

IN THE COURT OF APPEALS OF OHIO

TENTH APPELLATE DISTRICT

Selective Insurance Company of America,	:	
	:	
Plaintiff-Appellee,	:	
	:	
v.	:	No. 14AP-588
	:	(Ct. of Cl. No. 2009-07407)
Ohio Department of Rehabilitation and Correction,	:	(REGULAR CALENDAR)
	:	
Defendant-Appellant,	:	
	:	
DDC+, Inc. and Peter C. Tudela,	:	
	:	
Defendants-Appellees.	:	

D E C I S I O N

Rendered on March 3, 2015

Alber Crafton, PSC, Lee M. Brewer and Justin D. Owen, for appellees Selective Insurance Company of America, DDC+, Inc. and Peter C. Tudela.

Michael DeWine, Attorney General, James E. Rook and Kristin S. Boggs, for appellant.

Williams & Petro Co., LLC, and John J. Petro, for Amicus Curie The Surety & Fidelity Association of America.

APPEAL from the Court of Claims of Ohio

TYACK, J.

{¶ 1} Defendant-appellant, Ohio Department of Rehabilitation and Correction ("ODRC"), appeals the November 16, 2012 judgment of the Court of Claims of Ohio granting summary judgment in favor of plaintiff-appellee, Selective Insurance Company of America ("Selective") and the June 23, 2014 judgment of the Court of Claims of Ohio

granting summary judgment in favor of defendants-appellees, DDC+, Inc., and Peter Tudela ("DDC"). For the reasons that follow, we affirm the judgment of the Court of Claims.

I. Facts and Procedural History

{¶ 2} The procedural and factual history of this litigation largely is set forth in our earlier decision, *Selective Ins. Co. of Am. v. Ohio Dept. of Rehab. & Corr.*, 10th Dist. No. 11AP-597, 2012-Ohio-1314 ("*Selective I*"). The following is taken from that decision with additional facts and history where needed.

{¶ 3} "In February of 2007, DDC submitted a bid to the state of Ohio to upgrade the generator at the Northeast Pre-Release Center. Prior to the bid submittal, DDC secured a bid guaranty and contract bond from Selective. The state accepted DDC's bid, and DDC entered into a contract with ODRC to serve as the principal contractor on the project. *Id.* at ¶ 2. "DDC subcontracted with Buckeye Power Sales Company, Inc. ("Buckeye") for the purchase and installation of the new generator." *Id.* at ¶ 3.

{¶ 4} Although ODRC's contract with DDC called for a front access switchgear panel, Buckeye's purchase order called for a rear access panel, and that is what Buckeye provided. ODRC rejected the generator and asked DDC to fix it for no charge. ODRC also extended the date to finish the work to June 30, 2008. Buckeye made the changes for no charge. ODRC accepted the corrected work in June 2008.

{¶ 5} "DDC, however, failed to completely pay Buckeye. To attain the monies due it, Buckeye commenced the process to establish a mechanic's lien on payments due to DDC under the contract between DDC and ODRC. On March 12, 2008, Buckeye served ODRC and Pete Tudela, president of DDC with an affidavit of claim in the amount of \$359,059." *Id.* at ¶ 3.

{¶ 6} "Pursuant to R.C. 1311.28, upon receiving the affidavit, ODRC should have 'detain[ed] from the principal contractor or from the balance of the funds remaining in the contract with the principal contractor, an amount, up to the balance remaining in the contract, that does not in the aggregate exceed the claim.' When it received Buckeye's affidavit, ODRC had yet to pay DDC \$400,242.84 under the contract. Despite the mandate of R.C. 1311.28, ODRC did not detain \$359,059.00 of the \$400,242.84 as amounts became due to DDC. Rather, during July through December 2008, ODRC

issued payments to DDC totaling \$376,130.99. After issuing those payments, ODRC had only \$24,111.85 in unpaid contract funds." *Id.* at ¶ 4.

{¶ 7} "In addition to establishing a mechanic's lien on payments due DDC, Buckeye also filed a claim against the bond. In July 2008, Selective issued a \$100,000 payment to Buckeye. Selective issued a subsequent payment of \$27,466 to Buckeye in January 2009." *Id.* at ¶ 5.

{¶ 8} "On February 27, 2009, Buckeye filed suit against ODRC, DDC, Tudela, and Selective in the Franklin County Court of Common Pleas. Against DDC and Tudela, Buckeye alleged claims for breach of contract, violation of the Ohio Prompt Payment Act, fraud, and theft. Against Selective, Buckeye alleged a breach of contract claim for failure to pay its entire claim against the bond. Against ODRC, Buckeye sought recovery under R.C. 1311.32 of the \$24,111.85 remaining in the contract between ODRC and DDC." *Id.* at ¶ 6.

{¶ 9} "Ultimately, Buckeye settled its claims against ODRC and Selective. In the resulting settlement agreement, ODRC agreed to pay Buckeye \$24,111.85 in exchange for Buckeye's dismissal of its claims against ODRC. Selective agreed to pay Buckeye an additional \$30,000. In return, Buckeye agreed to dismiss its claim against Selective and assign its claims against DDC and ODRC to Selective." *Id.* at ¶ 7.

{¶ 10} In pertinent part, the settlement agreement contained the following language:

Buckeye shall not be deemed to have released its claims against ODRC for ODRC's alleged violation of R.C. 1311.26, et seq., which claims have been assigned to Selective, except to the extent ODRC has made payment to Buckeye. Nothing contained in this settlement agreement shall constitute a waiver of any defenses or rights ODRC may have concerning any claims of Buckeye or its assignee Selective, and nothing herein shall constitute any admission by ODRC as to the validity of any claims of Buckeye or its assignee Selective.

(Settlement Agreement and Release, at ¶ 6.)

{¶ 11} After Selective filed suit, ODRC brought third-party claims against DDC including breach of contract, fraudulent misrepresentation, indemnification and contribution.

{¶ 12} The Court of Claims dismissed the entire case for lack of subject-matter jurisdiction. This court reversed in the case cited above, *Selective I*, finding that Selective had stated a claim for money damages against the state that was cognizable in the Court of Claims.

{¶ 13} On remand, Selective and ODRC filed cross-motions for summary judgment. The trial court held an oral hearing, and on November 16, 2012, granted summary judgment in favor of Selective, denied ODRC's motion for summary judgment, and entered judgment in the amount of \$207,491.¹

{¶ 14} On June 23, 2014, a different trial court judge granted summary judgment in favor of DDC and against ODRC. This appeal followed.

II. Assignments of Error

{¶ 15} On appeal, ODRC assigns the following four errors for our review:

[I.] The Court erred because as a matter of law, equitable subrogation cannot lie against the State.

[II.] The Court erred in finding that the State wrongfully impaired the surety's collateral.

[III.] The Court erred in finding that the Department of Rehabilitation and Corrections' (DRC) acquiescence to the settlement of subcontractor's claims was tantamount to assenting to the validity and merit of the subcontractor's lien.

[IV.] The Court erred because it failed to hold the actions of a surety's principal against the surety.

III. First Assignment of Error

{¶ 16} In its first assignment of error, ODRC asserts that Selective's claim of equitable subrogation is not viable against the State of Ohio pursuant to R.C. 2743.02(D). R.C. 2743.02(D) provides in pertinent part as follows: "Recoveries against the state shall be reduced by the aggregate of insurance proceeds, disability award, or other collateral recovery received by the claimant."

¹ As memorialized in the settlement agreement, Buckeye received \$100,000 from DDC, \$24,111.85 from ODRC, and \$207,466 from Selective. The \$207,491 judgment includes the \$25 filing fee in the Court of Claims.

{¶ 17} Selective's claim for money damages was premised upon the common law theory of equitable subrogation. As the trial court stated, "a surety [Selective] of a government contractor [DDC] may recover progress payments made to a defaulting contractor [DDC] where such payments were made after the government entity [ODRC] received notice of the contractor's default." (November 16, 2012 Decision, at 5, citing *Lumberman's Mutual Casualty Co. v. United States*, 654 F.3d 1305 (Fed.Cir.2011)). Here, ODRC continued to make progress payments to DDC after receiving notice of Buckeye's lien. That wrongful conduct by ODRC impaired Selective's interest in the collateral securing its secondary obligation to pay Buckeye if DDC did not.

{¶ 18} Under Ohio law, a surety is subrogated to the public owner's rights in funds remaining due under a contract and is entitled to receive those funds after performing in accordance with the obligations undertaken in the bond. *State ex rel. Southern Surety Co. v. Schlesinger*, 114 Ohio St. 323 (1926). The Court of Claims did not grant summary judgment on a theory that Selective was bringing its claim as the subrogee of Buckeye or DDC. The claim for which the Court of Claims granted summary judgment was premised on an alleged breach of contract as well as the common law duty an obligee owes a surety to protect the collateral. *See Selective I* at ¶ 31. Selective was exercising its right of equitable subrogation after it had to pay out under the bond.

{¶ 19} Under R.C. 2743.02(D), the statute cited by ODRC, Selective is the claimant and had no collateral recovery. Therefore, there is no reduction of any recovery against the state.

{¶ 20} Accordingly, we overrule the first assignment of error.

IV. Second Assignment of Error

{¶ 21} In its second assignment of error, ODRC attacks the validity of Buckeye's lien. ODRC argues that although Buckeye may have perfected its lien by submitting it in compliance with R.C. 1311.261, the lien itself was not valid because it only covered defective work. ODRC argues that even if it had detained the funds pursuant to the lien, Buckeye did not have any valid lien rights that would have entitled it to recover public funds. Therefore, ODRC claims Selective cannot claim that ODRC's failure to detain the funds pursuant to the lien resulted in Selective, as surety, having to pay Buckeye.

{¶ 22} ODRC's attempt to contest the validity of the mechanic's lien is misplaced.

Upon receiving an affidavit of claim:

[T]he public authority shall detain from the principal contractor or from the balance of the funds remaining in the contract with the principal contractor, an amount, up to the balance remaining in the contract, that does not in the aggregate exceed the claim or claims.

* * *

The public authority shall place any detained funds in an escrow account as provided for under section 153.63 of the Revised Code, to be released at the times, in the amounts, and to the persons ordered by a court of competent jurisdiction or by agreement of the principal contractor and the subcontractor, material supplier, or laborer who filed the affidavit provided for in section 1311.26 of the Revised Code.

R.C. 1311.28.

{¶ 23} An affidavit of claim constitutes a stop notice due to the public authority, preventing the payment of moneys due to the principal contractor. *Selective I* at ¶ 13. It is up to a court of competent jurisdiction or an agreement of the parties to release funds. It is not up to the public authority to take it upon itself to decide the work was defective and then fail to detain the funds.

{¶ 24} R.C. 1311.26 authorizes the subcontractor even before the completion of the work, to serve an affidavit of lien. "Any subcontractor, material supplier, or laborer who is *performing* or has performed labor or work *or is furnishing* or has furnished material for any public improvement * * * may serve the public authority an affidavit." (Emphasis added.) Regardless of the validity of the lien, ODRC was required by statute to detain funds. "Upon receiving the affidavit required by section 1311.26 of the Revised Code, the public authority *shall* detain from the principal contractor or from the balance of the funds remaining in the contract with the principal contractor, an amount, up to the balance remaining in the contract, that does not in the aggregate exceed the claim or claims." R.C. 1311.28. (Emphasis added.) ODRC cannot ignore the mandate of the statute because it doubts the validity of the lien. ODRC is a stakeholder in the funds. The party authorized to challenge the lien was DDC, the bonded contractor whose funds were

to be detained. R.C. 1311.31. When ODRC failed to detain the funds, it impaired Selective's interest in the collateral securing its secondary obligation.

{¶ 25} Accordingly, we overrule the second assignment of error.

V. Third Assignment of Error

{¶ 26} In its third assignment of error, ODRC reiterates that the work Buckeye did was defective and constituted a breach of the contract by the prime contractor, DDC. Therefore, ODRC asserts, the lien was invalid, and the trial court was wrong to find that this issue had been laid to rest by the settlement of the earlier litigation.

{¶ 27} ODRC is correct that the settlement agreement contained the following language:

Nothing contained in this settlement agreement shall constitute a waiver of any defenses or rights ODRC may have concerning any claims of Buckeye or its assignee Selective, and nothing herein shall constitute any admission by ODRC as to the validity of any claims of Buckeye or its assignee Selective.

(Settlement Agreement and Release, at ¶ 6.)

{¶ 28} However, nothing in the settlement agreement affects Selective's right of equitable subrogation, which is the theory of the case pursued in the Court of Claims and upon which the trial court granted summary judgment.

{¶ 29} The third assignment of error is overruled.

VI. Fourth Assignment of Error

{¶ 30} In its fourth assignment of error, ODRC seems to be arguing that Selective has an obligation to indemnify the State of Ohio under R.C. 153.54(B)(2) which provides as follows:

(B) A bid guaranty filed pursuant to division (A)(1) of this section shall be conditioned to:

* * *

(2) Indemnify the state, political subdivision, district, institution, or agency against all damage suffered by failure to perform the contract according to its provisions and in accordance with the plans, details, and specifications therefor and to pay all lawful claims of subcontractors, material suppliers, and laborers for labor performed or material

furnished in carrying forward, performing, or completing the contract; and agree and assent that this undertaking is for the benefit of any subcontractor, material supplier, or laborer having a just claim, as well as for the state, political subdivision, district, institution, or agency.

{¶ 31} ODRC argues that Selective is statutorily required to indemnify ODRC against DDC's failure to perform the contract according to its provisions including the installation of the wrong generator, its failure to pay Buckeye, fraudulent submissions of pay applications, and failure to abide by terms of a change order. ODRC reiterates that Selective had no obligation to pay for defective work, and therefore, any payment under the bond by Selective was gratuitous. Therefore, according to ODRC, Selective did not have standing to bring a direct claim against ODRC.

{¶ 32} Once again, the validity of Buckeye's claim is not the issue. Rather, the damages in this case were created by ODRC's failure to detain funds thereby impairing Selective's suretyship rights. ODRC is not entitled to recover damages from Selective for its own negligence in failing to detain funds.

{¶ 33} Accordingly, we overrule the fourth assignment of error.

IV. Disposition

{¶ 34} Having overruled ODRC's four assignments of error, the judgment of the Court of Claims of Ohio is affirmed.

Judgment affirmed.

BROWN, P.J., and KLATT, J., concurs
