

HANOVER INSURANCE CO. V. DUNBAR MECHANICAL CONTRACTORS, LLC

Recently, the United States Court of Appeals for the Eighth Circuit ruled on a matter involving a subcontractor's performance bond. As discussed below, the holding of the case is that the federal requirement for work subcontracted to service disabled veterans can only be determined upon completion of performance.

Facts:

Dunbar Mechanical Contractors, LLC ("Dunbar") is a Service Disabled Veteran Owned Small Business.¹ On December 18, 2013 Dunbar was awarded a ditch and tributary construction contract through Army Corps of Engineers.² This contract was a Service Disabled Veteran Set-Aside Project.³ On the same day, Harding Enterprises LLC ("Harding") was hired as a subcontractor.⁴ Dunbar entered into another contract with Gregg Harding (the only member for Harding), where he was asked to serve as the project manager.⁵ A subcontract performance bond and a subcontract payment bond were issued to guarantee Harding's performance.⁶

On April 20, 2017, Harding defaulted and Dunbar terminated the agreement.⁷ Dunbar contacted Hanover Insurance Company ("Hanover"), who issued the performance bond on the project.⁸ After an investigation of the claim, Hanover denied Dunbar's claim because the subcontract was for over 85% of the work to a non-qualifying entity.⁹

¹ *Hanover Ins. Co. v. Dunbar Mech. Contractors, LLC*, No. 19-2226, 2020 WL 3864318, at *1 (8th Cir. July 9, 2020).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ *Id.* at *2.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* ("[T]he federal regulation governing the government award of a contract to an SDVOSB requires the SDVOSB to perform at least 15% of the cost of the prime contract.").

Procedural History and Court Rulings:

Hanover brought a lawsuit in the United States District Court for the Eastern District of Arkansas and sought a declaratory ruling that Hanover had no obligations under the bond and to rescind the bond due to the subcontract's illegality.¹⁰ Hanover filed a motion for judgment on the pleadings, which the court converted into a motion for summary judgment.¹¹ The district court ruled in favor of Hanover and granted the motion for summary judgment. The district court found that there was a violation of federal law in the subcontract.¹² Dunbar appealed.¹³

Court's Analysis:

The Eighth Circuit reversed and remanded the case. The appellate court disagreed with the district court's ruling.¹⁴ The pertinent regulation states: "An [SDVOSB] prime contractor can subcontract part of an SDVO contract ... provided ... [i]n the case of a contract for general construction, the [SDVOSB] spends at least 15% of the cost of contract performance incurred for personnel on the concern's employees or the employees of other [SDVOSBs.]"¹⁵ The appellate court found that in order to be compliant with the regulation, the use of spending in relation to the contract's performance cost has to be determined.¹⁶ This can only be determined once the contract is completed.¹⁷ Thus, the district court calculated the percentage prematurely, and therefore the conclusion that the subcontract violated the regulation, was inaccurate.¹⁸

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.* at *4.

¹⁵ 13 C.F.R. § 125.6(b)(2) (2008).

¹⁶ *Hanover Ins. Co.*, 2020 WL 3864318, at *3.

¹⁷ *Id.*

¹⁸ *Id.*

The appellate court also found that Hanover was not justified in being discharged from its obligations solely on its potential liability under the federal False Claims Act (“FCA”) from performing under the bond.¹⁹ There are other solutions if there is potential FCA liability: “Hanover could either pay the obligee and, having satisfied its obligations, remove itself entirely from any further involvement, or perform under the bond while giving notice to the government of the potential for false claims if there is no further modification of contract performance.”²⁰ While the case was remanded, in the meantime, Hanover was still responsible under the bond and Dunbar’s subcontract was not, at this time, in violation of the federal regulation.

Lessons Learned:

This case demonstrates the importance of completing the performance before calculating percentages of an SDVO contract to determine regulation compliance. Furthermore, potential liability under the FCA does not discharge obligations or allow for rescinding a contract. In this case, not enough time had passed for an accurate calculation to be made about the percentages of performance via the subcontract.

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¹⁹ *Id.* at *4.

²⁰ *Id.* (citing *United States v. President & Fellows of Harvard Coll.*, 323 F. Supp. 2d 151, 187 (D. Mass. 2004)).