second, "the defendant who fraudulently conceals a cause of action should not

be permitted to shield himself behind the statute of limitations where his own fraud has placed him." *Id.* (quotation omitted).

Since 1931, Minnesota courts have repeatedly restated this rule to require the defendant asserting the limitations period as a bar to plaintiff's claim to have engaged in the fraudulent concealment. *See, e.g.*, *Dalton v. Dow Chem. Co.*, 280 Minn. 147, 153, 158 N.W.2d 580, 584 (1968) (stating the accrual of the cause of action is not tolled by "ignorance of a cause of action not involving continuing negligence or trespass, or *fraud on the part of the defendant*" (emphasis added)); *Sletto v. Wesley Constr., Inc.*, 733 N.W.2d 838, 846 (Minn. Ct. App. 2007) (stating the first element of fraudulent concealment for tolling purposes is "*the defendant made a statement* that concealed plaintiff's potential cause of action" (emphasis added)); *Williamson v. Prasciunas*, 661 N.W.2d 645, 650 (Minn. Ct. App. 2003) (stating the fraudulent concealment inquiry includes "not only an examination of the plaintiff's knowledge, but also *an examination of the defendant's conduct*" (emphasis added)); *Haberle v. Buchwald*, 480 N.W.2d 351, 357 (Minn. Ct. App. 1992) (stating a limitations period "may be tolled if the cause of action is *fraudulently concealed by the defendant*" (emphasis added)).

In this case, Granite is the defendant asserting the protection of the one-year limitations period set forth in the Bond. EnviroTech completed its work on the Project in May 2009. Assuming, solely for purposes of argument, that the Funds were claimants entitled to sue under the Bond, they were required to bring suit no later than May 2010. Instead, Granite was served on April 6, 2011, almost two years after EnviroTech completed its work.

The fraudulent concealment doctrine as articulated by the Minnesota courts would at most permit a limitations period to be tolled against EnviroTech. But because Granite did not fraudulently conceal the Funds' claims, and neither knew of nor participated in the alleged fraudulent concealment committed by EnviroTech, the fraudulent concealment doctrine does not toll the one-year limitations period set forth in the Bond for claims against Granite.

Because Minnesota law does not permit them to prosecute their claim against the Bond, the Funds rely upon contrary provisions of the Restatement and inapposite cases discussing surety relationships. Neither argument is persuasive.

B. The Restatement provisions cited by the Funds are inconsistent with existing Minnesota law and should not be adopted by this court.

The Funds first turn to the statements contained in two Restatements for the proposition that a limitations provision should be tolled against a surety based upon the principal's (alleged) fraudulent concealment. Restatement (Third) of Suretyship & Guaranty § 66 (1996); Restatement of Security § 121 (1941).

As discussed above, this proposition is contrary to existing Minnesota law. Therefore, it should not be adopted by this court. *Travertine Corp.*, 683 N.W.2d at 271-72 (stating Restatement provisions are not adopted when "our precedent is to the contrary and we believe that our precedent still reflects the proper rule of law"). Such a change in the law can be made only by the Minnesota Supreme Court or the legislature. *Tereault v. Palmer*, 413 N.W.2d 283, 286 (Minn. Ct. App. 1987).

In addition, the Restatement provisions do not constitute the majority rule. The only decisions to cite Restatement of Security § 121 involved fidelity bonds. *Vill. of Herkimer v. Am. Sur. Co. of N.Y.*, 238 N.Y.S.2d 290 (N.Y. App. Div. 1963) (fidelity bond covering village treasurer); *Chisholm v. House*, 183 F.2d 698 (10th Cir. 1950) (fidelity bond covering trustees of inter vivos trust). The very nature of a fidelity bond is to insure against the fraud or other dishonesty of the covered individual. *See, e.g.*, Minn. Stat. § 367.15 (2010) (requiring town treasurers to post fidelity bonds); Minn. Stat. § 574.11 (2010) (requiring court-appointed receivers and trustees to post fidelity bonds). Unlike a fidelity bond surety, a payment bond surety has not obligated itself to cover fraud or other wrongdoing perpetrated by the principal. No court has applied Restatement of Security § 121 outside the context of fidelity bonds nor specifically to private payment bonds.

The only opinion to cite Restatement (Third) of Suretyship & Guaranty § 66 is a dissenting opinion in a case that did not involve fraudulent concealment. *Gateway Commc'ns, Inc. v. John R. Hess, Inc.*, 541 S.E.2d 595, 601-02 (W.Va. 2000) (Starcher, J., dissenting). A Restatement provision that has not been widely adopted is not suitable for adoption in Minnesota. *See Domagala v. Rolland*, 805 N.W.2d 14, 25 (Minn. 2011) (declining to adopt a Restatement provision that had been criticized by other courts).

Because the Restatement provisions cited by the Funds are contrary to Minnesota precedents and have not been adopted by other courts in the context of private payment bonds, they should not be adopted by this court.

C. The suretyship cases cited by the Funds do not support extending the doctrine of fraudulent concealment.

The Funds next cite a number of mostly foreign cases for purported general principles of suretyship, and argue that the suretyship relationship (as envisioned by the Funds) requires Granite to be deprived of the benefit of the limitations period of the Bond.

The Funds cite two Minnesota cases and several foreign cases for the proposition that a "surety's liability is tied directly to its principal's liability." This sweeping statement is a mischaracterization of suretyship law and the cases cited by the Funds.

First, the Minnesota cases cited by the Funds stand for limited principles. *MacKenzie* states two rules irrelevant to the question before the court: (1) the amount of a guarantor's liability is limited to the amount of the borrower-principal's liability, and (2) the creditor may proceed first against the guarantor, at its option. *MacKenzie v. Summit Nat'l Bank of St. Paul*, 363 N.W.2d 116, 120 (Minn. Ct. App. 1985). The amount of EnviroTech's liability is not relevant to whether EnviroTech's alleged fraudulent concealment bars Granite from raising a limitations defense. Nor has Granite argued that the Funds must first exhaust their efforts to collect from EnviroTech. *Schurmeier* states the basic rule that a surety is not entitled to relitigate the principal's liability, if the underlying liability has already been established by judgment. *Conn. Mut. Life Ins. Co. v. Schurmeier*, 125 Minn. 368, 373, 147 N.W. 246, 248 (1914). The Funds have not obtained a judgment against EnviroTech; this rule is therefore also irrelevant to the present dispute.

Second, none of the foreign cases cited by the Funds relates to fraudulent concealment or the tolling of a limitations period. Instead, they stand for two basic rules not relevant to whether EnviroTech's alleged fraudulent concealment bars Granite's limitations defense: (1) a surety is not liable if the principal is not liable, and (2) the amount of the surety's liability cannot exceed the amount of the principal's liability. *Commercial Money Ctr., Inc. v. Ill. Union Ins. Co.*, 508 F.3d 327, 344-45 (6th Cir. 2007) (stating the obligation of the surety cannot be greater than the obligation of the principal); *R.I. Hosp. Trust Nat'l Bank v. Ohio Cas. Ins. Co.*, 789 F.2d 74, 78-81 (1st Cir. 1986) (concluding a surety was not liable because its principal was not liable); *Am. Motorists Ins. Co. v. Worker's Comp. Bd.* (*In re Kemper Ins. Cos.*), 819 N.E.2d 485, 491 (Ind. Ct. App. 2004) (stating the surety's obligation is no greater than the principal's, and is further limited by the terms of the bond as written); *City of Ferndale v. Florence Cement Co.*, 712 N.W.2d 522, 528 (Mich. Ct. App. 2006) (concluding that because summary judgment had been improperly granted to principal, it must also be reversed as to surety); *Fid. & Guar. Ins. Co. v. Blount*, 63 So. 3d 453, 460 (Miss. 2011) (stating that a surety is liable only if the principal is liable); *Wright Way Constr. Co. v. Harlingen Mall Co.*, 799 S.W.2d 415, 426 (Tex. App. 1990) (reversing judgment against surety because principal's default had not been established); *Bd. of Supervisors v. S. Cross Coal Corp.*, 380 S.E.2d 636, 639 (Va. 1989) (concluding that the verdict against the principal was the measure of damages to which the claimant was entitled from the surety); *Wellington Power Corp. v. CNA Sur. Corp.*, 614 S.E.2d 680, 688 (W.Va. 2005) (concluding that surety was not liable because principal had not defaulted); *Milwaukee Bd. of Sch. Dirs. v. BITEC, Inc.*,

775 N.W.2d 127, 130 ¶ 9 (Wis. Ct. App. 2009) (stating a surety is not liable if its principal is not liable).

D. Extending the doctrine of fraudulent concealment would have harmful effects in the construction industry, especially for laborers.

If this court is inclined to consider whether, as a matter of policy, the fraudulent concealment doctrine should be extended to prevent an innocent third party surety from raising a limitations defense because its principal allegedly fraudulently concealed the plaintiff's claims, then the court should consider the likely effects of that extension.

The surety is an outsider to the underlying contractual relationship. The project owner, the contractor, the laborers, and the material suppliers all have a closer relationship to the project than the surety. The surety is in the position least amenable to discovering wrongdoing, such as the payroll practices that underlie the Funds' claim and the alleged fraudulent concealment of those practices. Tolling the limitations period based on the principal's alleged fraudulent concealment, of which the surety had no knowledge, would cause sureties to have no comfort that their exposure to liability under a bond was ever at a close. The price of bonds would rise, leading to three possible outcomes: (1) construction projects would be more expensive; (2) construction budgets would be changed to shift dollars away from labor and materials, perhaps by reducing quality, and toward bond costs; or (3) the number of private payment bonds written would decline, denying recovery to those who would otherwise have been protected by them.

None of these outcomes furthers the principles underlying limitations periods or the fraudulent concealment doctrine, much less a robust construction industry.

Because there is no basis on which to extend the doctrine of fraudulent concealment in the way the Funds propose, this court should affirm the district court's summary judgment.

III. If this Court reverses the district court, a remand is necessary because the Funds have not established that they are entitled to summary judgment.

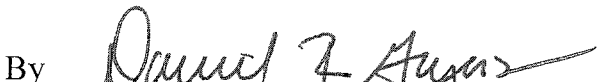
The Funds seek a reversal and entry of judgment in their favor. If this court concludes both that the Funds are claimants under the Bond and that the Funds may, as a doctrinal matter, assert fraudulent concealment to toll the limitations period under the Bond, then it should remand to the district court. *Rosenberg v. Heritage Renovations, LLC*, 685 N.W.2d 320, 330 (Minn. 2004). The district court did not determine whether there were any genuine issues of material fact regarding several important questions: (1) whether the Funds had established all the elements of fraudulent concealment required to toll the limitations period; (2) whether the Funds had established the extent of the underlying liability for covered work; and (3) whether Granite is liable for attorney fees, costs, disbursements, and liquidated damages.

CONCLUSION

For the foregoing reasons, Respondent Granite Re, Inc. respectfully requests this court affirm the district court.

GREGERSON, ROSOW, JOHNSON & NILAN, LTD.

Date: August 29, 2012

By 

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