

**EIGHTEENTH ANNUAL  
NORTHEAST SURETY AND FIDELITY  
CLAIMS CONFERENCE**

**SEPTEMBER 27<sup>th</sup> and 28<sup>th</sup>, 2007**

**“COMPLETE WAIVER OF DEFENSES: WHEN IS THE NOTICE  
THE SURETY NEVER RECEIVED GOOD ENOUGH?”**

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## I. INTRODUCTION

This paper examines recent cases construing the AIA – A312 Payment Bond requirement that a surety “answer” a claim within 45 days of receipt. A copy of the AIA – A312 Payment Bond (1984) is annexed as **Exhibit A**.<sup>1</sup> Essentially, an AIA – A312 Payment Bond provides for the following series of bond claim events: (1) A Claimant gives notice to the Surety;<sup>2</sup> (2) the Surety “answers” the Claimant within 45 days;<sup>3</sup> (3) the Surety pays the Claimant any portion of the claim the Surety does not dispute.<sup>4</sup>

### A. MARYLAND & VIRGINIA DECISIONS FOCUS ON § 6.1 OF THE AIA – A312 PAYMENT BOND

Recent cases from mid-Atlantic states<sup>5</sup> hold that a Surety’s failure to strictly follow the AIA – A312 Payment Bond language and “answer” the Claimant’s notice within 45 days is a complete waiver of the Surety’s defenses.<sup>6</sup> The cases hinge on what constitutes an “answer.”<sup>7</sup> They strictly construe the AIA – A312 Payment Bond language. The pertinent provision of the AIA – A312 Payment Bond states:

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<sup>1</sup> AIA – A312 PAYMENT BOND (1984) is © The American Institute of Architects.

<sup>2</sup> AIA – A312 PAYMENT BOND § 4 (1984). The notice requirement of the AIA – A312 Payment Bond deserves significant discussion. This paper addresses it in more detail in Section II.E.

<sup>3</sup> AIA – A312 PAYMENT BOND § 6.1 (1984).

<sup>4</sup> AIA – A312 PAYMENT BOND § 6.2 (1984).

<sup>5</sup> It is worth noting that in absence of their own precedential authority, both Virginia and the District of Columbia look to Maryland’s common law. See Conseco Indus., Ltd. v. Conforti & Eisele, Inc., 627 F.2d 312, 315-16 (D.C. Cir. 1980) (“Since there is no District law on point, we should look to Maryland law first not only because the contract was executed there with a Maryland party, but also because the District of Columbia derives its common law from that state and because District of Columbia courts have in the past looked to Maryland law for guidance.”); Casey Indus., Inc. v. Seaboard Sur. Co. (Casey I), 2006 WL 2850652, at \*3 n.2 (E.D. Va. Oct. 2, 2006) (“There is no controlling Virginia precedent governing this particular issue, so Plaintiff looks to a Maryland decision for guidance. However, Virginia precedent agrees with the Maryland court that the plain meaning rule applies to . . . surety contracts.”).

<sup>6</sup> Casey Indus., Inc. v. Seaboard Sur. Co. (Casey II), 2006 WL 3299932, at \*4 (E.D. Va. Oct. 26, 2006) (“This Court must follow the plain meaning language, and deem any bases for dispute not raised [by the Surety] in the [45-day] contractual period as waived.”), clarifying Casey I; Nat’l Union Fire Ins. Co. of Pitt. v. David A. Bramble, Inc., 879 A.2d 101, 106 (Md. 2005) (“Because we determine that the language of Paragraph 6 of the [AIA – A312] payment bond requires that the sureties answer a subcontractor’s claim and delineate the portions of the claim that they intend to dispute within 45 days after the claim is submitted and that the sureties failed to do so, we find that [the claimants] are entitled to judgment under the bond and affirm the judgments of the Court of Special Appeals. Our determination, like that of the Circuit Court, is based solely on an interpretation and application of the language of the [AIA – A312] payment bond.”), aff’g Nat’l Union Fire Ins. Co. of Pitt. v. Wadsworth Golf Constr. Co. of the Midwest, 863 A.2d 347, 357 (Md. Ct. Spec. App. 2004) (“We are persuaded that Paragraph 6 of the [AIA – A312] payment bond, read alone and in the context of the remainder of the bond, provides the surety 45 days to dispute a subcontractor’s claim for payment and, if the surety does not answer within that time period, the surety waives its right thereafter to dispute the claim.”). But see Fisher Skylights, Inc. v. CFC Constr. Ltd. P’ship, 79 F.3d 9, 11-12 (2d Cir. 1996) (holding that a Surety’s failure to answer a payment bond claim within the required time does not waive the one-year limitations period for payment claims).

<sup>7</sup> E.g., Wadsworth, 863 A.2d at 355 (“Resolution of this appeal hinges upon this Court’s interpretation of Paragraph 6 of the [AIA 312] payment bond.”).

6. When the claimant has satisfied the conditions of Paragraph 4, the Surety shall promptly and at the Surety's expense take the following actions:

**6.1** Send an **answer** to the Claimant, with a copy to the Owner, **within 45 days** after receipt of the claim, **stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.**

**6.2** Pay or arrange for payment of any undisputed amounts.<sup>8</sup>

The cases establish that a typical reservation of rights investigatory letter is not an "answer."<sup>9</sup> The typical reservation of rights letter is insufficient under § 6.1 even as a complete denial because it does not state the basis for challenging the claim. If a reservation of rights letter is the Surety's only correspondence in the first 45 days to an AIA – A312 Payment Bond Claimant, expect the Claimant to argue that the Surety waived all of its defenses.

## **B. WAIVER OR ESTOPPEL**

One of those elusive distinctions in the law is that between waiver and estoppel. Though not interpreted the same way everywhere, in general, waiver is intentionally giving up a known right<sup>10</sup> and estoppel is being precluded from changing your position if the change would disadvantage someone that relied on your position.<sup>11</sup> It is clear that the Maryland and Virginia courts are applying the doctrine of waiver to find that Sureties not "answering" an AIA – A312 Payment Bond Claimant within 45 days lose all of their defenses.<sup>12</sup>

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<sup>8</sup> AIA – A312 PAYMENT BOND § 6 (1984) (emphasis added).

<sup>9</sup> E.g., David A. Bramble, 879 A.2d at 104.

<sup>10</sup> BLACK'S LAW DICTIONARY (8th ed. 2004) ("waiver (way-v<<schwa>>r), n. 1. The voluntary relinquishment or abandonment -- express or implied -- of a legal right or advantage; FORFEITURE <waiver of notice>. • The party alleged to have waived a right must have had both knowledge of the existing right and the intention of forgoing it. Cf. ESTOPPEL.").

<sup>11</sup> Id. ("estoppel (e-stop-<<schwa>>l), n. 1. A bar that prevents one from asserting a claim or right that contradicts what one has said or done before or what has been legally established as true. . . . 3. An affirmative defense alleging good-faith reliance on a misleading representation and an injury or detrimental change in position resulting from that reliance. Cf. WAIVER (1)."); see also, e.g., Potesta v. United States Fid. & Guar. Co., 504 S.E.2d 135, 142 (W. Va. 1998) ("Although the doctrines of waiver and estoppel are both grounded in equity, they differ significantly in application. To effect a waiver, there must be evidence which demonstrates that a party has intentionally relinquished a known right. Estoppel applies when a party is induced to act or to refrain from acting to her detriment because of her reasonable reliance on another party's misrepresentation or concealment of a material fact." (quoting Ara v. Erie Ins. Co., 387 S.E.2d 320, 324 (W. Va. 1989))).

<sup>12</sup> E.g., Wadsworth, 863 A.2d at 356 ("Wadsworth does not, and indeed cannot, contend that the Sureties expressly relinquished their contractual right to dispute Wadsworth's claim. Wadsworth does assert, however, that the conduct of the Sureties supports the inference of their intention to relinquish their rights under the payment bond, reflecting an implied waiver of their right to defend against non-payment of the claim. We agree."). Cf. Fisher Skylights, 79 F.3d at 11-12 ("Whatever may be the remedy for a surety's failure to give proper notice [to a payment bond claimant] within ninety days, [as required by Connecticut Statutes,] it does *not* postpone the

## II. ANALYSIS

The primary intent of this paper is to provide a thorough analysis of the Maryland and Virginia decisions.<sup>13</sup> Our analysis begins by examining the holdings of the Maryland and Virginia cases, which penalize Sureties that do not strictly comply with the requirement of the AIA – A312 Payment Bond that a Surety “answer” a claim within 45 days of receipt. Our analysis then reviews similar holdings from other jurisdictions, examining their reasoning and import, and distinguishing them as appropriate. We then proceed to a more in-depth consideration of the underlying rationale of the Maryland and Virginia decisions, focusing on public policy, equity, and the application of the insurance doctrine of coverage by waiver or estoppel. Our analysis then compares the holdings of the Maryland and Virginia cases to state statutes confronting the same timely payment issue. Finally, our analysis dissects the requirement that the claimant provide the Surety notice of the claim and hypothesizes about potential implications of effective substitute service of notice on the Surety’s agent. In the final analysis, we consider the possibility that the Surety never itself receives notice of a claim but impliedly fails to respond to a claim about which the Surety is charged with constructive notice.

### **A. MARYLAND & VIRGINIA DECISIONS SEVERELY PENALIZE SURETIES THAT DO NOT TIMELY ANSWER CLAIMS IN STRICT COMPLIANCE WITH § 6.1 OF THE AIA – A312 PAYMENT BOND**

In what some commentators have called “welcome news to payment bond claimants and . . . a warning to sureties,”<sup>14</sup> on October 12, 2004, the Maryland Court of Special Appeals decided National Union Fire Insurance Co. of Pittsburgh v. Wadsworth Golf Construction Co. of the Midwest.<sup>15</sup> The central holding of Wadsworth is “that Paragraph 6 of the [AIA – A312] payment bond . . . provides the surety 45 days to dispute a subcontractor’s claim for payment and, if the surety does not answer within that time period, the surety waives its right thereafter to dispute the claim.”<sup>16</sup>

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running of the one-year limitations period. . . . [The claimant] also argues that, even if the one-year limitations period began to run on the date work was completed, [the Surety] should be estopped from asserting the limitations period because of its failure to comply with [the ninety-day response period of] § 49-42(a). Again, we disagree. . . . [The claimant]’s failure to bring suit within one year of completing work on the project precludes its claim, and estoppel cannot cure this failure.”); S. Win-Dor, Inc. v. RLI Ins. Co., 925 So. 2d 884, 890-91 (Miss. Ct. App. Oct. 25, 2005) (Griffis, J., dissenting) (“The record is clear that [the Surety] failed to meet its obligation and duty under paragraph 6 [of the AIA – A312 Payment Bond]. It did not respond to [the claimant] in any of these three ways. . . . These facts fall squarely under the doctrine of equitable estoppel defined in Izard. [The Surety] may not assert statute of limitations as a defense where [the Surety] has violated a duty to [the claimant] that caused [the claimant] to ‘subject his claims to the statutory bar.’ The doctrine of equitable estoppel will not allow [the Surety] to ‘wrongfully’ obtain an advantage ‘by inducing [the claimant] to believe that an amicable adjustment of the claim will be made without suit.’”).

<sup>13</sup> Please note that we sometimes use the phrase “the Maryland and Virginia decisions” to refer generally to all case law interpreting a Surety’s failure to “answer” an AIA – A312 Payment Bond claim within 45 days as a waiver of defenses or as potential bad faith. Other times, we use the phrase “the Maryland and Virginia decisions” to refer specifically to the Wadsworth, David A. Bramble, Casey I, and Casey II decisions. We hope the meaning is clear from context and believe that in most instances the distinction is immaterial.

<sup>14</sup> Alexander E. Barthet & Brian S. Dranoff, Payment Bond Payout: The Forty-Five Day Countdown, 25 CONSTRUCTION LAW. 17, \*19 (Winter 2005).

<sup>15</sup> 863 A.2d 347.

<sup>16</sup> Id. at 355, 357.

Following the decision, the Wadsworth Sureties petitioned the Maryland Court of Appeals, Maryland's highest court, "to determine the effect of a general contractor's payment bond surety's failure to fulfill a contractual provision requiring it to answer a subcontractor's payment claim within 45 days after receiving that claim."<sup>17</sup> After

determin[ing] that the language of the [AIA – A312] payment bond requires the sureties to delineate those portions of the claim that they intend to dispute within the 45-day period and that, under the language of the bond, a failure to do so results in the entirety of the claim being undisputed[.]

Maryland's highest court affirmed the Maryland Court of Special Appeals' grant of summary judgment to the payment bond claimants in Wadsworth.<sup>18</sup>

The language of David A. Bramble, which affirmed Wadsworth, is especially troubling for Sureties. The opinion provides in pertinent part:

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<sup>17</sup> David A. Bramble, 879 A.2d at 103.

<sup>18</sup> Id.

**National Union Fire Ins. Co. of Pittsburgh v. David A. Bramble, Inc., 879 A.2d 101 (Md. 2005).**

[T]he payment bond, provided by [the general contractor], was a “form” surety bond, specifically identified as Document A312 from the American Institute of Architects . . . . No alterations were made to the original language of the payment bond.

. . . .

Wadsworth completed the construction of the golf course and . . . unsuccessfully attempted to collect \$720,963.45 still owed by [the general contractor].

. . . Wadsworth notified the sureties by certified letter of its claim under the payment bond for the amount that [the general contractor] had failed to pay. Ten days later, Federal Insurance Company responded to Wadsworth’s claim, stating:

. . . .

Federal Insurance Company writes this letter with a full reservation of its rights and with the understanding that any actions we have taken or may take do not constitute a waiver of any defenses under the bond or applicable law . . .

. . . AIG [also] acknowledged receipt of Wadsworth’s claim . . . stat[ing]:

Please be advised that this action is taken at this time without waiver of or prejudice to any of the rights and defenses, past or present, known or unknown which either the above referenced Surety (National Union Fire Insurance Company) or Principal ([the general

contractor]) may have in this matter.

. . . .

[About 6 months later], Wadsworth filed a single count complaint . . . against the sureties. . . . Wadsworth also filed a motion for summary judgment, arguing that the sureties were not entitled to challenge its claim under the payment bond because the sureties had not answered Wadsworth’s claim and had [sic] delineated the grounds for dispute here and the amounts within 45 days of receiving it.

. . . .

[The trial court] granted the motion on alternative grounds, the first being that Wadsworth was entitled to the money under the terms of the bond[, the Sureties not having raised any defenses by “answer”,] and the second being public policy. . . .

The Court of Special Appeals affirmed [the trial court]’s conclusion that the [AIA – A312] bond language operated to preclude the sureties from disputing the claims submitted by Wadsworth due to their failure to comply with Paragraph 6 of the [AIA – A312] payment bond because Paragraph 6 “provides the surety 45 days to dispute a subcontractor’s claim for payment and, if the surety does not answer within that time period,” the surety cannot thereafter dispute the claim. Moreover, the opinion noted that its construction of Paragraph 6 was consistent with the purpose of such bonds, which is to “insure that claimants who perform work are paid for their work in the event that the principal does not pay.” The court concluded that to interpret Paragraph 6 otherwise would render the provision nugatory. . . .

. . . .

Because we determine that the language of Paragraph 6 of the payment bond requires that the sureties answer a subcontractor's claim and delineate the portions of the claim that they intend to dispute within 45 days after the claim is submitted and that the sureties failed to do so, we find that Wadsworth and Bramble are entitled to judgment under the bond and affirm the judgments of the Court of Special Appeals. Our determination, like that of the Circuit Court, is based solely on an interpretation and application of the language of the payment bond.

.....

Primarily, the sureties contend that their failure to answer Wadsworth and Bramble's claims within the 45-day period set forth in Paragraph 6 indicates that the entirety of the claims were being disputed.

.....

The sureties do not contest the fact that they breached the requirements of Paragraph 6. Instead, they argue that when they failed to answer within the 45-day period of Paragraph 6, the entirety of the claim was disputed. We disagree.

The language of Paragraph 6.1 requires the sureties to do three things: answer the Claimant's claim, define what amounts are undisputed, and list the bases for challenging the payment of any amounts that are disputed. This language necessarily required the sureties to communicate with Wadsworth and Bramble, with a copy of the correspondence to the owner, concerning what portions of the submitted claim are subject to dispute. Although the lead surety, AIG, responded to Wadsworth and Bramble's claims, acknowledging receipt, the sureties failed to explicate which parts of the claims were disputed and undisputed

as mandated by the language of the bond within the time allotted.

To satisfy Paragraph 6.1, the sureties were required to, in their answer, state the amounts that were undisputed and the basis for challenging the claims that were disputed. Although the sureties corresponded with Wadsworth and Bramble during the 45-day period set forth in Paragraph 6.1, the record contains no evidence that the sureties attempted to comply with the language of the bond. The sureties argue that because they failed to explicate both the amounts that are undisputed and those subject to challenge, the function of the paragraph is to render the entirety of the claim in dispute. Paragraph 6 does not, however, simply require that the sureties state which portions of the claim are disputed and which are not; they must also specifically delineate the grounds underlying the dispute. This places a greater burden on the sureties with respect to those amounts they wish to challenge as compared to those parts of the claim that are undisputed, the latter of which the sureties must only list. Therefore, it would not be consistent with the plain meaning of the provisions of Paragraph 6 to interpret it to permit the sureties to dispute a claim in its entirety through inaction.

If we were to adopt the sureties' interpretation of Paragraph 6, we would be rendering the 45-day time requirement essentially nugatory. This runs afoul of our long-standing tenet of contractual interpretation that provisions of a contract are to be interpreted, if possible, so as to give effect to all. The primary purpose of Paragraph 6 is to better facilitate the timely payment of claims under the bond, as we recently delineated:

The reasonable behavior required of a surety acting in good faith is not meant to foster reluctance on a surety's part to

satisfy bond claims. We agree with the court in General Accident Insurance Co. of America v. Merritt-Meridian Construction Corp., 975 F. Supp. 511, 516 (S.D.N.Y.1997), which explained:

Sureties enjoy such discretion to settle claims because of the important function they serve in the construction industry, and because the economic incentives motivating them are a sufficient safeguard against payment of invalid claims. The many parties to a typical construction contract – owners, general contractors, subcontractors, and sub-subcontractors – look to sureties to provide assurance that defaults by any of the myriad other parties involved will not result in a loss to them. Courts have recognized that ‘as a practical matter the suppliers and small contractors on large construction projects need reasonably prompt payment for their work and materials in order for them to remain solvent and stay in business.’

(Citations omitted)

....

The 45-day time period and the specificity of the procedures to dispute a claim as mandated in Paragraph 6 of the payment bond directly embody that purpose. . . . The requirements of Paragraph 6 function to insure that subcontractors and sub-subcontractors are not forced to absorb the risk of non-payment over a protracted period by the contractor and the owner, through no fault of their own.

A paid surety is classified as an insurance company, and as such, courts tend to construe contracts involving compensated sureties in favor of the party who benefits under the bond. In the present case, the sureties are compensated corporate sureties. Therefore, to construe the language of Paragraph 6 in a manner favorable to the party whose interests are protected by the bond is proper under Maryland law. Our determination is consistent with that tenet.

The sureties argue that such an interpretation results in a potential expansion of the coverage of the bond because they would be forced to pay for claims that are beyond the scope of the bond’s coverage. . . . [T]here is nothing in the record to indicate that the sureties asserted that any portion of Wadsworth and Bramble’s claims was beyond the scope of the bond’s coverage within the 45-day period delineated in Paragraph 6. By the plain language of the bond, the sureties are precluded from arguing otherwise. Therefore, the Circuit Court correctly granted summary judgment in favor of Wadsworth and Bramble.

#### Conclusion

Under the terms of Paragraph 6, the sureties were required to delineate which portions of Wadsworth and Bramble’s claim were disputed and failed to do so. Therefore, the effect of the provisions in Paragraph 6 is that the entirety of the claim is undisputed and the sureties are required to promptly pay the claims submitted by Wadsworth and Bramble. Thus, we affirm the judgments of the Court of Special Appeals.

JUDGMENTS OF THE COURT OF SPECIAL APPEALS AFFIRMED. COSTS IN BOTH COURTS TO BE PAID BY PETITIONERS.<sup>19</sup>

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<sup>19</sup> David A. Bramble, 879 A.2d at 103-11 (internal citations omitted).

In their commentary, Payment Bond Payout: The Forty-Five Day Countdown, Barthelet and Dranoff hopefully state:

[T]he tide may be turning as a result of . . . [t]he Wadsworth decision[, which] is likely to set an important precedent. As a claimant's right to recover under a bond is dependent upon compliance with the bond's notice requirements, courts in the future should be expected to agree with the Wadsworth court that no greater hardship is imposed upon the surety by requiring that it also comply with the terms of its bond. For this reason, the decision should be expected to signify a trend, which will come as welcome news to payment bond claimants and as a warning to sureties.<sup>20</sup>

Affirmance of the Wadsworth decision by Maryland's highest court<sup>21</sup> strengthens Barthelet and Dranoff's argument for the state of the law.

## **B. OTHER DECISIONS CONSTRUING THE AIA – A312 PAYMENT BOND**

Though few in number, other cases have construed the AIA – A312 Payment Bond. At least one court has construed the bond to different effect than the Maryland and Virginia cases.<sup>22</sup> In Southern Win-Dor, the Mississippi Court of Appeals found a standard reservation of rights letter without a subsequent answer sufficient to preserve at least the Surety's statute of limitations defense.<sup>23</sup> Despite a vigorous dissent that tracks the reasoning of the Maryland and Virginia cases,<sup>24</sup> albeit defining the issue as estoppel instead of waiver, the Southern Win-

<sup>20</sup> Barthelet & Dranoff, supra note 14, at \*18-19.

<sup>21</sup> David A. Bramble, 879 A.2d 101 (Md. 2005).

<sup>22</sup> S. Win-Dor, Inc. v. RLI Ins. Co., 925 So. 2d 884, 888-89 (Miss. Ct. App. Oct. 25, 2005), cert. denied, 927 So. 2d 750 (Miss. Apr. 6, 2006).

<sup>23</sup> Id. ("The dissent argues that we do not appreciate the significance of [the Surety]'s response to [the claimant] that [the claimant]'s claim was denied pending the outcome of [the claimant]'s litigation against [the Principal]. Quite the contrary, we do appreciate the significance of [the Surety]'s response in this regard. We just believe that we must consider the entirety of what [the Surety] said in its March 10 letter. Even if [the Surety], by use of the term 'pending,' was indicating that it was deferring decision on [the claimant]'s claim until the litigation between [the claimant] and [the Principal] had concluded, it also, by use of the statement, '[we] make no waivers and reserves all rights and defenses,' was indicating and placing [the claimant] on notice that any claim [the claimant] had against it would become time barred if the litigation between [the claimant] and [the Principal] had not concluded prior to the running of the statute of limitations on any claim [the claimant] might have against [the Surety]. Otherwise, the statement: '[The Surety] makes no waivers and reserves all rights and defenses' becomes meaningless.").

<sup>24</sup> Id. at 889-90, 92 ("I am of the opinion that [the Surety] is estopped from asserting the benefit of the one year statute of limitations . . . . The material supplier[ claimant] believed that it was owed money by [the Principal]. Indeed, by letter dated February 22, 2000, [the Surety] acknowledged receipt of [the claimant]'s claim documents and requested a completed proof of claim form. On February 29, 2000, [the claimant] executed [the Surety]'s proof of claim form and delivered it to [the Surety]. At this point, [the claimant] had met its obligation under paragraph 4.1 of the [AIA – A312] Payment Bond. Submission of the proof of claim . . . shifted the obligation to [the Surety], . . . to respond in one of three ways. First, [the Surety] could simply pay the entire claim. Second, [the Surety] could deny the entire claim and provide [the claimant] with an 'answer' that states the 'basis for

Dor holding may be limited to non-waiver of the statute of limitations in light of another case suggesting that the Surety does not waive the statute of limitations defense by failing to timely respond to a payment bond claim.<sup>25</sup>

Other courts that have construed the AIA – A312 Payment Bond, or even statutory response requirements for Sureties, tend to agree with the Maryland and Virginia cases. In Fisher Skylights, the Second Circuit suggests that a Surety's failure to respond to a payment bond claim within the statutory timeframe set out by § 49-42(a)<sup>26</sup> could be a waiver of, or as the court says, could estop the Surety from asserting, defenses to the payment bond claim (not including the defense that one-year time limitation for payment bond claims passed before the claim was made).<sup>27</sup>

In Ruffin Building Systems, Inc. v. Fort Walton Beach Steel, Inc., the United States District Court for the Southern District of Alabama interpreted the AIA – A312 Payment Bond as “specifically requir[ing] that [the Surety] promptly ‘send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.’”<sup>28</sup> The Ruffin decision pre-dates the Maryland and Virginia decisions by at least a decade and does not address the possible waiver of the Surety's defenses. However, the Ruffin decision clearly rests on the same interpretation of the AIA – A312 Payment Bond that underlies the Maryland and Virginia decisions.

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challenging any amounts that are disputed.’ The third alternative would have been for [the Surety] to acknowledge that a portion of the claim was disputed and a portion was undisputed. If so, [the Surety] was required to pay any undisputed amounts and provide [the claimant] with an ‘answer’ that states the ‘basis for challenging any amounts that are disputed.’ The record is clear that [the Surety] failed to meet its obligation and duty under paragraph 6 [of the AIA – A312 Payment Bond]. [The Surety] did not respond to [the claimant] in any of these three ways. . . . These facts fall squarely under the doctrine of equitable estoppel defined in Izard. [The Surety] may not assert statute of limitations as a defense where [the Surety] has violated a duty to [the claimant] that caused [the claimant] to ‘subject his claims to the statutory bar.’ The doctrine of equitable estoppel will not allow [the Surety] to ‘wrongfully’ obtain an advantage ‘by inducing [the claimant] to believe that an amicable adjustment of the claim will be made without suit.’ [The claimant] has clearly met the requirements of this doctrine. [The Surety] seeks to obtain an advantage, wrongfully in my opinion, through its March 10th letter that indicated that [the claimant]’s claim would be adjusted after the [Principal] versus [the claimant] litigation was resolved. The majority interprets the March 10th letter to be a preemptive denial of [the claimant]’s claim. They reason ‘[t]here was no promise that [the Surety] would pay [the claimant]’s claim.’ Conversely, there was no explicit and unequivocal denial of the claim. The majority cannot, and does not, claim that [the Surety] complied with its contractual duty under paragraph 6 of the [AIA – A312] Payment Bond. Instead, all we have is the vague and ambiguous wording that ties [the Surety]’s decision on [the claimant]’s claim to the pending litigation.”).

<sup>25</sup> Fisher Skylights, 79 F.3d at 11-12 (“Whatever may be the remedy for a surety’s failure to give proper notice [to a payment bond claimant] within ninety days, [as required by Connecticut Statutes,] it does *not* postpone the running of the one-year limitations period. . . . [The claimant] also argues that, even if the one-year limitations period began to run on the date work was completed, [the Surety] should be estopped from asserting the limitations period because of its failure to comply with [the ninety-day response period of] § 49-42(a). Again, we disagree. . . . [The claimant]’s failure to bring suit within one year of completing work on the project precludes its claim, and estoppel cannot cure this failure.”).

<sup>26</sup> CONN. GEN. STAT. § 49-42(a) (2007) (“Not later than ninety days after service of the notice of claim, the surety shall make payment under the bond and satisfy the claim, or any portion of the claim which is not subject to a good faith dispute, and shall serve a notice on the claimant denying liability for any unpaid portion of the claim.”).

<sup>27</sup> Fisher Skylights, 79 F.3d at 11-12.

<sup>28</sup> 1992 U.S. Dist. LEXIS 12119, at \*20 (S.D. Ala. 1992).

The Ruffin court found that

[t]he lateness of the July, 1991 \$21,113.35 payment, which [the Claimant] argues is an admission by [the Surety] that those sums were due under the bond and there was no debatable reason for denying them, and [the Surety]’s failure to notify [the Claimant] within forty-five days of the claim of the reasons for challenging the disputed amounts, **creates a jury issue on whether [the Surety] is guilty of bad faith in failing to promptly investigate the claim and/or pay the claim.**<sup>29</sup>

In short, the Ruffin court held that a Surety’s failure to notify an AIA – A312 Payment Bond claimant, within 45 days of the claim, of the Surety’s reasons for disputing all or a portion of claimant’s claim creates a jury issue of whether the Surety is guilty of bad faith.

In addition to the case law, commentators have latched onto the Maryland decisions and some cite the cases as standing for the more sweeping proposition that “[a] surety may waive its right to assert bond defenses by failing to timely perform its obligations under the bond.”<sup>30</sup> With the prevalence of the Maryland cases in both commentary and respected summaries of the law, any strategy for handling AIA – A312 Payment Bond claims must anticipate a waiver-of-defenses argument if the 45 day deadline under § 6.1 of the AIA – A312 Payment Bond is allowed to pass without the Surety providing an answer to the claimant stating the amounts of the claim that are undisputed and the basis for challenging any amounts that are disputed.

### C. RATIONALE OF THE MARYLAND AND VIRGINIA DECISIONS

There are several reasons Surety claims people and outside counsel should be familiar with the Maryland and Virginia decisions. The first reason is that their widespread publicity

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<sup>29</sup> Id. at \*20-21 (emphasis added).

<sup>30</sup> 3 BRUNER & O’CONNOR CONSTRUCTION LAW § 8:176 (2007); see also 3 BRUNER & O’CONNOR CONSTRUCTION LAW § 8:157 n.1 (2007) (“A Maryland court has determined that the surety’s obligation to respond within the 45-day time limit creates a duty upon the surety to timely respond which, if breached, results in the waiver of all defenses to the claim.”); Larry R. Leiby, 8 FLA. PRAC., CONSTR. LAW MANUAL § 10.06 (2007) (“The [AIA – A312 Payment B]ond . . . provide[s] that when the claimant has satisfied the notification requirements, . . . the surety shall promptly and at the surety’s expense send an answer to the claimant within 45 days after receipt of the claim stating the amounts that are undisputed, the basis for challenging any amounts that are disputed, and then pay or arrange for payment of any undisputed amounts. This form of bond certainly favors the bond claimant, not the bond principal who is posting the bond. Based on the [Maryland] case described below, it would appear prudent for a contractor or surety to modify this language before giving this form of bond. . . . In a case from Maryland, a court held that a surety who failed to state the basis for disputed amounts within 45 days of receipt of the claim waived any right to dispute the amounts.”); Jeffrey R. Cruz & Jayne Czik, Hard Hat Case Notes, 26 CONSTRUCTION LAW. 42 (Winter 2006) (“Payment Bond Sureties Waived Right to Contest Subcontractors’ Claims by Failing to Respond Timely to Proof of Claims.”). But see Scott D. Baron, et al., Recent Developments In Fidelity And Surety Law, 41 TORT TRIAL & INS. PRAC. L.J. 429, 441-42 (Winter 2006) (“The court did not explain why the bond claimants’ remedy should not be limited to recovery of the damage caused to it by the surety’s failure to respond within forty-five days. The court also offered no explanation for the wholesale forfeiture of rights and defenses resulting from its holding.”).

means that good construction claim attorneys will emphasize the Maryland and Virginia decisions when negotiating with or litigating against AIA – A312 Payment Bond Sureties. The second reason, which is related to the first but more important, is that the Maryland and Virginia decisions suggest a rationale that judges may tend to find persuasive.<sup>31</sup> Because a careful consideration of the decision’s logic is required to evaluate their potential to “signify a trend,”<sup>32</sup> we provide the following objectively critical but pragmatic analysis of the rationale behind the Maryland and Virginia decisions.

The key<sup>33</sup> holding of the Maryland and Virginia decisions is that a Surety waives its defenses<sup>34</sup> to an AIA – A312 Payment Bond claim if it does not send an answer to the claimant within 45 days that states the amounts of the claim that are undisputed and specifies the reasons for any disputed amounts.<sup>35</sup> The decisions seek to avoid a direct conflict with the established doctrine of waiver, which requires the *intentional* surrender of a *known* right, by

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<sup>31</sup> E.g., Casey I, 2006 WL 2850652, at \*3 (E.D. Va. Oct. 2, 2006) (“While National Union is not controlling on this Court, it is persuasive.”).

<sup>32</sup> Barthelet & Dranoff, supra, note 14, at \*19.

<sup>33</sup> See Wadsworth, 863 A.2d at 355 (“Resolution of this appeal hinges upon this Court’s interpretation of Paragraph 6 of the [AIA – A312 Payment Bond].”).

<sup>34</sup> It should be noted at this point that the Maryland decisions do not delineate whether the Surety waived all factual and legal defenses, or just its factual defenses, to the Payment Bond claim. The Casey I opinion strongly suggests that there is no reason to support the interpretation that a Surety waives its legal defenses if it does not properly answer an AIA – A312 Payment Bond claim. 2006 WL 2850652, at \*4 (“While National Union did specifically discount ‘blanket waivers’ and the logic of the case supports Plaintiff’s position that bases for challenging amounts disputed are deemed waived if not included in the response letter, neither National Union, nor any other case cited by the Plaintiff supports the notion that all legal defenses (such as statute of limitations or collateral estoppel) must be raised in a pre-litigation response letter or be deemed waived. . . . [N]either the contract, nor National Insurance addresses the waiver of *legal defenses*, and such defenses should not be deemed waived because they were not included in a response letter prior to any litigation. Therefore, even though this Court is inclined to follow National Insurance with respect bases for disputing claims, doing so will not bar any *legal* defenses from being raised.”); accord Fisher Skylights, 79 F.3d at 11-12 (holding that a Surety’s failure to give proper notice to a payment bond claimant within ninety days, as required by Connecticut Statutes, does not waive the Surety’s legal defense of the one-year limitations period.); S. Win-Dor, 925 So. 2d at 888-89 (“[The Surety], by use of the statement, ‘[we] make no waivers and reserves all rights and defenses,’ was indicating and placing [the claimant] on notice that any claim [the claimant] had against it would become time barred if the litigation between [the claimant] and [the Principal] had not concluded prior to the running of the statute of limitations on any claim [the claimant] might have against [the Surety]. Otherwise, the statement: ‘[The Surety] makes no waivers and reserves all rights and defenses’ becomes meaningless.”).

<sup>35</sup> See David A. Bramble, 879 A.2d at 110-11 (“The language of Paragraph 6.1 requires the sureties to do three things: answer the Claimant’s claim, define what amounts are undisputed, and list the bases for challenging the payment of any amounts that are disputed. . . . Although the sureties corresponded with Wadsworth and Bramble during the 45-day period set forth in Paragraph 6.1, the record contains no evidence that the sureties attempted to comply with the language of the bond. . . . Paragraph 6 does not . . . simply require that the sureties state which portions of the claim are disputed and which are not; they must also specifically delineate the grounds underlying the dispute. This places a greater burden on the sureties with respect to those amounts they wish to challenge as compared to those parts of the claim that are undisputed, the latter of which the sureties must only list. Therefore, it would not be consistent with the plain meaning of the provisions of Paragraph 6 to interpret it to permit the sureties to dispute a claim in its entirety through inaction.”).

interpreting the AIA – A312 Payment Bond as mandating that the Surety either fully address all aspects of a claim within 45 days or waive all of defenses to the claim.<sup>36</sup>

Despite the courts' interpretation, the AIA – A312 Payment Bond does not on its face state any consequences for the Surety's failure to answer a claim within 45 days.<sup>37</sup> The Sureties argued to at least the Wadsworth court that the "plain language of the [AIA – A312 Payment B]ond does not set forth express consequences for a surety's failure to answer a claim within 45 days of receiving it."<sup>38</sup> The court professed to be persuaded by the ridiculous counter-argument that "had the Sureties wanted a 'non-forfeiture of defenses' provision to be included in the bond, they certainly could have included such a provision."<sup>39</sup>

Though the Maryland and Virginia courts rely on additive contractual interpretation as their means around violating principles of waiver,<sup>40</sup> their elaborative opinions and an intuitive examination of the appellate briefs confirm that their decisions were based on several other factors and principals. Because judges often find equitable and public policy arguments persuasive when asked to resolve conflicting legal principles,<sup>41</sup> it seems likely that public policy and a sense that "turnabout is fair play" most influenced their decisions.

## 1. Public Policy & Fairness

The public policy underlying payment bonds is to make sure subcontractors and materialmen get paid reasonably quickly in the event the contractor defaults.<sup>42</sup> Many construction industry groups have at various times said that Surety is the life blood of the

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<sup>36</sup> See Wadsworth, 863 A.2d at 357 ("We are persuaded that Paragraph 6 of the payment bond, read alone and in the context of the remainder of the bond, provides the surety 45 days to dispute a subcontractor's claim for payment and, if the surety does not answer within that time period, the surety waives its right thereafter to dispute the claim.").

<sup>37</sup> See AIA – A312 PAYMENT BOND § 6 (1984).

<sup>38</sup> See Wadsworth, 863 A.2d at 355 ("The Sureties also assert that they are not liable to Wadsworth under the payment bond because the plain language of the bond does not set forth express consequences for a surety's failure to answer a claim within 45 days of receiving it.").

<sup>39</sup> See id. at 356.

<sup>40</sup> See id. (acknowledging that Sureties did not expressly relinquish their contractual right to dispute the claim, but finding that the Sureties impliedly waived their defenses under the payment bond by failing to answer the claim within 45 days).

<sup>41</sup> The authors owe credit for this particular insight to our very own Duane A. Daiker, who is 1 of about 150 (at press time) Florida Bar Board Certified Appellate Practice Specialists.

<sup>42</sup> See David A. Bramble, 879 A.2d at 110-11 ("The primary purpose of Paragraph 6 is to better facilitate the timely payment of claims under the bond . . . . Courts have recognized that 'as a practical matter the suppliers and small contractors on large construction projects need reasonably prompt payment for their work and materials in order for them to remain solvent and stay in business.' . . . The requirements of Paragraph 6 function to insure that subcontractors and sub-subcontractors are not forced to absorb the risk of non-payment over a protracted period by the contractor and the owner, through no fault of their own.").

construction industry.<sup>43</sup> The reality is that cash flow is the life blood of the construction industry and Sureties are often the entities around that can provide cash flow to keep a project alive. Sureties infuse cash flow both by payments to unpaid subcontractors and materialmen and in those instances that they choose to take over a project after a performance default.

The “turnabout is fair play” sentiment,<sup>44</sup> which is a “fairness” or equitable argument, is not highlighted in the Maryland and Virginia decisions. However, the bond claimants made the point to the courts and its simplicity and emotional appeal probably had a greater impact on the courts’ thinking that their written opinions reveal. The claimants argued that

Construing the 45-day period strictly, and literally, is consistent with the approach courts have taken in connection with construing bond language imposing a time limit within which a claimant must submit a claim to a surety or other person. Failure of the claimant to comply with the applicable notice requirement to a surety . . . deprives the claimant of its right to recovery under the bond. . . .

. . . .

**[H]olding sophisticated sureties to a strict deadline in accordance with the contractual language of the Payment Bond is no more a windfall to claimants than holding that a claimant must comply with a strict deadline for the filing of a claim under the Bond is a windfall to sureties.** Petitioner Sureties would have no doubt been willing to take advantage of any “windfall” to them had Respondent waited another six weeks to file this suit so that it did not meet the one year to file suit provision in the bond.<sup>45</sup>

The public policy and fairness arguments that underlie the Maryland and Virginia decisions suggest that the decisions may persuade courts in other jurisdictions faced with the conflicting legal principles raised in the interpretation of § 6.1 of the AIA – A312 Payment Bond.<sup>46</sup>

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<sup>43</sup> E.g., Brief of Amicus Curiae: Florida AGC Council Inc., Florida Transportation Builders’ Ass’n., Inc., , Associated Builders and Contractors of Florida at 6, Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co., 945 So. 2d 1216 (Fla. 2006) (“The lifeblood of the commercial construction industry is surety bonding.”).

<sup>44</sup> Other common colloquialisms expressing the sentiment include: “You can’t have it both ways;” “What’s sauce for the goose is sauce for the gander;” and, “What goes around comes around;” In sum, the sentiment is that because deadlines are strictly enforced against claimants, deadlines should likewise be strictly enforced against Sureties.

<sup>45</sup> Brief of Respondent, David A. Bramble, Inc., to the Maryland Court of Appeals, 2005 WL 1303968, \*13, \*16 (Submitted May 12, 2005) (internal citations omitted) (emphasis added).

<sup>46</sup> But see S. Win-Dor, Inc. v. RLI Ins. Co., 925 So. 2d 884 (Miss. Ct. App. 2005).

One of the central legal principles of the decisions is that “upon default by the principal of the obligation to pay, the surety is immediately liable.”<sup>47</sup> That principle appears related to the growing prevalence of surety being defined merely as a type of insurance,<sup>48</sup> which may signal that the law is receding from Pearlman v. Reliance Insurance Co.’s clear distinction.<sup>49</sup>

## 2. Coverage By Waiver/Estoppel

The Maryland and Virginia decisions are essentially an outgrowth of judicial maxims commonly applied against insurers.<sup>50</sup> In many states, statutes have unnecessarily and with increasing regularity lumped Sureties together with insurers and the judiciary has followed suit. Many cases have applied similar rules to Sureties as they would insurers.<sup>51</sup> The rationale

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<sup>47</sup> Wadsworth, 863 A.2d at 353; accord Atl. Contracting & Material Co. v. Ulico Cas. Co., 844 A.2d 460, 468 (Md. 2004) (“The surety is primarily or jointly liable with the principal and, therefore, is immediately responsible if the principal fails to perform.”); Middlebrook Tech, LLC v. Moore, 849 A.2d 63, 74 (Md. Ct. App. 2004) (“A suretyship contract . . . is a direct and original undertaking under which the surety is primarily liable with the principal obligor and therefore is responsible at once if the principal obligor fails to perform.”).

<sup>48</sup> E.g., Garden State Tanning, Inc. v. Mitchell Mfg. Group, Inc., 273 F.3d 332, 335 (3d Cir. 2001) (“[C]orporate suretyship, ‘an undertaking for money consideration by a company chartered for the conduct of such business, . . . is essentially an insurance against risk.’ These guarantors ‘may call themselves ‘surety companies,’ [but] their business is in all essential particulars that of insurance.’”) (internal citations omitted); David A. Bramble, 879 A.2d 101, 108 (Md. 2005) (“A paid surety which is a surety or bonding company is usually considered to be in the same class as an insurance company, its contract being held to be in the nature of insurance and to be construed according to the rules applicable to insurance contracts.”). But see Associated Indem. Corp. v. CAT Contracting, Inc., 964 S.W.2d 276, 280 (Tex. 1998) (holding that the relationship between insurer and insured is fundamentally different from that between surety and obligee, such that the surety does not owe its obligee the duty of good faith and fair dealing that the insurer owes its insured and that is implied in most contracts) (citing Great Am. Ins. Co. v. Austin Mun. Util. Dist. No. 1, 908 S.W.2d 415, 418-20 (Tex. 1995)).

<sup>49</sup> Pearlman v. Reliance Ins. Co., 371 U.S. 132, 140 n.19 (1962) (“[T]he usual view, grounded in commercial practice, [is] that suretyship is not insurance.”); see also Shannon R. Ginn Constr. Co. v. Reliance Ins. Co., 51 F. Supp. 2d 1347, 1350 (S.D. Fla. 1999) (“Suretyship and insurance have similar characteristics and sometimes are discussed as related concepts; nonetheless, they are distinct.”).

<sup>50</sup> The outgrowth is only natural for Maryland and Virginia, which treat Sureties especially roughly. See Conseco Indus., 627 F.2d at 317 (“[T]he law of Maryland and of other states is that in a case involving a compensated or corporate surety, the doctrine that the surety is the favorite under the law does not apply, and recovery under the bond is the preferred result.”); Lange v. Bd. Of Educ. Of Cecil County, ex rel. Int’l Bus. Machs. Corp., 37 A.2d 317, 321 (Md. 1944) (“[S]ince the advent of corporate bonding companies, the old doctrine that a surety is a favorite of the law and that a claim against him is strictissimi juris has been greatly minimized; . . . the liability upon bonds executed by surety corporations has been liberally extended beyond that to which sureties were formerly held.”); Century Indem. Co. v. Esso Standard Oil Co., 79 S.E.2d 625, 630 (Va. 1954) (“The undertaking of a compensated surety is to be liberally construed in favor of the assured, and where a bond is reasonably susceptible of two constructions, the one more favorable to the claimant will be adopted.”); see also cases cited, supra, note 47.

<sup>51</sup> See B.C. Hart, Bad Faith Litigation Against Sureties, 24 TORT & INS. L.J. 18, n.11 (1988) (“Both the judicial and legislative branches have sometimes shown a distinct inclination not to separate the analysis used in surety and insurance bad faith actions.” (citing Szarkowski v. Reliance Ins. Co., 404 N.W.2d, 502, 504-05 (N.D. 1987) (holding that a paid Surety is generally to be treated as an insurer rather than according to the strict laws of suretyship); Farmers Union Cent. Exch., Inc. v. Reliance Ins. Co., 626 F. Supp. 583, 590 (D.N.D. 1985) (finding that the bonding business is the business of insurance)). “Sureties have been held subject to state unfair insurance trade practice acts in the states of California, North Dakota, Louisiana and Wyoming.” (citing Gen. Ins. Co. of Am. v. Mammoth Vista Owner’s Ass’n, 220 Cal. Rptr. 291, 300 (Cal. Dist. Ct. App. 1985) (holding that an obligee under a Surety bond may bring an action against its Surety for engaging in unfair claims settlement practices in violation of the Insurance Code); Austin v. Parker, 672 F.2d 508, 519 (5th Cir. 1982) (holding that a

underlying the Maryland and Virginia decisions was no exception.<sup>52</sup> This has been the subject of much criticism, given the obvious differences of the tri-partite relationship among the Surety, its principal, and the bond obligee, from the insurer/insured relationship.<sup>53</sup>

Under various states' laws, insurers face the task of providing proper notices to the insured of the insurer's receipt of the claim and initiation of an investigation into coverage of the claim, a disclaimer of risks not covered appearing on the face of the insured's claim, and a reservation of rights to disclaim coverage for other circumstances tending to exclude coverage for the claim. Such "kitchen sink" notices<sup>54</sup> to the insured attempt to reserve the insurer's rights along with any and all potential exclusions from coverage. Like the Surety in the Maryland case, insurers face the difficult task of determining coverage and responding to a claim in a reasonably short amount of time despite having only limited information about the claim. Because uninformed insurers cannot reasonably determine coverage, these situations commonly lead to delayed payment of what turn out to be covered claims and subsequent arguments by insureds for "coverage by estoppel." Such notions are based on the assertion that in the insurance context waiver or estoppel can operate against insurers to bring causes of loss within coverage under an insurance policy, including risks not covered by the plain language of the policy and even risks expressly excluded from coverage by the policy.<sup>55</sup> The estoppel argument hinges on the insured's ability to show it was "prejudiced" by the insurer's later change in position.<sup>56</sup> The waiver argument is bottomed on the silence of the insurer, where it lists some potential defenses but fails to lists others.<sup>57</sup>

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Surety falls under the regulation of the Insurance Code section penalizing insurers for failing to pay a fully documented proof of loss); State Sur. Co. v. Lamb Constr. Co., 625 P.2d 184, 188 (Wyo. 1981) (holding that a Surety is an insurance company within the meaning of the statute))).

<sup>52</sup> David A. Bramble, 879 A.2d at 108 ("A paid surety which is a surety or bonding company is usually considered to be in the same class as an insurance company, its contract being held to be in the nature of insurance and to be construed according to the rules applicable to insurance contracts.")

<sup>53</sup> See, e.g., Dadeland Depot, 945 So. 2d at 1239-43 (Wells, J., dissenting).

<sup>54</sup> See 1 AUTO. LIABILITY INS. 4th § 13:7 (2007), discussing an insurer's right to change coverage denial grounds, and cases cited therein on both sides of the issue.

<sup>55</sup> See, e.g., W. C. Crais III, Annotation, Comment note: Doctrine of estoppel or waiver as available to bring within coverage of insurance policy risks not covered by its terms or expressly excluded therefrom, 1 A.L.R.3d 1139 (1965).

<sup>56</sup> Id.

<sup>57</sup> See Peiffer v. State Farm Mut. Auto. Ins. Co., 940 P.2d 967, 970 (Colo. Ct. App. 1996), aff'd, 955 P.2d 1008 (Colo. 1998); First Mercury Syndicate, Inc. v. Tel. Alarm Sys., Inc., 849 F. Supp. 559, 568 (W.D. Mich. 1994); Cont'l Ins. Co. v. Beecham, Inc., 836 F. Supp. 1027, 1045 (D.N.J. 1993); Jones v. Jackson Nat. Life Ins. Co., 819 F. Supp. 1372, 1377 (W.D. Mich. 1993), aff'd, 27 F.3d 566 (6th Cir. 1994); Mauer v. Bd. of Trs. of Mo. State Employees' Ret. Sys., 762 S.W.2d 517, 519 (Mo. Ct. App. 1988); Zumbrun v. United Servs. Auto. Ass'n, 719 F. Supp. 890, 895-96 (E.D. Cal. 1989); N.Y. v. AMRO Realty Corp., 936 F.2d 1420, 1430-32 (2d Cir. 1991); St. Paul Fire and Marine Ins. Co. v. Molloy, 420 A.2d 994, 997 (Md. Ct. App. 1980), judgment rev'd, 433 A.2d 1135 (Md. 1981); Otto v. Farmers Ins. Co., 558 S.W.2d 713, 720 (Mo. Ct. App. 1977); Reed v. Commercial Union Ins. Co., 468 N.Y.S.2d 738, 739 (N.Y. App. Div. 1983); Segalla v. United States Fire Ins. Co., 373 A.2d 535, 538 (Vt. 1977); McLaughlin v. Conn. Gen. Life Ins. Co., 565 F. Supp. 434, 451 (N.D. Cal. 1983); Colard v. Am. Family Mut. Ins. Co., 709 P.2d 11, 15 (Colo. Ct. App. 1985); Hamlin v. Mut. Life Ins. Co., 145 Vt. 264, 487 A.2d 159, 162-63 (1984).

The Maryland and Virginia cases have strong undertones of insurance waiver and estoppel law blended together and imposed against the Sureties. The Maryland and Virginia cases follow the premise of “implied waiver by silence.” The courts imposed a waiver of bond defenses against the surety, similar to how they would treat an insurer:

The Sureties also maintain that their failure to answer Wadsworth’s claim within 45 days cannot rightly be deemed a forfeiture or waiver of their right to dispute the claim or otherwise defend against it, because they were merely silent in response to the claim. In so arguing, the Sureties seize upon the following language from A/C Elec. Co.: “[S]ilence on the part of a surety is not ordinarily regarded as acquiescence or consent.” They omit, however, the full text of that sentence, which reads: “While silence on the part of a surety is not ordinarily regarded as acquiescence or consent, **if Aetna [the surety for profit] is to be regarded as an insurer, other principles may apply.**” The Sureties also omit the very next sentence of the opinion, which reads: “**It is well recognized that an insurer may, by its conduct, be deemed to have waived a condition of its policy or some irregularity on the part of its insured.**”

. . . [T]he Court of Appeals set forth in considerable detail the close relationship between waiver and estoppel, and, at times, the difficulty in distinguishing between an implied waiver and an estoppel. The Court stated that

many courts now state that waiver not only includes the intentional relinquishment of a known right, but such conduct as warrants an inference of the relinquishment of such a right, and may result from an express agreement or be inferred from circumstances.

Waiver is closely inter-related and intertwined with estoppel. The distinction between waiver and estoppel most frequently adverted to is that waiver rests upon the intention of a party, while estoppel rests upon a detrimental change of position induced by the acts or conduct of the party estopped.

. . . .

Wadsworth does not, and indeed cannot, contend that the Sureties expressly relinquished their contractual right to dispute Wadsworth’s claim. Wadsworth does assert, however, that the conduct of the Sureties supports the inference of their intention to relinquish their rights under the

payment bond, reflecting an implied waiver of their right to defend against non-payment of the claim. We agree.

As we have said, on three occasions the Sureties acknowledged Wadsworth's claim. Yet at no time did the Sureties answer Wadsworth's claim by "stating the amounts that are undisputed and the basis for challenging any amounts that are disputed," as required by the payment bond. Indeed, the Sureties stood silent in the face of Wadsworth's claim for many months beyond the lapse of the 45-day period for answer, coming forward with their defenses to the claim only in answer to Wadsworth's lawsuit.<sup>58</sup>

Notably, the Surety's waiver of defenses occurs not by failing to respond at all, but by responding and failing to delineate disputed amounts and the reasons for dispute. This takes the insurance waiver-by-silence rule to a whole new level. Not only must the Surety respond and dispute the claim, but it also must detail or waive every basis for disputing any part of the claim.

In the normal claim scenario, the Surety is already in somewhat of a "Catch-22," even without the Damoclean sword of the 45 day deadline of § 6.1 of the AIA – A312 Payment Bond. Courts have held Sureties to be "volunteers" where it is shown that a surety's payment of a payment bond claim was unreasonable or based on an improper investigation.<sup>59</sup> Additionally, Sureties have a duty of good faith to their indemnitors in settling claims.<sup>60</sup> Yet,

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<sup>58</sup> Wadsworth, 863 A.2d at 356 (internal citations omitted) (emphasis added).

<sup>59</sup> Gen. Ins. Co. of Am. v. K. Capolino Constr. Corp., 903 F. Supp. 623, 626 (S.D.N.Y. 1995) ("[A] party that pays a claim it is not obligated to pay is a volunteer and may not recover those expenses."); Nat'l Union Fire Ins. Co. v. Ranger Ins. Co., 599 N.Y.S.2d 347, 348 (N.Y. App. Div. 1993) ("Because National was not obligated under its policy of insurance, it became a volunteer with no right to recover the monies it paid on behalf of its insured. It is well settled that '[a] mere volunteer or intermeddler will not be substituted in the place of a person whose rights he seeks to acquire, simply because he has paid a debt, or discharged an obligation, for which that person was responsible.' This principle has been applied to insurance carriers. '[A]n insurer which pays a loss for which it is not liable thereby becomes a mere volunteer, and is not entitled to subrogation, in the absence of an agreement therefore.'" (internal citations omitted)); Fid. & Cas. Co. of N.Y. v. Finch, 159 N.Y.S.2d 391, 394 (N.Y. App. Div. 1957) ("[The surety] may recover only the amount which it was reasonably required to pay under the terms of its surety bonds. As to anything beyond this obligation it would be merely a volunteer and not entitled to subrogation."); Timms v. James, 621 P.2d 798, 800 (Wash. Ct. App. 1980) ("[T]he surety's right to reimbursement extends only to the surety's payment of debts which the principal debtor actually owed. If the surety pays a debt which the principal debtor did not owe, i.e., where the surety fails to assert the principal debtor's defense, the surety is merely a volunteer and cannot claim reimbursement."); see also Am. Mfrs. Mut. Ins. Co. v. Payton Lane Nursing Home, Inc., 2007 WL 674691, at \* 8 (E.D.N.Y. Feb. 28, 2007) ("[U]nder New York law, a mere volunteer is not entitled to subrogation . . . . The payment of a claim presented by its obligee is sufficient to entitle a surety to subrogation if it is made in good faith and because of the surety's supposed liability on its undertaking.").

<sup>60</sup> See Am. Motorist Ins. Co. v. Southcrest Constr., Inc., 2006 WL 995202, at \* 3 (N.D. Tex. April 17, 2006) ("A fundamental principle of suretyship law is that a contract of compensated suretyship is deemed to be a contract of insurance. . . . An insurer's duty of good faith and fair dealing to its insured arises whenever the insurer's conduct creates a risk that the insured will bear some of the loss. This is true even if an insurance contract purports to leave to the insurer complete discretion over when to settle. If the possibility exists that a judgment against the insured will exceed policy limits, an insurer has a duty of good faith and fair dealing in connection with the

based on the holdings in the Maryland and Virginia cases, Sureties will be forced to make hasty decisions and are certain to face the volunteer argument when those decisions later turn out to be misguided.

#### **D. STATUTES SIMILAR TO THE MARYLAND & VIRGINIA DECISIONS**

Several states have statutes that embody the principle of a time limitation on the Surety to satisfy payment bond claims. As discussed above, other states deal with Sureties as insurers and subject them to bad faith claims by claimants who were not paid quickly.<sup>61</sup> Among the states with a statute similar to the common law of the Maryland and Virginia decisions, Connecticut has the most similar.

In 2006, Connecticut's governor signed into law a bill entitled "An Act Concerning Subcontractor Claims," which repealed and replaced § 49-42 of the Connecticut Statutes. The new § 49-42 allows a payment bond Surety only 90 days to respond to a claimant with substantially the same information required as an "answer" under § 6.1 of the AIA – A312 Payment Bond. Connecticut General Statutes § 49-42(a) states in pertinent part:

Not later than ninety days after service of the notice of the claim, the surety shall make payment under the [payment] bond and satisfy the claim, or any portion of the claim which is not subject to a good faith dispute, and shall serve a notice on the claimant denying liability for any unpaid portion of the claim.<sup>62</sup>

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determination of whether or not to settle. The duty of good faith and fair dealing has been extended from insurance contracts to contracts of suretyship. When suretyship contracts are given in exchange for indemnity agreements, the duty of good faith is present because the principal/indemnitor almost always bears the risk of loss resulting from actions of the surety." (citations omitted)); Rush Presbyterian St. Luke's Med. Ctr. v. Safeco Ins. Co. of Am., 712 F. Supp. 1344, 1346 (N.D. Ill. 1989) ("Illinois thus requires only a showing of negligence in actions alleging the breach of a surety's duty of good faith toward its insured, where the insured is obligated to indemnify the surety."); Fid. & Dep. Co. v. Henry, 69 So. 1011, 1013 (Miss. 1915) ("The general rule of law, sustaining which the authorities are in accord, is that where the indemnitee is sued, the judgment rendered against him is conclusive upon the indemnitor, provided always, that notice be given to the latter and fair opportunity is given to defend the original action; but when the indemnitor, being thus liable over, is given due notice of the pendency of the suit against his indemnitee and requested to defend the action, he is then regarded, not as a stranger to the litigation, but the really interested defendant, and should be accorded all reasonable opportunity and the full right to submit any legitimate defense, to controvert by proper pleadings the claim sued on, to reserve exception to any alleged erroneous ruling of the trial court, and to prosecute an appeal from any adverse judgment. 'In order to bind an indemnitor to a judgment rendered against the indemnitee the covenantor must be tendered a full and fair opportunity to meet the controversy, . . . he should be allowed all the means of defense open to him had he been made a party.' Freeman on Judgments, § 181."); Fid. & Cas. Co. of N.Y. v. Harrison, 274 S.W. 1002, 1005 (Tex. Civ. App. 1925) (holding that the action of the surety company in making the settlement payment must be in good faith and free of fraud); Fid. & Cas. Co. of N.Y. v. McNamara, 36 S.E.2d 402, 404 (W.Va. 1945) (holding that a surety must exercise good faith in effecting the settlement of liability on the bond); see also Deminsky v. Arlington Plastics Mach., 657 N.W.2d 411, 428 (Wis. 2003) ("[I]ndemnitor is entitled to produce evidence that the settlement was unreasonable, including evidence that the indemnitee faced no potential liability or that the settling parties were involved in fraud or collusion.").

<sup>61</sup> E.g., Dadeland Depot, 945 So. 2d at 1236 ("[T]he obligee of a surety contract qualifies as an 'insured' and is therefore entitled to sue its surety for bad faith refusal to settle claims.").

<sup>62</sup> CONN. GEN. STAT. § 49-42(a) (2006).

Connecticut law also subjects Sureties to claims under the Connecticut Unfair Trade Practices Act,<sup>63</sup> for failure to comply with the time restrictions of § 49-42(a).<sup>64</sup>

Mississippi law specifically subjects Sureties to bad faith penalties for unreasonably delaying payment. Mississippi Code § 31-5-57 provides in pertinent part:

Whenever any person supplying labor or material in the prosecution of the work brings an action on such payment bond and the trial judge finds that the defense raised to such action by the . . . surety was not reasonable, or not in good faith, or merely for the purpose of delaying payment, then the trial judge may, in his discretion, award the claimant a reasonable amount to be determined by the trial judge as claimant's attorney's fees in bringing such successful action.<sup>65</sup>

Mississippi's statutory penalty for failing to pay payment bond claims with reasonable promptness seems to be more in line with the potential prejudice a claimant might suffer than the draconian complete waiver of defenses.

Lastly, it is worthy of note that the South Carolina House not many years ago introduced a bill requiring use of the AIA – A312 Payment Bond form. The bill provided:

Performance and payment bonds required by this section must be obtained from surety insurers authorized by the Department of Insurance to do business in this State. The bond form must be equivalent to the American Institute of Architects performance and payment bond for AIA312. Whether a bond form is equivalent to the bond form AIA312 must be determined by the board.<sup>66</sup>

The South Carolina General Assembly referred the bill to the Labor, Commerce and Industry Committee, where the bill died in committee.

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<sup>63</sup> CONN. GEN. STAT. § 42-110(a), et seq. (2006).

<sup>64</sup> Mercury Cabling Sys., LLC v. N. Am. Spec. Ins. Co., 2006 WL 1320489, at \*6 (Conn. Super. Ct. 2006) (“The plaintiff alleges that [the Surety] violated § 49-42(a) and further alleges that [the Surety] failed to adopt and implement reasonable standards for the prompt investigation of claims arising under bonds, that it refuses to pay bond claims without conducting a reasonable investigation, that it does not make a good faith attempt to effectuate a prompt, fair and equitable settlement of bond claims and fails to provide a reasonable explanation of its basis for denial or failure to pay bond claims. Specifically, the plaintiff alleges that [the Surety] did not make payment on all or any portion of the plaintiff's claim or deny the plaintiff's claim within ninety days after service of the notice of claim as specified by § 49-42.”).

<sup>65</sup> MISS. CODE ANN. § 31-5-57 (2006).

<sup>66</sup> Gen. B. 3618, Gen. Assemb., 114th Sess. (S.C. 2001).

## E. REQUIRED NOTICE

The AIA – A312 Payment Bond requires that a claimant provide notice to the Surety.<sup>67</sup> Interestingly, the exact terminology differs between the notice to Surety required by § 4.1 and § 4.2.3. Section 4.1, which applies to claimants who are employed by or have a direct contract with the principal, requires the claimant to “give[] notice to the Surety (at the address described in Paragraph 12).”<sup>68</sup> Section 4.2.3, which applies to claimants who do not have a direct contract with the principal, requires the claimant to “sen[d] . . . written notice to the Surety (at the address described in Paragraph 12).”<sup>69</sup>

The AIA – A312 Payment Bond does not define what constitutes sufficient notice of the claim. There are significant problems with the wording of the AIA – A312 Payment Bond. First, it is not clear why § 4.1 required “notice,” while § 4.2.3 requires “written notice.” No court of which the authors are aware has yet confronted the issue in a published opinion. Under standard principles of contract interpretation, the use of “written” in § 4.2.3 suggests that the notice required by § 4.1 need not be written. However, it is nonsensical that oral notice could be sent to the Surety “at the address described in Paragraph 12.”<sup>70</sup> The most likely explanation for the difference between the notice requirements of §§ 4.1 and 4.2.3 is inconsistent drafting by the American Institute of Architects.

The language of §§ 4.1 and 4.2.3 of the AIA – A312 Payment Bond requires that notice be sent to the Surety “at the address described in Paragraph 12.” Paragraph 12 provides:

Notice to the Surety, the Owner or the Contractor shall be mailed or delivered to the address shown on the signature page. Actual receipt of notice by Surety, the Owner or the Contractor, however accomplished, shall be sufficient compliance as of the date received at the address shown on the signature page.<sup>71</sup>

Paragraph 12 provides that notice must be sent to “the address shown on the signature page.” By doing so, the bond encourages claimants’ confusion about where to send notice and also provides claimants with arguments that their notice was effective even though not sent to the Surety.

There is typically appended to a bond a signed power of attorney, which usually lists the address of the Surety’s local agent. A claimant could reasonably profess confusion about

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<sup>67</sup> AIA – A312 PAYMENT BOND § 4 (1984).

<sup>68</sup> AIA – A312 PAYMENT BOND § 4.1 (1984).

<sup>69</sup> AIA – A312 PAYMENT BOND § 4.2.3 (1984).

<sup>70</sup> See also 20 STANDARD PENN. PRAC. 2d § 108:27 (2007) (“[W]here a payment bond contains a 90-day notice requirement, a materialman who does not have a direct contractual relationship with the prime contractor and gives notice by telephone to the prime contractor and the surety that it did not receive payment for the materials it supplied, is not permitted to maintain an action on the bond as the written notice requirement is a condition precedent to bringing suit and oral notice does not satisfy the requirement.”).

<sup>71</sup> AIA – A312 PAYMENT BOND § 12 (1984).

whether the power of attorney was the “signature page” cited by Paragraph 12 and perhaps then take the position that it understood the address of the Surety’s local agent provided on the power of attorney to be the Surety’s address for receiving a notice of claim under the AIA – A312 Payment Bond. Whether that argument succeeds remains to be seen. However, it is beyond doubt that the AIA – A312 Payment Bond unnecessarily complicates the task of informing potential claimants about where to send notice of their claims to the Surety. As addressed in more detail below, there is certainly support for the proposition that service on a Surety’s local agent is effectively service on the Surety.<sup>72</sup>

Some commentators suggest that claimants submit to the Surety an executed and notarized generic proof of claim and all supporting documentation including the subcontract, payment applications, and relevant correspondence, so that the Surety will have no basis to assert that the 45 day countdown did not begin immediately upon claimant’s submission of its proof of claim.<sup>73</sup> While a Surety’s job evaluating payment bond claims would certainly be made easier if all claimants followed Barthelet and Dranoff’s advice and submitted complete back-up with their claims, it would be naïve for the Surety not to recognize that some claimants will seek to impose liability on the Surety through operation of the 45 day deadline in the AIA – A312 Payment Bond.

The two primary ways claimants will try to force Sureties into waiving their defenses by failing to respond are (1) by submitting notice of their claims to Sureties without sufficient back-up for the Sureties to determine whether the claim is legitimate and due to be paid, and (2) by submitting notice of their claims a Surety’s agent or indemnitor in the hopes that the claims will not make it to the Surety claims person until it is either too late for the Surety to assert any defenses or too late for the Surety to properly investigate the claim before making its decision about whether to pay the claim. This section primarily addresses the latter means of trying to trick a Surety into waiving its defenses by failing to respond.

Is it possible that a Surety could impliedly waive its defenses to an AIA – A312 Payment Bond claim that it never received? That is certainly the “nightmare scenario” about which this paper seeks to warn Surety claims people. If a claimant is able to effectively serve a Surety’s local agent<sup>74</sup> for writing bonds with an AIA – A312 Payment Bond claim, it is possible that the Surety’s claims department will never receive the claim from the local agent. If the Surety never receives and disputes the claim, but is chargeable with the notice provided to its agent, it may impliedly waive its defenses to the claim by failing to answer the claim within 45 days allowed by § 6.1 of the AIA – A312 Payment Bond.

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<sup>72</sup> *Western Cas. & Sur. Co. v. Meyer*, 192 S.W.2d 388, 390 (Ky. 1946) (“[S]ince [the local agent] had authority to execute the bonds, the [Surety] company is chargeable with whatever knowledge [the local agent] acquired as to proceedings under the[ bonds] and with whatever [the local agent] did under the[ bonds] in the apparent scope of his authority.”).

<sup>73</sup> Barthelet & Dranoff, *supra* note 14, at \*19 (“In addition to providing a notice of nonpayment, claimants and their counsel may wish to contemporaneously provide the surety with an executed and notarized generic proof of claim and all supporting documents including the subcontract, payment applications, and relevant correspondence. The result will be the commencement of the ‘forty-five-day countdown’ without incurring additional delay inherent in the surety’s customary request for additional information.”).

<sup>74</sup> *Meyer*, 192 S.W.2d at 390 (“[T]he [Surety] company is chargeable with whatever knowledge [the local agent] acquired as to proceedings under the[ bonds].”).

There is no question that an AIA – A312 Payment Bond claimant can effectuate service on a Surety by serving the Surety’s general agent.<sup>75</sup> However, a much more dangerous common law holding is that notice to an indemnitor is effective as to its indemnitee.<sup>76</sup> It is certainly arguable that holding could be applied to result in a Surety (indemnitee) being charged with having received notice of a claim given to its principal (indemnitor).<sup>77</sup> Additionally, some states’ statutes provide methods for notifying the Surety<sup>78</sup> that may not

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<sup>75</sup> See Kroeger v. Union Indem. Co., 14 P.2d 258, 262 (Ariz. 1932) (“The person who actually executed the bond on behalf of defendant was admittedly its general agent for Arizona. In the absence of some showing to the contrary, a general agent for a bonding company has all the powers that the corporation itself has in regard to the execution and delivery of bonds, and notice to him is notice to the corporation.”); Sykes v. Sperow, 179 P. 488, 489-90 (Or. 1919) (“We might place our conclusion in this regard upon the presumption that the agent had performed his duty and actually forwarded the notices to the home office. . . . ‘The reason for this rule is based on the theory that it is incumbent on the agent to impart to his principal all information that he may obtain which would affect his interest, and by invoking the presumption that such obligation has been performed the conclusion is reached that the principal is chargeable with notice thereof.’ Assuming, then, that the notice actually reached the surety company at its home office in proper time, any difference in the mere manner of transmitting it, from the method provided in the contract, would have been merely technical and trivial, and could have caused no injury or prejudice to the defendant. . . . But in addition to this it is our opinion that the general agent of the company had authority, under the circumstances in this case, to waive or qualify a provision like the one in this contract, providing for the manner of serving notice of the default upon the surety company--assuming, of course, that the testimony of the plaintiff as to what occurred was accurate and correct. . . . It is conceded that Smith was designated as such general agent, and in addition to this the testimony on the part of the plaintiff tended to show that he was such general agent in fact. It is well settled that such a general agent is the alter ego of the principal, and can perform any act or do anything that the principal itself could do or perform.”).

<sup>76</sup> Conseco Indus., 627 F.2d at 317-18 (“It can be seen that notice to HSL-DC is not that important if C & E was notified in time for C & E had agreed to indemnify HSL-DC. C & E thus stood in the shoes of HSL-DC. To allow this technical noncompliance to bar this action would be in effect requiring notice for notice’s sake, and would result in serving no practical end.”); see also Jack v. Craighead Rice Mill. Co., 167 F.2d 96, 100 (8th Cir. 1948) (“The other ground specified in the motion for a directed verdict was that plaintiff failed to give the Surety notice of the alleged defaults, as required by the bond. . . . The court held in effect that this provision was valid but that it was one that might be waived by the Surety, and left to the jury the question as to whether there had in fact been such a waiver, and also left to the jury the question as to whether or not the Surety had actual notice. The Surety here, it must be remembered, is a paid surety and the contract of suretyship is to be construed in the same manner as a contract of insurance. If the Surety already had knowledge or was chargeable with knowledge of the default, then failure to give notice in the form required by the stipulation would not relieve it from liability.” (internal citations omitted)).

<sup>77</sup> Cf. THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA ERICA SUBCONTRACTOR PAYMENT BOND § 2.2.1 (1988 ed.) (“Unless Claimant, other than one having a direct contract with the Principal, shall have given written notice to **any two of the following: Principal, Obligee, or the Surety** above named, within ninety (90) days after such Claimant did or performed the last of the work or labor, or furnished the last of the materials for which said claim is made, . . . . **Such notice shall be served by mailing the same by registered mail or certified mail, postage prepaid, in an envelope addressed to the Principal, Obligee or Surety at any place within the United States where an office is regularly maintained for the transaction of business**, or served in any manner in which legal process may be served in the state in which the aforesaid Project is located . . . .” (emphasis added)).

<sup>78</sup> IND. CODE § 4-13.6-7-10 (2007) (“In order to proceed against the [payment] bond . . . the claimant must notify the surety . . . by sending a copy of the claim . . . to the surety company. The claimant shall also inform the division that the surety has been notified. The division shall supply the claimant with any information the claimant requires to notify the surety.”); ME. REV. STAT. ANN. tit. 24-a, § 421 (2007) (“Before the superintendent authorizes it to transact business in this State, each insurer shall appoint an agent to receive service of legal process issued against the insurer in this State. . . . Any person or entity required . . . to appoint an agent for service of process who does not have a valid appointment on file with the superintendent is deemed to have appointed the superintendent as agent for service of process.”); N.H. REV. STAT. ANN. § 447:17 (2007) (“To obtain the benefit of

result in the Surety actually receiving notice or may result in the Surety receiving notice without enough time left in the 45-day countdown to conduct a reasonable investigation of the claim. Sureties should be prepared for AIA – A312 Payment Bond claimants to attempt to provide effective notice without providing actual notice of the claim to the Surety and should put claims handling procedures in place to effectively manage notice issues.

### III. PRACTICAL APPLICATION

There are a number of ways a Surety can adapt its claims handling on AIA – A312 Payment Bonds.<sup>79</sup> Before ever getting to that point, though, Sureties should consider altering the language of the form AIA – A312 Payment Bond prior to issuing it. First, Sureties should consider striking some part of the language of § 6.1. The Surety’s most effective strategy may be to strike the “within 45 days” language, which would remove the intense time pressure on the Surety to investigate and determine the validity of the claim. Sureties should, as discussed above, also consider clarifying is the language of §§ 4 and 12 of the AIA – A312 Payment Bond that purports to specify the address at which the claimant must provide notice to the Surety. Finally, Sureties should consider inserting non-forfeiture of defenses language as suggested by Wadsworth,<sup>80</sup> which would simply state that the Surety’s failure to answer the claim under any deadline, whether specified under the bond or by statute, is not and shall not be construed to be a waiver of any of the Surety’s defenses to the claim.

The first thing a Surety should do upon receipt of an AIA – A312 Payment Bond claim is determine the earliest date on which the Surety can be charged with notice of the claim and calendar 45 days from that date to answer the claim. The Surety should next send a letter by certified mail to its principal enclosing the claim and asking the principal to respond within a specified amount of time about the validity of the claim and identify any and all bases for disputing the claim or any portion of the claim. As part of its letter to its principal, the Surety should state the date the claim was received and the date by which the Surety must answer the claimant. The Surety should also include a statement that if its principal does not respond to the request or responds without sufficient back-up to justify denial of any portion of the claim, the Surety may be forced to settle the claim with claimant because of the statutory and common law penalties for a Surety’s failure to timely pay a claim in absence of a reasonable basis for denying it. The Surety’s correspondence to its principal serves to inform the principal of the claimant’s claim, the timeframe under which an answer to the claim is due, the information needed to support denial of any portion of claimant’s claim, and the Surety’s intention to settle the claim within the applicable time constraints in absence of a supported basis for denying the claim. The Surety’s above-described correspondence to its principal is

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the bond. . . [claimant must] file in the office of the secretary of state, if the state is a contracting party, or with the department of transportation, if the state is a party to said contract by or through said department, or with the department of administrative services, if the state is a party to said contract by or through said department, or in the office of the clerk of the superior court for the county within which the contract shall be principally performed, if any political subdivision of the state is a contracting party, a statement of the claim, a copy of which shall forthwith be sent by mail by the office where it is filed to the principal and surety.”).

<sup>79</sup> It is crucial that the Surety carefully handle any claims on AIA – A312 Payment Bonds arising out of projects in Maryland, Virginia, or the District of Columbia, though the claims handling procedures outlined in this paper are also appropriate for AIA – A312 Payment Bond claims in other jurisdictions in light of the possibility that the Maryland and Virginia decisions may signify a trend.

<sup>80</sup> 863 A.2d at 356.

intended to insulate the Surety from an assertion by its principal that the Surety paid the claim as a volunteer.

If the principal instructs the Surety not to pay claimant's claim, but the principal fails to provide documentation to support denial of the claim, the Surety may still be worried about being found to be a volunteer if it pays claimant's claim. In that case, it may be advantageous, depending on the circumstances, for the Surety serve an AIA – A312 Payment Bond § 6.1 answer on claimant denying the claim for the following reasons: (1) Claimant has failed to provide sufficient documentation to support its claim; (2) The principal denies the claim and has instructed the Surety not to pay the claim; (3) The Surety owes a duty of good faith to its principal in settling claims against the payment bond and cannot settle claims in good faith until it has conducted a reasonable investigation; (4) The claimant's failure to provide sufficient documentation within the time period prescribed by the payment bond for the Surety to evaluate the claim has prevented the Surety from a good faith investigation of the claim; and, (5) The Surety must deny the claim because it cannot in good faith pay the claim without sufficient documentation and claim back-up from the claimant.

In sum, the key to responding to AIA – A312 Payment Bond claims is to immediately determine how much time the Surety has before it must “answer” the claim and then send a detailed letter to the principal soliciting the principal's response to the claim and documentation to support the principal's position. The Surety must balance the tight timeframe provided under § 6.1 of the AIA – A312 Payment Bond with its duty to its principal to investigate and settle claims in good faith. One of the best ways to balance the deadline with the Surety's duty of good faith is to put the principal on notice of the deadline and of the information the Surety will need to deny the claim in good faith and be able to enunciate the specific bases for denial. In that way, the Surety prepares itself to counter the principal's argument that the Surety is a volunteer if the Surety has to settle the claim. In no event should the Surety allow the 45 day deadline to pass without serving the claimant with a detailed answer setting out the amounts of the claim that are undisputed and the basis for challenging any amounts that are disputed.<sup>81</sup>

#### **IV. CONCLUSION**

Sureties must be very careful when handling AIA – A312 Payment Bond claims, especially if the claim arises out of a project in Maryland, Virginia, or the District of Columbia. Under recent case law, a Surety's failure to “answer” an AIA – A312 Payment Bond claim within 45 days of receiving the claim may be found to be a complete waiver of the Surety's defenses to the claim. That puts the Surety in a precarious position. The Surety must balance its duty to answer the claimant in 45 days with its duty to only settle claims against the bond in good faith after reasonable investigation. The Surety must be very attentive to the 45 day answer deadline and must write the principal immediately on receipt of the claim to determine any defenses the principal may have. By keeping the principal informed of the deadline, the Surety may seek to insulate itself from the assertion that it paid the claim as a volunteer. In handling an AIA – A312 Payment Bond claim, a Surety must act fast to identify, develop, and preserve any defenses its principal may have or risk waiving those defenses and having its principal argue that the Surety paid the claim as a volunteer because the principal had valid defenses to the claim.

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<sup>81</sup> As discussed above, a standard reservation of rights letter is not a sufficient denial of the claim to protect the Surety from waiving its defenses by failing to “answer” the AIA – A312 Payment Bond claim within 45 days.



1. The Contractor and the Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors, and assigns to the Owner to pay for labor, materials and equipment furnished for use in the performance of the Construction Contract, which is incorporated herein by reference.

2. With respect to the Owner, this obligation shall be null and void if the Contractor:

**2.1** Promptly makes payment, directly, or indirectly, for all sums due Claimants, and

**2.2** Defends, indemnifies and holds harmless the Owner from claims, demands, liens or suits by any person or entity whose claim, demand, lien or suit is for the payment for labor, materials, or equipment furnished for use in the performance of the Construction Contract, provided the Owner has promptly notified the Contractor and the Surety (at the address described in Paragraph 12) of any claims, demands, liens, or suits and tendered defense of such claims, demands, liens or suits to the Contractor and the Surety, and provided there is no Owner Default.

3. With respect to Claimants, this obligation shall be null and void if the Contractor promptly makes payment, directly or indirectly, for all sums due.

4. The Surety shall have no obligation to Claimants under this Bond until:

**4.1** Claimants who are employed by or have a direct contract with the Contractor have given notice to the Surety (at the address described in Paragraph 12) and sent a copy, or notice thereof, to the Owner, stating that a claim is being made under this Bond and, with substantial accuracy, the amount of the claim.

**4.2** Claimants who do not have a direct contract with the Contractor:

**.1** Have furnished written notice to the Contractor and sent a copy, or notice thereof, to the Owner, within 90 days after having last performed labor or last furnished materials or equipment included in the claim stating, with substantial accuracy, the amount of the claim and the name of the party to whom the materials were furnished or supplied or for whom the labor was done or performed; and

**.2** Have either received a rejection in whole or in part from the Contractor, or not received within 30 days of furnishing the above notice any communication from the Contractor by which the Contractor has indicated the claim will be paid directly or indirectly; and

**.3** Not having been paid within the above 30 days, have sent a written notice to the Surety (at the address described in Paragraph 12) and sent a copy, or notice thereof, to the Owner, stating that a claim is being made under this Bond and enclosing a copy of the previous written notice furnished to the Contractor.

5. If a notice required by Paragraph 4 is given by the Owner to the Contractor or to the Surety, that is sufficient compliance.

6. When the Claimant has satisfied the conditions of Paragraph 4, the Surety shall promptly and at the Surety's expense take the following actions:

**6.1** Send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.

**6.2** Pay or arrange for payment of any undisputed amounts.

7. The Surety's total obligation shall not exceed the amount of this Bond, and the amount of this Bond shall be credited for any payments made in good faith by the Surety.

8. Amounts owed by the Owner to the Contractor under the Construction Contract shall be used for the performance of the Construction Contract and to satisfy claims, if any, under any Construction Performance Bond. By the Contractor furnishing and the Owner accepting this Bond, they agree that all funds earned by the Contractor in the performance of the Construction Contract are dedicated to satisfy obligations of the Contractor and the Surety under this Bond, subject to the Owner's priority to use the funds for the completion of the work.

9. The Surety shall not be liable to the Owner, Claimants or others for obligations of the Contractor that are unrelated to the Construction Contract. The Owner shall not be liable for payment of any costs or expenses of any Claimant under this Bond, and shall have under this Bond no obligations to make payments to, give notices on behalf of, or otherwise have obligations to Claimants under this Bond.

10. The Surety hereby waives notice of any change, including changes of time, to the Construction Contract or to related subcontracts, purchase orders and other obligations.

11. No suit or action shall be commenced by a Claimant under this Bond other than in a court of competent jurisdiction in the location in which the work or part of the work is located or after the expiration of one year from the date (1) on which the Claimant gave the notice required by Subparagraph 4.1 or Clause 4.2.3, or (2) on which the last labor or service was performed by anyone or the last materials or equipment were furnished by anyone under the Construction Contract, whichever of (1) or (2) first occurs. If the provisions of this Paragraph are void or prohibited by law, the minimum period of limitation available to sureties as a defense in the jurisdiction of the suit shall be applicable.

12. Notice to the Surety, the Owner or the Contractor shall be mailed or delivered to the address shown on the signature page. Actual receipt of notice by Surety, the Owner or the Contractor, however accomplished, shall be sufficient compliance as of the date received at the address shown on the signature page.

13. When this Bond has been furnished to comply with a statutory or other legal requirement in the location where the construction was to be performed, any provision in this Bond conflicting with said statutory or legal requirement shall be deemed deleted herefrom and provisions conforming to such statutory or other legal requirement shall be deemed incorporated herein. The intent is that this

Bond shall be construed as a statutory bond and not as a common law bond.

14. Upon request by any person or entity appearing to be a potential beneficiary of this Bond, the Contractor shall promptly furnish a copy of this Bond or shall permit a copy to be made.

**15. DEFINITIONS**

15.1 Claimant: An individual or entity having a direct contract with the Contractor or with a subcontractor of the Contractor to furnish labor, materials or equipment for use in the performance of the Contract. The intent of this Bond shall be to include without limitation in the terms "labor, materials or equipment" that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental equipment used in the

Construction Contract, architectural and engineering services required for performance of the work of the Contractor and the Contractor's subcontractors, and all other items for which a mechanic's lien may be asserted in the jurisdiction where the labor, materials or equipment were furnished.

15.2 Construction Contract: The agreement between the Owner and the Contractor identified on the signature page, including all Contract Documents and changes thereto.

15.3 Owner Default: Failure of the Owner, which has neither been remedied nor waived, to pay the Contractor as required by the Construction Contract or to perform and complete or comply with the other terms thereof.

MODIFICATIONS TO THIS BOND ARE AS FOLLOWS:

(Space is provided below for additional signatures of added parties, other than those appearing on the cover page.)

CONTRACTOR AS PRINCIPAL  
Company: \_\_\_\_\_ (Corporate Seal)

SURETY Company: \_\_\_\_\_ (Corporate Seal)

Signature: \_\_\_\_\_  
Name and Title:  
Address:

Signature: \_\_\_\_\_  
Name and Title:  
Address: