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**SURETY v. SURETY: THE PROS AND CONS OF THE RIGHT
OF THE SURETY FOR THE GENERAL CONTRACTOR TO
MAINTAIN CLAIMS AGAINST THE SURETY FOR A
SUBCONTRACTOR**

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Introduction

Contract sureties do not get much attention unless and until something goes wrong on a project. Upon learning that its principal is financially unable to complete the project or pay its subcontractors and suppliers, or, even worse, upon receiving the obligee's demand to perform when it has defaulted the principal, the surety knows it is about to get the kind of attention most people do not seek – an outstretched hand making the “Pay up” sign. There is no time like the present to focus on minimizing any loss suffered under the bonds issued on behalf of the principal and maximizing recovery from as many solvent sources as can be found for the losses that cannot be avoided.

THE FACTUAL SETTING

The underlying factual setting for this paper arises out of the typical default scenario: the bonded general contractor is either standing on the brink of default and termination or perhaps has already been terminated. The surety for the general contractor fulfills its performance bond obligation by either financing the contractor, entering into a takeover with the owner and a completion agreement with a new general contractor or finding a new bonded general contractor and tendering the new general contractor to the owner. In most situations, the general contractor's surety will want to keep existing major subs on the project and keep the sureties for those subs on the hook. It is obviously of critical importance to keep the bonds for the subs in place. The general's surety typically will seek to ratify subcontractors, get them back to work on the project and rely on the fact that the subs are bonded. This then sets the stage for a surety vs. surety battle if the sub defaults.

When the surety for the sub has a claim from the general's surety, it will want to marshal its defenses and point out to the general contractor's surety all of the reasons why it has been released, discharged and has no liability. While all of us love to have the surety win, this factual setting of surety vs. surety sets up a situation where one surety will most definitely lose.

Scenarios involving troubled projects, defaulting general contractors and defaulting subs confronting the need to complete the bonded project have the potential to put all of us in situations where on some occasions as representatives of the surety for the general, we want to hold the sub and the sub's surety accountable for the subcontract on the one hand and at other times we may represent the sub's surety and deny claims of the general's surety. Of course, the ironic part about this is that at some time in our careers, each of us will want the general contractor's surety to prevail, and at other times, we will be raising the sub's surety's defenses. Indeed, we may find ourselves asserting both claims of the general contractor's surety and defenses of the sub's surety on different projects at almost the same time, where we have slightly different facts and different interests at stake. Who owes what rights to whom depends on some pretty basic matters: the provisions of the general contract and the contract documents, the terms of the subcontract, the terms of the subcontract bond and the unique facts of each case.

Most performance bonds today have language limiting who has a cause of action on the bond. Since the beginning point of analyzing responsibilities under the bond is to read the

bond, we should keep the following common clause in mind in considering the issues presented in this paper. The most common cause of action clause reads as follows:

No right of action shall accrue on this bond to or for the use of any person or corporation other than the Owner [or sometimes Obligee] named herein or the heirs, executors, administrators or successors of Owner.

THE GENERAL CONTRACTOR'S SURETY'S PERSPECTIVE:

The GC's Completing Surety has a Subrogation Claim Against the Subcontractor's Surety

From the general contractor's perspective, the first step in pursuing and perfecting a claim against a subcontractor's surety is to review the bond itself with particular emphasis upon the specific language employed in the right-of-action clause. Generally, the liability of a surety is determined by the language of the bond. *Getters v. Eagle Ins. Co.*, 834 S.W.2d 49, 50 (Tex. 1992). The right-of-action clause may limit the liability of the surety to those named in the bond by expressly excluding others from any right of action under the bond. Lybeck, *Scope of the Performance Bond Surety's Obligation*, The Law of Suretyship 10-5 (E. Gallagher, ed. 1993); *Rush Presbyterian St. Luke's Medical Center v. SAFECO Ins. Co. of America*, 1986 W.L. 2007 (N.D. Ill. 1986). Indeed, it is increasingly common for sureties to limit rights-of-action under their bonds to the Obligee named therein or its legal successors. To prevail on an action under a subcontractor's bond with such a limit, the general contractor's surety, obviously not the named Obligee, would have to qualify as a "legal successor" of the named Obligee, its principal.

Subrogation accomplishes that task, qualifying the general contractor's surety as a "successor" of its principal. The United States Supreme Court noted that "...there are few doctrines better established than that a surety that pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed." *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962). This rule holds true whether the surety performs by completing the project or by paying its principal's subcontractors and suppliers. *Prairie State Bank v. United States*, 164 U.S. 227, 17 S.Ct. 142, 41 L.Ed. 412 (1896); *Henningsen v. United States Fid. & Guar. Co.*, 208 U.S. 404, 28 S.Ct. 389, 52 L.Ed. 547 (1908).

Under the Doctrine of Equitable Subrogation, the GC's Completing Surety is the Successor of its Principal.

In the surety context, it is almost impossible to distinguish the terms "subrogee" and "successor". *Subrogee* is defined as "...one who succeeds to the rights of another by subrogation." BLACK'S LAW DICTIONARY 1596 (Revised 4th ed. 1968). Further down in that very same volume, *subrogation* is defined as "the substitution of one person in the place of another with reference to a legal claim, demand or right, [Cit.]; so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies or securities." *Id.*

The Georgia courts continue to recognize a robust doctrine of legal or equitable subrogation and in a variety of contexts, have acknowledged that the subrogee succeeds to the rights of the subrogor, even quoting BLACK'S definition in this regard:

Subrogation is “[t]he substitution of one person in the place of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities.” “It is of equitable origin, being founded upon the dictates of refined justice, and its basis is the doing of complete, essential, and perfect justice between the parties, and its object is the prevention of injustice.” The right of subrogation can arise from equity, contract or statute. Legal subrogation takes place as a matter of equity, without any agreement to that effect.

Jones Motor Co. v. Anderson, 268 Ga. App. 458, 459, 602 S.E.2d 228, 230 (2004) (internal footnotes omitted). See also *First Nat. Bank of Atl. v. American Sur. Co.*, 71 Ga. App. 112, 30 S.E.2d 402 (1944) (“[S]ubrogation is the substitution of another person in the place of the creditor whose obligation is paid, so that the person in whose favor it is exercised succeeds to all the rights of the creditor.”).¹

Florida courts also hold that an equitable subrogee is a successor: “As a result of equitable subrogation, the party discharging the debt stands in the shoes of the person whose claims have been discharged and thus succeeds to the rights and priorities of the original creditor.” *Florida Farm Bureau General Ins. Co. v. Insurance Co. of North America*, 763 So.2d 429, 436 (Fla. App. DCA5, 2000), quoting *Dade County School Bd. v. Radio Station WQBA*, 731 So.2d 638, 646 (Fla., 1999).

There are Many Ways in Which the GC’s Completing Surety May Qualify as a “Subrogee.”

While the performance bond surety’s sole obligation is to guarantee completion of the construction project, there is no one right way in which to do so. *American Home Assurance Co. v. Larkin General Hospital, Ltd.*, 593 So.2d 195 (S. Ct. Fla. 1992). There are many ways in which the general contractor’s surety may satisfy its obligations under its bond and thus qualify as its principal’s “subrogee.” For example, the surety can tender a sum of money to the owner in return for the bond, rebid the project and complete it with a replacement contractor, tender a completion contractor to the owner for the owner to complete the project, finance its principal to completion and even elect to do nothing and allow the obligee to complete. *The Law of Suretyship*, § 10-1.

There is no substantial difference between a surety’s completion of a bonded project in its own name and a surety providing financial assistance to the original bonded contractor

¹ Georgia also recognizes equitable subrogation statutorily: “A surety who has paid the debt of his principal shall be subrogated, both at law and in equity, to all the rights of the creditor and, in a controversy with other creditors, shall rank in dignity the same as the creditor whose claim he paid.” O. C. G. A. § 10-7-56 (Subrogation to rights of creditor).

to enable completion. This very issue was addressed in the case of *Great American Insurance Company v. United States*, 481 F.2d 1298 (Ct. Cl. 1973). In that case, Great American's principal was financially unable to complete its project and at the principal's request, Great American financed the contractor to completion. *Id.* at p. 1300, n. 8 The Court noted that when the contractor notified the surety that it was unable to complete the contract work, the obligation of the surety vested under the performance and payment bonds. Once the surety financed the contractor to completion, the surety was then subrogated to the rights of the contractor. *Id.* at p. 1308. Great American was subrogated and succeeded to the rights of its principal.

Further support on this issue is found in the case of *Aetna Cas. and Sur. Co. v. United States*, 845 F.2d 971 (Fed. Cir. 1988). Aetna provided bonds for a contractor on three separate projects. During the course of the construction of those projects, the contractor informed Aetna that "it was unable to meet its obligations under the contracts." *Id.* Aetna agreed to fund the contractor's operations.

The contractor then advised Aetna that its future earnings under the three contracts would be sufficient to allow the contractor to complete. Upon receipt of that notice, Aetna ceased all funding to the contractor yet continued to pay the contractor's subcontractors and suppliers. The contractor, in fact, was unable to meet its construction schedules. The owner suggested that Aetna apply some financial pressure upon the contractor or provide management assistance to bring about the completion of the projects but Aetna declined to do so.

Ultimately, the contractor failed to complete the project and the owner took beneficial occupancy of the project, executing deductive change orders for all of the work that had not been completed by the contractor. Aetna asserted its subrogation rights to the remaining contract balances. Aetna lost its case in the Claims Court because the Claims Court erroneously held that a surety "qualifie[s] as a performing surety...if- and only if- it assumed the primary responsibility for the completion of the work under the several contracts." *Id.* On appeal, however, the United States Court of Appeals for the Federal Circuit overturned the Claims Court ruling as follows:

A performance bond gives the surety the option of completing performance or of assuming liability for the Government's costs in completing the contract which are in excess of the contract price. [Cit.] ...Neither formal termination of the contract by the Government nor execution of a formal take-over agreement by the surety is necessary in order for a surety to qualify as a performing surety. [Cit.] Thus, a surety may satisfy its obligation in various ways.... A performing surety may ... satisfy its obligation by providing funds to an insolvent contractor to complete performance. *Great American Ins. Co. v. U.S.*, 481 F.2d 1298, 1300 n.8 (Ct. Cl. 1973); *Morgenthau v. Fidelity & Deposit Co.*, 94 F.2d 632 (D.C. Cir. 1937)("No difference between completion of the work by the surety...and the furnishing of money to the contractor after his default...to enable him to perform the contract.") [Cit.]...Since Aetna was acting as a performing surety prior to the time when direct payments to labor and materialmen were made, these periodic

payments are part of the cost of completing the contract and fall within Aetna's performance bond obligations. [Cit.]”

845 F.2d at p. 975-976.

The general rule holds that no formal declaration of default is required; default in the relevant sense occurs when the principal finds itself unable to pay and calls upon the surety to pay in accordance with the terms of the bond. The right of subrogation actualizes once the surety either pays the first subcontractor or supplier or performs to complete the project. *Cotton States Mut. Ins. Co. v. Citizens and Southern Nat. Bank*, 168 Ga. App. 83, 308 S.E.2d 199 (1983).

Georgia's courts have routinely held that a surety which completes a contract on behalf of its principal is subrogated not only to the rights of its principal but also to the rights of the owner for whom the contract was completed and the rights of the creditors whose claims for labor and materials the surety paid. *Argonaut Ins. Co. v. C&S Bank of Tifton*, 140 Ga. App. 807, 232 S.E.2d 135 (1976). The significance and importance of a surety's right of subrogation was underscored by the *Argonaut* court when it noted that “[T]he surety, in a sense, is ‘secured’ by its right of subrogation, which relates back to the issuance of the bond to defeat intervening creditors.” *Id.*

To sum up, sureties who complete projects on behalf of their principals are subrogated to the rights of their principals. The completing surety is also subrogated to the rights of its bond obligee and the rights of the creditors it paid for labor and material. This right is so valuable that the courts have ruled that it relates back to the date of the issuance of the bond and that as a result of this relation back, completing sureties may defeat the rights of intervening creditors. As a “subrogee,” the completing surety qualifies as a “successor” of its principal.

As a Successor, the GC's Completing Surety has a Right of Action Under the Subcontractors' Bonds.

In recognition of the unique service that sureties provide in ensuring the completion of construction projects and the payment of laborers and materialmen for labor performed and material supplied on those projects, appellate courts around the country have ruled in favor of a general contractor's surety's cause of action against a subcontractors' surety for losses suffered on construction projects.

In Florida, the prevailing precedent on this issue is the case of *Argonaut Ins. Co. v. Commercial Standard Ins. Co.*, 380 So.2d 1066 (2d Fla. DCA 1980). In that case, the general contractor's surety sought to recover against the subcontractor's surety. The right-of-action clause in the bond read as follows:

No right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein or the heirs, executors, administrators or successors of the Obligee.

380 So.2d at p. 1067.

The subcontractor's surety in the *Argonaut* case contended that the general contractor's surety had no standing to bring suit on the bond. The court ruled that the general contractor's surety occupied the status of "successor" to the Obligee on the subcontractor's surety's bond and as such, had a cause of action on the bond. The court noted that the terms of the general contractor's performance bond required the surety to complete the construction when and if its principal defaulted.

When the general contractor defaulted and its surety arranged for the completion of the construction, the surety became subrogated to the rights of its principal. The general contractor's surety, as the completing surety, stepped into the shoes of its principal and assumed its principal's rights.

In likening a subrogee to a successor, the *Argonaut* court noted that a "successor" is generally defined as "he that followeth or cometh in another's place" or "who follows or takes the place another has left and sustains the like part or character." *Id.* at p. 1068. Just as a successor takes the place of another, a completing surety takes the place of and succeeds to the rights of its principal.

Of particular note is the *Argonaut* court's assertion that the reason that the subcontractor's bond included a clause limiting those who could maintain a cause of action on the bond was to protect the surety from claims of the subcontractors and materialmen of its principal who might claim protection otherwise as third party beneficiaries under the performance bond. The introductory clause in the *Argonaut* bond clearly stated that the protection afforded under the bonds extended to the interest of the Obligee. The protection afforded by the bond extended to the general contractor's surety as a subrogee of the Obligee.

The *Argonaut* decision was followed in the 4th District of Florida in 1981 by the case of *Financial Ind. Co. v. Steele & Sons, Inc.*, 403 So.2d 600 (4th Fla. DCA 1981). In that case, as in *Argonaut*, the general contractor's surety filed suit to recover against its subcontractor's surety. The Fourth District Court of Appeals in Florida relied on the *Argonaut* decision, *supra*, in holding that the general contractor's surety did in fact have a cause of action on the subcontractor's bond under the doctrine of subrogation.

Courts in other states have ruled on this very specific issue in favor of the general contractor's completing surety. The Supreme Court of New York, relying on the *Argonaut* decision from Florida, ruled that a completing surety was a "successor" of its principal, the general contractor, and as such, had standing to sue one of the subcontractor's sureties for damages resulting from the subcontractor's wrongful conduct which occasioned and contributed to the general contractor's default. *Menorah Nursing Home, Inc. v. Zukov*, 153 A.D.2d 13, 548 N.Y.S.2d 702 (1989).

The District Courts of Appeal in both the Third and Fourth Districts of California have also rendered similar decisions. In the case of *Storm & Butts v. Lipscomb*, 3 P.2d 567 (4th Cal. DCA 1931), the court ruled that the general contractor's surety, upon satisfying the obligation of its principal, was subrogated to its principal's rights and was in fact a proper party plaintiff

in a suit against the subcontractor and the subcontractor's surety for a breach of that subcontract. The general contractor's surety acquired its rights by way of subrogation and not merely by way of assignment.

In *Continental Cas. Co. v. Hartford Acc. & Ind. Co.*, 52 Cal. Rptr. 533 (3d. Cal. DCA 1966), the court ruled that the subcontractor's surety was liable to the general contractor's surety for unpaid bills for construction materials for which the subcontractor had failed to pay.

The *Continental Cas.* decision, when viewed in light of its complex facts, may provide the strongest support for the proposition that a completing surety is a successor of its principal. The general contractor in that case, Hal Hayes, entered into a contract with the United States for a construction project on an Air Force base. Continental provided the surety bond on behalf of Hal Hayes. Thereafter, Hal Hayes assigned the entire contract to Hayes-Cal. It was Hayes-Cal that subcontracted the plumbing work to Country Boys. Hartford was the surety for Country Boys. Country Boys failed to pay for goods and materials furnished by its suppliers. Continental, the surety for Hal Hayes, paid the suppliers and thereafter filed suit against Country Boys' surety, Hartford, to recover for the amounts paid.

Hartford contended that Continental could not maintain an action on the subcontractor's bond because the obligations owed under the bond were owed only to Hayes-Cal, the named obligee. In response, the court ruled that where the completing surety has made a payment, satisfied an obligation or suffered a loss by reason of a subcontractor's breach of its contract, the completing surety is entitled to recover for that loss from the surety of the subcontractor. Having suffered a loss as a result of the subcontractor's default, the general contractor's surety, regardless of the technical differences in the names of the obligee and the surety's principal, was entitled to recover for its loss from the subcontractor's surety.

It is clear from these decisions that the courts have recognized that the general contractor's surety which performs under its bonds earns its status as "successor" to the rights of its principal, the named obligee on the subcontractor's bond, by stepping into the shoes of its principal and satisfying its contractual obligations, whether by arranging for the completion of the contract or by paying the claims of subcontractors and suppliers for labor and material incorporated into that project.

The GC's Completing Surety's Rights are no Greater Than Those of its Principal.

The general contractor's completing surety which steps into its principal's shoes must be prepared to handle any potential defenses the principal may have given to subcontractors before the surety could jump in and right the ship. This is because the surety cannot take any greater rights than its principal had when it steps into the general contractor's shoes, as a successor via equitable subrogation:

To employ an oft-cited metaphorical expression, subrogation places the subrogee in the shoes of the subrogor. Consequently, the rights to which the subrogee succeeds are the same as, and no greater than, those of the subrogor; therefore, the subrogee's rights are subject to any limitations incident to them in

the hands of the subrogor, and subject to any defenses that might have been urged against the subrogor.

Franco v. Cox, 265 Ga. App. 514, 516, 594 S.E.2d 717, 720 (2004), quoting *Maryland Cas. Ins. Co. v. Welch*, 257 Ga. 259, 262(2), 356 S.E.2d 877 (1987) (citations omitted).

This limitation on the rights acquired through equitable subrogation is recognized under Florida law, as well:

[U]nder equitable subrogation, "the person discharging the debt stand[s] in the shoes of the person whose claim has been discharged, thereby succeeding to the rights and priorities of the original creditor." *Eastern Nat'l Bank v. Glendale Fed. Sav. & Loan Ass'n*, 508 So.2d 1323, 1324 (Fla. 3d DCA 1987); see also *Cleary Bros. Constr. Co. v. Upper Keys Marine Constr., Inc.*, 526 So.2d 116, 116-17 (Fla. 3d DCA 1988) ("In subrogation, the subrogee, now in the same posture as the plaintiff/subrogor, acquires all rights as against the defendant/wrongdoer and is thus able to bring an action against that party to recover the monies paid."). From this premise, it logically follows that if the subrogor has no rights or priorities against a specified third party, then the subrogee has nothing to inherit as against that third party.

Dade County School Bd. v. Radio Station WQBA, 731 So.2d 638, 647 (Fla.,1999).

Even in the face of claims asserted by the subcontractor's surety that the general contractor's actions have destroyed any claim that the GC's surety might have had against it and the subcontractor's surety's resistance to perform upon receipt of the GC's surety's demand to do so, the general contractor's surety is not without recourse. The GC's surety has a variety of arguments at its disposal:

- ***Did the general contractor breach at all – "Pay When Paid"?***

While the subcontractor's surety may argue that the general contractor breached the subcontract by failing to timely pay the subcontractor, the subcontractor's right to receive a payment may not have been properly perfected under the subcontract. If the pay application was not prepared according to contract standards or lacked the required documentation, such as partial lien waivers from second tier subcontractors and suppliers, or if another condition precedent to payment had not been met, the general contractor's failure to pay the subcontractor would not constitute a breach.

"Pay when paid" clauses are generally enforceable on their terms in a number of states. Georgia is one such state: "A provision in a contract may make payment by the owner a condition precedent to a subcontractor's right to payment if 'the contract between the general contractor and the subcontractor should contain an express condition clearly showing that to be the intention of the parties.'" *Sasser & Co. v. Griffin*, 133 Ga. App. 83, 87, 210 S.E.2d 34, 39 (1974) (cit. omitted); *Georgia Glass & Metal, Inc. v. Arco Chemical Co.*, 201 Ga. App. 15, 17, 410 S.E.2d 142, 143 (1991). In this regard, however, "Georgia is a minority view state." *Statesville Roofing & Heating Co., Inc. v. Duncan*, 702 F. Supp. 118, 121 (W.D.N.C., 1988).

In those states where “pay when paid” clauses are enforced, the completing surety may find that the nonpayment claimed to be a breach of the subcontract is not, in fact, a breach because the general contractor has not yet been paid by the owner for such work, and thus the general contractor’s obligation to pay the subcontractor has not matured. See, e.g., *St. Paul Fire & Marine Ins. Co. v. Georgia Interstate Elec. Co.*, 370 S.E.2d 829, 831, 187 Ga. App. 579, 580 (1988) (judgment against the surety was reversed; surety entitled to the benefit of pay when paid clause).

Of course, not all states give the surety this defense. Some states which will enforce a pay when paid clause as to the contractor do not give that benefit to the surety. Thus, in *Coastline Fire Prot. Co., Inc. v. Peabody Constr. Co., Inc.*, No. Civ. A. 02-5619, 2004 W.L. 1791425 (Mass. Sup. Ct. July 12, 2004), the court found a pay when paid clause enforceable between the contractor and the subcontractor. The court acknowledged that the general rule was that the surety could not be liable if its principal was not liable, but refused to give the surety the benefit of the pay when paid clause. The payment bond allowed claimants to sue if they had not been paid within 90 days, and the court used this as the basis for denying the surety the benefit of the pay when paid clause.

- ***Was the alleged breach material?***

The actionable phrase in a successful breach defense asserted by a subcontractor’s surety is “material breach.” As is shown in the case of *Sentry Insurance v. Lardner Elevator Co.*, 153 Mich. App. 317, 395 N.W.2d 31 (1985), the mere fact that the general contractor may have defaulted on a project and its surety had to complete under its bond will not bar the action of the general contractor’s surety against the subcontractor for recovery of losses suffered as a result of a general contractor’s breach unless that default constituted a “material breach” of the subcontract.

According to the facts, Division Products contracted with Ingham County to renovate a shelter home. Sentry issued the performance bond on behalf of Division. Division subcontracted the installation of the elevator to Lardner. Division abandoned the project after running into serious financial difficulties and Sentry, in satisfaction of its obligations under the performance bond, hired a replacement contractor to complete the project for Division. Sentry, Lardner and Ingham thereafter executed an agreement under which Lardner was to be paid Twenty Thousand Dollars (\$20,000.00) up front and was to proceed to complete the elevator installation with all due haste. The balance of the funds owing to Lardner was to be placed in escrow.

Lardner accepted the Twenty Thousand Dollars (\$20,000.00) but thereafter only performed sporadically, not working at all on the project for a twenty-one (21) day period unrelated to Division’s default, and failing to do any work during deer hunting season, Thanksgiving, or the week immediately thereafter. In addition, Lardner removed equipment from the construction site. Lardner’s slow progress on the elevator delayed other aspects of the construction. Sentry was ultimately required to hire another contractor to complete the elevator installation and sued Lardner to recover the cost of replacement, damages for delay and attorneys’ fees.

Lardner contended both at trial and on appeal that Division's default on the project constituted a total breach excusing Lardner from performance. The Court noted that "one who commits the first substantial breach of a contract cannot maintain an action against the other contracting party for failure to perform." Citing *Allen-Codell* as controlling authority, the Court stated that, had Division breached the subcontract with Lardner, Lardner could have asserted that breach against Sentry to excuse its performance.

The Court found that Lardner's conduct showed it did not believe Division had defaulted: Lardner continued working on the project after Division's default on the general contract, dealing with Sentry and Ingham County, and Lardner accepted \$20,000.00 from Ingham County to complete the elevator installation expediently. The Court found that Lardner breached the subcontract and further delayed the project by failing to perform, and was not justified in terminating its performance, particularly after its acceptance of payment and its agreement to proceed to complete the installation of the elevator.

The *Lardner* decision illustrates the courts' inclination to view the equities of the situation in determining the viability of a general contractor's surety's claim against a subcontractor's surety. In the *Lardner* case, although Division was financially unable to complete the project and Sentry, its surety, was called upon to and did satisfy its obligations under the performance bond to do so, the court did not find that Division's default constituted a "material breach" of the subcontract such that it excused Lardner from performing. The facts of the particular case are going to drive the defense and the surety with the "superior equity" will most likely prevail.

- ***Was the subcontract terminated?***

The most common defense raised by the subcontractor's surety is that the termination of the general contract engendered a downstream termination of the subcontract and as such, neither the subcontractor nor its surety owes any duty to complete. Absent a clause similar to the one in the case of *Carolina Casualty Insurance Co. v. Ragan Mechanical Contractors, Inc.*, 262 Ga. App. 6, 584 S.E.2d 646 (2003), termination of the general contract does not *ipso facto* constitute a termination of the subcontract. The AIA 201 General Conditions provide in Article 5.4 that subcontracts are assigned to the Owner upon the default of the general contractor, subject to the rights of the GC's surety. If the subcontracts are assigned upon termination of the general contractor, then the subcontracts survive the termination of the general contractor and are not terminated by the Owner's termination of the general contract.

In fact, a close reading of the decision in the case of *Sentry Insurance v. Lardner Elevator Co.*, 153 Mich. App. 317, 395 N.W.2d 31 (1985) appears to indicate that even if the general contractor defaulted on its obligations under the general contract, unless the subcontractor was unduly delayed by the GC's default, there is not breach and the subcontract is not terminated.

In the event that the subcontract contains a clause granting the subcontractor a right to terminate the subcontract as a result of the GC's breach, the GC's completing surety should evaluate whether the subcontractor has complied with any and all contractual preconditions to its right to terminate. The subcontract may require certain written notices to be given in the

event of a claimed default, and the allowance of time to cure any claimed default. If the subcontractor has not complied with such conditions, the completing surety may have the opportunity to quickly cure any actual or perceived default and insist upon the subcontractor's continued performance.

- ***Even if the subcontract is terminated, liability exists for defective work.***

Even if the subcontract has been terminated, the subcontractor and its surety remain liable for the cost of correcting any and all defective work performed by the subcontractor prior to the termination. The breach of the subcontract occurs at the time the work was performed, not when the defective work is discovered. *National Hills Shopping Center, Inc. v. Insurance Co. of North America*, 320 F. Supp. 1146 (S.D. Ga. 1970). This fact also goes to the question of which party breached first, the general contractor by failing to pay the subcontractor or the subcontractor by performing defective work? If the defective work was installed prior to any failure of the general contractor to make a timely payment to the subcontractor, the GC's completing surety may argue that the subcontractor was in breach at the time it installed defective work and as such, was not entitled to be paid for that work. In that event, the GC's failure to make a payment to the subcontractor would not constitute a breach of the subcontract, material or not.

- ***Surety's subrogation and assignment rights are not mutually exclusive.***

Subrogation and assignment are two very different and independent rights of the surety. In the case of *Maryland Cas. Co. v. Brown*, 321 F. Supp. 309 (N.D. Ga. 1971), the District Court noted that subrogation differs from an ordinary assignment of a debt in that the ordinary assignment assumes the continued existence of the debt, while subrogation follows upon its payment. *50 Am. Jur. Subrogation*, § 4, p. 681. In other words, in the context of subrogation, the party who satisfies the obligation or pays the debt of another, actually steps into the shoes of the party whose obligation or debt it satisfied and acquires all of the rights, securities and remedies of that party by reason of the actual satisfaction of that obligation or debt. *Argonaut Ins. Co. v. C&S Bank of Tifton*, 140 Ga. App. 807, 232 S.E.2d 135 (1976); *Cotton States Mut. Ins. Co. v. Citizens & Southern Nat. Bank*, 168 Ga. App. 83, 308 S.E.2d 199 (1983); *First Nat. Bank of Atl. v. American Sur. Co.*, 71 Ga. App. 112, 30 S.E.2d 402 (1944).

Even where the financing agreements may provide that the defaulting general contractor "assigns" its rights to the contract, including the right to collect and receive the remaining contract balances, to the surety, or where the indemnity agreement provides that upon default, the principal "assigns" all of its rights to the surety, those assignments are in addition to and not in derogation of the more valuable subrogation rights of the completing surety. Once that surety performs under its payment and performance bonds, it succeeds to its principal's rights, including the right to pursue a cause of action against a subcontractor's surety for damages resulting from its breach.

This is not to say, however, that a completing surety should simply abandon its assignment rights and place all of its eggs in the subrogation basket.

The standard Indemnity Agreement includes terms under which the principal and its indemnitors assign to the surety all of the principal's rights under its various contracts (which may or may not be limited to those in connection with which the surety actually furnished bonds.) The assignment is created by contract. That fact alone distinguishes it from the surety's rights of subrogation.

The Surety's Indemnity Agreement: Law and Practice 14 (Marilyn Klinger, Gary Judd and George J. Bachrach, eds., American Bar Association, 2002).

The indemnity agreement assigns to the surety the rights under every subcontract. It is well recognized that ordinary business contracts are assignable. 6 Am. Jur.2d Assignments §28. Contract duties are generally delegable unless prohibited by a statute, public policy or terms of the contract. 29 Williston on Contracts §74.27 (4th ed.). The Restatement (Second) of Contracts provides that one required to perform under a contract may delegate the duty to another unless it is barred by the terms of the contract or public policy.

Moreover, the AIA A201-1997, General Conditions of the Contract for Construction, contains the following provisions:

5.3.1 By appropriate agreement, written where legally required for validity, the Contractor shall require each Subcontractor, to the extent of the Work to be performed by the Subcontractor, to be bound to the Contractor by terms of the Contract Documents, and to assume toward the Contractor all the obligations and responsibilities, including the responsibility for safety of the Subcontractor's Work, which the Contractor, by these Documents, assumes toward the Owner and Architect.

....

5.4.1 Each subcontract agreement for a portion of the Work is assigned by the Contractor to the Owner provided that:

.1 assignment is effective only after termination of the Contract by the Owner for cause pursuant to Paragraph 14.2 and only for those subcontract agreements which the Owner accepts by notifying the Subcontractor and Contractor in writing; and

.2 assignment is subject to the prior rights of the surety, if any, obligated under bond relating to the Contract.

The GC's completing surety possesses both valuable subrogation and assignment rights at the time of termination. While the right of action clause in the bond may force the GC's completing surety to wear only one of its hats, that of subrogee, when asserting its rights against the subcontractor's surety, the GC's completing surety wears both of its hats, as assignee and subrogee of the general contractor, when asserting its rights against the subcontractor to return and complete the work of its subcontract. There is nothing prohibiting the GC's surety, as assignee and subrogee of the general contractor, from demanding that the subcontractor return and complete the performance of its subcontract.

THE SUBCONTRACTOR'S SURETY'S PERSPECTIVE

Termination Of The General Contract May Automatically Terminate The Subcontract.

Projects involving a general contractor default are by definition projects where the general contract is terminated. If the surety for the general contractor is financing completion of the work, they likely can avoid a declaration of default. In other instances of performance bond claims, there is almost always an owner declared default and termination of the general; in fact in many instances, the surety will insist upon it. The question then becomes whether the owner's termination of the general contract results in an automatic and immediate termination of the subcontract. In other words, is termination of the general contractor *ipso facto* termination of the subcontract?

There are no cases directly on point. (*Century Insurance v. Lardner Elevator Co.*, 153 Mich. App. 317, 395 N.W.2d 31 (1986), discussed *supra.*, never squarely dealt with this question.) However, a reasonably good argument can be made that when the general contract is terminated, there is by definition, a termination of the subcontract. First, the flow down clause contained in most subcontracts can be used as a basis for asserting an *ipso facto* termination of the subcontract. The flow down clause essentially states that the sub owes to the general the same duties which the general owes to the owner. Thus, the argument goes that once the owner has terminated the general contractor's performance of work, there is automatically a termination of that portion of the work the sub was performing. Since the sub owes duties to the general which mirror the duties owed by the general to the owner, once the owner terminates work of the general one may argue that there is a termination of duties the sub owes to the general.

There are many other arguments that can be raised by the subcontractor and its surety. For example, impossibility. Once the general contractor has been terminated, the sub may be able to argue that it is impossible for it to any longer proceed. (Of course, this assumes that the facts are present to support this position.)

A relatively recent Georgia Court of Appeals case dealt with a unique subcontract clause which was held to effectively result in an *ipso facto* termination of the sub upon the general contractor's termination. In *Carolina Casualty Insurance Co. v. Ragan Mechanical Contractors, Inc.*, 262 Ga. App. 6, 584 S.E.2d 646 (2003), a term in a subcontract clause provided:

Should the [owner] terminate the [general] Contract or any part of the [general] Contract which includes the Subcontractor's Work, this Contract shall also be terminated and the Subcontractor shall immediately stop Subcontractor's related Work."

584 S.E.2d 646.

The *Ragan* court held that when the owner terminated the general contract, it had the immediate effect of terminating the subcontract. The Court held that the plain language of the subcontract required the holding that termination of the general contract terminated the

subcontractor's obligations to proceed and complete its unfinished portion of the work. The Court was not persuaded by the cases of *United States v. Continental Cas. Co.*, 210 F.Supp. 433 (S.D.N.Y.1962); and *Appeals of Rayco, Inc. et al.*, 1983 WL 13521 (Eng. B.C.A.1983), which held that a letter from the government which said that a contractor was "terminated" did not mean that the contractor and its surety were excused from further performance.

Assignees of a Named Obligee do not Have a Cause of Action Under the Bond.

The general contractor will typically have executed an indemnity agreement in which it assigns to its surety all of its rights on contracts related to bonded projects. This may tempt the general's surety to claim that the assignment includes a transfer of rights the general has in the sub's bond, and aver standing through this mechanism.

This is a losing position however. The "no right of action" clause limits claims to the named obligee, their heirs, executors, administrators or **successors**. It does not extend rights to assigns, and efforts by assignees to convert their status to one of a successor have generally failed. This was the fate of the assignee in *TRST Atlanta, Inc. v. 1815 The Exchange, Inc.*, 220 Ga. App. 184, 469 S.E.2d 238 (1969). In this case, the permanent lender foreclosed on a construction project and made claims against the surety of the general contractor. The performance bond contained a clause stating that principal and surety bound "themselves, their heirs, executors, administrators, successors and assigns, jointly and severally," to the named obligee. *Id.* The lender argued that this gave assignees of the obligee standing to bring an action on the bond. However, the bond also contained the clause stating "No right of action shall accrue on this bond to or for the use of any person or corporation other than the Owner named herein or the heirs, executors, administrators or successors of the Owner." *Id.* The lender's efforts to proceed with a claim on the bond were rejected.

The court in *TRST* defined successor in the case of a corporation as succeeding by a process of amalgamation, consolidation, or duly authorized legal succession. It contrasted this definition with that of an assignment, which was a transfer or setting over of property or an interest. 469 S.E.2d at 240. The lender's rights under an assignment and its ownership of the construction project via foreclosure were not enough to make it a "successor". The Court correctly held that the lender was an assignee, and nothing more; since its right arose out of and were limited to rights via assignment, it could not bring a claim on the bond.

This opinion affirmed the prior decision of the same court in *Southern Patrician Assoc. v. Internat'l Fid. Ins. Co.*, 191 Ga. App. 106, 381 S.E.2d 98 (1989). There, the general contractor had subcontracted certain work, and that sub in turn subbed out its work, resulting in a sub-sub actually performing that scope of work. The first tier sub went into default, and its surety ultimately assigned to the general contractor all of their rights against a sub-subcontractor and the sub-sub surety. The general contractor then endeavored to assert a claim against the bond of the sub-subcontractor. This effort was rejected when the court reaffirmed the significant distinction between "successors" and "assigns." This court held that the bond language was unambiguous, that there was a distinction between assignees and successors, and that the general contractor as assignee had no rights on the sub-sub bond.

A very recent First Circuit case applied the “no cause of action” clause to a dual obligee rider. In *Citibank v. Grupo Cupey, Inc.*, 382 F.3d 29 (1st Cir. 2004), the surety issued its performance bond along with a dual obligee rider. The performance bond ran to the developer and contained the typical language that no right of action should accrue to any person other than the owners, heirs, executors, administrators and assigns. Surety also issued a dual obligee rider to the bank. The rider contained a very strict cause of action clause and provided: “No right of action shall be accrued [sic] on this bond to or for the use of benefit [sic] of any person or corporation other than the Owner and lender named herein” 382 F.3d at 31. The development went bad, and Citibank filed suit against the developer, the developer’s guarantor, and the surety. Citibank and the guarantor ultimately settled, and entered into an agreement by which the bank purported to “sell, assign and transfer” all of its rights to the guarantor of the loan.

The loan guarantor was then substituted for Citibank in the litigation suing the surety, and the surety moved for summary judgment. The First Circuit had no difficulty whatsoever in finding that the plain language of the dual obligee rider limited any cause of action on the rider to the owner and the lender. The guarantor’s claims as assignee were dismissed by the District Court, and this was affirmed by the Court of Appeals. The Court did this even though under Puerto Rico law, surety contracts are to be construed liberally in favor of the obligee. However, the Court found that this was not a blank check to rule out the agreement between the parties. Since the right of action clause was not ambiguous, the guarantor’s claims as assignee were dismissed. The guarantor tried to argue that it was a “successor,” but this was rejected because of the more restrictive language in the rider which did not extend rights to a “successor.” Finally, the Court found that the procedural substitution of the guarantor for the bank did not change the substantive rights of the parties.

The “no right of action” clause helped a law firm defeat a legal malpractice claim against it. In *Augusta Court Co-Owners’ Assoc. v. Levin, Roth & Kasner, P.C.*, 971 S.W.2d 119 (Ct. App. Tex. 14th Dist. 1989), a condominium homeowner’s association brought a legal malpractice claim against their former law firm alleging that the law firm had failed in asserting a timely suit against a surety on a construction bond. The law firm defended on the basis that the Association (which was not the original project owner) was not the named obligee on the general contractor’s performance bond. The Texas court joined states in holding that the “no right of action” clause limited those who could bring claim and barred the homeowner’s association’s standing. As an interesting aside, the homeowner’s association argued that the general contract had been assigned to it and that all of the contract documents were assignable. They then argued that because the performance bond was one of the “contract documents,” the bond could be assigned. The court never reached this question, but one must give the Association a nice gold star for being imaginative.

The *Augusta Court* opinion found that when applied to a corporation, a successor was clearly distinct from an assignee, and a successor was used in respect to corporate entities which resulted from consolidation, merger or amalgamations. Finding that the bond’s terms limited who could bring claims, it dismissed their suit.

The General Contractor's Material Breach Bars Claims Against the Subcontractor and its Surety

A material breach on the part of the general contractor gives the subcontractor the right to take the breach as a repudiation of the entire contract and excuse performance by the sub. A material breach occurs when there is a breach of an essential feature of the contract, that is, an element which induced the other party to enter into it. In other words, the breach must go to the substance of the contract and defeat the party's objective. Thus, it must be a breach of some matter of vital, significant importance going to the essence of the contract or to defeat the essential purpose of the contract. 17A Am. Jur.2d Contract Section 706.

Williston on Contracts defines a material breach by starting with the point that not every breach excuses the other party from performance of the contract; if a breach is minor, not of the essence of the contract, the other party is still bound to the contract and may not abandon performance. In other words, a non-performing or breaching party is liable for any breach of contract, but the other party is discharged from further performance only when there is a material breach. Williston goes on to note that the cases define material breach by using words such as "breaches which are fundamental", or breaches which "defeat the essence" or "essential purpose of the contract", "makes it impossible for the other party to perform", or "go to the root of the contract". Thus, a breach is material if the promisee receives something substantially less or different from that for which he or she bargained. 23 Williston on Contracts Section 63:3(4th ed.).

The Restatement(Second) of Contracts echoes these factors, but goes on to note that they are only circumstances for consideration, not rules. It describes the following circumstances (or facts) as significant:

- (a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
- (b) the extent to which the injured party can be compensated for that part of the benefit for which it will be deprived;
- (c) the extent to which the party failing to perform will suffer forfeiture;
- (d) the likelihood that the party failing to perform will cure, taking into account reasonable assurances; and
- (e) the extent to which the behavior of the party failing to perform comports with standards of good faith and fair dealing.

Restatement (Second) of Contracts § 241. Some cases address the question of material breach by using phrases such as "breach the contract as a whole" or "a total breach." *Keefe Co. v. American Intern, Inc.*, 755 A.2d 469 (B.C. 2000).

Where the general contractor has committed a material breach, it will relieve the sub and its surety from any further performance. This is what happened to the performance bond surety for the general contractor in *Nat'l Sur. Corp. v. Allen-Codell Co.*, 70 F. Supp. 189 (1947). In this case, the state of Kentucky entered into a general contract with Gwinn, who was bonded by National Surety; Gwinn later entered into a subcontract with Allen-Codell. The subcontract contained neither an express provision as to when the subs work should begin or be completed, nor did the subcontract stipulate that time was of the essence. However, Gwinn was required to complete the project by December, 1941, and did very little work until the next summer. However, National Surety had dug its heels, and only arranged for work to be completed by the summer of 1943.

The *Allen-Codell* court readily recognized the right of the surety for the general contractor to stand in the general contractor's shoes and enforce whatever rights there were against the subcontractor. Indeed, the court noted that the surety had both a right of assignment which it had obtained from Gwinn, as well as a right of subrogation. However, the court held that the surety for the general contractor had no rights against the sub because the general contractor breached first.

When the court acknowledged National Surety's right of subrogation, it agreed that while the surety did indeed stand in the shoes of the general contractor, it had no better right or remedy than did the general contractor. Thus, when Gwinn abandoned the project, he in effect repudiated his obligations under the subcontract, and the subcontract was terminated. The court then concluded that Gwinn's breach was material, and that it excused any further performance. 70 F. Supp. at 192.

Agency Arguments Will not Defeat the "Right of Action" Clause in the Bond.

Imaginative parties who are not named obligees have tried another tactic, albeit unsuccessfully, to get to the bond of the subcontractor. In *Rush Presbyterian St. Luke's Medical Center v. Safeco Ins. Co. of America*, 825 F.2d 1204 (7th Cir. 1987), the Medical Center, as owner, hired a general contractor to manage the construction project. The general contractor then subbed work and obtained a bond for the sub running in favor of the general contractor. This bond contained the "no right of action" clause barring anyone but the general contractor-obligee from standing to make a claim on the bond. The owner asserted that the general contractor was acting as its agent and that the general contractor had obtained the bond for the owner's benefit. Thus, it claimed that the owner as a disclosed principal could enforce the general contractor's right under the sub's performance bond. The District Court granted judgment to the surety and the Circuit Court affirmed; both courts found that although the general rule was that a disclosed principal may enforce rights under an agreement entered into by its agent, this rule did not apply where the agreement (in this case, the bond) unambiguously and unequivocally set forth an intent to limit standing to bring an action on the bond.

There is no Third Party Beneficiary to the Performance Bond.

The surety for the general contractor may try to claim third party beneficiary status as to the subcontractor's performance bond. Fortunately for the sub-surety, this position will not fly.

The language in the performance bond limiting the cause of action to the named obligee clearly establishes that there is no third party beneficiary to the bond. In *Young v. General Ins. Co. of America*, 33 Ill. App.3d 119, 337 N.E.2d 739 (1995), the court squarely held that the subcontractor's bond does not have any provision justifying any interpretation that it was entered into with the intention of granting a third party rights under the bond. The facts of this case are particularly interesting in light of potential third party claims. The owner entered into the general contract, and the general contractor shortly subbed out the entire project. The subcontract required the sub to furnish a performance bond which also ran to the owner, but the sub never did this. The sub only provided a bond running in favor of the general contractor. When there was a default on the project, the owner ended up claiming it was a third part beneficiary to the sub's bond. After all, that bond incorporated the subcontract, which required a bond running to the owner. The court found that in spite of the language requiring the sub to provide a bond running to the owner, the owner was, nevertheless not a third party beneficiary to the only bond which was provided, namely the bond running to the general contractor. See also, *Brd. of Educ., School District No. 15 v. Fred L. Ockerlund, Jr. & Assoc.*, 165 Ill. App.3d 439, 519 N.E.2d 95 (1988).

The Subcontractor's Surety May be Discharged by Novation.

The actions of the GC's surety upon default may grant a subcontractor's surety an absolute discharge if its actions are found to constitute a novation. Under the facts of the *Sentry Insurance v. Lardner Elevator Co.*, 153 Mich. App. 317, 395 N.W.2d 31 (1985) case, upon the general contractor's, Division's, default, Sentry, the general contractor's surety, Lardner, the subcontractor, and the Owner entered into an agreement whereby Lardner was paid a lump sum up front and agreed to proceed to complete the installation of the elevator on the project. Under the agreement, the balance of the funds owing to Lardner was to be placed in escrow. *Id.* at p. 319. Under the original subcontract, however, "... on or before the last day of each month, Lardner was to submit to Division on a required form a written pay request for the proportionate value of the work installed to date, which requisition was to be approved for payment by the contractor's project manager." *Id.* at p. 320. In addition, while the original subcontract provided, after amendment, that the elevator was to be completed by November, the new agreement entered into between Lardner, Sentry and Ingham County in October merely provided that the Lardner was to "...proceed post-haste to complete..." the installation of the elevator. *Id.*

The *Lardner* court never truly addressed the issue of novation, but merely noted that it was one viable theory under which Lardner proceeded to complete the project. For the subcontractor's surety, however, a finding by a court that such an agreement constituted a novation could result in a complete discharge of the subcontractor's surety from any liability under its bond or a discharge to the extent that the surety could prove it had been injured or prejudiced thereby. *Brunswick Nursing & Convalescent Center, Inc. v. Great American Ins.*

Co., 308 F. Supp. 297 (S.D. Ga. 1970); O.C.G.A. §10-7-21. Any unconsented increase in the risk is an independent ground for discharge of a surety. *Upshaw v. First State Bank*, 244 Ga. 433, 260 S.E.2d 483 (1979). The new agreement in *Lardner* altered the payment terms and the timing of the performance terms of the subcontract. Just such a change in the terms of payment under a building contract may operate to discharge a surety. *Brunswick Nursing & Convalescent Center, Inc.*, supra. Although the novation defense was not raised or addressed in *Lardner*, the decision is illustrative of yet another defense that may be raised by a subcontractor's surety which finds itself defending against a claim of the GC's surety after the general contractor's default.

A Ratification Agreement by the Subcontractor and Assignment to a New Completing Contractor May Discharge the Sub's Surety.

The surety for the general contractor will quite typically obtain ratification agreements from major subcontractors. Once these subs are lined up, the general contractor's surety will often arrange for a new completion contractor to step in, take over the work and complete. The ratified subs are then assigned to the new completion contractor, who undertakes work. Seldom does the general contractor's surety or the completion contractor ever obtain new bonds from this sub, and seldom do they ever have the surety for the sub issue a rider changing the obligee.

The assignment of the sub to a new completion contractor will likely forgive any further completion obligation by the sub's surety. Although we could not find any cases directly on point, this would appear to be the result.

The completion contractor could not bring an action against the sub's surety because of lack of standing. The completion contractor is not subrogated to any rights of the original obligee on the subcontractor's bond, and its rights arise solely by way of assignment. Since assignees are barred from asserting claims under the typical bond, the completion contractor will not be able to pursue a claim against the sub's surety.

Although the surety for the general contractor at one point may have had subrogation rights against the sub's surety, once the subcontract is assigned by the surety, it no longer has any right to demand that the sub perform. Since the subcontractor no longer owes any duties to the surety for the general contractor, it necessarily follows that the surety for the subcontractor owes no duty to the surety for the general contractor.

The Subcontractor's Surety has a Right of Action Under the GC's Payment Bond.

In terms of preserving rights to the recovery of contract balances due its principal for losses suffered as a result of satisfying its obligations under performance and payment bonds, the subcontractor's surety enjoys the same rights as the general contractor's surety with respect to such a claim. In the 5th Circuit case of *Traveler's Ind. Co. v. Peacock Constr.* 423, F.2d 1153 (5th Cir. 1970), Judge Brown began his decision by noting that not only does a completing surety succeed to the rights of the obligee, but also succeeds to the rights of its principal. The general contractor's surety had defended the claim on the basis that the subcontractor's surety was not a "claimant" as defined under the general contractor's bond and

as such, was not entitled to maintain the cause of action. The Court noted that, since the surety's principal (the subcontractor) was a "claimant" as defined under that bond, and since the subcontractor's surety was subrogated to its principal's claim, the subcontractor's surety was entitled to recover under the bond of the general contractor.

CONCLUSION

A general contractor's completing surety, as subrogee of its principal, has standing as "successor" to the named obligee's (general contractor's) right on the sub's bond. This will allow it to pursue a cause of action against a subcontractor's surety for recovery of losses suffered as a result of a subcontractor's breach. In assessing the rights of the battling sureties, the courts will look to the facts and rights of the parties in the dispute. When the general contractor has defaulted on the contract, the completing surety must prevail on the argument that its principal's default did not constitute a "material breach" and in no way contributed to or caused the subcontractor's breach. When it steps in to finance or take over the contract, the completing surety must be very circumspect as to any agreements it enters into with the subcontractors, ever cognizant that any novation will serve to discharge the subcontractor's surety. When the surety for the General Contractor performs its obligations under their performance and payment bonds, it "succeeds" to the rights of their principals, so those completing sureties should succeed against subcontractor's sureties in their actions against their bonds.

The surety for the subcontractor will need to evaluate its obligations to the surety for the general contractor by going back to the basic, fundamental questions that we should all keep in mind. First, look at the terms of the subcontract bond. Does it have a clause limiting any right of action? Second, look at the subcontract and determine whether termination of the general contract terminates any duty to perform the subcontract. Third, look at the flow down clauses and determine whether those contract documents create a scenario under which termination of the general contract terminates the subcontractor's duty.

One of the more significant, complex questions that the subcontractor's surety will have to answer is whether the general contractor committed a material breach. Did the general contractor fail to pay, and were there appropriate notices and demands required under the subcontract made? Did the general contractor abandon or delay the project and excuse the sub's performance? Did the general contractor interfere with the sub's performance so as to breach and excuse further duties? These and other questions will have to be evaluated.

Finally, if the subcontract and the subcontractor's duties to perform have been transferred to a new completion contractor, then the sub's surety likely has no duties to the new completion contractor. This transfer and assignment is a novation, that is, a new subcontract which was not agreed to, waived or bonded by the subcontractor's surety.

All of us will sooner or later be in a surety versus surety battle. We all love cases where the surety wins, but these by definition are cases where somebody's going to smile and somebody's going to cry.