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THE SURETY AND THE UNITED STATES COURT OF FEDERAL CLAIMS – REVISITED*

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I. JURISDICTION OF THE COURT OF FEDERAL CLAIMS.

"The Court of Federal Claims is a court of special jurisdiction. Absent congressional consent to adjudicate a claim against the United States, this court lacks authority to grant relief." Transamerica Ins. Co. v. United States, 31 Fed. Cl. 602, 604 (1994). See generally United States v. Testan, 424 U.S. 392, 399, 96 S. Ct. 948, 953, 47 L. E.2d 114 (1976).[1] Because the Court is a court of limited statutory jurisdiction, it is imperative that the parties seeking recovery from the United States (hereinafter referred to as the "Government") be able to prove the existence of jurisdiction. Reliance Ins. Co. v. United States, 27 Fed. Cl. 815, 820 (1993). The Tucker Act, 28 U.S.C. § 1491, and the Contract Disputes Act, 41 U.S.C. § 601, are the two jurisdictional statutes generally applicable to the construction bond surety's claims against the Government.[2]

The Government's first line of attack in its effort to defeat the surety's claim often is to file a motion to dismiss or a motion for summary judgment predicated upon the Court's

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* This paper is an update of a paper that the authors prepared for the 1995 Annual Meeting of the Surety Claims Institute entitled "The Surety and the United States Court of Federal Claims." The present version of the paper contains additional cases decided since the prior paper was published in 1995, and reorganizes some of the material.

[1] The Court has enacted very particular modifications to the Federal Rules of Civil Procedure and certain statutes impact on the practice before the Court. It is beyond the scope of this paper to discuss the procedures of the Court, but any lawyer practicing before the Court, whether on a surety claim or otherwise, should become familiar with those procedures. Because the procedures are contained in different rules, appendices, and general orders, consultation with a practitioner's guide such David B. Stinson, The United States Court of Federal Claims Handbook and Procedures Manual, (Bar Ass'n. of the District of Columbia, 1993) will save you some headaches. There are two (and perhaps only two) pleasantries about litigating with the Government in the Court. First, personal jurisdiction over the Government is never an issue. Second, service of process is effectuated automatically when the complaint is filed.

[2] It should be noted that the Court also has either exclusive or concurrent jurisdiction over numerous other types of claims not relevant to this paper. See, e.g., 28 U.S.C. § 1346 (certain tax refund cases); 42 U.S.C. § 300aa-10 (the National Vaccine Injury Compensation Program); Atkins v. United States, 214 Ct. Cl. 186, 556 F.2d 1028 (1977), cert. denied, 434 U.S. 1009 (1978) (jurisdiction over claims for the taking of property under the Fifth Amendment of the Constitution); 28 U.S.C. § 2509 (congressional reference cases), and other miscellaneous cases such as military pay claims, Indian claims, and Japanese internment claims. This paper will only discuss the Tucker Act and the Contract Disputes Act as they are the two jurisdictional bases most applicable to the surety. Obviously, the National Vaccine Act is applicable only to personal sureties who have not gotten their shots.

alleged lack of subject matter jurisdiction.[3] Therefore, the surety should be prepared to fight over subject matter jurisdiction before the case is filed.

The burden is on the plaintiff surety to establish that it has met the jurisdictional requirements of the Court. Reliance Ins. Co. v. United States, 23 Cl. Ct. 108, 115 (1991). On a motion to dismiss for lack of subject matter jurisdiction, the Court will accept the surety's allegations as true and will draw all reasonable inferences in the surety's favor, Westech Corp. v. United States, 20 Cl. Ct. 745 (1990), and will construe the allegations of the complaint favorably to the surety. Reliance Ins. Co. v. United States, 27 Fed. Cl. 815, 820 (1993). If a motion to dismiss for lack of subject matter jurisdiction challenges the truth of jurisdictional facts alleged in the complaint, the Court may also consider relevant evidence in order to decide disputed facts. George W. Kane, Inc. v. United States, 26 Ct. 655, 657 (1992). But where the jurisdictional facts alleged are closely intertwined with the merits, the preferred practice is to assume subject matter jurisdiction exists and to address the merits of the claim. Ransom v. United States, 17 Cl. Ct. 263, 267 (1989), aff'd, 900 F.2d 244 (Fed. Cir. 1990).

A motion to dismiss for lack of subject matter jurisdiction may be raised at any time and must be considered by the Court. R.U.S. Fed. Cl. 12(h)(3). Subject matter jurisdiction may not be waived or granted by consent of the parties. George W. Kane, Inc. v. United States, 26 Cl. Ct. 655, 661 (1992).

A. The Surety and the Tucker Act.

Enacted in 1887, the Tucker Act is the principal source of the Court's jurisdiction. The Tucker Act grants the Court subject matter jurisdiction over "any claim against the United States founded. . . upon any express or implied contract with the United States." 28 U.S.C. § 1491(a)(1).[4] However, the Tucker Act does not create a substantive

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[3] Several of the more recent cases decided since 1995 describe the Government's attack on the surety's claim as being beyond the subject matter jurisdiction of the Court. International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706, 711-12 (1998); Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449, 456-57 (1998).

[4] The Tucker Act provides:

> (1) The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.
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> (2) The Court of Federal Claims shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978, including a dispute

right of recovery against the Government; it only vests jurisdiction in the Court when a substantive right exists. International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706, 710 (1998); Transamerica Ins. Co. v. United States, 31 Fed. Cl. 602, 604 (1994). The surety must still prove the existence of a contract or other legal authority creating a substantive right to recover money damages from the Government in order to establish subject matter jurisdiction. Westech Corp. v. United States, 20 Cl. Ct. 745, 748 (1990).

Absent the existence of a takeover agreement (i.e., an express contract), the surety's traditional method of asserting a substantive right to recover money damages from the Government is through its equitable rights of subrogation. Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308, 311 (1994).

> To bring itself within the ambit of the Tucker Act, 28 U.S.C. § 1491 (1988) (the court's basic jurisdictional statute), a government contract surety must demonstrate the existence of a contract-based right to sue here. That right may rest either on the equitable doctrine of subrogation, Balboa Ins. Co. v. United States, 775 F.2d 1158, 1161 (Fed. Cir. 1985) or, alternatively, on a contract right of its own, Fireman's Fund Ins. Co. v. United States, 909 F.2d 495, 499 n. (Fed. Cir. 1990).

Fidelity & Deposit Co. of Md. v. United States, 31 Fed. Cl. 540, 542 (1994).

In order to invoke Tucker Act jurisdiction, the surety must prove the existence of a contractual right to money damages. In order to establish a contractual right to money damages, the surety must prove (absent the existence of a takeover agreement) that it has equitable rights of subrogation. Thus, to prove jurisdiction the surety must essentially prove that it will prevail on the merits.

Understandably, in many opinions from the Court, the discussion of whether the Court has subject matter jurisdiction becomes a discussion of the merits of the surety's claims against the Government. It is often difficult to figure out if the Court is discussing jurisdiction or the merits. See, e.g., Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308, 311-13 (1994). However, the surety should fight against having to prove its entire case in the context of a motion to dismiss. See Employers Ins. of Wausau v. United

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> concerning termination of a contract, rights in tangible or intangible property, compliance with cost accounting standards, and other nonmonetary disputes on which a decision of the contracting officer has been issued under section 6 of that Act.
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> (3) To afford complete relief on any contract claim brought before the contract is awarded, the court shall have exclusive jurisdiction to grant declaratory judgments and such equitable and extraordinary relief as it deems proper, including but not limited to injunctive relief. In exercising this jurisdiction, the court shall give due regard to the interests of national defense and national security.

States, 23 Cl. Ct. 579 (1991) (factual issues relating to the existence and terms of the contract(s) between the parties, which may affect the Court's ultimate determination of jurisdiction as well as the merits of the case, require that the motion to dismiss for lack of subject matter jurisdiction be denied); Ransom v. United States, 17 Cl. Ct. 263, 267 (1989), aff'd, 900 F.2d 242 (Fed. Cir. 1990) (preferred practice is to assume jurisdiction where decision would involve deciding merits). Nonetheless, the surety should not focus exclusively on the merits of its action and forget about proving the existence of jurisdiction. See, e.g., Balboa Ins. Co. v. United States, 775 F. 2d 1158, 1163 n.3 (Fed. Cir. 1985) (Government's focus on merits of claim improper for jurisdictional argument); Fidelity & Deposit Co. of Md. v. United States, 14 Cl. Ct. 421 (1988) (surety's focus on litigating the default termination apparently resulted in oversight of the jurisdictional requisites).

1.Express and Implied Contracts - Tucker Act Jurisdiction.

The Tucker Act grants the Court jurisdiction over express and implied-in-fact contracts with the Government. Examples of express contracts are the underlying construction contract between the principal and the Government and a takeover agreement between the surety and the Government. Travelers Indem. Co. v. United States, 16 Cl. Ct. 142 (1988). An express contract is a written document signed by the Government wherein the Government undertakes obligations to the surety. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495, 499-00 (Fed. Cir. 1990); Ransom v. United States, 900 F.2d 242, 244 (Fed. Cir. 1990). The bonds are not an express contract between the surety and the Government because they are not signed by the Government and the Government does not undertake any obligations in the bonds to the surety. Ransom v. United States, 900 F.2d 242, 244 (Fed. Cir. 1990). Nothing in the bonds requires the Government to fulfill its obligations to the principal, whether for the benefit of the principal or the surety. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495, 500 (Fed. Cir. 1990). Finally, the surety is not a party to the construction contract. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495, 499 (Fed. Cir. 1990). Absent a takeover agreement, the surety likely does not have an express contract with the Government. However, it is possible to show an implied-in-fact contract with the Government.

An implied-in-fact contract requires a meeting of the minds, "which, although not embodied in an express contract, is inferred, as a fact, from conduct of the parties showing, in the light of the surrounding circumstances, their tacit understanding." Employers Ins. of Wausau v. United States, 23 Cl. Ct. 579, 581 (1981) (quoting Russell Corp. v. United States, 537 F.2d 474, 210 Ct. Cl. 596, 609 (1976), cert. denied, 429 U.S. 1073 (1977)).[5]

The decision in Travelers Indemnity Co. v. United States, 16 Cl. Ct. 142 (1988) contains a good discussion of the difference between express and implied-in-fact contracts

[5] The Tucker Act does not extend to implied in law contracts. Travelers Indem. Co. v. United States, 16 Cl. Ct. 142, 149 (1988). A contract implied-in-law is not a true contract, but is "a duty imposed by law and treated as a contract for the purposes of a remedy only" and may not even embrace the true intentions of the parties. Id. (quoting Algonac Manufacturing Co. v. United States, 428 F.2d 1241, 1255-56, 192 Ct. Cl. 649, 674 (1970)).

and an example of how the surety may be able to alternatively assert claims for breach of both under the proper circumstances. The surety entered into a takeover agreement with the United States based upon the assumption that 90% of the work had been satisfactorily completed and that less than 10% of the work had not been performed (based upon the percentages of payments to date). The takeover agreement provided that the surety would complete the work required under the construction contract in accordance with its original terms and conditions. 16 Cl. Ct. at 145. Unfortunately, the principal had performed less than 75% of the work required under the contract. Not only was a substantial amount of the work performed and paid for actually defective, but the principal had been paid for work that was never performed. Id. The surety incurred significant expenses in completing the work and submitted a claim to the contracting officer that was eventually denied. The surety alleged that the Government withheld critical information in the form of memoranda, daily work shift reports, and daily logs and field reports of its engineer that would have alerted the surety that the principal had performed less than 75% of the work required. Id.

The surety filed suit alleging causes of action based upon the breach of the takeover agreement, the construction contract, the payment bond, the performance bond, conversion, misrepresentation, reformation of the takeover agreement, rescission of the takeover agreement and breach of an implied contract. The Government moved to dismiss for lack of subject matter jurisdiction. The surety argued that the takeover agreement should be rescinded based upon the Government's misrepresentations as to the amount of work satisfactorily completed, and that the surety should be allowed to recover from the Government its excess costs to complete based on an implied-in-fact contract.

The court held that the surety alleged sufficient facts to show the possible existence of an implied-in-fact contract arising out of the negotiations between the surety and the Government resulting in the execution of the takeover agreement. 16 Cl. Ct. at 150. The court also held that implied covenants of good faith and fair dealing were not implied-in-law contracts but an obligation implicitly contained within an existing contract. Therefore, the court could exercise subject matter jurisdiction over the surety's claims alleging breach of these implied covenants in the takeover agreement, the bonds, and the underlying contract. 16 Cl. Ct. at 149. The court further held that a cause of action alleging tortious breach of contract is within the court's Tucker Act jurisdiction because it is based upon a breach of contract even though it also alleges that the Government engaged in tortious conduct. 16 Cl. Ct. at 150-51. The court determined that it had jurisdiction under the Tucker Act to entertain the alternative claims for breach of an express contract and breach of an implied-in-fact contract and denied the motion to dismiss.

Conversely, in Ransom v. United States, 900 F.2d 242 (Fed. Cir. 1990), the court held that the surety failed to prove the existence of either an express contract or an implied-in-fact contract. Ransom was a personal bid, payment, and performance bond surety on a housing rehabilitation project. The Government failed to notify the surety that the principal's bid was approximately $1.7 million lower than the Government's estimate of the performance costs plus profit and that the principal reported an error of approximately $400,000 in its bid. The judge advocate concluded that a bona fide error did exist in the

bid, but that clear and convincing evidence of the intended amount in the bid was lacking. Faced with a decision to proceed with the contract or withdraw its bid (but not amend the bid), the principal elected to proceed with the contract. Inevitably, a default occurred. Demand was made upon the surety and the surety executed a takeover agreement to complete the contract. Upon completing the contract, the surety submitted a claim for its costs in completing the contract on the theory that the Government breached obligations of good faith and fair dealing owed to the surety. After rejecting the surety's claim that an express contract existed, the court also held that no implied-in-fact contract arose from the requirement that bonds be issued because there was no objective manifestation of an intent to undertake obligations to the surety. 900 F.2d at 244-45. Absent an express or implied-in-fact contract, the court held that no jurisdiction existed under the Tucker Act and dismissed the claim. 900 F.2d at 245.

It has consistently been held in other cases that the performance and payment bonds, and the events leading up to their execution, including the fact that the contract requires bonds, do not create an implied-in-fact contract directly between the surety and the Government. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495, 500 (Fed. Cir. 1990); Fidelity & Deposit Co. of Md. v. United States, 14 Cl. Ct. 421, 423 (1988) (the argument is "merely a recasting of the equitable doctrine of subrogation in contract terms."). Because the bonds do not create an implied-in-fact contract between the surety and the Government, the surety that does not execute a takeover agreement must usually rely upon its equitable rights of subrogation, which are only triggered once notice is given by the surety of the principal's alleged default. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495 (Fed. Cir. 1990).

2.The Surety's Subrogation Rights - Tucker Act Jurisdiction.

A surety's traditional means for gaining access to the Court of Federal Claims is through the equitable doctrine of subrogation.[6] Balboa Ins. Co. v. United States, 775 F.2d 1158, 1161 (Fed. Cir. 1985).

> A surety can establish a right of subrogation in either of two ways: by completing a contract pursuant to its obligation under the performance bond or by paying off materialmen's claims brought under the payment bond. In the first situation - where the surety completes the contract - it steps into the shoes of the Government. Dependable Ins. Co. v. U.S., 846 F.2d 65, 67

[6] A surety does not have standing to assert a claim against the Government on the basis of an agreement of indemnity between the principal contractor and the surety pursuant to which the surety issued the performance and payment bonds to the Government. Such agreements of indemnity may contain assignment provisions that assign a contractor's rights, claims and causes of action to the surety. Such an assignment of the contractor's claim against the Government to the surety would be invalid under the Assignment of Claims Act, 31 U.S.C. § 3727, 41 U.S.C. § 15 (1998). Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449, 460 (1998).

> (Fed. Cir. 1988). When paying off materialmen, however, the surety is subrogated not only to the rights of the materialmen to retained contract funds, but also to the right of the Government to use retained contract funds to pay materialmen, and the right of the contractor to these funds in the event he has paid his materialmen. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 141, 83 S. Ct. 232, 237, 9 L. E.2d 190 (1962). Hence, a surety that has paid materialmen's claims can come directly against the Government as the holder of retained contract funds.

International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706, 711-12 (1998); Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308, 312 (1994).[7]

The Court has jurisdiction over the equitable subrogation claims of a performance bond surety that executes a takeover agreement with the Government, Transamerica Ins. Co. v. United States, 31 Fed. Cl. 602, 605-07 (1994), finances the principal to completion, Universal Surety Co. v. United States, 10 Cl. Ct. 794, 800 (1986), or tenders a contractor and makes payment to the contractor of excess costs to complete, Transamerica Ins. Co. v. United States, 31 Fed. Cl. 532, 536 (1994). The Court also has jurisdiction over the equitable subrogation claim of a payment bond surety regarding disbursement of contract

[7] While the Balboa case clearly states that the surety can establish its equitable rights of subrogation by completing a contract pursuant to its obligations under its performance bond or by paying the claims of subcontractors and suppliers under the payment bond, more recent cases have attempted to redefine the two ways that a surety may establish its subrogation rights. In Admiralty Construction, Inc. by National American Ins. Co. v. Dalton, 156 F.3d 1217 (Fed. Cir. 1998), the court stated that "to maintain a claim for equitable subrogation, a surety must either take over contract performance or finance the completion of the defaulted contract under its performance bond." 156 F.3d at 1222. The court then stated that because the surety "did not finance the contract to completion nor take over completion itself, [the surety] cannot invoke the doctrine of equitable subrogation to maintain its claim in place of [the principal]." 156 F.3d at 1222. The court in Admirality seems to ignore the fact that the surety may also maintain its equitable rights of subrogation when it pays under its payment bond.

Despite the clear statement in Balboa concerning the surety's subrogation rights when it pays the claims of its principal's subcontractors and suppliers, the court, in another payment bond case, Hartford Fire Ins. Co. v. United States, 40 Fed. Cl. 520 (1998), again scrambled up the subrogation rights of the surety. The court acknowledged that the surety was entitled to its equitable rights of subrogation when it financed a project to completion after the default of its principal. The court then went on to state that the surety was entitled to assert its subrogation rights because it financed the project to completion "by paying subcontractors and suppliers as required under its payment and performance bonds." 40 Fed. Cl. at 523.

Based upon the language of Admiralty, the question remains as to whether the Government will now contend that the surety can only establish its equitable rights of subrogation to the extent that it takes over a project or finances a project to completion, and disregard that the "financing" may include the surety's payment of the principal's subcontractors and suppliers under the payment bond. See Hartford Fire Ins. Co. v. United States, 1999 U.S. App LEXIS 3197, n.2 (Fed. Cir., February 26, 1999).

funds after notice of the contractor's nonpayment of subcontractors. Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308 (1994).[8]

The various rights to which a surety can claim equitable subrogation are discussed in greater detail in another section. However, two points are appropriate to raise here. First, the question of whether the surety is operating pursuant to its performance bond or payment bond obligations may determine whether it has equitable rights of subrogation and hence whether the Court has jurisdiction over the surety's claim. For example, the Government is entitled to set off tax debts against claims made by a payment bond surety, but not claims made by a performance bond surety. International Fidelity Ins. Co. v. United States, 27 Fed. Cl. 107, 109 (1992). Whether payments are made pursuant to performance bond or payment bond obligations may be a disputed question of fact preventing the entry of summary judgment. Id. at 109-11. The United States Court of Appeals for the Federal Circuit has discussed the criteria to be reviewed in determining whether a surety is operating pursuant to its performance bond or payment bond obligations:

> We agree with Aetna's position that there is no requirement that a performing surety must assume "the primary responsibility for the completion of the work." A performance bond gives the surety the option of completing performance or of assuming liability for the Government's costs in completing the contract which are in excess of the contract price. Security Insurance Co. v. United States, 428 F.2d at 841 n.6. Neither formal termination of the contract by the Government nor execution of a take-over agreement by the surety is necessary in order for a surety to qualify as a performing surety. Id. at 839, 843. Thus, a performing surety may satisfy its obligation in various ways. For example, the surety may formally take over the project and contract for its completion, or it may allow the protect to be defaulted and let the government complete or contract for the completion of the project, in which case the surety is responsible for costs in excess of the contract price. A performing surety may also satisfy its obligation by providing funds to an insolvent contractor to complete performance. (Citations omitted).

[8] The Government has begun to raise the defense against the surety that, because the Government has not waived sovereign immunity with respect to the surety's claims under its equitable rights of subrogation, the Court of Federal Claims lacks subject matter jurisdiction to address such claims, and the surety's claims based upon its equitable rights of subrogation must be dismissed. The Government's position is based upon the case of Department of the Army v. Blue Fox, Inc., 119 S. Ct. 687 (1999). There are good arguments why Blue Fox is not applicable to the surety's claim against the Government pursuant to its equitable rights of subrogation, including the surety's rights to sue the Government under the bond and the surety's rights as subrogee of a party in privity of contract with the Government, namely the principal contractor. There are several ongoing cases which may decide that issue in the near future.

Aetna Cas. & Sur. Co. v. United States, 845 F.2d 971, 975 (Fed. Cir. 1988).

The second important point regarding subrogation rights to raise here is that in order to establish the existence of equitable rights of subrogation (and hence jurisdiction), the surety must prove that it has discharged its obligations and has incurred a loss. See, e.g., Fidelity & Deposit Co. of Md. v. United States, 31 Fed. Cl. 540 (1994) (where surety had not paid out any funds under its performance bond, it could not assert equitable rights of subrogation and was unable to prove the existence of Tucker Act jurisdiction to contest the default termination). Generally, proof of payment supported by an affidavit of a person with personal knowledge, a copy of the check by which payment was made, and proof of receipt by the claimant is sufficient to establish the fact and amount of payment. Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308, 312-13 (1994). Thus, it is the safe practice to build a thorough record of any Miller Act bond payment in the event that it later becomes necessary to institute litigation against the Government in the Court.

3.Limitations on Tucker Act Relief.

The Court does not have general jurisdiction to grant equitable relief. Rather, the Tucker Act contemplates equitable relief in contract actions only in limited circumstances prior to award of the contract. 28 U.S.C. § 1491(a)(3). Otherwise, equitable relief must be associated with and subordinate to a monetary claim. Fidelity & Deposit Co. of Md. v. United States, 14 Cl. Ct. 421, 423 (1988) (declaration that the default termination was improper is beyond the Court's jurisdiction both when sought by the contractor and when sought by a surety that does not stand in privity of contract with the Government).

There is a particular limitations period for claims over which the Court has jurisdiction. All claims must be filed within six years after the claim first accrues. 28 U.S.C. § 2501.[9]

B. The Surety and the Contract Disputes Act.

Unlike the Tucker Act, which only confers jurisdiction in the Court where a separate substantive right of action exists, the CDA confers subject matter jurisdiction upon the Court for certain claims, 41 U.S.C. § 609(a),[10] establishes jurisdictional prerequisites for

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[9] 28 U.S.C. § 2501 provides that every claim of which the United States Court of Federal Claims has jurisdiction shall be barred unless the petition thereon is filed within six years after such claim first accrues.

[10] 41 U.S.C. § 609(a) provides:

> (a) (1) Except as provided in paragraph (2), and in lieu of appealing the decision of the contracting officer under section 605 of this title to an agency board, a contractor may bring an action directly on the claim in the United States Court of Federal Claims, notwithstanding any contract provision, regulation, or rule of law to the contrary.

pursuit of claims in the Court, 41 U.S.C. §§ 605(a) and 605(c)(1), and creates substantive rights of action available to a surety pursuant to the terms of a takeover agreement between the surety and the Government. 41 U.S.C. § 605(a).[11]

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[11] 41 U.S.C. § 605 provides:

> (a) All claims by a contractor against the government relating to a contract shall be in writing and shall be submitted to the contracting officer for a decision. All claims by the government against a contractor relating to a contract shall be the subject of a decision by the contracting officer. Each claim by a contractor against the government relating to a contract and each claim by the government against a contractor relating to a contract shall be submitted within 6 years after the accrual of the claim. The preceding sentence does not apply to a claim by the government against a contractor that is based on a claim by the contractor involving fraud. The contracting officer shall issue his decisions in writing, and shall mail or otherwise furnish a copy of the decision to the contractor. The decision shall state the reasons for the decision reached, and shall inform the contractor of his rights as provided in this chapter. Specific findings of fact are not required, but, if made, shall not be binding in any subsequent proceeding. The authority of this subsection shall not exceed to a claim or dispute for penalties or forfeitures prescribed by statute or regulation which another Federal agency is specifically authorized to administer, settle, or determine. This section shall not authorize any agency head to settle, compromise, pay or otherwise adjust any claim involving fraud.
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> (c) (1) For claims of more than $100,000, the contractor shall certify that the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable, and that the certifier is duly authorized to certify the claim on behalf of the contractor.
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> . . .
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> (6) The contracting officer shall have no obligation to render a final decision on any claim of more than $100,000 that is not certified in accordance with paragraph (1) if, within 60 days after receipt of the claim, the contracting officer notifies the contractor in writing of the reasons why an attempted certification was found to be defective. A defect in the certification of a claim shall not deprive a court or an agency board of contract appeals of jurisdiction over that claim. Prior to the entry of a final judgment by a court or a decision by an agency board of contract appeals, the court or agency board shall require a defective certification to be corrected.
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> (7) The certification required by paragraph (1) may be executed by any person duly authorized to bind the contractor with respect to the claim.

1.The Jurisdictional Aspects of the CDA.

The CDA confers subject matter jurisdiction upon the Court for appeals arising out of a contracting officer's final decision on a claim. A contractor may file a direct action against the Government in the Court within one year after the contracting officer's final decision on the claim. 41 U.S.C. § 609(a). As will be discussed further in the next subsection, the provisions of the CDA conferring subject matter jurisdiction for appeals on contracting officers' final decisions will come into play most generally for a surety executing a takeover agreement. See, e.g., Westech Corp. v. United States, 20 Cl. Ct. 745, 749 (1992).

The CDA contains certification requirements for claims over $100,000. 41 U.S.C. § 605(c). Prior to the amendments to the CDA that took effect in 1992, the CDA required that all claims in excess of $50,000 be certified in accordance with strict requirements.[12] Public Law No. 102-572, signed into law on October 29, 1992, altered these certification requirements. Formerly, the certification requirements were considered to be a jurisdictional obstacle. Transamerica Ins. Co. v. United States, 6 Ct. Cl. 367, 370 (1984). Substantial compliance with the certification requirements was rejected, strict compliance was required or the claim was dismissed. Reliance Ins. Co. v. United States, 23 Cl. Ct. 108, 115-16 (1991). In numerous cases, certifications submitted by performance bond sureties that had executed takeover agreements were rejected as insufficient under the statutory language. See, e.g., Reliance Ins. Co. v. United States, 27 Cl. Ct. 815, 824-25 (1993);[13] Industrial Indem. Co. v. United States, 26 Cl. Ct. 443, 445 (1992); National Sur. Corp. v. United States, 20 Cl. Ct. 407, 410-12 (1990).

One of the primary difficulties encountered by the surety (prior to the 1992 amendment) was that it could not produce a "senior company official in charge at the contractor's plant or location involved." This provision was interpreted to require a physical presence at the location of the primary contract activity. United States v. Grumman

[12] 41 U.S.C. § 605 (prior to 1992 amendment) provided:

> (c) (1) For claims of more than $50,000, the contractor shall certify that the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, and that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable.

[13] The certification requirements of the CDA prior to the October 29, 1992 Amendment applied to Reliance's claims in this case because suit was filed prior to October 29, 1992. It should be noted that Reliance asserted 12 different claims, only two of which were dismissed for the improper certification. The Government had argued that the remaining ten claims arose out of a common set of operative facts, and, therefore, should be treated as a unified claim which aggregated over $50,000 and which was not admittedly certified. Reliance, on the other hand, argued that the ten claims should be viewed as distinct claims, none of which exceeded $50,000, and therefore did not need to be certified. Upon a factual review of the claims, the Court determined that the claims arose out of two different common sets of operative facts and that the claims attributable to each particular set did not aggregate over $50,000. Therefore, certification was not required.

Aerospace Corp., 927 F.2d 575, 580 (Fed. Cir. 1991). Generally, a surety does not have a senior company official with a physical presence on the job site. The surety was therefore required to have the certification executed by "an officer or general partner of the contractor having overall responsibility for the conduct of the contractor's affairs." Generally, bond claim managers and regional vice-presidents have been held not to meet this test even though they are the persons primarily responsible for handling the claim. Reliance Ins. Co. v. United States, 27 Fed. Cl. 815, 824-25 (1993). After the amendment, the certification need only be executed by "any person duly authorized to bind the contractor with respect to the claim." 41 U.S.C. § 605(c)(7). With this amendment, a regional vice-president or a bond claim manager should be able to execute the certification. In addition, the CDA as amended now provides that that a defect in the certification does not deprive a court of jurisdiction over the claim and defects can be cured. 41 U.S.C. § 605(c)(6). Thus, certification of claims should no longer prove to be a trap for the performance bond surety which executes a takeover agreement.

2.The Substantive Aspects of the CDA.

The CDA applies to claims from "contractors" under "government contracts." 41 U.S.C. § 605(a). In order for a surety to qualify as a "contractor", the surety must be "a party to a government contract other than the government." 41 U.S.C. § 601(4). A "government contract" is an express or implied contract for the procurement of services or construction, alteration, repair or maintenance of real property. 41 U.S.C. § 602. The most likely government contract between a surety and the Government is a takeover agreement executed upon the default of the principal. See, e.g., Reliance Ins. Co. v. United States, 27 Fed. Cl. 815 (1993); Employer Ins. of Wausau v. United States, 23 Cl. Ct. 579 (1991); Travelers Indem. Co. v. United States, 16 Cl. Ct. 142 (1988). Absent the execution of a takeover agreement, the surety does not qualify as a "contractor" and cannot rely upon the CDA to create a substantive right of action in its favor. Universal Surety Co. v. United States, 10 Cl. Ct. 749, 800 (1986).[14] The payment and/or performance bonds are not "government contracts." Westech Corp. v. United States, 20 Cl. Ct. 745, 749 (1990).

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[14] In Admiralty Construction, Inc. by National American Ins. Co. v. Dalton, 156 F.3d 1217 (Fed. Cir. 1998), the court found that the surety was not a "contractor" as required by the Contract Disputes Act, that the surety had not executed a takeover agreement with the Government to complete the defaulted contract, and, therefore, the surety was not entitled to file a claim on behalf of its principal against the Government. 156 F.3d at 1221. Furthermore, the court noted that the principal itself had already brought its own suit against the Government on the same claim in the Court of Federal Claims. The court stated that the Contract Disputes Act attempted to prevent just such a duplication by requiring a "single point of contact" for contract claims, namely through the contractor and not the surety which has not executed a takeover agreement with the Government. 156 F.3d at 1221. The court found that the surety was neither a contractor nor an entity in privity with the Government, and therefore was not eligible to appeal the decision under the Contract Disputes Act. 156 F.3d at 1222.

Furthermore, the court found that the surety could not act for the contractor as the contractor's attorney-in-fact under the terms of the agreement of indemnity between the contractor and the surety. 156 F.3d at 1222.

After the takeover agreement is signed, the surety becomes a “contractor” and is entitled to assert claims arising out of its performance of the work, Reliance Ins. Co. v. United States, 27 Fed. Cl. 815, 821-24 (1993), arising out of representations made by the Government and the actions of the Government leading up to the execution of the takeover agreement, Travelers Indem. Co. v. United States, 16 Cl. Ct. 142, 152-54 (1988), for alleged breaches of the underlying contract for construction and/or the bonds themselves, id., or for alleged abuse of discretion in the failure to terminate the contract and for making improper payments after notice of default, Employers Ins. of Wausau v. United States, 23 Cl. Ct. 579 (1991). The surety’s failure to submit claims arising out of the surety’s performance of the takeover agreement to the contracting officer will deprive the Court of jurisdiction to consider the claim on appeal. Reliance Ins. Co. v. United States, 931 F.2d 863, 866 (Fed. Cir. 1991).

Perhaps the leading discussion of the surety’s rights under the CDA is set forth in Travelers Indem. Co. v. United States, 16 Cl. Ct. 142, 153-54 (1988). The operative facts are discussed above. The Government moved to dismiss the surety’s various claims on limitations and lack of jurisdiction grounds and also filed a motion for summary judgment on a laches defense. The surety responded by alleging that all its causes of action were properly brought under the CDA because the surety executed a takeover agreement with the Government agreeing to complete the construction contract under the initial terms and conditions therein. Therefore, the surety’s claims were based upon its contractual relationship with the Government, not its status as surety. 16 Cl. Ct. at 147. In denying the Government’s motion to dismiss, the court held:

> As Travelers, here, has executed such a takeover agreement, it necessarily possesses greater rights to sue the government than might a non-completing surety. In fact, upon the execution of said Takeover Agreement, Travelers became the prime party in privity with the government. It is, therefore, the holding of this court that where a surety has executed a takeover agreement, as herein, upon the default of the prime contractor in order to complete the work under the construction contract, it becomes a “party to a Government contract’” and thus, logically, a “contractor” within the meaning of § 601(4) of the CDA. See Balboa, 775 F.2d at 1160.
>
> . . .
>
> As Travelers can maintain an action under the CDA based upon the Takeover Agreement, we hold that it may also maintain an action based upon the construction contract terms to the extent that they are incorporated by reference into such agreement. This we hold for the additional reason that whereas here the CAFC has held that “a surety. . . is as much a party to the

> government contract as the contractor." See Balboa, 775 F.2d at 1160 (emphasis added).

16 Cl. Ct. at 153-54.

3.The Surety's Equitable Rights of Subrogation and the CDA.

Though a surety may have equitable rights of subrogation in the absence of a takeover agreement, a surety is generally not subrogated to the contractor's claims under the CDA. Admiralty Construction, Inc. by National American Ins. Co. v. Dalton, 156 F.3d 1217, 1222-23 (Fed. Cir. 1998); Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449 (1998);[15] Westech Corp. v. United States, 20 Cl. Ct. 745, 749-50 (1990); Universal Sur. Co. v. United States, 10 Cl. Ct. 794, 800-01 (1986). Thus, absent a takeover agreement, the surety cannot assert substantive claims, either of its own or of its principal, under the CDA. As explained by the Court in Westech:

> The recovery available under equitable subrogation, however, has been limited to funds held by the government, or funds improperly disbursed to a third party, only to the amount of the contract balance. (Citations omitted). In the instant case, Fireman's Fund has not asked for relief allowable under subrogation, i.e., the recovery of funds held by the government or the retrieval of improper disbursements. (Footnote omitted). Instead, Fireman's Fund has sought standing to recover for delay and acceleration damages suffered by Westech. As noted above, a surety's recovery of such damages suffered by a contractor is simply beyond the scope of equitable subrogation.

20 Cl. Ct. at 749-50.

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[15] In Intercargo, the court stated:

> [A] surety is not permitted on the facts of this case, to step into the shoes of the contractor for the purpose of converting a default termination into a termination for convenience so as to make a contract claim, which it could not make under equitable subrogation, against the contract balance. See Universal Sur. Co. v. United States, 10 Cl. Ct. 794, 799 (1986). Plaintiff's surety right under subrogation amounts to a security interest in the monies earned and due and owing the contractor pursuant to the contract. It does not give rise to an assignment of the contractor's legal status under the contract. See Universal Sur. Co., 10 Cl. Ct. at 798-99. n. 2.

41 Fed. Cl. at 460. The principal had already settled its claim against the Government by converting a termination for default into a termination for convenience and waiving and releasing the Government from all of its claims for money damages.

On the other hand, the existence of a takeover agreement does not prevent the surety from asserting its equitable rights of subrogation. The CDA does not apply to a performance bond surety's equitable subrogation claims. Transamerica Ins. Co. v. United States, 31 Fed. Cl. 602 (1994). This opinion is a decision of the Court of Federal Claims upon remand from the United States Court of Appeals for the Federal Circuit in Transamerica Ins. Co. v. United States, 989 F.2d 1188 (Fed. Cir. 1993). The Federal Circuit held that the surety stated a cause of action against the Government for equitable subrogation to the Government's rights to use funds payable to the principal on a second contract to offset the losses incurred by the surety on the first contract. The Federal Circuit reversed the dismissal of the surety's complaint. On remand to the Court of Federal Claims, the Government again moved to dismiss arguing that the court lacked subject matter jurisdiction because the surety executed a takeover agreement on the first contract but failed to submit a properly certified claim to the contracting officer for the funds payable on the second contract. The surety argued that its subrogation rights to the funds on the second contract were independent of any contractual relationship between the surety and the Government on the first contract, and that the certification requirements of the CDA (which were admittedly not met) did not operate to bar the surety's claims to the funds on the second contract. The issue became whether the surety's right of equitable subrogation was a claim "arising under or relating to" the takeover agreement. 31 Fed. Cl. at 606. In holding that the surety's equitable subrogation claims did not arise under or relate to the takeover agreement and were not subject to the certification requirements of the CDA, the court stated:

> By its very nature, plaintiff's claim for equitable subrogation is not related to the school contract takeover agreement. Transamerica's claim is derived from its subrogative right to step into the shoes of the government and recover proceeds withheld on a contract unrelated to the school project, which may result in recovery from the government for breach of its equitable duty to safeguard contract retainage. Although defendant correctly notes that plaintiff's equitable subrogation rights matured when it completed performance of the school contract takeover agreement, see Fidelity and Deposit Co. v. United States, 183 Ct. Cl. 908, 912, 393 F.2d 834 (1968) ("surety's potential rights become an actuality when it pays the obligations of its principal"), plaintiff merely discharged its obligations under the performance bond of the defaulted contract by completing the school project.
>
> * * *
>
> The existence of potential subrogation rights and contract retainage at the time of the contractor's default, the subsequent maturing of those rights whether by takeover agreement or in some other fashion, and the fact that a surety's rights relate

> back to the date of execution of the bonds, preclude the court from finding that Transamerica's claim relates to the takeover agreement. The court finds that plaintiff's equitable subrogation claim relates to the circumstances and duties of the defaulted school contract and the performance bond, rather than the takeover agreement executed by Transamerica.
>
> * * *
>
> The court concludes that neither execution nor performance of the school contract takeover agreement transformed the equitable nature of Transamerica's subrogation rights into rights arising under or relating to that contract as contemplated by the CDA.

31 Fed. Cl. at 606-07 (emphasis in original).

One final limit on subrogation rights under the CDA bears mention. In George W. Kane, Inc. v. United States, 26 Cl. Ct. 655 (1992), the court held that a contractor completing a project for the surety after the surety executed a takeover agreement with the Government was not in privity of contract with the Government. The completing contractor was not entitled to assert claims under the CDA because it was not a party to a Government contract. 26 Cl. Ct. at 660-61. Careful drafting of a completion agreement could prevent this result by allowing the contractor to prosecute CDA claims in the name of the surety (who does have a contract with the Government).

4.Limitations on CDA Claims.

Claims under the CDA are not governed by the six year limitations period set forth in 28 U.S.C. § 2501 applicable to actions over which the Court has jurisdiction.[16] Rather, the CDA contains two relevant time limitations: (1) for submission of claims to the contracting officer; and (2) for appeals from final decisions of the contracting officer. All claims must be submitted to the contracting officer within 6 years after accrual of the claim. 41 U.S.C. § 605(a). Appeals from the final decision of a contracting officer must be filed within one year after the final decision. 41 U.S.C. § 609(a)(3).[17]

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[16] In Travelers Ins. Co. v. United States, 16 Cl. Ct. 142, 151-52 (1988), the court held that the six year limitation period applicable generally to actions in the court did not apply to submission of claims to a contracting officer. As a result, the fact that more than six years transpired from accrual of claims to submission to contracting officer was not a bar to subsequent suit in the court. Since the decision in Travelers, the CDA has been amended to make the limitations periods parallel.

[17] 41 U.S.C. § 609(a)(3) provides:

> Any action under paragraph (1) or (2) shall be filed within twelve months from the date of the receipt by the contractor of the decision of the contracting officer concerning the claim, and shall proceed de novo

C. Conclusion.

The first section of this paper has focused on the jurisdiction of the Court. Because the jurisdiction of the Court is narrowly defined, the Government raises jurisdictional questions at every opportunity, often successfully. The jurisdictional prerequisites of the Court should be considered not just in the context of deciding whether to file suit but are also important to consider during the surety's decision as to how to proceed after the principal's default and the Government's demand. For example, there are times when executing a takeover agreement will allow the performance bond surety to contest the failure to timely terminate the principal or to question the use of contract funds that would not be available to a surety that merely tenders a contractor or indemnifies the Government. In addition, perfection of the surety's equitable rights of subrogation through providing prompt and timely notice of default and obtaining proof admissible in evidence that the surety has satisfied its bond obligations can avoid later jurisdictional problems in the event that suit needs to be brought in the Court. Therefore, it is crucial that the surety bear in mind the jurisdictional requirements of the Court in any Miller Act performance or payment bond case because of the possibility of future litigation with the Government. Of course, surviving the motion to dismiss is only the first step. Therefore, this paper will next focus on the types of claims that the surety can assert against the Government and the surety's equitable rights of subrogation.

II. KINDS OF SURETY CLAIMS AGAINST THE GOVERNMENT.

The kinds of surety claims against the Government are dependent upon whether the surety has a direct contract with the Government (i.e., a takeover agreement) or is exercising its equitable rights of subrogation.

A. Surety Claims Under a Takeover Agreement.

1.Contract Funds.

When the surety executes a takeover agreement with the Government, it has all of the rights of one with a direct contract with the Government.[18] A takeover

in accordance with the rules of the appropriate court.

[18] In Travelers Indemnity Co. v. United States, 16 Cl. Ct. 142, 153 (1988), the court stated:

> In Carchia v. United States, 202 Ct. Cl. 723, 735, 485 F.2d 622, 628 (1973), the court held that a completing surety, i.e., one that has executed a Takeover Agreement to complete performance under the original construction contract upon the original contractor's default, had standing to sue the government on the takeover contract for extra work that it had performed in excess of that contemplated in the original contract price. With the existence of a takeover agreement, therefore, "the surety, in effect, becomes the contractor, subject to the terms of the new agreement." Universal Surety, 10 Cl. Ct. at 800; see also Transamerica Insurance Co. v. United States, 6 Cl. Ct. 367, 371 (1984); Morrison Assurance Co. v. United States, 3 Cl. Ct. 626 (1983).

agreement typically provides that the surety will receive the remaining contract funds which have not been paid to the original contractor that has defaulted under its contract with the Government. Those contract funds include both ongoing progress payments and the retainage held by the Government.

(a) Progress Payments.

With respect to the ongoing progress payments, once the surety has executed a takeover agreement, entered into a contract with a completion contractor, and the completion contractor has performed the work on a timely basis, the surety will be paid the ongoing progress payments in accordance with the terms of the original construction contract. This is strictly a matter of contract law based upon the terms and conditions of the takeover agreement and the original construction contract.

(b) Retainage.

The same situation should apply to the payment of the contract retainage. The Government should release the retainage in accordance with the terms and conditions of the takeover agreement and the original construction contract. However, the surety may have a claim against the Government if the Government has wrongfully released retainage to the original contractor in breach of the terms of the original construction contract.

2. Claims and Extras for Delay, Acceleration, Wrongful Termination, Etc.

A surety executing a takeover agreement also has rights to make contractual claims for delay and acceleration, whether those claims are those of the original contractor or the surety under the takeover agreement.[19] The surety may "maintain an action based upon the construction contract terms to the extent that they are incorporated by reference into [a takeover agreement]." Travelers Indemnity Co. v. United States, 16 Cl. Ct. 142, 154 (1988).[20]

The court held that where a surety executed a takeover agreement upon the default of the contractor, it became a party to a Government contract and a contractor within the meaning of the Contract Disputes Act. 16 Cl. Ct. at 153.

[19] Carchia v. United States, 202 Ct. Cl. 723, 485 F.2d, 622 (1973). The Court of Claims allowed a completing surety to claim payment for extra work beyond that contemplated in the original contract price. In Carchia, there was a separate takeover agreement between the Government and the surety after the default by the contractor. "In that circumstance, the surety in effect becomes the contractor, subject to the terms of the new agreement." Universal Surety Co. v. United States, 10 Cl. Ct. 794, 800 (1986).

[20] A surety asserting claims, including claims for additional delay overhead, is bound by the terms of the construction contract. Reliance Insurance Co. v. United States, 931 F.2d 863 (Fed. Cir. 1991).

The surety executing a takeover agreement also has the right to challenge the termination of the contractor's right to proceed under the original contract. In Westech Corp. v. United States, 20 Cl. Ct. 745, 749 (1990), the court stated:

> Had Fireman's Fund executed a takeover contract with defendant to complete the contract, it would have standing to sue. In fact, under that circumstance Fireman's Fund could even challenge the propriety of defendant's prior actions including the decision to terminate for default. See Carchia v. United States, 485 F.2d 622, 628-30, 202 Ct. Cl. 723 (1973); Travelers Indem. Co. v. United States, 16 Cl. Ct. 142, 153 (1988); Universal Sur. Co. v. United States, 10 Cl. Ct. 794, 800 (1986).

A surety which defaults under the terms of its takeover agreement with the Government because of the surety's lack of significant progress may also challenge the default termination by the Government. Indemnity Ins. Co. of North America v. United States, 14 Cl. Ct. 219 (1988).

3. Liquidated Damages.

The surety is entitled to contest the assessment of liquidated damages, both against the original contractor and under the takeover agreement, that reduce the amount of the remaining contract funds.

4. Improper Payments.

Normally, the performance and payment terms of the construction contract between the original contractor and the Government are incorporated into the takeover agreement. Travelers Indemnity Co. v. United States, 16 Cl. Ct. 142 (1988).

(a) Progress Payments.

In Transamerica Insurance Co. v. United States, 6 Cl. Ct. 367 (1984), the Government entered into a takeover agreement with the surety. Subsequently, the Government discovered that in making previous progress payments to the original contractor, it had overpaid the original contractor in an amount of $79,810.74 beyond the amount properly due the original contractor for the work accomplished. That amount was subsequently withheld from a progress payment due to the takeover surety. The surety made a claim for the amount withheld. 6 Cl. Ct. at 369.

The court questioned why the surety should bear the financial burden resulting from the Government's mistake. Upon executing the takeover agreement, the surety's reasonable intent was to obtain the balance of the contract price remaining at the time of default. The court stated:

> It seems reasonable to conclude that when the parties provided that Transamerica's reimbursement should be limited to "the balance of the contract price unpaid at the time of default," the parties intended to exclude from Transamerica's reimbursement only those previous payments made to [the contractor] in accordance with the provisions of the contract. It would be unreasonable to believe that Transamerica would have undertaken to complete the defaulted contract if it had known there was a prospect that reimbursement of its costs might be jeopardized by unknown payments mistakenly made to [the contractor] in excess of contract requirements.

6 Cl. Ct. at 371. The court went on to state that:

> [A] performance bond surety which completes a defaulted contract has conferred a benefit on the Government by relieving the Government of the burden of completing the contract, and, accordingly, that the surety should be able to recover its costs without being subject to claims which the Government may have against the defaulting contractor, seems to be applicable to the present case. In other words, Transamerica's right to recover its costs in completing this contract should not be reduced because the Government mistakenly made an excessive payment to [the contractor] before the default.

6 Cl. Ct. at 372.

(b) Retainage.

In National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997), the Government terminated the principal contractor's contract for default. The surety entered into a takeover agreement with the Government providing that the surety would complete performance for the remaining contract funds. The surety then arranged for completion by another contractor. The work was accepted and the Government paid the remaining contract funds to the surety.

Subsequently, the surety made a claim against the Government for certain retainage paid to the contractor before its default. The surety contended that the funds should have been held as retainage by the Government, thereby reducing the surety's loss. The court held that the surety was entitled to recover from the Government the retainage paid to the contractor[21] because the "retainage provision in a bonded construction contract serves to

[21] The Court of Federal Claims in National Surety Corp. v. United States, 31 Fed. Cl. 565 (1994), allowed the surety to recover damages in the amount that should have been retained by the Government. However, the court in National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997) concluded that the surety's "recovery should not exceed any losses that ensued, directly or indirectly, from the impairment of the security (the

protect the surety as well as the government , . . ." 118 F.3d at 1545. The court found that the "duty devolves upon the government to administer the contract, during the course of its performance, in a way that does not materially increase the risk that was assumed by the surety when the contract was bonded." 118 F.3d at 1546. The court went on to say:

> The ten percent retainage provision was in the contract between Dugdale and the government when National Surety set the price for and executed its surety bonds. The retainage requirement served as security for performance of the bonded contract, and this requirement contributed to the surety's assessment of the risk involved. The surety was entitled to rely on the government's obligation to retain this percentage in accordance with the terms of the bonded contract, and on its right of subrogation to this security. National Surety's right was fixed upon execution of the surety bonds, and was not dissolved or altered when the government failed to implement the retainage required by the contract. See Balboa Insurance, 775 F.2d at 1161 (subrogation rights encompass funds wrongfully disbursed). The government, with knowledge that Dugdale had not met the contractual condition predicate to release of the retainage, did not defeat National Surety's subrogation right. Home Indemnity, 376 F.2d at 895 (government held liable to surety despite having disbursed the retainages).

118 F.3d. at 1546. The surety prevailed, notwithstanding the fact that it did not give notice to the Government. [22]

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retainage paid to the contractor). Thus, it is relevant to consider what the contractor did with the released funds." 118 F.3d at 1548. The court remanded the case to the Court of Federal Claims because it concluded that "damages are fairly measured not by the calculated amount of the required retention, but by the injury, loss, or prejudice to the surety due to the government's failure to implement the required retention." 118 F.3d at 1545.

[22] The court in National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997) distinguished the case of Fireman's Fund Insurance Company v. United States, 909 F. 2d 495 (Fed. Cir. 1990). In Fireman's Fund, the contract provided for the Government's discretion in releasing the retainage. Because of the contract provisions contained in the original construction contract in National Surety, the Government was bound by the limitations on its discretion for the release of the retainage. The court stated:

> In contrast [to Fireman's Fund], Dugdale's bonded contract gave no discretion to the government to depart from the requirement of the ten percent retainage until after the complete project arrow diagram was submitted and approved. That condition was never met. When the contractor abandoned performance before completion, as did Dugdale, and the government had knowledge of the default, as here, Fireman's Fund does not impose a further requirement that the surety notify the government that "the principal has defaulted." The holding in Fireman's Fund did not change the rules of subrogation, but simply dealt with the rights and obligations of the parties on the conditions of that case.
>
> We conclude that National Surety's right of subrogation was not defeated by the

B. Surety Claims Under Its Equitable Rights of Subrogation.

Generally, a performance bond surety's remedy in the Court under its equitable rights of subrogation is "limited to recovery from a fund held by the government/owner pursuant to the construction contract." Universal Surety Company v. United States, 10 Cl. Ct. 794, 797 (1986).[23] The Court has recognized several kinds of surety claims against the Government under the surety's equitable rights of subrogation.

1. Contract Funds.

(a) Progress Payments.

During the original contractor's performance of the work, the Government has certain discretion concerning the payment of progress payments.[24] In order for the surety to make a claim against the Government for progress payments improperly paid to the contractor during the performance of the work, surety must give notice to the Government.[25]

> government's release of the retainage in contravention of the terms of the bonded contract.

118 F.3d at 1547.

[23] "The recovery available under equitable subrogation, however, has been limited to funds held by the government, or funds improperly disbursed to a third party, only to the amount of the contract balance." Westech Corp. v. United States, 20 Cl. Ct. 745, 749 (1990).

In Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449 (1998), the principal contractor was terminated for default for failure to maintain its workmen's compensation insurance. At the time of the termination for default, the contractor had billed and been paid for its first requisition. The surety made payment to a supplier under its payment bond for specially manufactured materials ordered by the contractor, but the materials were never delivered to the project site. Prior to the Government receiving notice of the surety's claim to the contract funds, the Government decided not to re-procure and complete the work, and "de-obligated" the remaining contract balance. Thereafter, the surety settled with the claimant under the payment bond and made claim for the contract funds.

The court found that to the extent the Government owes the contractor monies for contract performance, the surety, by paying suppliers and materialmen, is subrogated to the contractor's rights to those funds." 41 Fed. Cl. 57. However, because there were no contract funds due and owing to the contractor for any work performed on the contract, and because the Government held no funds due and owing to the contractor, the Government was neither a stakeholder nor was the surety entitled to stand in the shoes of the contractor to make a claim against the Government.

[24] See Section IV, infra.

[25] See Section III, infra.

After the performance and completion of the contract, the Government assumes the role of a stakeholder with respect to the unpaid progress payments. In the event that the surety provides the Government with notice of its claims against the progress payments, the Government, as a stakeholder, must hold onto the progress payments.[26]

(b) Retainage.

The contract retainage is determined at the time of the original contractor's default. Balboa Insurance Company v. United States, 775 F.2d 1158, 1163 (Fed. Cir. 1975). The contract retainage is part of the remaining contract funds, and may include progress payments.[27]

2. Contract Funds From Other Jobs.

(a) Claims of a Performance Bond Surety.

In Transamerica Insurance Company v. United States, 989 F.2d 1188 (Fed. Cir. 1993), the court found that the surety stated a cause of action against the Government under the following circumstances. The principal for the surety, the original contractor, had two contracts with the Government. One contract was completed by the original contractor at a profit as a result of certain claims for additional costs. On the other contract, which was bonded by the surety, the contractor was defaulted. The surety took over and completed the defaulted project and incurred a loss under its performance bond. The surety gave notice to the Government of its right to the profit on the first contract completed by the contractor to offset the surety's losses on the second contract completed by the surety under its performance bond. The court held that the surety had a right to claim the funds from the profitable contract to offset its losses on the contract taken over and completed by the surety under its performance bond.[28]

(b) Claims of a Payment Bond Surety.

In Dependable Insurance Company v. United States, 846 F.2d 65 (Fed. Cir. 1988), the surety incurred payment bond losses on one job in excess of $40,000, and made claim against the retainage of slightly more than $41,000. Competing against the surety's claim was the claim of the Internal Revenue Service as a result of the failure of the contractor to pay substantial amounts of withholding, social security and

[26] See Section V, infra.

[27] In Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 313 (1994), the court stated that "contract funds in the hands of the obligee are viewed as security or 'collateral' to which the surety can turn to cover any losses that may be incurred should the principal obligor (the contractor) default on the underlying obligation and the surety be required to pay out under its bond."

[28] In Transamerica Insurance Company v. United States, 31 Fed. Cl. 602, 607 (1994), the court determined that the surety's execution of a takeover agreement does not require the surety's claims of equitable subrogation to be determined under the Contract Disputes Act because the subrogation claim "neither arises under nor is related to the contract to which [the surety] was a party - the takeover agreement."

unemployment taxes. The surety acknowledged that the Government had a right to set off the tax claims against the retainage when the surety was only a payment bond surety. However, the surety contended that it had the status of a performance bond surety on other contracts between the contractor and the Government which allowed the surety to prevail over the claims of the IRS. The court found that the surety "cannot use its status of a performance bond surety on unrelated federal contracts to expand its rights to retain contract proceeds under this Navy contract [a contract on which the surety was a payment bond surety only claiming against the retainage]. A surety's rights and remedies are limited to recovery of retained funds from the contract generating the claim." 846 F.2d at 67. The court held that a surety "cannot improve its position as a payment bond surety on the Navy contract by invoking its status as a performance bond surety on other federal contracts," 846 F.2d at 67, and that the surety's "power to defeat the Government's right of setoff is limited to the specific contracts in which it fulfills its performance bond obligations." 846 F.2d at 67.

3. Liquidated Damages.

In Transamerica Insurance Company v. United States, 31 Fed. Cl. 532 (1994), the performance bond surety sought to recover funds withheld by the Government as liquidated damages when the original contractor defaulted. The surety did not take over the contract. Rather, the surety tendered a completion contractor to the Government. The surety paid funds both to the completion contractor for the completion of the performance of the work and to fulfill its obligations under the payment bond. The surety contested the Government's assessment of liquidated damages against the original contractor.

The court stated that the surety did not have either an express or implied contract with the Government because it did not enter into a takeover agreement. However, the court found that the surety's rights of equitable subrogation as a performance bond surety (for funding the completion of the work[29]) allowed surety to sue the Government in the Court of Federal Claims. The court found that "[u]nder the doctrine of equitable subrogation, 'contract retainage' is determined as soon as the contractor defaults." 31 Fed. Cl. at 536 [citing Balboa Insurance Company v. United States, 775 F.2d 1158 (1988)]. As a result, the surety could assert a claim to the contract balance as it existed at the time of the original contractor's default, and could challenge the Government's management of the remaining contract funds, including the Government's decision to reduce them pursuant to a liquidated damages claim. 31 Fed. Cl. at 536.[30]

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[29] See Aetna Casualty & Surety Company v. United States, 845 F.2d 971 (Fed. Cir. 1988), which is cited in the Transamerica case. 31 Fed. Cl. at 535.

[30] In International Fidelity Insurance Co. v. United States, 25 Cl. Ct. 469 (1992), the surety contended that an improper termination of the contractor precluded the Government from assessing and wrongfully withholding liquidated damages. The court found that the reasonableness of the Government's actions created a genuine issue of material fact precluding summary judgment.

4. Claims and Extras For Delay, Acceleration, Wrongful Termination, Etc.

A surety which executes a takeover agreement has a contractual right to make claims against the Government for extras, delay, acceleration, wrongful termination, etc. A surety which does not takeover the performance of the construction contract may not make such a claim under its equitable rights of subrogation.[31] "The recovery available under equitable subrogation, however, has been limited to funds held by the government, or funds improperly disbursed to a third party, only to the amount of the contract balance." Westech Corp. v. United States, 20 Cl. Ct. 745, 749 (1990). The court went on to state:

> Fireman's Fund has sought standing to recover for delay and acceleration damages suffered by Westech. As noted above, a surety's recovery of such damages suffered by a contractor is simply beyond the scope of equitable subrogation. See Travelers, 16 Cl. Ct. at 153. ("[T]he right to sue the government over the construction contract [is] limited to the contractor."); see also Universal, 10 Cl. Ct. at 797-98. Moreover, to expand equitable subrogation to allow a surety to assert a contractor's claims would, in effect, be allowing an assignment of a claim against the government in violation of the Assignment of Claims Act, 31 U.S.C. § 3727, 41 U.S.C. § 15 (1988).

20 Cl. Ct. at 750. A takeover agreement creates privity between the surety and the Government. However, a "paying surety cannot maintain the prime contractor's claim for damages allegedly caused by the government." 20 Cl. Ct. at 750.[32]

In Universal Surety Co. v. United States, 10 Cl. Ct. 794 (1986), the surety sought payments from the Government for certain change orders, damages for clean up at the site (PCB's), increased excavation costs and other claims. The surety did not execute a takeover agreement. The court stated that "a surety's remedy is limited to recovery from a fund held by the government/owner pursuant to the construction contract." 10 Cl. Ct. at 797. As a result, the court found that the surety could not, through its equitable rights of subrogation, "seek recovery in this court for damages related to the change orders, the additional excavation cost, and the PCB clean up." 10 Cl. Ct. at 798.

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31 Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449, 460 (1998).

32 The surety in the Westech Corp. case contended that it would have taken action to formally enter into a takeover agreement with the Government had it known of its principal's claims. The court found that the Government "had no duty to inform the surety of claims which the contractor may have had." 20 Cl. Ct. at 751.

5. Improper Payments.

In Fireman's Fund Insurance Co. v. United States, 909 F.2d 495 (Fed. Cir. 1990), the surety declined to execute a takeover agreement with the Government, but did fulfill its obligations under the payment bond. When the Government assessed $583,903 in excess reprocurement costs, the surety challenged the assessment alleging that "the Government's premature release of the retainage breached the bonded contract and prejudiced its interest." 909 F.2d at 497. The court found that the surety did not provide notice to the Government of its claims against the retainage and that the release of the retainage was not a departure from the terms of the original construction contract.

However, in National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997), the surety recovered all or a portion of the retainage that should have been held by the Government and which was paid to the contractor in contravention of the express provisions of the construction contract. The surety did not have to provide notice to the Government because it was the Government that breached the provisions of the construction contract and improperly made the payment of the retainage to the contractor.

6. Interest.

Sureties have made claims for interest on the amounts not paid by the Government. "Interest on a claim against the United States may be allowed only under a contract or an Act of Congress granting the same. 28 U.S.C. § 2516(a) (1992)." Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 317 n.8 (1994); Morrison Assurance Company, Inc. v. United States, 3 Cl. Ct. 626, 638 (1983). Interest will be allowed where the surety is entitled, Ohio Casualty Insurance Company v. United States, 12 Cl. Ct. 590, 596 (1987), and will not be allowed where there is no entitlement, United Pacific Insurance Company v. United States, 16 Cl. Ct. 555, 561 (1989).

7. Attorney's Fees.

Sureties have made claims for attorneys' fees as a result of disputes with the Government. Attorneys' fees may be recoverable under the Equal Access to Justice Act, 28 U.S.C. § 2412 (1992). Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 317 n.8 (1994); United Pacific Insurance Company v. United States, 16 Cl. Ct. 555, 561 (1989). In the appropriate case, attorneys' fees have been awarded to the surety. Ohio Casualty Insurance Company v. United States, 12 Cl. Ct. 590, 596 (1987) ($152,042.20).

III. THE SURETY'S NOTICE TO THE GOVERNMENT.

A. The Surety is Required to Give Notice to the Government to Preserve its Claim Under the Surety's Equitable Rights of Subrogation.

It is clear from the cases that before the surety may assert its equitable rights of subrogation against the Government, it must give notice of those rights to the Government. In Fireman's Fund Insurance Company v. United States, 909 F.2d 495 (Fed. Cir. 1990), the surety declined to takeover the contract after the default of the original contractor. Upon fulfilling its obligations under the payment bond, the surety alleged that the Government's premature release of the retainage prejudiced the rights of the surety. The court found that the surety did not notify the Government of the contractor's failure to pay its subcontractors and suppliers until five months after the Government had released retainage which the surety claimed. The court found that:

> [T]he government as obligee owes no equitable duty to a surety like Fireman's Fund unless the surety notifies the government that the principal has defaulted under the bond. It is irrelevant whether the surety claims a right to funds during performance of the contract, or after it is completed when the government functions as a "stakeholder" of funds owed but not yet paid. In either event, notice by the surety is essential before any governmental duty exists.

F.2d at 498.[33]

The Government's equitable duty and obligation to the surety to avoid actions that impair the surety's interests in the contract funds "is triggered not only when the Government is informed of the contractor's actual default but also - and perhaps more typically - when the Government receives reasonable warning from the surety of a contractor's threatened default under the bond." Transamerica Insurance Company v.

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[33] In order to establish a claim under Balboa Insurance Company v. United States, 775 F.2d 1158 (Fed. Cir. 1985), notice by the surety must be given to the Government. As stated in Reliance Insurance Company v. United States, 27 Fed. Cl. 815, 826 (1993), it is "quite clear that notice by the surety to the government is a necessary first step to trigger the government's responsibility. Therefore, the eight point test in Balboa should be applied only if notice by the surety is given to the government." In Ransom v. United States, 17 Cl. Ct. 263 (1989), aff'd 900 F.2d 244 (Fed. Cir. 1990), the court ruled as a matter of law "that before any obligation arises to withhold or divert funds, the Government must be notified that the sureties believe the contractor is in default and cannot complete the contract. Because there was no notice to the Government in this case before the last progress payment, no obligation arose on the part of the Government to exercise due care on behalf of the sureties in making payments to the contractor." 17 Cl. Ct. at 272. Furthermore, the court ruled "as a matter of law that notice is required before the United States becomes obligated to a surety to exercise reasonable discretion in administering contract funds." 17 Cl. Ct. at 274. (See numerous cases concerning notice by the surety cited in Ransom, 17 Cl. Ct. at 273.)

United States, 32 Fed. Cl. 308, 313 (1994).[34] See also Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449, 459 (1998).

B. The Government's "Knowledge" is Not Sufficient Notice.

In Fireman's Fund Insurance Company v. United States, 909 F.2d 495 (Fed. Cir. 1990), the court acknowledged that certain subcontractors and suppliers had informed the Government of the original contractor's failure to pay certain bills prior to the release of the retainage. The court found that information concerning nonpayment of subcontractors and suppliers obtained by the Government from sources other than the surety:

> ... does not substitute for notice by the surety and does not trigger the government's equitable duty to act with reasoned discretion toward it. Fireman's Fund simply cannot rely on Westech's subcontractors or the government to protect its interests. By definition and agreement the surety protects the government's interest, not the other way around.
>
> We see no reason to impose on the government a duty toward the surety whenever a subcontractor or supplier complains of late or nonpayment by the contractor. Only the contract should limit the government's flexibility in resolving payment disputes so minor, and perhaps so inevitable, that the surety itself doesn't consider the contractor's role in them a potential default under the bond. Only when the surety may be called upon to perform, that is, only when it may become a party to the bonded contract, should the government owe it any duty. The surety knows best when this may occur; consequently, only notice by the surety triggers the government's equitable duty.

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[34] The court cited a number of cases where the surety gave notice to the Government of its claim for the contract funds. Those cases include: "Great Am. Ins. Co. v. United States, 203 Ct. Cl. 592, 596-99, 492 F.2d 821, 825 (1974) (contracting officer's demand for proof of surety's payment to materialmen before agreeing to withhold contract funds deemed improper because the Government became a stakeholder of those funds upon receipt of the surety's timely notice that materialmen were making claims against the bond and the surety's demand for protection of those funds); Home Indem. Co. v. United States, 180 Ct. Cl. 173, 178, 376 F.2d 890, 893 (1967) (Government because stakeholder when it was in receipt of surety's second letter, sent after completion of the contract, advising that two suppliers had made bond claims and asking the Government to retain any remaining funds pending settlement of the unpaid job expenses); American Fidelity Fire Ins. Co. v. United States, 206 Ct. Cl. 570, 578-79, 513 F.2d 1375, 1380 (1975) (surety's letter implying imminent default of contractor and asserting the surety's rights to remaining contract funds triggered the Government's stakeholder duty upon receipt before disbursement of final contract funds); and International Fidelity Ins. Co. v. United States, 25 Cl. Ct. 469, 477 (1992) (Government held to stakeholder duty where surety sent post-contract letter informing Government of claims received from subcontractors and demanding withholding of remaining contract funds)." 32 Fed Cl. at 314.

F.2d at 499.

However, when the Government already has notice of the surety's rights,[35] or the Government has breached its duties to the surety by making payments to the principal contractor in contravention of the underlying construction contract provisions,[36] then the surety does not have to provide separate notice to the Government to assert its equitable rights of subrogation.

C. Types of Surety Notice.

1. Contract Modification.

In Transamerica Premier Ins. Co. v. United States, 32 Fed. Cl. 308 (1994), after the surety had given written notice by letter to the Government, the Government, at the request of the surety and with its principal's agreement, executed a unilateral contract modification to change the mailing address for the remaining contract payments from the principal's office to the surety. When the Government failed to comply with its own unilateral contract modification, and sent the final contract funds to the principal, the surety sued the Government and prevailed.

In International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706 (1998), the principal contractor sent a letter to the Government asking that the remaining payments on the contract be made payable jointly to the contractor and the surety and sent to a particular address. The Government then unilaterally modified the contract to reflect that all payments should be made to the contractor and the surety. Subsequently, the contractor sent a progress payment application to the Government containing both the contractor's and the surety's names and requested that the check be sent to the specific address listed in the letter and the contract modification. However, the check was sent to and made payable solely to the contractor. Notwithstanding the fact that there was no notice from the surety directly to the Government, the court found that "in addition to the government's admitted knowledge of unpaid subcontractors and suppliers, the surety caused the contractor to request joint payments to the surety and the contractor, and the government in response modified the contract to affect the joint payment arrangement." 41 Fed. Cl. at 716. As such, no further notice was necessary by the surety to make a claim for the improperly paid contract funds from the Government to the contractor.

[35] International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706 (1998).

[36] National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997).

2. Notice Letter.

The most frequent method used by the surety in providing notice to the Government is by letter. In most of the cases cited in this paper, the surety that has provided adequate notice to the Government has usually done so by letter.[37]

IV. THE EQUITABLE DUTIES OF THE GOVERNMENT WITH RESPECT TO THE RIGHTS OF THE SURETY.

A. Generally.

The Government has an equitable obligation which it owes to the surety. Balboa Insurance Co. v. United States, 775 F.2d 1158 (Fed. Cir. 1985). Even though it is not in privity of contract with the surety, the Government has "an obligation, consistent with its own business needs, to avoid actions that impair the surety's interest in the contract collateral, i.e., the contract proceeds on hand payable for work done." Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 313 (1994).[38] Furthermore, the surety does not "contract to assume the risks of unreasonable conduct by a contracting officer which results in a loss to the government." Ohio Casualty Insurance Company v. United States, 12 Cl. Ct. 590, 591 (1987). The Court will protect the surety's rights when the Government violates its equitable obligations and duties to the surety.[39] Any discussion of the equitable duties of the Government with respect to the rights of the surety must start with an analysis of Balboa Insurance Co. v. United States as provided below.

B. Balboa.

In Balboa Insurance Co. v. United States, 775 F.2d 1158 (Fed. Cir. 1985), the Miller Act surety sued the Government for the recovery of a progress payment in the sum of $23,163.50 alleged by the surety to have been improperly paid to the contractor by the Government after the surety had notified the Government that the contractor was in default. Six days before the Government paid the progress payment to the contractor, the surety, by letter, notified the Government that the contractor would not be able to fulfill its payment and performance obligations, and demanded that no further payments be released to the

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[37] See Klinger, Marilyn, "The Surety's Notice: What Does it Say and Does it Work?", Subrogation Rights of the Contract Bond Surety (George J. Bachrach, ed.), Tort and Insurance Practice Section--American Bar Association (1990).

[38] The Government executing a contract with a contractor is acting in a proprietary capacity and not in its sovereign capacity. As a result, it has a duty not to act negligently and cause loss to third parties, whether by mistake, erroneous legal opinion or without any explanation. 32 Fed. Cl. at 316.

[39] As stated in Section III, supra., "the government as obligee owes no equitable duty to a surety...unless the surety notifies the government that the principal has defaulted under the bond...notice by the surety is essential before any governmental duty exists." Fireman's Fund Insurance Company v. United States, 909 F.2d 495, 498 (1990).

contractor without the surety's consent. Four months after the progress payment was paid to the contractor, the Government terminated the contract, which was then completed by another firm. The surety made payments to subcontractors and suppliers in excess of the amount of the progress payment.

The court dealt with a number of issues. The first issue concerned the jurisdiction of the Claims Court with respect to the surety's suit against the Government to recover an allegedly improperly paid progress payment. The court found that "the traditional means of asserting a surety's claim is under the equitable doctrine of subrogation." 775 F.2d at 1161. Citing United States Fidelity & Guaranty Co. v. United States, 475 F.2d 1377, 1382 (Ct. Cl. 1973), the court explained the respective rights of subcontractors and a Miller Act surety to sue the Government as follows:

> [T]he surety was entitled to the benefit of all the rights of the laborers and materialmen whose claims it paid and those of the contractor whose debts it paid. The surety then is subrogated to the rights of the contractor who could sue the Government since it was in privity of contract with the United States. The surety is likewise subrogated to the rights of the laborers and materialmen who might have superior equitable rights to the retainage but no right to sue the [United States].

775 F.2d at 1161.

The second issue concerned whether there was a distinction between a surety's claim for a progress payment as opposed to the retainage held by the Government. The court found that:

> [U]pon notification by the surety of the unsatisfied claims of the materialmen, the Government became a stakeholder with respect to the amount not yet expended under the contract that it holds at the time of notification of default. However, we can discern no reasonable basis for the Government's distinction between retainages and progress payments when, as in this case, the surety informed the Government of the contractor's alleged breach before the payment was disbursed.

775 F.2d at 1162. The court went on to cite National Surety Corp. v. United States, 319 F. Supp. 45, 49 (N.D. Ala. 1970) for the proposition that:

> [T]he Courts make no distinction between earned progress payments and retained percentages in determining the surety's equitable rights upon the contractor's default.

> The surety's rights apply to the total fund, no matter what it is called, which remains in the hands of the United States (or any owner-obligee) at the time notice of default under its bond is established.

775 F.2d at 1163. The court in Balboa then found that:

> [T]here is no valid distinction between money held by the Government which is a "retainage" and a "progress payment." In either case, the "total fund" remaining in the Government's possession, to the extent the surety has obligations arising under the contract, is available to the surety.

775 F.2d at 1163.

Upon finding that the Claims Court had jurisdiction to hear the claim of the surety against the Government for the progress payment allegedly improperly disbursed to the contractor, the court then addressed the third issue, namely whether the Government acted properly when it released the progress payment to the contractor. The surety asserted that the Government either did not exercise discretion or acted unreasonably in paying the progress payment to the contractor. In describing the role of the Government and its obligation to the surety, the court stated:

> As the Court of Claims stated in Argonaut Insurance Co. v. United States, 434 F.2d 1362, 1367-68 (Ct. Cl. 1970), there is a significant difference between the Government's role before and after completion of performance on a contract. As opposed to its interest in disbursing retainage payments after completion, during performance it has a vital interest in the "timely and efficient" completion of the work. It is to overcome "various unforeseen circumstances which may hinder performance" that the Government incorporates into the contract broad rights and permits the federal procurement officials broad discretion and flexibility. Id.; United States Fidelity & Guaranty Co. v. United States, 676 F.2d 622, 628 (Ct. Cl. 1982). With respect to the surety, however, this discretion and flexibility is limited by its "duty to exercise its discretion responsibly and to consider the surety's interest in conjunction with other problems encountered in the administration of the contract." Argonaut Insurance Co., 434 F.2d at 1368.
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> Where the Government is entitled to exercise its discretion, the "plaintiff has an unusually heavy burden of proof in showing that the determination made...was arbitrary and capricious," Royal Indemnity Co. v. United States, 529 F.2d 1312, 1320 (Ct. Cl.

> 1976); and "[t]he standard of proof to be applied in a case where an arbitrary and capricious disregard of the surety's interests, and an abuse of discretion, are charged must be, and is, high. Id., (citing Keco Industries, Inc. v. United States, 428 F.2d 1233 (Ct. Cl. 1970)); United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 628.
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> "It is common knowledge that contractors rely upon contract proceeds administered through progress payments to properly finance the contract." Fireman's Fund Insurance Co. v. United States, 362 F. Supp. 842, 846 (D. Kan. 1973). Thus, the Government has no legal obligation to suspend a progress payment merely upon the unsupported request of a contractor's surety, United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 628. However, when a surety has informed the Government that the contractor is in default, the Government has an obligation to take "reasonable steps to determine for itself that the contractor had the capacity and intention to complete the job." Fireman's Fund Insurance Co., 362 F. Supp. at 848.

775 F.2d at 1164.

The court went on to list eight factors which it considered to be important in determining whether the Government has exercised reasonable discretion in disbursing the contract funds to one other than the surety:[40]

> (1) Attempts by the Government after notification by the surety, to determine that the contractor had the capacity and intent to complete the job. United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 631; Royal Indemnity Co., 529 F.2d at 1321; Argonaut Insurance Co., 434 F.2d at 1366, 1369; Firemen's Fund Insurance Co., 362 F. Supp. at 848.
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> (2) Percentage of contract performance completed at the time of notification by the surety. United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 631; United States Fidelity, 475 F.2d at 1385; Argonaut Insurance Co., 434 F.2d at 1366.

[40] 775 F.2d at 1164-65. In its opinion, the court provides the full citations for the cases listed with shortened references in the eight factors. The full citations for those cases are as follows: United States Fidelity & Guaranty Co. v. United States, 676 F.2d 662 (Ct. Cl. 1982); Royal Indemnity Co. v. United States, 529 F.2d 1312 (Ct. Cl. 1976); United States Fidelity & Guaranty Co. v. United States, 475 F.2d 1377 (Ct. Cl. 1973); Argonaut Insurance Co. v. United States, 434 F.2d 1362 (Ct. Cl. 1970); and Fireman's Fund Insurance Co. v. United States, 362 F. Supp. 842 (D. Kan. 1973).

> (3) Efforts of the Government to determine the progress made on the contract after notice by the surety. United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 631; Royal Indemnity Co., 529 F.2d at 1320-21. See United States Fidelity, 475 F.2d at 1385.
>
> (4) Whether the contract was subsequently completed by the contractor (not conclusive, but relevant to show the reasonableness of the contracting officer's determination of the progress on the project). See Argonaut Insurance Co., 434 F.2d at 1369.
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> (5) Whether the payments to the contractor subsequently reached the subcontractors and materialmen (this goes to the equitable obligation of the Government to subcontractors and others to see that they will be paid; also, because the surety is liable to the subcontractors, any money that reaches them furthers the objectives of the surety as well as those of the Government). United States Fidelity, 475 F.2d at 1385; Argonaut Insurance Co., 434 F.2d at 1369.
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> (6) Whether the Government contracting agency had notice of problems with the contractor's performance previous to the surety's notification of default to the Government. United States Fidelity, 475 F.2d at 1385.
>
> (7) Whether the Government's action violates one of its own statutes or regulations. United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 630.
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> (8) Evidence that the contract could or could not be completed as quickly or cheaply by a successor contractor. United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 631; Royal Indemnity Co., 529 F.2d at 1321; Argonaut Insurance Co., 434 F.2d at 1369.

The court found that the summary judgment granted by the Claims Court in favor of the Government was improper for two reasons:

1. The Claims Court failed to consider or evaluate the surety's evidence presented in opposition to the Government's Motion for Summary Judgment based upon the eight factors listed above; and

2. The Claims Court found that the surety did not submit any proof of deliberate or fraudulent conduct on the part of the Government. The court stated:

> Proof of "deliberate or fraudulent conduct" is only one way of demonstrating abuse of discretion and is required only when allegations of bad faith have been asserted. See United States Fidelity & Guaranty Co. v. United States, 676 F.2d at 629. Proof of such conduct is not required to prove arbitrary or capricious action or abuse of discretion on the part of the Government.

775 F.2d at 1165. As a result, the case was remanded for further proceedings to determine whether the Government's payment of the progress payment "was a reasonable exercise of the discretion conferred on the contracting agency by the terms of the contract and the applicable law and regulations." 775 F.2d at 1165.

C. Cases Since Balboa.

The surety's claim of abuse of discretion by the Government and the use of the eight factors listed in Balboa have arisen in several contexts in cases before the Court of Federal Claims. Those cases and their analysis are discussed below.

1. The Surety's Claim to Progress Payments.

In United Pacific Insurance Company v. United States, 16 Cl. Ct. 555 (1989), the issue was whether the Government abused its discretion in issuing a progress payment during the course of a construction contract. The court found that the original contractor made false statements to the Government about the degree of completion of the equipment required under the contract, and was not paying its bills to subcontractors and suppliers. However, the Government continued, without investigation, to make progress payments during the course of construction. The court found that the Government's "authority to make progress payments is limited by its 'duty to exercise its discretion responsibly and to consider the surety's interest in conjunction with other problems encountered in the administration of the contract'" 16 Cl. Ct. at 558. The court reviewed in detail the eight factors identified in Balboa and found that the Government "failed to protect not only the interests of the surety, but its own, and therefore abused its discretion in issuing the fifth progress payment" to the contractor. 16 Cl. Ct. at 560. The court granted the surety's motion for summary judgment.[41]

It is clear that in the appropriate case, the Court will find an abuse of discretion on the part of the Government in disbursing progress payments to the contractor, its assignee, or others.

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[41] It is rare in a Balboa-type case that there are no genuine issues of material fact in dispute that preclude the entry of summary judgment. See United States Fidelity & Guaranty Co. v. United States, 16 Cl. Ct. 541 (1989) (payment made to defaulting contractor's assignee) and Integon Indemnity Corp. v. United States, 12 Cl. Ct. 115 (1987) (payment made to the defaulting contractor).

2. The Government's Failure to Default the Contractor.

In Ohio Casualty Insurance Company v. United States, 12 Cl. Ct. 590 (1987), the surety alleged that the Government violated its equitable duty to the surety and abused its discretion in failing to terminate a government contractor bonded by the surety. The court looked at the eight factors cited in Balboa and found that the Government abused its discretion by failing to timely terminate the contractor. The court found that the evidence "overwhelmingly showed a pattern of unreasonable conduct on the part of those responsible for the administration of the contract," 12 Cl. Ct. at 591, and that "it would be manifestly unjust to make the surety pay for the Navy's mistake." 12 Cl. Ct. at 591.[42]

3. The Government's Overpayment to the Contractor.

Normally, the Government has wide discretion in paying progress payments to the contractor. Assuming that adequate notice is given by the surety to the Government,[43] the Government may be liable to the surety for overpayments to the contractor as opposed to merely paying progress payments. For example, in United Pacific Insurance Company v. United States, 16 Cl. Ct. 555 (1989), the contractor was overpaid as a result of false statements about the degree of completion of the equipment. In National Surety Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997),[44] the Government's discretion may be limited by contract, and the Government's failure to withhold 10% retainage as required by a condition precedent in the contract resulted in liability to the surety. However, where the contract provides wide discretion, and the surety failed to notify the Government prior to the release of the retainage, the Government was not liable to the surety for the release of the retainage. Fireman's Fund Ins. Co. v. United States, 909 F.2d 495 (1990).

V. THE SURETY'S CLAIMS AGAINST THE GOVERNMENT AS A STAKEHOLDER.

A. Generally.

In the Balboa line of cases, the dispute between the surety and the Government concerns whether the Government abused its discretion in making payment to the contractor or its assignee despite notice of the surety's claims against the remaining contract funds. The role of the Government changes after the performance of the work and

[42] "The evidence clearly supports a finding that the contractor in this case should have been terminated no later than November of 1981 and that it was an abuse of the contracting officer's discretion to not do so. In so abusing its discretion, the Navy violated an equitable duty it owed to plaintiff [surety]. The evidence also supports a finding that the plaintiff [surety] suffered financial losses of $592,687.81 as a result of the government's failure to terminate by such date." 12 Cl. Ct. at 591.

[43] See Section III, supra.

[44] See Section II. A.4.(b)., supra.

the completion of the contract. In Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 315-16 (1994), the court stated that during performance:

> the Government's principal interest is in the efficient completion of the contract...To that end, federal officials are given broad discretion over the administration of the contract. Importantly, those officials must be free to disburse contract funds to allow the contractor to finance the project to completion...It was in this context that the court [in Balboa] articulated the eight factors to measure the reasonableness of the Government's conduct before the completion of the contract. After performance, however, the Government's interest in retaining funds to ensure contract completion disappears and the contractor's and surety's interests in the retained funds become paramount. Bluntly put, the Government's interest at this point does not extend beyond avoiding liability for sending the retained funds to the wrong party. See International Fidelity Ins. Co. v. United States, 25 Cl. Ct. 469, 477 n.11 (1992).

The Government becomes a stakeholder when the Government no longer has an interest in the remaining contract funds. Upon receipt of notice from the surety and possibly other claimants to the remaining contract funds, the Government, as a stakeholder, must hold on to the remaining contract funds. In Newark Insurance Co. v. United States, 144 Ct. Cl. 655, 169 F. Supp. 955 (1959), the court stated that where the Government has on hand contract funds owing for work done, and receives notice and demand from the surety as a result of unpaid subcontractors and suppliers, the Government may not pay those funds to the contractor or anyone else without running the risk of having to pay a second time. The court stated:

> Surely a stakeholder, caught in the middle between two competing claimants, cannot, in effect, decide the merits of their claims by the mere physical act of delivering the stake to one of them. If his position as stakeholder becomes uncomfortable, and the claimants do not take steps to get a judicial solution of the question, the law has provided him with an interpleader proceeding by which he can deposit the stake in court and walk out free of the annoyance of being in the middle.
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> If it is made to appear that the Government's officials, after due notice of the facts giving rise to an equitable right in the plaintiff surety company, and of the plaintiff's assertion of such a right, paid out, without a valid reason for so doing, the money in question to someone other than the plaintiff, the plaintiff will be entitled to a judgment.

144 Ct. Cl. at 658-59, 169 F. Supp. at 957.

When the surety is competing against the Government or other claimants for the remaining contract funds held by the Government as a stakeholder, it utilizes its equitable rights of subrogation. A detailed discussion of all of the cases from the Court of Federal Claims and its predecessors is beyond the scope of this paper. There are several sources for all of the cases describing the surety's equitable rights of subrogation to the remaining contract funds in the hands of the Government.[45] The following is a brief review of the variables involved in the surety's equitable subrogation rights, the role of the Government as a stakeholder, and a summary of the cases relevant to the surety's equitable rights of subrogation in the Court of Federal Claims and its predecessors.

B. Variables.

There are a number of variables that are important in analyzing the surety's equitable rights of subrogation.[46]

1. Who is the Surety Competing Against.

The most common parties the surety competes against in the Court of Federal Claims are the Government itself, which may assert its setoff rights against the remaining contract funds as a result of other contracts, obligations or claims against the contractor by the Government; assignee/lenders, including assignees under the Assignment of Claims Act; trustees in bankruptcy and/or debtors-in-possession; and subcontractors and/or suppliers on the bonded projects. There appear to be no cases where the contractor (other than the contractor that has been wrongfully paid by the Government as described below), other taxing authorities or general creditors, including judgment creditors, are competing with the surety for the remaining contract funds before the Court of Federal Claims.

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[45] See, e.g., The Subrogation Database: Cases Concerning the Subrogation Rights of the Contract Bond Surety (George J. Bachrach, ed.), Tort and Insurance Practice Section - American Bar Association (1995). The Subrogation Database contains all of the cases concerning the subrogation rights of the contract bond surety organized in an Outline (Matrix) form. The Outline (Matrix) lists the significant issues concerning the subrogation rights of the contract bond surety and provides a framework or structure to identify, organize and categorize all cases concerning the surety's subrogation rights; The Law of Suretyship, Chapter 26 (Edward G. Gallagher, ed.), entitled "The Surety's Subrogation Rights" by George J. Bachrach and John V. Burch, Tort and Insurance Practice Section - American Bar Association (1993); Subrogation Rights of the Contract Bond Surety (George J. Bachrach, ed.), Tort and Insurance Practice Section - American Bar Association (1990) (papers presented at the Annual Meeting of the Fidelity & Surety Law Committee of the Tort and Insurance Practice Section of the American Bar Association on August 7, 1990).

[46] These variables are more fully set forth in the Outline (Matrix) portion of The Subrogation Database: Cases Concerning the Subrogation Rights of the Contract Bond Surety (George J. Bachrach, ed.), Tort and Insurance Practice Section - American Bar Association (1995).

2. What Funds are Involved.

The funds involved can be progress payments, retainage or other contract funds, including extras and claims.[47] Generally, enforcing the surety's equitable subrogation rights against the claims of others to the remaining contract funds held by the Government does not depend upon the kind of the remaining contract funds involved.

> [T]here is no valid distinction between money held by the [obligee] which is a "retainage" and a "progress payment." In either case, the "total fund" remaining in the [obligee]'s possession, to the extent the surety has obligations arising under the contract, is available to the surety.

Balboa Ins. Co. v. United States, 775 F.2d 1158, 1163 (Fed. Cir. 1985).

3. What Kind of Surety is Involved.

Rightfully or wrongfully, the Court of Federal Claims attempts to define the role of the surety and distinguish the rights of the surety under its performance bond and the surety under its payment bond. In Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 312 (1994), the court stated:

> A surety can establish a right of subrogation in either of two ways: by completing the contract pursuant to its obligation under the performance bond or by paying off materialmen's claims brought under the payment bond.

Several cases out of the Court of Appeals for the Federal Circuit, the Court of Federal Claims and its predecessors have attempted to define the difference between a performance bond surety and a payment bond surety.[48] The payment bond surety is clearly paying the claims of subcontractors, suppliers, laborers and materialmen on the

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[47] In Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308, 313 (1994), the court stated that "contract funds in the hands of the obligee are viewed as security or 'collateral' to which the surety can turn to cover any losses that may be incurred should the principal obligor (the contractor) default on the underlying obligation and the surety be required to pay out under its bond."

However, if there are no contract funds due and owing to the contractor for work performed on the contract because the contractor has been paid to the date of the termination for default or because the Government has "de-obligated" the contract funds by choosing not to continue the performance of the work under the contract, there are no contract funds to which the surety may be subrogated. Intercargo Ins. Co. v. United States, 41 Fed. Cl. 449 (1998).

[48] See, however, note 7, supra., to see how those courts have recently obscured the definition of when a surety is entitled to assert its equitable rights of subrogation as a performance bond surety or a payment bond surety.

bonded projects. However, the definition of a performance bond surety is more difficult. In Aetna Casualty & Surety Company v. United States, 845 F.2d 971, 975 (Fed. Cir. 1988), the court defined a performance bond surety as follows:

> A performance bond gives the surety the option of completing performance or of assuming liability for the Government's costs in completing the contract which are in excess of the contract price. Security Insurance Co. v. United States, 428 F.2d at 841 n.6. Neither formal termination of the contract by the Government nor execution of a take-over agreement by the surety is necessary in order for a surety to qualify as a performing surety. Id. at 839, 843. Thus, a performing surety may satisfy its obligation in various ways. For example, the surety may formally take over the project and contract for its completion, or it may allow the project to be defaulted and let the government complete or contract for the completion of the project, in which case the surety is responsible for costs in excess of the contract price. A performing surety may also satisfy its obligation by providing funds to an insolvent contractor to complete performance. Great American Insurance Company v. United States, 481 F.2d 1298, 1300 n.8 (Ct. Cl. 1973); Morgenthau v. Fidelity & Deposit Co., 94 F.2d 632, 635 (D.C. Cir. 1937) ("No difference between completion of the work by the surety...and the furnishing of money to the contractor after his default...to enable him to perform the contract."); see also Morrison Assurance Co. v. United States, 3 Cl. Ct. at 634 (surety was entitled to the status of a completing surety even though it left on-site performance and supervision to the contractor).

4. Whether the Surety Has Made Payment to All Subcontractors and Suppliers.

A number of cases have held that a surety making claim against the remaining contract funds under its equitable rights of subrogation as a result of paying claims under its payment bond is not entitled to assert its equitable rights of subrogation until it shows it has fully paid the claims of all subcontractors and suppliers arising out of the bonded contract. See International Fidelity Insurance Company v. United States, 25 Cl. Ct. 469, 473-74 (1992) and the cases cited therein. Frequently, the surety is given the opportunity to provide further evidence that all subcontractors and suppliers have been paid in order to assert its equitable rights of subrogation.[49]

[49] American Fidelity Fire Ins. Co. v. United States, 513 F.2d 1375 (Ct. Cl. 1975); Fireman's Fund Insurance Co. v. United States, 421 F.2d 706 (Ct. Cl. 1970).

C. The Government's Role as a Stakeholder.

Technically, the Government becomes a stakeholder when it holds the remaining contract funds after the completion of the project. At times, the Government should have been a stakeholder. However, as a result of a payment to the contractor or the contractor's assignee, the surety may proceed directly against the Government for its wrongful payment. At other times, the Government really has the role of a stakeholder, holding the remaining contract funds until a decision has been made concerning the rights of the competing parties. The following cases and their discussion will, where appropriate, identify where the Government has already paid out the remaining contract funds to claimants other than the surety, and, therefore, must pay a second time to the surety, and where the Government holds the remaining contract funds as a true stakeholder.

D. Stakeholder Cases.

1. The Government's Wrongful Payment to the Contractor.

There are a number of cases where the Government, after notice of claims by the surety, whether it is a performance bond surety or a payment bond surety, should have held onto the remaining contract funds for the protection of the surety, but has already paid the contractor or the contractor's assignee despite the surety's notice.

With respect to the Government's payment of progress payments and the contractor's performance of the work, the Government's liability for a wrongful payment to the contractor or the contractor's assignee is governed by the eight factors in Balboa Insurance Co. v. United States.[50]

With respect to any retainage that the Government should be holding, but the Government releases to the contractor or the contractor's assignee, the Government will be liable to the surety.[51] In Transamerica Premier Insurance Company v. United States, 32 Fed. Cl. 308 (1994), the Government mistakenly ("due to an administrative error," 32 Fed. Cl. at 311) paid the contractor the final contract payment of $35,376.56 despite notice from the surety and a contract modification directing all payments to the surety.[52] The Government was required to pay the surety despite the fact it had already paid the contractor. Similarly, in International Fidelity Insurance Company v. United States, 25 Cl.

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[50] See Section IV, supra.

[51] American Fidelity Fire Ins. Co. v. United States, 513 F.2d 1375 (Ct. Cl. 1975); Great American Insurance Co. v. United States, 492 F.2d 821 (Ct. Cl. 1974) (payments to contractor's assignee); Fireman's Fund Insurance Co. v. United States, 421 F.2d 706 (Ct. Cl. 1970); Home Indemnity Co. v. United States, 376 F.2d 890 (Ct. Cl. 1967); cf., United Pacific Insurance Co. v. United States, 362 F.2d 805 (Ct. Cl. 1966) (payment to contractor was lawfully disbursed to the contractor under the contract prior to any default or notice from the surety).

[52] See also International Fidelity Ins. Co. v. United States, 41 Fed. Cl. 706 (1998).

Ct. 469 (1992), the Government owed the final payment to the surety because it did not have any right to retain the final payment based upon certain agreements with the contractor.

Finally, in Transamerica Insurance Company v. United States, 989 F.2d 1188 (Fed. Cir. 1993), the Government was liable to the performance bond surety for the payment of certain contract funds from another job in derogation of the surety's equitable rights of subrogation as a performance bond surety.[53]

2. Surety v. Government Exercising its Setoff Rights.

When the Government has already "paid" itself by exercising its rights of setoff because the contractor "owes" the Government a debt on another obligation (a separate contract claim, an IRS claim for taxes due from the contractor, etc.), the Government will have to "repay" those funds to a performance bond surety.[54] However, the Government will prevail against a payment bond surety.[55]

The same holds true if the Government is holding the remaining contract funds as a stakeholder and intends to exercise its rights of setoff against those funds. A performance bond surety will prevail against the setoff claims of the Government,[56] but the Government's setoff rights will prevail over the claims of a payment bond surety.[57]

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[53] See Section II.B.2.(a).

[54] Aetna Casualty & Surety Company v.. United States, 845 F.2d 971 (Fed. Cir. 1988); Morrison Assurance Company, Inc. v. United States, 3 Cl. Ct. 626 (1983).

[55] See generally, United States v. Munsey Trust Co., 332 U.S. 234, 67 S. Ct. 1599, 91 L. Ed. 2022 (1947).

[56] Security Insurance Co. of Hartford v. United States, 428 F.2d 838 (Ct. Cl. 1970); International Fidelity Insurance Co. v. United States, 27 Fed. Cl. 107 (1992) (a question of fact whether the surety's payments were pursuant to its performance bond obligations or its payment bond obligations).

[57] United States v. Munsey Trust Co., 332 U.S. 234, 67 S. Ct. 1599, 91 L. Ed. 2022 (1947); Sentry Insurance v. United States, 12 Cl. Ct. 320 (987) (amounts owed by contractor to the Small Business Administration); American Fidelity Fire Ins. Co. v. United States, 513 F.2d 1375 (Ct. Cl. 1975) (even though the Government wrongfully paid contract proceeds to the contractor and was therefore liable to reimburse the payment bond surety for payments made to a subcontractor, the Government was not further liable to pay contract retainages to the surety since the Government was entitled to offset such retainages against the amount wrongfully paid to the contractor); Great American Insurance Co. v. United States, 492 F.2d 821 (Ct. Cl. 1974); Royal Indemnity Co. v. United States, 371 F.2d 462 (Ct. Cl. 1967); Barrett v. United States, 367 F.2d 834 (Ct. Cl. 1966).

3. Surety v. Assignee/Lenders.

Assuming that there is a valid default[58] (actual or threatened), the surety, whether it is a performance bond surety[59] or a payment bond surety[60] will prevail against the Government if it has already paid the remaining contract funds to the assignee/lenders. If the Government is holding the remaining contract funds as a stakeholder, the surety will prevail against the assignee/lender whether it is a performance bond surety[61] or a payment bond surety.[62] The failure of the surety to "perfect" its rights under the Uniform Commercial Code does not prevent the surety from prevailing over an assignee/lender with a perfected security interest in the remaining contract funds. The Uniform Commercial Code does not alter the surety's equitable rights of subrogation.[63]

4. Surety v. Trustees in Bankruptcy/Debtors in Possession.

The penultimate case is Pearlman v. Reliance Insurance Co., 371 U.S. 132, 83 S. Ct. 232, 9 L. Ed.2d 190 (1962). In Pearlman, the Government had turned over the remaining contract funds to the bankrupt's trustee. The Supreme Court held that a surety had a superior right to the remaining contract funds held by the Government over the rights of the bankruptcy trustee.

Where the Government is holding the remaining contract funds as a stakeholder, the surety will prevail against the trustee in bankruptcy or the debtor in possession whether it is a performance bond surety[64] or a payment bond surety[65]

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[58] National Union Fire Insurance Co. of Pittsburgh, Pa. v. United States, 304 F.2d 465 (Ct. Cl. 1962) (no default by contractor or notice to Government by surety prior to payment to contractor's assignee).

[59] Great American Insurance Co. v. United States, 481 F.2d 1298 (Ct. Cl. 1973); see also United States Fidelity & Guaranty Co. v. United States, 16 Cl. Ct. 541 (1989).

[60] Great American Insurance Co. v. United States, 492 F.2d 821 (Ct. Cl. 1974); Newark Insurance Company v. United States, 169 F. Supp. 955 (Ct. Cl. 1959).

[61] Prairie State National Bank v. United States, 164 U.S. 227, 17 S. Ct. 142, 41 L. Ed. 412 (1896); Reliance Insurance Company v. United States, 15 Cl. Ct. 62 (1988).

[62] Henningsen v. United States Fidelity & Guaranty Co., 208 U.S. 404, 28 S. Ct. 389, 52 L. Ed. 547 (1908); Reliance Insurance Company v. United States, 15 Cl. Ct. 62 (1988); Argonaut Ins. Co. v. United States, 434 F.2d 1362 (Ct. Cl. 1970); National Surety Corporation v. United States, 133 F. Supp. 381 (Ct. Cl. 1955) (Assignment of Claims Act does not affect the surety's equitable rights of subrogation).

[63] Home Indemnity Co. v. United States, 433 F.2d 764 (Ct. Cl. 1970).

[64] United Pacific Insurance Co. v. United States, 319 F.2d 893 (Ct. Cl. 1963).

[65] Id.; Continental Casualty Company v. United States, 164 Ct. Cl. 160 (1964); Continental Casualty Co. v. United States, 169 F. Supp. 945 (Ct. Cl. 1959).

5. Surety v. Subcontractors and Suppliers on the Bonded Projects.

A subcontractor lacks standing to bring suit against the Government for compensation due to the subcontractor under a subcontract with the Government contractor where both the contractor and the surety have failed or refused to make payment, and the Government has retained funds owing on the contract.[66] While the subcontractors lack standing to sue the Government directly for any amounts retained by the Government under a contract, the Government owes the subcontractors an equitable obligation to see that they get paid. To the extent that the surety pays the subcontractors, the Government is released from that equitable obligation.[67]

6. Common Obligee Theory.

Where the Government is a stakeholder holding contract funds on one contract for the contractor when the performance bond surety has incurred losses on a second contract between the Government and the contractor, the surety may assert its equitable rights of subrogation to the contract funds from the first contract.[68] It is unclear whether the court will similarly extend the equitable subrogation rights of the payment bond surety, especially when the Government has a competing claim to the contract funds on the profitable jobs.[69]

VI. CONCLUSION.

The Court of Federal Claims many times mixes up its discussion of the jurisdiction of the Court with the merits of the case. Assuming that the Court has jurisdiction over the surety's claims against the Government, a surety may pursue a number of claims against the Government, whether under a takeover agreement or pursuant to its equitable rights of subrogation. It is mandatory that the surety give notice to the Government in order to preserve its claims against the Government unless the Government breaches the nondiscretionary provisions of its contract with the contractor. The surety has claims against the Government arising out of the equitable duties of the Government with respect to the rights of the surety, and against the Government as a stakeholder holding the remaining contract funds.

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[66] United Electric Corporation v. United States, 647 F.2d 1082 (Ct. Cl. 1981).

[67] United States Fidelity & Guaranty Co. v. United States, 475 F.2d 1377 (Ct. Cl. 1973).

[68] Transamerica Insurance Co. v. United States, 989 F.2d 1188 (Fed. Cir. 1993). See Section II.B.2.(a).

[69] Dependable Insurance Company, Inc. v. United States, 846 F.2d 65 (Fed. Cir. 1988). See Section II.B.2.(b).