

**EIGHTH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE
APRIL 3-4, 1997**

**“WHAT'S NEXT - FIDELITY COVERAGE UNDER
PAYMENT AND PERFORMANCE BONDS? SURETY'S
DEFENSES AGAINST COMMON LAW BONDS
- WITH SPECIAL EMPHASIS ON FLORIDA LAW”**

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**WHAT'S NEXT - FIDELITY COVERAGE UNDER PAYMENT
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I. INTRODUCTION

I openly admit that this paper is a knee jerk reaction to a payment and performance bond which I recently encountered while handling various claims on several Florida Department of Transportation projects. Needless to say, I was appalled that the bond was underwritten, but fortunately for the surety, it did not have any major implications to adjusting the pending claims. That is not to say, however, that this bond will not jump up and bite a surety where it counts, you know -- where the wallet goes!

The offensive language contained in the bond was as follows:

NOW, THEREFORE, the condition of this obligation is such that if the above-bounden Principal in all respects shall comply with Section 255.05 and 337.18, Florida Statutes, and shall promptly, faithfully and efficiently perform said Contract according to plans and specifications therein to and made a part thereof, and within the time period specified, . . .

* * *

and shall be liable to the State in a civil action instituted by the Department or any officer of the State authorized in such cases for double any amount in money or property the State may lose or be overcharged or otherwise defrauded of, by reason of any wrongful or criminal act, if any, of the Contractor, its agents, or employees

That's right -- we have a PUNITIVE FIDELITY BOND in a payment and performance bond. What actions of the surety would justify or warrant the imposition of punitive damages under this bond? Why should the obligee be entitled to "double" recovery against the performance bond? In addition to this bond, we have collected a potpourri of other beautiful gems for your amusement which are attached as Exhibit "A."

What underwriting considerations go into issuing a bond like this one? The short answer is - none. The reality of the surety industry is that most sureties do not review the conditions of bonds before issuing them and accepting premiums. Although one could argue that the surety industry could impose its way on the conditions of the bonds it is underwriting, the opposite (especially in the public domain) is quite true. Some municipalities have mastered the art of drafting surety bonds to suit their needs, forcing the principals to procure the bond forms attached to their bid documents. Principals and sureties alike sign off on these overreaching bonds without challenging the bond forms.

The mantra of my paper is, therefore, "JUST SAY NO" to common law bonds. Some state statutes, including Florida, provide the specific statutory language for public construction bonds. Don't deviate! If the surety feels compelled to change the explicit statutory language, it can

always turn to the standard forms of the AIA 311 and 312 bonds. It is a recipe for disaster to rely upon the home concocted self-serving bonds of municipalities which sometimes go far beyond the requirements of state statutes patterned after the Miller Act.

I recognize that this is not a new subject. In fact, there have been some recent papers addressing similar topics.¹ Apparently, the surety industry has not gotten the message of these papers as issuing common law bonds is still "commonplace" in the industry, no pun intended. So we'll hear it one more time, just like a bad commercial -- JUST SAY NO TO COMMON LAW BONDS!

II. Different Approaches to Common Law Bonds

There are generally two lines of cases dealing with common law bonds. The first is the "Read-In and Read-Out" approach recognized in Georgia. The second is what I like to call the "You Issued It, You Bought It" approach recognized in Florida.

A. The "Read-In and Read-Out" Approach

Jack Burch of Bovis, Kyle & Burch of Atlanta, Georgia, presented a paper in last year's Southern Surety & Fidelity Claims Conference pertaining to the "Read-In and Read-Out" approach to common law bonds so I will not go into great depth in this paper on that issue. Suffice it to say that under this approach, "whatever is included in the bond but which is not required must be read out, and whatever is not expressed but ought to have been incorporated must be read in, so as to conform to the requirements of the statute."² Georgia, Delaware and Iowa follow this approach.³

Although this approach may at times cut against the surety,⁴ it provides sureties with a safe harbor against the overreaching common law bond. Under this approach, no matter how you slice it up, you will end up with a statutory bond.

B. The "You Issued It, You Bought It" Approach

This approach will cause some surety claims managers to have sleepless nights. In jurisdictions which adhere to this doctrine, the sky is the limit as the bond is not restricted

¹ Burch, The Surety's Responsibility Where There is a Variation Between the Bond & Statutory Requirements (or Who Wrote This Damn Thing?) - With Special Emphasis on Georgia Law, presented at the Seventh Annual Southern Surety & Fidelity Claims Conference in Atlanta, GA, April 11, 1996; Gamel, When Bonds are Required to be Broader Than the Statute: The New Trend in the Exercise of Local Authority to Broaden the Surety's Risk, presented at the National Bond Claims Association Seminar in Pinehurst, NC, October 2-4, 1996.

² Burch, The Surety's Responsibility Where There is a Variation Between the Bond & Statutory Requirements (or Who Wrote This Damn Thing?) - With Special Emphasis on Georgia Law, at p. 3, presented at the Seventh Annual Southern Surety & Fidelity Claims Conference in Atlanta, GA, April 11, 1996; Denny & Assoc. v. So. Aggregates Co., 363 S.E. 2d 50 (1987); Campbell v. Benton, 122 S.E. 2d 223 (1961); Talmdge v. General Cas. Co. of America, 76 S.E. 2d 562 (1953); generally, 17 Am. Jur. Contractors' Bonds, §73.

³ For Georgia cases, see footnote 2, supra.; Delaware: Savery & Cooks, Inc. v. Fidelity & Deposit Co. of Md., 194 A.2d 858 (Del. Supr. 1963); Iowa: Ottumwa Boiler Works v. M.J. O'Meara & Son, 218 N.W. 920 (Iowa 1928).

⁴ See, Home Ind. Co. v. Battey Machinery Co., 136 S.E. 2d 193 (1964)(surety lost benefit of more restrictive language in the payment bond pertaining to notices of non-privy claimants).

to the statutory provisions for payment and performance bonds. In describing this approach, a scholar wrote: "[w]hile the surety is required by statute to afford protection under certain statutory rules, if the surety elects by the terms of its bond to extend protection of the less stringent rules, it may do so and is bound by the terms of the bond"⁵ In other words, although there is a floor of minimum statutory requirements for payment and performance bonds which the surety cannot go below, there is no ceiling under this approach should the surety, at the behest of an obligee, provide more expansive coverage.

1. **Florida.** The common law "dinosaur" bond still lives in Florida. The recent Florida case of Martin Paving Company v. United Pacific Ins. Co., 646 So. 2d 268 (Fla. 5th DCA 1994), acknowledged that common law bonds continue to exist despite recent attempts by the Florida legislature to curtail their use. Martin Paving involved the denial of a payment bond claim on the basis of improper notice, although the bond had not been recorded in the public records. In that case, the surety argued that the common law bond became extinct with the 1980 amendments to Florida's little Miller Act.

An explanation of the statutory scheme is required to understand the significance of this case in Florida. Prior to 1980, the Florida Statute was modeled after the Miller Act. In 1980, Florida's legislature added subsections (4) and (6), providing as follows:

(4) The payment provisions of all bonds furnished for public work contracts described in section (1) shall, **regardless of form**, be construed and deemed statutory bond provisions, subject to all requirements of subsection (2);

* * *

(6) All bonds executed pursuant to this section shall make reference to this section number and shall contain reference to the notice and time limitation provisions of this section.

The Martin Paving court rejected the surety's construction of the little Miller Act statute abolishing common law bonds in Florida. Instead, the court relied on the 1980 amendments, coupled with a 1988 amendment (requiring bonds to be recorded in the county where the project is located and to contain certain minimum information), to question whether the common law argument was even necessary under the circumstances. In limiting the restrictive language in subsection (4) to apply only to the "payment provisions" of the bond, the Martin Paving court declared:

Nothing in this language [subsection 4] can support the conclusion that common law bonds have ceased to exist in Florida, however. The term "common law bond" still means, as it always has meant, a bond whose protections exceed the minimum obligations imposed by statute. (Citations omitted).

The Fifth District Court of Appeals in Florida construed the Martin Paving bond to be a common law bond, rather than a statutory bond, because the contractor and the surety failed to record a

⁵ 17 Am. Jur. Contractors' Bonds, §73.

copy of the bond and the bond did not contain the statutory notice requirements and time limitation provision as required by statute.

The court in Martin Paving also disposed of the surety's argument that the obligee, not the surety, required and drafted the bond. In a comical note, the court recognized that the FDOT must not have had much work for several years as its bond form expressly covered compliance with Fla. Stat. §337.13, a section which had been repealed since 1976. Notwithstanding the foregoing, the court determined that the form FDOT used and the procedures FDOT followed were not controlling on the questions of the rights of the surety and principal under the Florida Statute. See also, Wal-Board Supply Co., Inc. v. Daniels, 629 S.W. 2d 686 (Tenn. App. 1981)(noting the problems confronted by sureties when bonds are drafted by others).

2. Louisiana. Although Louisiana once followed the "read-In and Read-Out" approach,⁶ the Supreme Court of Louisiana in Construction Materials v. American Fidelity, 388 So.2d 365 (La. 1980) adopted the "You Issued It, You Bought It" approach. This court reversed the appellate courts opinion for the surety, declaring that the "Public Works Act does not prohibit a contractor's surety from voluntarily contracting to pay claims to unpaid workmen or suppliers who are unprotected by the contractor's bond of his right of action."⁷

3. Tennessee. Like Florida and Louisiana, Tennessee also follows the "You Issued It, You Bought It" approach. When the terms of the bond are parallel to the statutory minimum requirements, the courts of Tennessee strictly construe the bond in accordance with the statute; however, should the bond exceed the minimum statutory requirements, Tennessee courts will hold the surety's feet to the fire, applying common law bond principles.⁸

4. New York. In recognizing common law bonds, New York courts have rejected sureties' challenges to the authority of municipalities to require sureties to issue bonds exceeding the statutory requirements.⁹ For an excellent discussion of surety's challenges to a public entity's authority to go beyond the enabling statute, see Gamel, When Bonds are Required to be Broader Than the Statute: The New Trend in the Exercise of Local Authority to Broaden the Surety's Risk, presented at the National Bond Claim Association Seminar in Pinehurst, NC, October 2-4, 1996.

⁶ E.L. Burns Co., Inc. v. Cashio, 289 So.2d 226 (La. App. 1974).

⁷ See also, Honeywell, Inc. v. Jimmie B. Quinn, Inc., 440 So.2d 973 (La. App. 1983).

⁸ Wal-Board Supply Co., Inc. v. Daniels, 629 S.W. 2d 686 (Tenn. App. 1981); Heeglar v. MacAdoo Contractors, Inc., 487 S.W. 2d 312 (Tenn. App. 1972).

⁹ See, Scaccia Concrete Corp. v. Hartford Fire Insurance Co., 628 N.Y.S. 2d 746 (N.Y. App. 1995); Dutchess Quarry & Supply Co., Inc. v. Firemen's Ins. Co. of Newark, N.J., 596 N.Y.S. 2d 898 (N.Y. App. 1993); Merchants Mutual Casualty Co. v. United States Fidelity and Guaranty Co., 2 N.Y.S. 2d 370 (N.Y. App. 1938).

5. **Other Jurisdictions.** In addition to the foregoing, other jurisdictions applying the "You Issued It, You Bought It" approach include: (a) Illinois¹⁰; (b) Michigan¹¹; (c) Wisconsin¹²; and (d) Miller Act - New Jersey.¹³

III. What Does It Mean To Be More Expansive

When not strictly complying with the statutory requirements under the "You Issued It, You Bought It" approach, sureties may be held liable for coverage exceeding the minimum statutory requirements. This begs the question -- when does a bond exceed the minimum statutory requirements? The answer to this question will vary from state to state. For the purposes of this paper, I will focus on Florida law and sprinkle in cases from other jurisdictions from time to time.

A. The Type of Claimant Covered

To recover under a payment bond claim, the claimant must fall within the class of persons protected under the bond. On common law bonds, the language of the bond, coupled with documents incorporated by reference, may be interpreted to create a third party beneficiary status to certain persons who typically would not be covered under a statutory bond.

Generally, a statutory payment bond covers "all lienors" supplying labor, material and supplies used directly or indirectly by the principal in the prosecution of the work provided in the contract. When a bond provides coverage for "all persons" who have furnished labor or materials for the project, some courts will construe it to be a common law bond. DiCamillo v. Westinghouse Elec. Corp., 122 So. 2d 499 (Fla. 2d DCA 1960); Southwest Fla. Water Management Dist. ex. rel. Thermal Acoustic Corp. v. Miller Const. Co. of Leesburg, 355 So. 2d 1258 (Fla. 2d DCA 1978).

B. The Type of Damages Covered Under a Payment Bond

A common law bond may arise out of coverage for items not contemplated in the statutory bond. Most payment bond statutes typically provide coverage for "labor, materials, and supplies." It is when you provide coverage beyond these items when you get in trouble.

1. **Delay Damages.** In Travelers Indem. Co. v. Housing Auth. of City of Miami, 256 So. 2d 230 (Fla. 3d DCA 1972), the court found that the bond exceeded the minimum statutory requirements by covering delay damages. The court concluded that "the terms of the bond here are sufficiently broad, when construed strictly against the drafter of the contract, to extend coverage under the bond to damages for delay claimed by the subcontractor." But see, D.I.C. Com'l. Const. v. Knight Erec. & Fab., 547 So. 2d 977 (Fla.. 4th DCA 1989)(payment bond covering labor,

¹⁰ Aluma Systems, Inc. v. Frederick Quinn Corp., 564 N.E. 2d 1280 (1990).

¹¹ Trustees for Michigan Laborers' Health Care Fund v. Warranty Builders, Inc., 921 F. Supp. 471 (E.D. Mich. 1996) (where bonding contract for public construction project sets terms less stringent than statutory provisions upon the laborer, surety must be bound by its language, especially where that language is relied upon to laborer's detriment); see also, Hub Elec. Co., Inc. v. Gust Const. Co., Inc., 585 F.2d 183 (6th Cir. 1978).

¹² Nagle Hart, Inc. v. United Pacific Ins. Co., 417 N.W. 2d 36 (Wis. App. 1987).

¹³ Gypsum Contractors, Inc. v. Am. Surety Co., 181 A.2d 174 (1962).

implements, machinery, equipment, tools, apparatus, materials, means of transportation, and performance of all work shown on drawings and described in specifications, did not cover damages stemming from delays caused by another subcontractor).

2. Materials. A payment bond which enumerates the particular material items covered under the bond may be considered more expansive than the statutory bond. This argument was rejected in Standard Heating Service v. Guymann Const., 459 So.2d 1103, 1105 (Fla. 2d DCA 1984). That Florida court determined that the specific covered items listed in the bond (i.e. water, gas, power, light, heat, oil, gasoline, telephone service, or rental equipment) were still "materials" under the meaning of the statute and, thus, was not more expansive than the statutory bond.

3. Services. A payment bond may exceed the statutory minimum requirements by covering services as opposed to just "labor, materials and supplies." The court in Phoenix Indemnity Co. v. Board of Public Instruction of Alachua County, 114 So. 2d 478 (Fla. 1st DCA 1959) followed this principle in permitting recovery for insurance premiums based upon the expanded coverage of the payment bond.

4. "All Just Claims". This type of language opens the door for just about any type of claim (i.e. delay damages, increased cost of labor, lost profits, etc.). In United States ex. rel. Pertun Const. Co. v. Harvesters Group, Inc., 918 F.2d 915 (11th Cir. 1990), a federal Miller Act payment bond was interpreted to require the surety to pay for increased costs of labor due to a contractor's delay. See also, Travelers Indemnity Co. v. Housing Authority of City of Miami, 256 So. 2d 230 (Fla. 3d DCA 1972)(surety obligated to pay claimant for delay damages and negligent or intentional interference with performance of contract).

C. The Type of Notice and Suit Limitation Provisions.

Payment bonds with notice or suit limitation provisions differing from statutory requirements may also be construed as common law bonds. But see, National Fire Ins. v. L.J. Clark Const., 579 So.2d 743 (Fla. 4th DCA 1991)(holding bond to be a statutory bond even though the bond: (1) only required the claimant to provide a notice of non-payment and not the statutory requisite notice to contractor; and (2) allowed a claimant to file an action against the bond from the **principal's** last performance as opposed to the **claimant's** last performance as required under the little Miller Act).¹⁴

Another illustrative case is W.F. Thompson Const. Co. v. Southeastern Palm Beach Hosp. Dist., 174 So.2d 410 (Fla. 3d DCA 1965). In that case, although the notice requirements were not incorporated in the Florida Statutes at the time the opinion was rendered, the opinion suggests that where a bond requires additional notices be given than required by the statute, the notice requirements will not be construed to expand the coverage of the bond.

D. The Type of Damages Covered Under a Performance Bond.

¹⁴ Reader beware, some judges still don't get it! See, Allan Electric Company, Inc. v. Power Facilities, Inc., 450 So.2d 1145 (Fla. 5th DCA 1984)(where dissenting judge suggested that payment bond claimant could rely on expansive performance bond coverage to create a common law bond with a five year statute of limitations).

Under Florida's little Miller Act, the surety is obligated under the performance bond to ensure that "the contractor perform the contract in time and manner prescribed in the contract." The court in Florida Keys Community College v. Ins. Co. of North America, 456 So. 2d 1250 (Fla. 1980), found a performance bond wherein the surety covered the contractor's negligence and misconduct of its employees to be a common law bond.

IV. Impact on Notice and Suit Limitations

Generally, a claimant will argue that a bond is a common law bond to skirt the notices and suit limitations required under a statutory bond. Even under a common law bond, however, a claimant may be required to comply with notice and suit limitations set forth in the bond and, possibly, the statute.

For instance, Florida law only requires that any notice provision be "reasonable" in a common law bond. See, W.F. Thompson Const. Co. v. Southeastern Palm Beach Hosp. Dist., 174 So. 2d 410, 414 (Fla. 3d DCA 1965); Balboa Ins. Co. v. Alpha Elec. Supply, Inc., 373 So. 2d 391 (Fla. 1st DCA 1979). Failure to give notice may constitute a defense under a common law bond. Travelers Indemnity Co. v. National Gypsum Co., 394 So. 2d 481 (Fla. 3d DCA 1981). In the event the common law bond is silent as to its notice requirements, none will be implied. Martin Paving Co. v. United Pac. Ins. Co., 646 So. 2d 268 (Fla. 5th DCA 1994).

The limitation periods of common law bonds are typically the same as those for other written contracts which varies from state to state. In Florida, a common law bond cannot contain a provision which is less than the five (5) year statute of limitations applicable for written contracts. United Bonding Ins. Co. v. City of Holly Hill, 249 So. 2d 720 (Fla. 1st DCA 1971).

With the enactments of the 1980 and 1988 amendments to the little Miller Act in Florida, a common law bond will still be subject to the notice and statute of limitations applicable to a statutory bond **provided** that the contractor and surety have complied with subsection (1) of said statute. Martin Paving Co. v. United Pac. Ins. Co., 646 So. 2d 268 (Fla. 5th DCA 1994).

V. Conclusion

If you are fortunate to be in a jurisdiction which follows the "Read-In and Read-Out" approach, you will not be faced with the complexity of issues raised by common law bonds. Be happy that you can avoid this fight!

If you are unfortunate to be in a jurisdiction which applies the "You Issued It, You Bought It" approach, listen carefully. Educate your surety underwriters to spot common law bonds before you have issued the bonds or accepted the premiums. It is at the underwriting stage that the surety has leverage and may be empowered to reduce the risk that it is being ask to underwrite. Once the bond has been issued, it is generally too late. If necessary, you should encourage surety underwriters to sit down and negotiate the terms of the bonds; at least, you may be able to avoid a one sided contract slanted to benefit municipalities. These sit downs are being used more often in the surety industry, if for nothing else, to educate the public bodies that are proposing the overreaching bonds.¹⁵

¹⁵ For a good example of the negotiation procedures, see King and Siegel, The Underwriting of "Non-Standard" Payment and Performance Bonds: A Debate Between Surety and Public Owner, presented at the Annual ABA Meeting in Orlando, FL, August 2-6, 1996.

Get accustomed, and train your people, to "JUST SAY NO" to common law bonds. Like any bad habit, it will take some time and effort.