CONSTRUCTION BONDS - PERFORMANCE, PAYMENT AND OTHER MISCELLANEOUS BONDS

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Construction Bonds

A. BONDS vs. INSURANCE POLICIES

The two most common bonds one will encounter in construction are payment and performance bonds. Bonds are essentially a form of suretyship. Suretyship is distinguishable from insurance. Insurance is a two-party relationship, directly between an insured and an insurer, wherein, the insurer agrees to compensate or protect the insured for a known or unknown risk in accordance with the terms of the insurance policy. Suretyship, on the other hand, is a contractual relationship, in the form of a bond, whereby one person agrees to answer for the debt, default or other failure to perform an obligation of another. Thus, suretyship is a three party relationship (often referred to as "tripartite") wherein the "surety" agrees to answer to the "oblige" for the "principal's" conduct, subject to certain limitations contained in the bond. *See, e.g., F&M Bldg. Partnership v. Farmers & Merchant Bank, Rodgers, Arkansas*, 871 S.W.2d 338 (Ark. 1994); *see generally* RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTEE §1 (1996); 74 AMJUR 2D Suretyship §1; BLACK LAW DICTIONARY 1293 (5th Ed. 1979). Cases that discuss surety relationships are replete with archaic language and special terms, because suretyship is, in particular, an ancient concept.

In the construction context, the suretyship relationship usually consists of a contractor as the principal, the owner of the project as the obligee, and the entity issuing the bond (typically, an insurance company) acting as the surety on behalf of the principal. But the identities of the parties may vary; for example, a surety may issue a subcontract performance bond, wherein the subcontractor is the principal and the general contractor (not the owner) is the obligee. In essence, a surety agrees to indemnify the obligee in the event the principal fails to perform its obligation to the obligee. *See Hightower and Co., Inc. v. U.S. Fidelity &Guar. Co.*, 527 So. 2d 698 (Ala. 1988); *Hendricks v. Blake & Pendleton, Inc.*, 472 S.E. 2d 482 (Ga. Ct. App. 1996); *Republic Ins. Co. v. Bd. of County Comm'rs*, 511 A.2d 1136 (Md. 1986).

Another difference between suretyship and insurance is a surety owes no duty to the obligee **unless and until** the principal fails to perform some specified obligation (e.g., make payment, complete performance). Often, a surety owes no duty until the obligee fulfills or complies with certain terms or conditions of the bond, first. On the other hand, an obligee has an obligation to act with "reasoned discretion" toward the surety, in the event the principal is failing its obligations to the obligee. *Argonaut Ins. Co. v. U. S.*, 434 F.2d 1362 (1970). In other words, the obligee may not act financially irresponsibly as to the surety, once the surety has advised the obligee (or, the obligee otherwise knows) that the principle is in default of some obligation. By way of example, when a surety notifies an obligee of its concern over the ability of the principal to perform its obligations and requests that the obligee refrain from disbursing further contract sums without the surety's consent, the obligee **must** honor such notice and request. In this example, a prudent practice for the obligee is to obtain a written consent of surety to make final payment in order to minimize the opportunity for the surety to claim that the contractor acted irresponsibly in making payment.

In addition, should the principal fail to perform its contractual obligations, the principal owes a duty to indemnify the surety. Thus, as should be patent, the surety relationship inherently contains a number of competing interests not present in typical insurance relationships. Recognizing this inherent conflict in suretyship relationships, a minority of jurisdictions have held that a surety owes no common law duty of good faith toward an obligee. *Great American Ins. Co. v. North Austin Mun. Utility Dist. No. 1,* 908 S.W. 2d 415 (Tex. 1995) (. . . "a surety, like its principal, should be entitled to test the merits of an obligee's claim without the imposition of extra contractual duties to the bond obligee."); Florida Statute §624.155(9) ("A surety issuing a payment or performance bond on the construction or maintenance of a building or roadway project is not an insurer"). In most jurisdictions, however, state insurance codes have been broadened to encompass sureties. In such cases, the statutes ignore the inherent distinctions between suretyship and insurance.

It is further important to understand the principle of “coextensive liability.” The liability of a surety has generally been held to be “coextensive” with that of its principal. *Morse/Diesel, Inc. v. Trinity Indus., Inc*., 67 F.3d 435 (2nd Cir. 1995); *E.L. Farmer Const. Co., Inc. v. Hartford Acc. & Indem. Co.*, 560 P.2d 65 (Ariz. Ct. App. 1976). This is, the principal must be liable, before a surety can be made liable (and not the other way around). Stated slightly differently: in the absence of liability on the part of the principal, a surety cannot be held liable. *Taylor Building Corp. of Kentucky v. Boutcher*, 836 S.W.2d 455 (Ky. App. 1992); *Lindsay Masonry Co., Inc. v. Jenkins & Assoc., Inc.*, 897 S.W. 2d 6 (Mo. Ct. App. 1995); *Rockland County v. Aetna Casualty & Surety Co.*, 514 N.Y.S.2d 102 (N.Y. App. Div. 1987). The most important caveat to this general principal is that the surety issuing a bond assumes no liability beyond that set forth in its bond. *American Home Assurance Co. v. Larkin General Hospital, Ltd*., 593 So.2d 195 (Fla. 1992); *Mendel-Mesick-Cohen-Architects v. Peerless Ins. Co.*, 426 N.Y.S.2d 124 (N.Y. App. Div. 1980); *Houston General Ins. Co. v. Brock Constr. Co., Inc.*, 246 S.E.2d 316 (Ga. 1978). Given the coextensive nature of the underlying liability, the surety is typically entitled to assert all of the defenses available to its principal. *Rhode Island Hosp. Trust Nat’l Bank of Ohio v. Ohio Casualty & Sur. Co.*, 789 F.2d 74 (1st Cir. 1986); *Commercial Standard Ins. Co. v. Alabama Surface Mining Reclamation Comm’n*, 443 So.2d 1245 (Ala. Civ. App. 1983), *cert. denied*, 467 U.S. 1242; *In re MacDonald’s Estate*, 67 N.W.2d 227 (Mich. 1954); *Exton Drive-In, inc. v. Home Indem. Co.*, 261 A.2d 319 (Pa. 1969), *cert. denied*, 400 U.S. 819 (1970); *Board of Supervisors v. Southern Cross Coal Corporation*, 380 S.E.2d 636 (Va. 1989); *but see Smith Plumbing Co. v. Aetna Casualty & Sur. Co.*, 475 So.2d 379 (Ariz.) (surety may not assert personal defenses of principal), *cert. denied*, 479 U.S. 987 (1986). Likewise, if an obligee waives its claim(s) against the principal, it also waives them against the surety. *Barr/Nelson, Inc. v. Tonto’s, Inc.*, 336 N.W.2d 46 (Minn. 1983).

B. PERFORMANCE BONDS

A performance bond is a contract and, as a contract, is subject to the general laws of contract construction. *Hightower and Co., Inc. v. U.S. Fidelity &Guar. Co.*, 527 So. 2d 698 (Ala. 1988); *Hendricks v. Blake & Pendleton, Inc.*, 472 S.E. 2d 482 (Ga. Ct. App. 1996); *Republic Ins. Co. v. Bd. of County Comm’rs*, 511 A.2d 1136 (Md. 1986). Given the nature of the suretyship relationship, as discussed above, the obligations of the surety are generally said to be secondary to those of the principal in that the surety has no obligation to perform in the absence of some failure of performance by the principal. Generally, in a performance bond undertaking, the surety agrees that should the principal fail to fulfill its contractual obligations to the obligee, the surety will perform in the principal’s place, subject to the terms and conditions of its bond.

A performance bond, as with any contract, should be construed by the courts to effectuate the parties’ intentions. Where the provisions of the performance bond are clear and unambiguous, a court must enforce the terms of the bond as written. To determine the intent of the parties, a court should examine the language of the contract, the subject matter of the contract, and its object and purpose. *American Home Assurance Co. v. Larkin General Hospital, Ltd.*, 593 So. 2d 195 (Fla. 1992). Where an ambiguity exists in the performance bond, the ambiguity will generally be construed against the surety and in favor of the obligee. *Fayetteville Investors v. Commercial Builders, Inc.*, 936 F.2d 1462 (Cir. 4th 1991); *Stonechiper v. Mitchel*, 655 So. 2d 1381 (La. App. 1995); *Krenski v. Continental Casualty Co.*, 908 S.W. 917 (Mo.App. 1995); *Johnson City Cent. School Dist. v. Fidelity & Deposit Co. of Maryland*, 641 N.Y. Supp.2d 426 (N.Y. App. Div. 1996). However, unlike a policy of insurance, the language of a performance bond may actually be drafted or selected by the obligee and not the surety issuing the bond; in that case ambiguities should be construed against the obligee as drafter and not against the surety. *See Granite Const. Co. v. American Motorist Ins. Co.*, 34 Cal. Rptr.2d 835 (Cal. Ct. App. 1994) (ambiguities in suretyship contract to be construed against drafter). A bond will also usually be interpreted in conjunction with the principal’s contract to determine the intent of the parties. *Bank of Tokyo-Mitsubishi, Ltd. v. Kvaerner*, 671 N.Y.Supp. 2d 905 (N.Y. App. Div. 1998). In almost all instances, the underlying contract is incorporated by reference into the bond. Courts have held that by incorporating the obligations of the principal into the performance bond, the surety assumes the same, i.e. “coextensive liability”, as its principal. *Soreson v. Ewing*, 448 P.2d 110 (Ariz. Ct. App. 1968); *Amerson v. Christman*, 68 Cal. Rptr. 378 (Ct. App. 1968); *Nicholson & Loup, Inc., v. Carl E. Woodward, Inc.*, 596 So.2d 374 (La. Ct. App. 1992), *Howard Const. Co. v. Teddy Woods*

Constr. Co., 817 S.W.2d 556 (Mo. Ct. App. 1991); *Babylon Assocs. v. Suffolk County*, 475 N.Y.S.2d 869 (N.Y. App. Div. 1984); *Haywood County Consol. Sch. Sys. v. United States Fidelity & Gaur. Co.*, 257 S.E.2d 670 (N.C. Ct. App. 1979); *Waukesha Concrete Prods. Co. v. Capital Indem. Corp.*, 379 N.W.2d 333 (Wis. Ct. App. 1985). A few courts have recognized that despite the "coextensive" nature of the liability of the surety, the performance bond and not the incorporated contract determines the measure and type of damages which the surety owes to the obligee. *American Home Assurance Co. v. Larkin General Hospital Ltd.*, 593 So.2d 195 (Fla. 1992), *see also*, *Marshall Contractors v. Peerless Ins. Co.*, 827 F. Supp. 91 (D.R.I. 1993). Courts have equated coextensive liability to mean coextensive damages, thus sureties have been held liable for a variety of damages that arise from the default of the principal, including, increased costs of completion, loss of profits, loss rental income, loss of use and other consequential delay damages. *Leo Spear Constr. Co. v. Fidelity & Casualty Co. of New York.*, 446 F.2d 439, 444 (2nd Cir. 1971); *Continental Realty Corp. v. Andrew J. Crevolin Co.*, 380 F. Supp. 246 (S.D. W. Va. 1974); *Burnett & Doty Dev. Co. v. Philips*, 148 Cal. Rptr. 569 (Ct. App. 1978); *Smart v. United States Fidelity & Guar. Co.*, 513 S.W.2d 291 (Tex. Civ. App. 1974); *Bossier Medical Properties v. Abbot & Williams Constr. Co.*, 557 So.2d 1131 (La. App. 1990); *Donlan v. American Bonding & Trust Co.*, 51 S.E. 924 (N.C. 1905); *State Surety Co. v. Lamb Constr. Co.*, 625 P.2d 184 (Wyo. 1981). Lastly, when a surety bond is issued pursuant to a statutory obligation, the obligations of the statute will generally be read into the bond. *United States ex rel Modern Elec., Inc. v. Ideal Elec. Sec. Co.*, 868 F. Supp. 10 (D.D.C. 1994); *Paul Schoonover, Inc. v. RAM Const., Inc.*, 630 P.2d 27 (Ariz. 1981); *Sheldon Pollack Corp. v. Pioneer Concrete of Texas, Inc.*, 765 S.W. 2d 843 (Tex. Ct. App. 1989).

Another area where incorporation of the underlying contract may have a significant impact on the obligations of the surety is the area of arbitration. While few performance bonds actually contain an arbitration provision, in a majority of jurisdictions, courts compel sureties to arbitrate when the underlying contract incorporated into the bond contains an arbitration clause. *United States Fidelity & Guar. Co. v. West Point Constr. Co.*, 837 F. 2d 1507 (11th Cir. 1988); *Exchange Mut. Ins. Co. v. Haskell Co.*, 742 F.2d 274 (6th Cir. 1984); *Transamerican Premier Ins. Co. v. Collins & Co.*, 735 F. Supp. (N.D. Ga. 1990); *Hoffman v. Fidelity & Deposit Co.*, 734 F. Supp. 192 (D. N.J. 1990); *Boys Club v. Fidelity & Deposit Co.*, 8 Cal. Rptr. 2d 587 (Ct. App. 1992); *St. Paul Fire & Marine Ins. Co. v. Woolley/Sweeney Hotel No. 5*, 545 So. 2d 958 (Fla. Dist. Ct. App. 1989); *Kearsarge Metallurgical Corp. v. Peerless Ins. Co.*, 418 N.E.2d 580 (Mass. 1981); *City of Piqua v. Ohio Farmers Ins. Co.*, 617 N.E. 2d 780 (Ohio Ct. App. 1992). A few courts have held that the surety cannot be bound to arbitrate in the absence of a specific, i.e. not incorporated, agreement to submit to arbitration. *Transamerica Ins. Co. v. Yonkers Contracting Co.*, 267 N.Y.S.2d 669 (Sup. Ct. 1966); *Episcopal House Corp. v. Federal Ins. Co.*, 239 S.E.2d 647 (S.C. 1977).

There is no such thing as a "standard" performance bond. The American Institute of Architects (AIA) has promulgated performance bonds which have been widely utilized in the industry. There are significant differences in the obligations and duties of the parties between the older AIA A311(1970) bond and the newer AIA A312 (1984) bond. The A311 utilizes the suretyship bond language from the turn of the last century to define the obligations of the parties. The A312 bond provides more detailed provisions for the default procedure and further delineates the obligations of the surety to the obligee and vice-versa. For example, the A312 bond requires that as a precondition to a declaration of default a meeting must be requested by the owner to meet with the surety and the contractor in an effort to prevent a default. The new form also provides that the Owner must formally declare the Contractor in default no earlier than twenty days after requesting the meeting. The Owner must also agree to pay the balance of the contract proceeds to the surety. Only after these material conditions have been met is the surety obligated to remedy the default as provided in the bond.

While the A311 bond cryptically provides that after a declaration of default the surety may "remedy the default" or complete the project, the A312 bond form more expansively details the remedial actions that may be taken by the surety. The A312 bond provides a number of options for the surety. The surety may utilize the principal to complete the project, undertake to complete the project itself or negotiate proposals from qualified contractors to complete the work under contract with the Owner. Alternatively, rather than completing the project, the surety after an investigation into the amount for which it may be liable, may tender to the obligee the amount owed or deny liability in whole or in part and notify the obligee of the basis for the denial of liability.

There are few statutory requirements for performance bonds issued in connection with private construction projects. In general, private projects are left to the parties who are free to negotiate the terms and conditions of the performance bond. Public works projects, on the other hand, are almost universally regulated by statute. Federal public works projects are governed by the Miller Act. 40 USC § 270. The Miller Act applies to "any contract for the construction, alteration or repair of a public building or public work of the United States." The typical Miller Act project is one in which the United States (or its representative agencies) both owns the land and contracts for its improvements.

In those instances where the Miller Act applies, a contractor must furnish a performance bond from a surety in a form satisfactory to the officer awarding the contract in an amount deemed adequate for the protection of the United States. While the Miller Act itself does not prescribe the form of the performance bond to be issued, the Code of Federal Regulations provides a standard form which is commonly used. *United States ex rel Mississippi Road Supply Co. v. H.R. Morgan, Inc.*, 542 F. 2d 262 (5th Cir. 1976), *modified on reh'g*., 554 F. 2d 164, *cert. denied*, 434 U.S. 828 (1977). The standard Miller Act performance bond provides little guidance as to the obligations of the surety to the United States in the event of default of the principal on its contractual obligations. The standard Miller Act performance bond merely provides that the surety is liable up to the penal sum of the bond unless the principal performs and fulfills all of the undertakings, covenants, terms, conditions, and agreements of the contractor in the original term of the contract and pays to the Government the full amount of the taxes imposed by the Government. Despite the recommended form, many government agencies have developed their own bond forms.

The Miller Act has been liberally construed in order to effectuate the intent of Congress which was to protect labor and materialmen as well as the United States. However, this liberal construction does not justify ignoring the plain language of the limitations set forth in the bond and wholesale liability upon Miller Act sureties. For example, Miller Act performance bonds have been held to be solely for the benefit of the United States and courts have denied claims of purported third-party beneficiaries.

Most states have adopted versions of the Miller Act, often referred to as the "Little Miller Act", which closely track the language of the federal statutes. ALA. CODE §§ 39-1-1 & 39-2-8 (1994); ARIZ. REV. STAT. ANN. §34-222 (1994); ARK. CODE ANN. §22-9-403 (1994); CAL. CIV. CODE §3247 (WEST 1994); CAL. PUB. CONT. CODE §10821 (WEST 1994); COLO. REV. STAT. §24-105-202 (1994); DEL. CODE ANN. TIT. 29, §6909(D)(1994); FLA. STAT. ANN. §255.05(3) (WEST 1994); GA. CODE ANN. §36-10-4 (1994); IDAHO CODE §54-1926 (1994); IND. CODE §36-1-12-14 (1994); IND. CODE ANN. §36-1-12-14(G) (WEST 1994); KAN. STAT. ANN. §60-1111 (1993); LA. REV. STAT. ANN. §38:2216 (WEST 1994); MICH. COMP. LAWS ANN. §129.201 (1994); MISS. CODE ANN. §31-5-51 (1994); N.J. STAT. ANN. 2A:44-147 (WEST 1994); NEV. REV. STAT. §339.025 (1993); N.M. STAT. ANN. §13-4-18 (1994); N.C. GEN. STAT. §44A-33 (1994); OHIO REV. CODE ANN. §153.571 (ANDERSON 1993); PA. CONS. STAT. §193 (1994); S.C. CODE ANN. §57-5-1660(B) (LAW CO-OP. 1993); TEX. GOV'T CODE ANN. §2253.021 (WEST 1994); VA. CODE ANN. §11-58 (MICH. 1994). On any public works project governed by statute, an important question arises when the performance bond issued in connection with the project fails to comply with the statutory requirements. In most jurisdictions, the liability of the surety is determined by the terms by statute, regardless of the specific language of the bond. *Paul Schoonover, Inc. v. Ram Const., Inc.*, 630 P.2d 27 (Ariz. 1981). *See also United Fire & Casualty Co. v. Acker*, 541 N.W. 517 (Iowa 1995); *Frank Curr and Lumber Co. v. 11 Co.*, 76 Cal. Rptr. 753 (Cal. Ct. App. 1969) (statutory provisions are incorporated into the bond and become part of it).

Generally, when the principal and surety fail to perform as agreed without any legal justification, an obligee is entitled to recover all direct and consequential damages caused by the breach of the principal. *See, e.g., Phoenix Assurance Co. v. Appleton City*, 296 F. 2d 787, 796 (8th Cir. 1961); *General Builders Supply Co., Inc. v.*

McArthur, 179 A.2d 868, 872 (Md. 1962). The recovery of damages is generally limited to the penal sum of the bond. *Trainor v. Aetna Casualty & Sur. Co.*, 290 U.S. 47 (1933); *United States v. Seaboard Sur. Co.*, 817 F.2d 956 (2nd Cir.), *cert. denied*, 484 U.S. 855 (1987); *Bill Curphy Co. v. Elliot*, 207 F.2d 103 (5th Cir. 1953); *In re Technology for Energy Corp.*, 123 B.R. 979 (E.D. Tenn. 1991). However, courts have held that a surety may be liable beyond the penal sum for damages flowing from its own breach of its performance bond obligations. *Continental Realty Corp. v. Andrew J. Crevolin Co.*, 380 F. Supp. 246 (S.D. W. Va. 1974); *cf Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F. Supp. 91 (D.R.I. 1993) (dicta). Similarly, those jurisdictions that allow claims for bad faith against sureties allow recovery beyond the penal sum. Sureties have also been held to be liable beyond the penal sum for pre-judgment interest. *Ins. Co. of North America v. United States*, 951 F.2d 1244 (Fed. Cir. 1991).

A performance bond surety has many potential defenses to a claim against the bond. The most common defenses relate to the following:

(1) Defenses of its principal: *Taylor Building Corp. of Kentucky v. Boutcher*, 836 S.W.2d 455 (Ky. App. 1992); *Lindsay Masonry Co., Inc. v. Jenkins & Assoc., Inc.*, 897 S.W. 2d 6 (Mo. Ct. App. 1995); *Rockland County v. Aetna Casualty & Surety Co.*, 514 N.Y.S.2d 102 (N.Y. App. Div. 1987); *Bear v. Duval Lumber Co.*, 112 Fla. 240 (Fla. 1933).

(2) Improper Notice/Termination or Default: Failure to default a principal in accordance with the underlying contract or the bond may be considered a failure to trigger the surety's obligations under the bond. In many instances simply complaining of bad conduct may not be a sufficient trigger of the surety's liability. *L&A Contracting Company v. Southern Concrete Services, Inc.*, 17 F.3d 106 (5th Cir. 1994) (applying Florida law). *C.f.*, *DCC Constructors, Inc. v. Randall Mech. Inc.*, 791 So. 2d 575 (Fla. 5th DCA 2001); *Ins. Co. of North American v. Metropolitan Dade Cnty*, 705 So. 2d 33 (Fla. 3d DCA 1997); *School Board of Escambia Cnty, Florida v. TIG Premier Ins. Co.*, 110 F.Supp.2d 1351 (N.D. Fla. 2000); *Nat'l Fire Ins. Co. of Hartford v. Fortune Constr. Co.*, 320 F.3d 1260, 1279 (11th Cir. 2003).

(3) Cardinal Change to the bonded obligation: A material change in the underlying contract made without a surety's consent may operate to discharge the surety if the modification materially increases the surety's risk. *See National Surety Corp. v. United States*, 118 F.3d 1542, 1544 (Fed.Cir.1997)("surety bond embodies the principle that any material change in the bonded contract, that increases the surety's risk or obligation without the surety's consent, affects the surety relationship" and, other than an extension of time for payment, discharges surety if modification materially increases surety's risk); *Leila Hospital and Health Center v. Xonics Medical Systems, Inc.*, 948 F.2d 271, 275 (6th Cir.1991) ("surety law suggests that a substitution of obligors releases the surety because it creates 'a different contract on which they never intended to become liable' "); *United States v. Reliance Ins. Co.*, 799 F.2d 1382, 1385 (9th Cir.1986) ("as a general rule a surety will be discharged where the bonded contract is materially altered or changed without the surety's knowledge or consent").

(4) Statutes of Limitation/Repose: Performance bond claims are subject to various state's statutes of limitation. In Florida, for example, the time to bring a suit against a performance bond surety is substantially different than the time to bring a suit against the contractor. A claim against a surety must be brought within five years of acceptance of completion of the project and is not subject to the latent defect extensions available for claims against its principal in Florida. *Federal Ins. Co. v. The Southwest Fla. Retirement Center, Inc.*, 707 So. 2d 1119 (Fla. 1998); *The Clark Constr. Group, Inc. v. Wentworth Plastering of Boca Raton, Inc.*, 840 So. 2d 357 (Fla. 4th DCA 2003); *BDI Constr. Co. v. Hartford Fire Ins. Company*,995 So. 2d 576 (Fla. 3d DCA 2008).

C. PAYMENT BONDS

Payment bonds may be issued in conjunction with performance bonds or may be issued separately in relation to a particular construction project. However, usually when an Owner requires a contractor to be "bonded" for a construction project that Owner is looking for both a performance and a payment bond. In a sense a payment bond is a very narrow performance bond that guarantees only the obligation of payment to a defined class, which typically includes subcontractors, suppliers and material supplier acting under the bonded contractors "prime" contract. In most jurisdictions, payment bonds also serve the secondary function of providing a mechanism to keep the Owner's property free from liens of persons other than the prime contractor.

A payment bond generally provides that the surety will pay for subcontractors and suppliers of labor and materials furnished to a construction project should the principal fail to do so. *See D.I.C. Commercial Constr. Corp. v. Knight Erection and Fabrication, Inc.*, 547 So. 2d 977 (Fla. 4th DCA 1989) (payment bond surety liable for labor and materials but not delays); *Coastal Caisson Drill Co., v. American Casualty Co. of Reading, Pennsylvania*, 523 S. 2d 791 (Fla. 2d DCA 1988). In many instances this obligation will be conditioned upon certain notices being provided to the surety in accordance with obligations in the bond or by statute. In addition most states will have limitations on the time for bringing a claim, which may be a relatively short period of time. For example, in Florida a lawsuit against a payment bond must be filed within one year of furnishing labor service or materials to a Project.

In general, the persons protected by a payment bond are the claimants as opposed to the obligee, who are considered to be direct and intended beneficiaries of such bonds. *See Gorman v. Frank Maio General Contractor, Inc.*, 438 So. 2d 1018 (Fla. 4th DCA 1983) (purpose of payment bonds is to protect subcontractors and suppliers). Generally, while a payment bond may provide some coverage for payments made by the obligee to suppliers or incidental protection related to such claims, a payment bond is not a substitute for a performance bond and the obligee's unrelated losses are not covered by the payment bond. Most bonds provide something to the effect that "every claimant as herein defined ... may sue on this bond for the use of such claimant." *Ribeira & Lourenco Concrete Constr. v. Jackson Health Care Assocs.*, 254 N.J.Super. 445, 603 A.2d 976, 979 (N.J.Super.Ct.App.Div.1992) ("Obligee" had no legal basis for recovering under the payment bond because it was not a claimant.); see also *Walbridge Aldinger Co. v. CBN Steel Constr., Inc.*, 2007 WL 2219351, at *7 (E.D.Mich. July 27, 2007); *In Federal Ins. Co. v. Maine Yankee Atomic Power Co.*, 183 F.Supp.2d 76 (D.Me.2001)("the caselaw generally disfavors an owner/named obligee bringing suit on a payment bond."); *Standard Accident Ins. Co. of Detroit v. Rose*, 314 Ky. 233, 234 S.W.2d 728 (Ky.1950)("The purpose and only purpose of a labor and materials payment bond is to protect the owner against the claims of those who furnish labor and materials to the contractor because, if he fails to pay these bills, mechanics liens can be filed against the owner and payment enforced even though the owner had no direct dealing with the labor and material men.")

The particular states statutes where a payment bond is issued must be closely examined in making a payment bond claim. Many jurisdictions have statutes, which would control over the particular notice provisions in a bond. For example, in Florida, Florida Statute Chapter 713, has different notice requirements for claimants in "privity", i.e. directly contracting with the contractor, and those who are not in privity. Fla. Stat. § 713.23(1)(c). In addition, Florida statutory scheme contemplates both a preliminary notice at the time work commences as well as a final notice after work is completed. Fla. Stat. § 713.23(1)(d). Failure to furnish those notices is an absolute bar to claims against the payment bond surety under Florida law. *Travelers Indemnity Company v. National Gypsum Company*, 394 So.2d 481 (Fla. 3d DCA 1981)(failure to file notice of non-payment per the terms of the bond barred claim against bond), approved by *Nat'l Gypsum Co. v. Travelers Indem. Co.*, 417 So. 2d 254 (Fla. 1982); *W.G. Mills, Inc. v. M & MA Corporation*, 465 So. 2d 1388 (Fla. 2d DCA 1985)(failure to provide timely notice to owner under Fla. Stat. § 255.05 barred payment bond claim).

All Federal projects are governed by the Miller Act. The Miller Act requires the issuance of both payment and performance bonds on all federal projects exceeding $100,000. 40 U.S.C. § 3131, *et seq*. Section3133 of the Miller Act discusses payment bond requirements and those who have a right to bring a civil action under the Act. This includes every person who has furnished labor or material in carrying out the work provided for in the bonded contract, namely, subcontractors and suppliers in privity with the contractor and those in privity with the subcontractor. 40 U.S.C. § 3133. Most states have adopted versions of the Miller Act, often referred to as the "Little Miller Act", which closely track the language of the federal statutes. *See supra* at page 7.

The Miller Act requires those who are not in privity with the contractor to serve written notice to the contractor "within 90 days from the date on which the person did or performed the last of the labor or furnished or supplied the last of the material for which the claim is made." 40 U.S.C. § 3133(b)(2). "Privity" means the claimant has a direct contractual relationship with the bonded contractor. The notice must be substantially accurate as to the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. The notice must be in writing and delivered to the contractor at any place where the contractor maintains an office or conducts business or at the contractor's residence. 40 U.S.C. § 3133(b)(2).

40 U.S.C. § 3133(b)(3) provides that the civil action under the payment bond must be brought "in the name of the United States for the use of the person bringing the action" and "in the United States District Court for any district in which the contract was to be performed and executed, regardless of the amount in controversy." 40 U.S.C. § 3133(b)(4) requires that "[a]n action brought under this subsection must be brought no later than one year after the day on which the last of the labor was performed or material was supplied by the person bringing the action." All actions under the Miller Act must be filed in federal court. The Act does not provide for jury trials. If a surety posts a bond under the Miller Act, the language of the statute, rather than the language of the bond, controls.

D. LIEN TRANSFER AND OTHER MISCELLANEOUS BONDS

Lien Transfer Bonds

Many jurisdictions, including Florida, allow for contractors and their subcontractors and suppliers to lien the real property upon which they are working if they are not paid for improvements to that property. As a corollary, most jurisdictions provide that an owner may remove liens from his property by posting a bond or other collateral. Fla. Stat. § 713.24; *Deltona Corp. v. Indian Palms, Inc.*, 323 So. 2d 282, 283 (Fla. 2d DCA 1975)(lien transfer bond "permit any owner, whether or not he is in privity"); § 53.171, Texas Property Code; *In re Orah Wall Fin. Corp.*, 84 B.R. 442, 445 (Bankr. W.D. Tex. 1986) ("The bond under § 53.171 allows a party subject to a mechanic's lien to 'bond around' the lien in order to sell the property, with all claims to be recovered from the bond").

These bonds are much less complicated than payment or performance bonds. Generally, the bond is simply a substituted security for the Owner's real property. In the event the lienor successfully prosecutes the lien claim under its state laws, recovery is had against the bond rather than the real property if the judgment is not satisfied by the Owner. In most instances the Owner is the Obligee and the transfer of lien bond is for the benefit of the lien holder. In certain jurisdictions the substitution of bond may limit rights to attorney's fees and other incidental recovery to the penal sum of the bond.

Bid Bonds

Bid bonds guarantee to the party receiving a bid (usually a government entity) that, if the contractor/principal is the successful bidder, the principal will enter into a contract with the obligee and will provide the appropriate security in the form of performance and payment bonds.

> Explaining the function of bid bonds, FAR 28.001 states that a bid guarantee is: a form of security assuring that the bidder (1) will not withdraw a bid within the period specified for acceptance and (2) will execute a written contract and furnish required bonds, including any necessary coinsurance or reinsurance agreements, within the time specified in the bid, unless a longer time is allowed, after receipt of the specified forms.

Interstate Rock Products, Inc. v. United States, 50 Fed. Cl. 349, 355–56 (2001), *aff'd sub nom. Interstate Rock Products, Inc. v. U.S., Gilbert W. Corp.*, 48 F. App'x 331 (Fed. Cir. 2002).

In the event that the principal does not enter into the contract it has been awarded, the surety will be liable to the obligee for the damage caused by the principal's failure to execute the contract – usually the difference between the principal's bid and the bid of the next highest bidder, and sometimes including delay damages. The measure of damages depends on the language of the bid bond. The penal sum of the bid bond is usually a percentage of the amount of the contract value in the bid. *Peerless Ins. Co. v. United States*, 674 F. Supp. 1202, 1208 (E.D. Va. 1987) ("As surety, pursuant to the terms of the bid bond, Peerless is liable on the bond for up to 20 percent of the contract amount"). "A surety's liability for a bid bond breach is usually limited to the penal sum of the bond, typically 5–10% of the bid amount." *Chas. H. Tompkins Co. v. Lumbermens Mut. Cas. Co.*, 732 F. Supp. 1368, 1373 (E.D. Va. 1990).

A bid bond or other adequate bid security is often a requirement for a public construction project. A bid bond surety will not be discharged from liability until the contract has been executed and the obligee accepts the performance and payment bonds instead of the bid bond. *City of Wildwood v. Gibbs & Register, Inc.*, 694 So. 2d 763 (Fla. 5th DCA 1997).

E. GENERAL AGREEMENTS OF INDEMNITY

As described above a significant conceptual difference between insurance and suretyship is that the principal is liable to the surety for any losses sustained by the surety in connection with issuing the bonds. The premiums for insurance are based on the risk assumed. The premiums for bonds are generally based on the financial strength and in the construction context capacity of the bonded principal. The practical effect of this fact means that unless a bonded principal is so large and financially solvent to fully compensate the surety in the event of a loss the surety will almost always condition the issuance of the bond upon the posting of collateral and other guarantees not only from the construction company but from the individuals who own the construction company. In addition to posting collateral, the most common requirement is that the bonded company **and** its owners sign a general agreement of indemnity ("GIA").

A GIA typically gives the surety a secured interest in all contract balances, accounts receivables remaining on the bonded project as well as a security interest in supplies, equipment, tools, and materials on all of the principals' jobs and may encumber the personal assets of the company's owners. Indemnity agreements of this type are generally enforceable. *Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp.*, 534 F. Supp. 2d 1290 (S.D. Fla. 2008); *Employers Ins. of Wausau v. Able Green, Inc.*, 749 F. Supp. 1100 (S.D. Fla. 1990); *Thurston v. Int'l Fidelity Ins. Company*, 528 So. 2d 128 (Fla. 3d DCA 1988).

A GIA also typically gives the surety almost unfettered rights and the surety also typically has the right to settle its principal's affirmative claims. Sureties may make payments to settle disputes even where in hind sight there was no actual liability. *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d 579, 584–85 (M.D. Pa. 1998), aff'd, 185 F.3d 864 (3d Cir. 1999). The requirement for collateral provision of the indemnity agreement is also enforceable. *Travelers Casualty and Surety Company of America v. Indus. Commercial Structures*, 2012 WL 4792906 (M.D. Fla. 2012); *Developers Surety and Indemnity Co. v. Bi-Tech Constr., Inc.*, 2013 WL 4563657 (S.D. Fla.). However, most courts recognize "a duty of good faith is implied in indemnification agreements, and that duty requires the surety to show that its conduct with regard to a bond claim was reasonable." *Hartford Fire Ins. Co. v. P & H Cattle Co.*, 451 F. Supp. 2d 1262, 1279 (D. Kan. 2006), aff'd, 248 F. App'x 942 (10th Cir. 2007); *Frontier Ins. Co. v. Int'l, Inc.*, 124 F. Supp. 2d 1211, 1214 (N.D. Ala. 2000) ("indemnitors can defeat a surety's right to recover under indemnity provisions by demonstrating either fraud or lack of good faith on the part of the surety in discharging its obligations under the bond").

F. BOND CLAIM CONSIDERATIONS

Attorney Fees

In most jurisdictions a prevailing party will usually be able to recover attorney's fees against a surety who issues a bond by statute or the language of the bond. Florida Statute § 713.29 (private projects); Florida Statute 255.05(2)(a)2 (state public projects), Florida Statute §§ 627.428 and 627.756 (insurance provision governing bonds). A surety is not liable for attorneys' fee awards against its principal in excess of the penal sum of the bond. *T&R Painting Const., Inc. v. St. Paul Fire & Marine Ins., Co.*, 29 Cal. Rptr.2d 199 (Ct. App. 1994). However, sureties have been required to pay attorneys' fees in excess of the penal sum where the surety unsuccessfully litigated a claim against the obligee. *Harris v. Western Nat'l Ins. Co. v. Harris,* 8 Cal. Rptr.2d 234 (Ct. App. 1992); *Great American Ins. Co. v. North Austin Municip. Util. Dist.*, 908 S.W.2d 415 (Tex. 1995).

Indemnity/Subrogation

Even without a written indemnity agreement the surety has common law indemnity rights against its bonded principal. *See Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp.*, 534 F.Supp. 2d 1290 (S.D. Fla. 2008); *SouthTrust Bank of Ala., N.A. v. Webb–Stiles, Co., Inc*., 931 So.2d 706, 712 (Ala.2005). "Under the common law, equity generally implies a right to indemnification in favor of a surety only when the surety pays off a debt for which his principal is liable." *U.S. Fid. & Guar. Co. v. Feibus*, 15 F. Supp. 2d 579, 583 (M.D. Pa. 1998), aff'd, 185 F.3d 864 (3d Cir. 1999).

When a surety completes a project or pays subcontractors it is also equitably subrogated to the rights of the party it paid. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 136 n. 12, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962); *Transamerica Ins. Co. v. Barnett Bank of Marion County, N.A.*, 540 So. 2d 113 (Fla. 1989). A surety's equitable subrogation rights are not limited to rights it obtains by standing in shoes of defaulting contractor, when a surety performs or pays on behalf of an obligee that surety steps into shoes of the obligee to extent of performance or payment and rights of surety as subrogee are not inferior even to the rights of the obligee and may be asserted against the obligee. *Hartford Fire Ins. Co. v. United States*, 108 Fed. Cl. 525, 532 (2012). Consequently, the surety usually has a right to claim contract funds before any other secured creditor, judgment creditor, or trustee in bankruptcy. *Id.* A surety paying claims under its payment bond accedes to the rights of the bond claimant who was paid, but not to rights of the obligee. *National Fire Ins. Co. of Hartford v. Fortune Constr. Co.*, 320 F. 3d 1260 (11th Cir. 2003).

Arbitration

If the bonded contract contains an arbitration clause and the bond incorporates the bonded contract by reference, then the surety will be obligated to arbitrate any dispute arising out of the bonded contract. *Exch. Mut. Ins. Co. v. Haskell Co.*, 742 F.2d 274, 275 (6th Cir. 1984); *Firemen's Ins. Co. v. Edgewater Beach Owner's Ass'n*, 1996 WL 509720, at *3 (N.D.Fla). June 25, 1996).The surety will be bound by an arbitration award against the bonded principal even if the surety is not a party to the arbitration, if the surety is aware of the existence of the arbitration action. *Drill South v. Int'l Fidelity Ins. Co.*, 234 F.3d 1232 (11th Cir.2000). The surety has a right to assert bond defenses in court that were not presented in the arbitration proceeding, however. In most instances, the surety may compel arbitration and may also join in any arbitration between the bonded contractor and the obligee to the extent that the surety may have ensuing liability. *Id.; U.S. for Use & Ben. of WFI Georgia, Inc., v. Gray Ins. Co.,* 701 F. Supp. 2d 1320, 1324 (N.D. Ga. 2010), *aff'd sub nom. U.S. ex rel. Capital Computer Grp., LLC v. Gray Ins. Co.*, 453 F. App'x 905 (11th Cir. 2011)(discussing issue surrounding surety compelling arbitration).