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THE RIGHTS AND OBLIGATIONS OF SURETIES UNDER PRINCIPLES OF APPORTIONMENT AND REIMBURSEMENT

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I. Introduction

In suretyship, various scenarios can arise, involving multiple sureties with a common liability, although different principals, and arising from a single default or wrongful act. For example, this may occur: (a) in the context of a payment bond claim where multiple sureties have issued bonds which are answerable for the same claim, or (b) when two separate sureties each issue separate performance bonds for different contractors on the same project. Further, claims involving successive sureties may arise in the context of administrator, or fiduciary bonds, as well as various other miscellaneous bonds. Under each scenario, one surety may seek recovery from the other for losses – or potential losses – on its bond.

This paper discusses the reimbursement, apportionment and indemnification rights of sureties as against each other. Section II of the paper sets forth some of the general principles of law applicable to claims between sureties. Section III discusses the reported caselaw relative to such claims. Section IV sets forth some concluding suggestions for a surety which is either prosecuting or defending a claim by or against another surety.

As will be discussed at greater length below, in the context of construction surety bonds the issue of apportionment between sureties arises most frequently where both the general contractor and its subcontractor provide separate performance and payment bonds for the same project. In such circumstances, a supplier or a second-tier subcontractor may make a claim -- and bring suit -- against the general contractor's surety. Conversely, the claimant may seek recovery against the subcontractor's surety. Occasionally, the claimant may bring suit against both sureties. Under each of these scenarios, the surety facing a potential loss or actually making payment may have rights of reimbursement from the other surety on the project.

The issue of apportionment between sureties has also arisen in the context of miscellaneous bonds, including fiduciary bonds. For example, one surety may issue a bond guaranteeing the principal's faithful performance of his general obligations as a principal, while a second surety has issued a separate bond guaranteeing a more specific obligation of the same principal (i.e., that he account for the proceeds of a real estate transaction). A default by the principal may lead to claims against either or both bonds, thereby potentially giving rise to a claim of apportionment or reimbursement by one surety against another.

II. General Principles of Laws

To delineate the rights of the sureties in claims for apportionment or reimbursement, one must first understand the basic common law rules developed by courts to address such claims.

In general, where two or more sureties are liable for the defaults of the same principal, the legal relationship between the sureties has been described at common law as either "cosuretyship" or "subsuretyship" See generally United States v. Horvath Brothers, Inc., 278 F. Supp. 159 (E.D. Wisc. 1967); Indemnity Insurance Company v. American Surety Co., 268 N.Y.S. 203 (A.D. 1933); Restatement (Third), Suretyship & Guaranty, §53(1) (1995), (hereinafter Restatement).

In cosuretyship, the sureties are equally liable for their aggregate share of the obligation. 74 Am. Jur. 2d Suretyship, §221 (1974); Schoenfeld v. Neher, 428 F.2d 152, 154 (l0th Cir. 1970); Tindall v. Holder, 892 S.W.2d 314, 324 (Mo. App. 1994); Keystone Bank v. Flooring Specialists, Inc., 518 A.2d 1179 (Pa. 1986). The parties may agree to be cosureties by contract. 74 Am. Jur. 2d Suretyship §223 (1974); United States v. Horvath Brothers, Inc., 278 F. Supp. 159 (E.D. Wisc. 1967); Restatement, §53(2).

In the absence of a contract, the law will presume the relationship to be cosuretyship, unless equity mandates otherwise. United States v. Horvath Brothers, Inc., 278 F. Supp. 159 (E.D. Wisc. 1967); St. Paul Insurance Companies v. Fireman's Fund American Ins. Co., 245 N.W.2d 209, 214 (Minn. 1976); 74 Am. Jur. 2d Suretyship, §221 (1974); Restatement §53 (3).

An equitable right of contribution exists between cosureties. Schoenfeld v. Neher, 428 F.2d 152, 154 (10th Cir. 1970); Indemnity Insurance Co. v. American Surety Co., 268 N.Y.S. 203 (A.D. 1933); 74 Am. Jur. 2d Suretyship, §221 (1974); Restatement §57(1). Thus, if one cosurety is required to pay more than its equitable share of the obligation, it is entitled to recover its overpayment from the other cosurety. Restatement §22(1),(2).

In contrast to the cosurety relationship is that of subsuretyship. In subsuretyship, a bond of the subsurety or "general surety" applies to a general default of the principal, while a bond of a "principal surety" applies to a more specific default of the same principal. Schinnell v. Doyle, 496 P.2d 566, 570 (Wash. Ct. App. 1972); Hartford Accident & Indemnity v. Anderson, 256 N.W. 185 (Minn. 1934); Restatement §53(4)(c).

Hence, when a default of the more specific nature occurs, the principal surety is liable to the subsurety for all losses incurred by the subsurety in connection with its bond. Restatement §§22(1). The parties may agree to a subsurety relationship by contract, or the court may impose such a relationship where equity demands it. Restatement §§53(2). See also St. Paul Insurance Companies v. Fireman's Fund American Ins. Co., 245 N.W.2d 209, 213 (Minn. 1976).

III. Caselaw as to Claims of Apportionment and Reimbursement Between Sureties

As will be discussed at greater length below, the issues of apportionment and contribution between sureties arise most commonly where one surety has issued a performance and payment bond for the general contractor on a project, and a separate surety has issued bonds for a subcontractor on the same project. Where a supplier or sub-subcontractor claims that the subcontractor has breached its contract, the supplier or sub-subcontractor may seek recovery on the general contractor's payment bond. In these circumstances, the general contractor's surety may seek reimbursement from the subcontractor's surety for the amount of its loss. Conversely, the subcontractor's surety may seek reimbursement from the general contractor's surety for any payments made on its bond.

The court addressed such a dispute between two performance bond sureties in Argonaut Insurance Company v. Commercial Standard Insurance Company, 380 So.2d 1066 (Fla.App. 1980) ("Argonaut"). In Argonaut, the owner contracted with the general contractor for the construction of an apartment complex. The general contractor provided a performance

bond from Argonaut. The general contractor thereafter subcontracted the heating, air conditioning and ventilation work to the subcontractor. The subcontractor in turn obtained its own performance bond from Commercial Standard. The obligee on this bond was the general contractor. Id. at 1067

Two years after commencement of the project, the general contractor defaulted on its contract, and Argonaut took over to complete the remaining work. The subcontractor either refused, or was unwilling, to complete the balance of its contract. Following this default, Argonaut made demand upon Commercial Standard to assume the responsibility for the extra costs incurred by Argonaut as a result of the subcontractor's breach of contract. Commercial Standard refused, thus prompting Argonaut to bring an action against it for these extra costs. Id. at 1067.

The Florida District Court of Appeals found in favor of Argonaut, and ruled that it was entitled to assert a claim against Commercial Standard for the extra costs it incurred as a result of the subcontractor's default. In so holding, the Court rejected Commercial's argument (which was accepted by the trial judge) that Argonaut lacked standing to bring suit on the performance bond. The Court reasoned that Argonaut, in completing the performance of its principal, became subrogated to the rights of both its principal and the owner of the project. Id. at 1068. In essence, the Court reasoned that Argonaut became subrogated to the general contractor's status as obligee on the subcontractor's performance bond.

The Court also rejected Commercial Standard's argument that language contained in its performance bond precluded Argonaut's claim of subrogation. Specifically, the bond provided as follows: "No right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein or the heirs, executors, administrators or successors of the Obligee." Id. at 1067. Because Argonaut assumed the role of completing surety on the general contractor's bond, it fit the definition of a "successor" under Florida law and, as such, was a proper claimant on the bond. Id. at 1067.

A later case from the Florida District Court of Appeals followed the reasoning of Argonaut in allowing a general contractor's surety to seek indemnity from a subcontractor's surety. Financial Indemnity Company v. Steele & Sons, Inc., 403 So.2d 600 (Fla.App. 1981) ("Financial Indemnity"). In Financial Indemnity, the general contractor obtained a payment bond from Safeco. The general contractor thereafter contracted with a subcontractor, who provided a payment bond from Financial. The subcontractor failed to pay a supplier, which thereafter made claim on the Safeco payment bond. Id. at 602.

The trial court found, and the Court of Appeals agreed, that Safeco was entitled to recover from Financial Indemnity the amounts of its payments to the suppliers. Id. at 602. In so holding, the Court expressly adopted the reasoning set forth in Argonaut above. It further rejected subcontractor's surety's claim that – as in Argonaut – the only proper claimant to the subcontractor's bond was the general contractor. The Court so held notwithstanding the fact that the subcontractor's bond explicitly stated that it would inure only to the benefit of the general contractor (unlike the bond language in Argonaut, which allowed for recovery by the "successors of the Obligee.")

The Court similarly found that a general contractor's surety was entitled to seek indemnification from a subcontractor's surety in St. Paul Fire & Marine Insurance Company v. Central National Insurance Company of Omaha, 480 N.W.2d 681 (Minn.App. 1992) ("St. Paul"). While the procedural history of this case is somewhat complex, the essential facts for our purposes are as follows. St. Paul issued performance and payment bonds for the general contractor on a state highway project. The general contractor contracted with a subcontractor to perform some of the work. The subcontractor obtained its own performance and payment bonds through Central National Insurance Company of Omaha ("Central Omaha"). The general contractor was named as the obligee on the subcontractor's bond. Id. at 683.

The subcontractor later went out of business without completing its work on the project. The subcontractor also owed money on the project to a supplier, and the supplier thereafter commenced an action against St. Paul (the general contractor's surety) for monies owed to it. St. Paul brought a third-party action against Central Omaha, and – under theories of contribution and indemnification – sought to recover any damages which might be awarded against St. Paul because of the supplier's claim. Id. at 683.

The trial court held, and the Appellate Court agreed, that St. Paul was entitled to seek reimbursement or indemnity from Central Omaha for any losses which St. Paul incurred as a result of the supplier's claims. Id. at 685. The Court so held notwithstanding the fact that, while the general contractor had actually paid money to the supplier, St. Paul had not. The Court reasoned that, if Central was obligated to indemnify St. Paul, the general contractor would thereafter have a right to seek indemnity from St. Paul for the amounts it previously paid to the supplier. As such, St. Paul was bringing the claim for indemnity on behalf of both itself and the general contractor, and was therefore entitled to bring a claim for indemnification notwithstanding the fact that it had not yet made a payment or sustained a loss. Id. at 685.

The Court relied common law principles of subrogation and the rules of successive suretyship in allowing a general contractor's surety to seek reimbursement from the subcontractor's surety in Continental Casualty Company v. Hartford Accident & Indemnity Company, 52 Cal.Rptr. 533 (1966) ("Continental"). In this case, Continental issued bonds in favor of the general contractor on a federal construction project. Hartford Accident and Indemnity ("Hartford") was the surety for the subcontractor on the project. The subcontractor failed to pay a supplier, and the supplier made claim on Continental's payment bond. Continental made payment on the claim and sought reimbursement from Hartford based upon its rights of subrogation. Id. at 535.

In allowing Continental to seek reimbursement from Hartford, the Court first stated the "general rule" applicable to such disputes:

> It may be stated that if the subcontractor's bond is conditioned for the indemnification of the contractor for any claim or damage for which the principal contractor may be held liable and for the payment of which the subcontractor is primarily liable, liability exists on the part of the surety on the bond of the subcontractor to indemnify the principal contractor against any liability which may be imposed upon him, or to reimburse him for any payment he may be required to make in respect of labor and materials furnished to the subcontractor. This conclusion is a fortiori true where payment for labor and materials furnished to the subcontractor is expressly made a condition of the

bond of the subcontractor, or has that effect by reference in the bond to the provisions of the subcontract as to payment for materials and labor furnished to the subcontractor.

Id. at 536, citing 17 Am.Jur.2d Contractor's Bonds, § 57, p. 235.

Addressing the specific contentions in the case, the Court rejected Hartford's argument that Continental was not entitled to seek reimbursement because is was not a proper claimant on the subcontractor's bond. Continental, 52 Cal.Rptr. at 535. The Court observed that the general contractor's bond incorporated by reference the terms and conditions of the general contract, and that such contract – along with the terms of the bond and the provisions of federal law – compelled the general contractor and its surety to make payment to all unpaid subcontractors and suppliers on the project. Thus Continental's payment of the claim was not a "voluntary act" by the surety. Id. at 536.

The Court completed its analysis by citing the common law rules governing multiple sureties. It construed the relationship between Continental and Hartford as that of "successive sureties" (as compared to cosureties) and declared: "If the first of two successive sureties is forced to pay the debt, he is subrogated to the creditor's rights upon the bond and may enforce it against the second surety." Id. at 537.

Most significantly, the Court held that the subcontractor's surety should assume the ultimate liability for the loss because it was the subcontractor's default – and not the general contractor's actions – which gave rise to the supplier's claim. The Court stated: "In issuing this bond Hartford became surety for [the subcontractor] and it was [the subcontractor's] default which occasioned the present loss. Continental, on the other hand, had issued its bond to the prime contractor, and the loss was not occasioned by any default on the part of the principal. The two sureties must be regarded as successive sureties, and the loss in equity should fall upon Hartford, whose principal's default occasioned it." Id. at 537.

Another instructive case is American Casualty Co. of Reading v. Brezina Construction Co., 295 F.2d 603 (8th Cir. 1961) ("Brezina"). While not squarely addressing a dispute between competing sureties, the Court in Brezina ruled that the prime contractor was entitled to reimbursement from the subcontractor's surety. In this case, a supplier to the subcontractor sued the general contractor and its surety for materials provided in connection with a federal construction project. The lower court held that the general contractor was entitled to indemnity from the subcontractor's surety, and the Court of Appeals agreed. In so holding, it rejected the subcontractor's surety's argument that the subcontract only required the subcontractor to "furnish" materials for the project, and not to pay for them. Id. at 604. Instead, the term "furnish" meant that the subcontractor would both provide for and pay for the materials. Thus the subcontractor failed to comply with his contractual obligations, thereby triggering the surety's obligation to answer to the general contractor on the bond. Id. at 606

Another case recognizing the right of the general contractor's surety to seek indemnification from the subcontractor's surety is Glens Falls Indemnity Company v. United States ex rel Westinghouse, 229 F.2d 370 (9th Cir. 1955) ("Glens Falls"). In this Miller Act case, both the general contractor and the subcontractor provided separate performance and payment bonds. A supplier to the subcontractor was not paid in full, and brought an action

against the general contractor and the general contractor's surety. In the course of the litigation, the general contractor's surety filed a cross-claim against the subcontractor's surety (Glens Falls) and also the subcontractor. In the cross-claim, the general contractor's surety sought indemnification for any judgment which may enter against it and in favor of the supplier. Id. at 372.

At trial, the court found in favor of the supplier in its claims against the general contractor and its surety, and also entered judgment in favor of the general contractor's surety on its claim for reimbursement against Glens Falls. Glens Falls appealed, and claimed inter alia that (1) the general contractor was not entitled to make a claim against – and recover from – Glens Falls absent an actual loss or payment by the general contractor's surety; (2) the Glens Falls payment bond was a contract which provided indemnity only against "loss" and not "liability"; and (3) its payment bond was to be construed with its performance bond, and the performance bond contained certain conditions precedent to recovery, which the general contractor's surety had not fulfilled. Id. at 374-75.

The Ninth Circuit Court of Appeals had little difficulty disposing of Glens Falls' arguments. First, it held that under the Federal Rules of Civil Procedure the general contractor's surety was not required to plead or allege that it had actually made a payment or sustained a loss to state a valid cross-claim for reimbursement. To hold otherwise would, according to the Court, thwart the rules of procedure which allow a party to assert cross-claims or third-party claims "contingent upon ultimate adjudication of the claimant's liability to the plaintiff." These rules likewise doomed Glens Falls' claim that its payment bond was a contract of loss and not indemnity. Id. at 374.

The Court also rejected Glens Falls' reliance upon its performance bond as a basis to avoid liability. As to the claim that the conditions of the performance bond were to be read into the payment bond, the Court observed: "Each of the bonds was a separate and distinct surety undertaking of Glens Falls and each was intended for a distinct and separate purpose. The reason for and purpose of the conditions in the performance bond have no necessary relationship to the payment bond and accordingly are not applicable thereto although both bonds were issued by the same surety for the same principal and related to the same contract." Id. at 375.

Finally, the Court held that Glens Falls was liable to the general contractor's surety on both its payment and performance bond. The Court reasoned that the subcontractor's contractual obligations included the duty to make full and timely payments to suppliers for materials incorporated into the project. Here, the general contractor's failure to pay the supplier "was just as much a breach of performance of the contract as if the [subcontract work] had not been completed." Id. at 375. As such, Glens Falls' liability to the general contractor's surety flowed from both its payment bond and its performance bond.

Another case finding the surety of the subcontractor liable to the surety of a prime contractor on a construction project is A & P Sheetmetal Co., Inc. v. Edward Hansen, Inc., 357 A.2d 37 (N.J. Super. 1976) ("A & P"). In this case, Travelers issued a payment bond in favor of the general contractor. Aetna thereafter issued performance and payment bonds on behalf of the subcontractor on the project. A supplier to the subcontractor sued both sureties,

claiming that the subcontractor had failed to make payment to the supplier. The sureties jointly settled the claim with the supplier, and thereafter litigated the issue of apportionment between each other. Id. at 38.

After discussing the general principles applicable to the rules of cosuretyship and subsuretyship, the Court concluded that Aetna – as the subcontractor's surety – was the primary surety and Travelers was subsurety; as such, Travelers was not obligated to contribute toward the settlement of the supplier's claim. The Court declared: "[W]here the default of one principal imposes liability on the other the surety of the defaulting principal should bear the primary responsibility." Id. at 44. The Court further noted that "[t[hat rule has been applied in a number of cases … to impose primary liability on the surety of a subcontractor where both the general contractor and the subcontractor are liable for claims of a labor or material supplier to the subcontractor." Id. at 44.

Indeed, this result was compelled not only from the fact that equity seeks to impose the ultimate liability on the party which caused the loss (i.e., the subcontractor and its surety) but also from the very nature and purpose of the subcontractor's bond: "Doubtless the prime contractor in requiring a bond of its subcontractor sought protection against his own liability to materialman of the subcontractor." Id. at 44. As such, "[r]eason and equity require that the primary source of satisfaction should be Aetna, whose principal caused the loss and whose bond was written in order to protect [the general contractor] from just such loss." Id. at 45.

Courts have addressed the issue of contribution and apportionment between sureties in the context of miscellaneous bonds as well as construction bonds. See, e.g. United States v. Horvath Brothers, 278 F.Supp. 159 (E.D.Wisc. 1967) ("Horvath Brothers"). In Horvath Brothers, Home Indemnity sought contribution from Travelers following a loss paid on a warehousemen's bond. Both sureties had issued bonds applicable to the same principal. Traveler's bond was a statutory bond issued for "the benefit of all persons interested" and guaranteeing the principal's performance of its general obligations as a warehousemen. Home Indemnity's bond – also a warehousemen's bond – was issued to guarantee the principal's faithful performance of a specific grain storage agreement. Id. at 160. Home Indemnity paid on its bond after load shortages were discovered relative to the specific storage agreement which it bonded. (The Court noted, however, that there was "no provable wrongdoing" on the part of the principal in relation to the agreement).

The Court disallowed Home's claim for reimbursement for its loss payment. Home first argued that it was a "subsurety" relative to Travelers because the grain storage agreement provided that its principal was obligated to obtain insurance for the grain and, as such, the parties intended that Home's surety bond liability would be secondary to other sources of recovery (i.e., the Traveler's bond and any insurance obtained for the grain). The Court rejected this argument because there was no evidence that the Traveler's bond was obtained in order to comply with this provision, and because there was no evidence that the hazards sought to be insured against were the cause of the grain shortage. Id. at 161.

Having found no contractual basis establishing the intention of the parties, the Court thereafter engaged in an equitable analysis of the respective roles of the two sureties. The Court observed: "The equities of the sureties are not equal and their relation is subsuretyship

rather than cosuretyship where one surety has undertaken a general obligation against defaults of the principal while the other surety has undertaken an obligation in respect of specific defaults, and the specific default occurs…. In such case, the surety against the specific default is the principal surety and the general surety is the subsurety." Id. at 161. Application of these rules compelled the conclusion that Home was the principal surety because its bond was an obligation regarding the specific default which gave rise to the loss in the case, i.e. the principal's apparent failure to comply with the grain storage agreement. Since Home's bond was issued to guarantee the performance of that specific contractual undertaking, and since Traveler's bond was issued to guarantee the principal's general obligations to comply with its duties as a warehouseman, Travelers was therefore a subsurety or general surety, and was not liable to Home. Id. at 162.

Another case involving claims of contribution between sureties on warehouseman's bonds is St. Paul Insurance Companies v. Fireman's Fund American Insurance Companies, 245 N.W.2d 209 (Minn. 1976). Here, St. Paul was the surety on a statutory warehouseman's bond issued to guarantee the warehouseman's compliance with all applicable laws. St. Paul's principal thereafter entered into a grain storage agreement, and – pursuant to the agreement – obtained a separate policy of insurance for the grain through Fireman's Fund. The policy expressly stated that Fireman's Fund role would be that of a subsurety. When the principal failed to supply grain under the contract, Fireman's Fund paid out on its policy and thereafter pursued St. Paul for the full amount of its payment. Id. at 212.

The Court allowed Fireman's Fund to recover from St. Paul on a theory that Fireman's Fund was subrogated to the rights of its insured as against St. Paul and its principal. In so holding, the Court rejected St. Paul's claim that the relationship between the companies was that of cosuretyship, and agreed with Fireman's Fund's assertion that it was a subsurety and St. Paul was the principal surety. The Court reasoned: "A surety may stipulate to be a supplemental or subsurety provided that it is under no duty to assume greater liability and that its stipulation will not inequitably increase the obligation of another surety." Id. at 213.

Here, Fireman Fund's policy expressly stated that its role would be that of a subsurety. Further, it did not matter that St. Paul did not consent to this arrangement, since the subsurety need only obtain the assent of the obligee/insured or the principal for the rules of cosuretyship to apply. Finally, the Court found that Fireman's Fund's status as a subsurety did not inequitably increase the obligations of St. Paul, since St. Paul was already obligated on its surety bond before Fireman's Fund had issued its insurance policy. Id. at 213.

The Court discussed the issues of contribution between sureties in the context of an administrator's bond in Hartford Accident & Indemnity Co. v. Anderson, 256 N.W. 185 (Minn. 1934) ("Anderson"). Here, the principal on both bonds was an administrator of an estate. The first bond (the "general bond") was an administrator's bond issued to guarantee the administrator's general performance of his duties; the second bond (the "real estate bond") was issued for the specific purpose of guaranteeing the administrator's proper accounting for the payment of proceeds from the sale of real estate. Id. at 185. When the administrator failed to properly account for the proceeds of the sale, the surety on the real estate bond made payment thereon, and sought contribution from the surety on the general bond.

The Court held that the surety on the real estate bond was not entitled to contribution from the surety on the general bond. While finding that the two sureties were cosureties with regard to the obligees and beneficiaries of the bonds, the Court held nonetheless that the there was no "equality of equity" between the sureties, and that surety on the real estate bond had made payment "for only his own just and proper share of the default[.]" As such, it was not entitled to seek contribution from the other surety. Id. at 185.

Two sureties litigated the issue of contribution on an auctioneer's bond in Indemnity Insurance Company of North America v. American Surety Company, 268 N.Y.S. 203 (App. Div. 1933) ("Indemnity Insurance"). Here, Bister agreed to act as an auctioneer for Day; they signed a contract which required Bister to provide a surety bond guaranteeing that Bister would turn over the proceeds of the auction. Bister obtained such a bond from Indemnity. At the time of the scheduled auction, Bister's license had lapsed; in order to obtain a new license, he was required to post a second statutory surety bond, which was provided by American Surety. Id. at 204. When Bister failed to turn over the proceeds of the auction, Indemnity paid the loss, took a written assignment from Day, and proceeded against American Surety for complete reimbursement of its loss payment.

The trial court found that the two sureties were cosureties, and thus allowed recovery to Indemnity for only a portion of its loss. The Appellate Division of the New York Supreme Court disagreed, concluding that Indemnity was entitled to complete reimbursement from American for its loss payment. In so holding, the Court expressly rejected the lower court's finding of a cosurety relationship. The Court reasoned that the bonds "were not furnished for the same purpose; did not run to the same obligees; did not cover the same subject-matter; and did not purport to guarantee against the identical acts of the principal." Moreover, because Indemnity was suing as an assignee of Day and not as a cosurety under equitable principles, it was therefore entitled to complete reimbursement from American. Id. at 205.

The Court also applied principles of cosuretyship and subsuretyship in a case involving bank deposit guarantee bonds in United States Fidelity & Guaranty v. Naylor, 237 F. 314 (8th Cir. 1916) ("Naylor"). In Naylor, Woodson County ("the County") obtained two separate surety bonds both guaranteeing the repayment of bank deposits made by the County. U.S.F.&G. issued the first bond, and the second bond was issued by various individuals (the "personal sureties bonds"). There were some variations in the terms of the bonds, including the penal sums, the dates of commencement of the obligations, the appellation of the named principal and obligee on the bond forms, and the recitation of the obligations of both sureties contained on the bond form. For example, U.S.F.&G.'s bond "guaranteed the payment of all checks and drafts of the treasurer of … [the County] … while the personal sureties guaranteed the payment of all warrants, checks and drafts legally drawn on said fund". Id. at 318.

After the bank failed to return the deposits to the County, the County sued and recovered some of its losses from U.S.F.&G., and U.S.F.&G. thereafter sought contribution from the personal sureties. The Court found that U.S.F.&G. and the personal sureties were cosureties, and as such U.S.F.&G. was entitled to contribution from the personal sureties. The Court rejected the personal sureties' argument that the variations in the bond form precluded a finding of cosuretyship. The Court characterized these variations as merely "minor

differences in the verbiage of the two bonds", which did not alter the fact that the essential obligations of both sureties were the same – to answer for the debts of the bank in failing to turn over the County's deposits in the bank. Id. at 320.

The personal sureties also argued that, as a matter of equity, U.S.F.&G. was not entitled to contribution because U.S.F.&G. was a compensated surety and the personal sureties had merely agreed to act as such as an accommodation to their friends (the directors of the bank). Id. at 320. The Court rejected this argument, reasoning that the rules of contribution relative to sureties are not always premised upon the "equality" of the parties:

> [T]he principle and practice of contribution among cosureties are neither founded upon nor do they require absolute equality among the sureties. They do not undertake to investigate, review, reform or give consideration to the motives, considerations or inducements that caused the cosureties to become such, nor do they attempt to equalize the contracts they made, and for that reason the consideration, or the lack of it, which sureties may have received, except where they receive practical indemnity, is immaterial.

Id. at 321.

Section IV. Concluding Suggestions and Observations

Upon review of the reported caselaw regarding apportionment and the compensated surety, we can make the following general conclusions. First, in the context of claims of apportionment involving sureties on a construction project, the vast majority of reported cases involve disputes between the general contractor's surety and the subcontractor's surety. Such disputes have generally arisen where the general contractor's surety has made payment to a supplier or second-tier subcontractor, and thereafter has sought recovery from the subcontractor's surety for the amount of the payment.

Virtually all of the reported cases located by this author held – in one fashion or another – that the subcontractor's surety was ultimately responsible and liable to the general contractor's surety. Courts have reached this result via a number of distinct – but related – theories. A surety seeking to assert such a claim should be aware of each theory, and should consider asserting each as a distinct basis for recovery.

Some courts find the subcontractor's surety liable under basic rules of equitable subrogation. Under this theory, the general contractor argues that – upon payment of the supplier's or sub-subcontractor's claims – it is subrogated to the general contractor's claims against the subcontractor, and hence the general contractor's claim against the subcontractor's surety. To prevail on this theory, the general contractor's surety should further allege and prove that the subcontractor breached its obligations to the general contractor by failing to make payment to the supplier for materials or labor used on the project. The general contractor's surety and its counsel should, of course, consult the terms of the contract and be prepared to argue that it obligates the subcontractor both to supply materials and pay for them.

A separate but related theory upon which the general contractor's surety may rely flows from the common law rules of "successive" or multiple sureties. As discussed in the first sections of this paper, courts in some cases have distinguished between a "general surety" or "subsurety" and a "principal surety". Stated simply, a general surety's bond applies to general defaults of the principal (and to the general obligations of the principal), and the principal surety's bond applies to more specific defaults (and obligations) of the principal. Where a default of the more specific nature occurs, and where the general surety makes payment, it is entitled to complete contribution from the principal surety.

Applying these principals to the construction surety bond context, the general contractor's surety should argue that – with respect to the claim of a supplier or a subcontractor – it assumes the role of a "general surety", while the subcontractor's surety assumes the role of the "principal surety." Indeed, there is a certain logic to this argument. The general contractor generally demands that its subcontractor post its own payment bond for the express purpose of protecting itself and the owner from the claims of an unpaid supplier or subsubcontractor. While the unpaid supplier may have standing to pursue claims on both bonds, the purpose of the subcontractor's payment bond would be negated completely if the subcontractor's surety is allowed to escape liability simply because the general contractor's surety paid the claim first.

The subcontractor's surety faced with a claim of reimbursement or apportionment has a difficult, but not impossible, burden. Certainly the caselaw suggests that a subcontractor's surety is likely to have the ultimate liability for satisfaction of a claim of an unpaid supplier or subsubcontractor. However, there is also caselaw suggesting that courts adjudicating disputes between sureties will impose the ultimate liability on the party who should equitably bear the burden. As part of this analysis, courts will seek to identify the party whose actions gave rise to the primary default leading to the bond claims (in other words, the breaching party). This analysis may, of course, be straightforward where the evidence shows that the general contractor has made payment to the subcontractor for the materials which are the subject of the claim, but the subcontractor has without justification failed to pay the claimant. In such circumstances the court will undoubtedly find against the subcontractor's surety.

The result may, however, be different where the subcontractor's surety can establish that the supplier's claim arose because of some default of the general contractor (or indeed the owner). For example, the owner or the general contractor may wrongfully withhold progress payments, or the general contractor may have wrongfully terminated the contract of the subcontractor. In such circumstances, the subcontractor's surety may indeed have a compelling argument that equity mandates imposition of the ultimate liability for the loss on the general contractor's surety. As a fallback position, the subcontractor's surety could argue that it is a cosurety, thereby mandating that both sureties share the loss equally.

As discussed in the previous sections of this paper, subcontractor sureties have argued that the general contractor's surety should not be entitled to recover on the subcontractor's bond because it is not a proper claimant on the bond. The courts addressing it have uniformly rejected this argument. Such argument is specious in the first instance because the claim or reimbursement or apportionment is generally construed as an equitable cause of action.

Moreover, where the general contractor has posted a performance bond, the obligee on such bond is generally the prime contractor. Where the prime contractor's surety has made payment on its payment bond, it is thereby subrogated to the prime contractor's claims against the subcontractor, and hence its claims on the subcontractor's performance bond. Under either theory, the general contractor's surety should not be precluded from recovering on the subcontractor's claim because it is not within the "class of claimants" facially covered by the bond.

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