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I. SURETY'S RIGHTS OF INDEMNITY AND EXONERATION AGAINST PRINCIPAL AND INDEMNITORS

In *Colonial Sur. Co. v. MedTek, Inc.*,¹ the United States District Court for the Eastern District of Pennsylvania granted summary judgment in favor of the surety and required the principal and indemnitors to deposit collateral with the surety before the surety paid any claims. The principal stopped work on the project, failed to make payment to a number of subcontractors and refused to resume performance of the remaining work which consisted mainly of punchlist items. The government owner threatened to declare the principal in default of the contract, but never did. Subcontractor claims totaled more than \$400,000.00. The surety demanded that the principal post collateral of \$375,000.00, which the principal refused to do. The principal argued that the surety was not entitled to the requested relief because the owner had not declared the principal to be in default and the remedies sought by the surety were based upon legal claims and not equitable claims, thereby making them unenforceable. The Court rejected all of the principal's arguments and enforced the express terms of the general indemnity agreement which stated that the only conditions precedent to the defendants' obligation to provide collateral security are: (1) a claim is made against a bond issued by the surety, and (2) the surety makes a demand for collateral.

The United States District Court for the Eastern District of Missouri, in *National Sur. Co. v. Prairieland Constr., Inc.*,² granted summary judgment in favor of a surety on a claim for indemnity against a principal and indemnitors. The Court also granted summary judgment in favor of the surety on the principal's counterclaim alleging tortious interference with the underlying bonded contract. Recognizing that indemnity agreements are routinely enforced in strict accordance with their terms, the Court held that a surety is entitled to be reimbursed for all amounts paid in good faith to settle claims, even where the surety in good faith misinterprets law regarding its liability to the claimant. The principal argued that the surety tortiously interfered with the bonded contracts when it sent a letter to the owner to freeze the remaining contract funds. The Court held that because a surety is a party to the bonded contract, the surety cannot interfere with the contract.

In *General Ins. Co. of America v. Mezzacappa Bros., Inc.*,³ a surety on series of public construction projects sued its principal to recover amounts expended in discharging its performance and payment obligations under certain of the bonds. The surety moved for summary judgment, which the principal opposed on the grounds that the surety did not act with commercial reasonableness in settling various claims of the principal, in the nature of offsets, on several of the bonded projects. Although the principal conceded the good faith standard

¹ 2005 WL 459642 (E.D. Pa. Feb. 25, 2005)

² 354 F.Supp.2d 1032 (E.D. Mo. 2004)

³ 2003 WL 22244964 (E.D.N.Y. 2003)

applied to the surety's settlement of claims asserted against the bonds, it maintained that the Uniform Commercial Code standard of commercial reasonableness should govern the surety's settlement of its principal's affirmative claims. Citing various cases, the trial court disagreed and concluded that the good faith standard applies equally to the surety's settlement of the contractor's affirmative claims.

United States Fid. & Guar. Co. v. Diggs,⁴ involved an action for indemnification against the wife of the bonded principal's owner. The wife admitted signing the indemnity agreement, but claimed she did so only as a witness to her husband's signature and not as a personal indemnitor. The wife also counterclaimed against the surety for costs of defense. The Court granted the surety's summary judgment motion and dismissed the wife's counterclaim. The court found the wife had signed the indemnity agreement as an indemnitor. The agreement listed her as an "undersigned" and expressly bound "all" parties. Moreover, the wife's signature was notarized and she gave her address and Social Security number, as the agreement required of all indemnitors.

In *Frontier Ins. Co. v. Renewal Arts Contracting Corp.*,⁵ the Supreme Court of New York, Appellate Division, held that alleged impropriety of the obligee in the administration of a contract did not prevent the surety from seeking indemnification from its principal in the absence of evidence of bad faith. Following the abandonment of a construction project by the principal, the obligee asserted a claim against the performance and payment bonds. The principal alleged that the obligee had failed to make progress payments and had otherwise acted wrongfully, but did not pursue any claim against the obligee for breach of contract. When the surety sought indemnity for amounts paid, the principal objected arguing that it was not liable to the surety because its default was the result of the obligee's failure to make progress payments. The Supreme Court disagreed, holding that the alleged default of the obligee was "irrelevant" to the principal's liability to the surety under the terms of the indemnity agreement.

The Court in *United States Fid. & Guar. Co. v. Stanley Contracting, Inc.*,⁶ held that a surety did not act in bad faith or with a wrongful motive in paying claims under a payment bond or in selecting a contractor to complete the principal's work. There, the obligee terminated the principal and called upon the surety to discharge its performance bond obligations. The surety ultimately retained another contractor to finish the work at a cost significantly higher than the amount quoted by the terminated principal. The surety also paid a number of claims asserted against the payment bond issued on the project.

⁴ 2004 WL 32917 (E.D. La. 2004)

⁵ 784 N.Y.S.2d 698 (2004)

⁶ 303 F. Supp.2d 1169 (D.Or. 2004)

The surety later sued to recover all amounts expended under the performance and payment bonds and moved for summary judgment. In opposing the motion, the principal maintained that the surety had not acted in good faith because it failed to conduct a reasonable investigation into the bond claims and the principal's defenses. The Court held the reasonable investigation standard was inapplicable to the surety's claims and granted the surety's summary judgment motion. The indemnity agreement clearly provided that the indemnitors were liable for all amounts paid by the surety in the good faith belief it was or might be liable, and which were necessary or advisable to protect the surety's rights or lessen its liability or alleged liability. The Court agreed with the surety that the good faith standard is met if there is no bad faith or wrongful motive, as opposed to whether a reasonable investigation is conducted. In finding the surety acted in good faith, the Court noted the surety had hired an independent consultant to review the various claims and sought the contractor's opinion before payments were made. The Court also ruled that the surety's selection of the completion contractor was made in good faith. The chosen contractor was bondable, while the principal was not, and the Court felt the surety was attempting to finish the project in the quickest and least contentious fashion.

In *New York City Housing Auth. v. Olympia Constr., Inc.*,⁷ the New York Supreme Court held that a surety could seek indemnity from a principal for losses under a bid bond which resulted after the surety refused to issue performance and payment bonds on behalf of the principal. After issuing a bid bond on behalf of the principal, and after the principal's bid was accepted, the surety required additional collateral in order to issue payment and performance bonds for the project. The principal could not post the necessary collateral and the surety refused to issue any additional bonds. Because the principal could not obtain bonding for the project, the bid bond was forfeited.

The principal argued that the surety was estopped from seeking indemnification because, the principal contended, the surety's refusal to issue performance and payment bonds was the direct cause of the principal having to forfeit the bid bond. The Court rejected this argument and held that the express terms of the indemnity agreement gave the surety the right to decline to issue any bond to the principal.

The Georgia Court of Civil Appeals, in *Anderson v. United States Fid. & Guar. Co.*,⁸ affirmed the entry of summary judgment in favor of a surety. In support of its damage claim, the surety submitted an affidavit of its claims attorney along with billing statements. In opposition to the summary judgment motion, the principal argued that (a) the billing statements attached to the affidavit were inadmissible hearsay, (b) the affidavit was not sworn to by an officer of the surety and, (c) the documents tendered to the trial court contained very few originals and were inherently unreliable. The Court of Civil Appeals rejected the principal's

⁷ 2004 WL 1870497 (N.Y.Sup. June 28, 2004)

⁸ 600 S.E.2d 712 (Ga. App. 2004)

argument as meritless and held that by signing the indemnity agreement, the principal expressly agreed to accept vouchers and other evidence of payment by the surety as *prima facie* evidence of the fact and extent of its liability.

In *Fidelity & Deposit Co. of Md. v. PAR Constr., Inc.*,⁹ the United States District Court for the Western District of Texas issued a preliminary injunction requiring the principal and indemnitor to disclose to the surety the terms of a confidential settlement and prohibiting any further dissipation of corporate or individual assets. The surety had issued performance and payment bonds on behalf of the principal on multiple school construction projects. The surety later received numerous claims on the projects and incurred expenses in excess of \$1.8 million.

Thereafter, the principal filed an independent action against the obligee's insurance carrier seeking damages for delay on one of the projects and for the defective work of a subcontractor. The principal settled its claims against the insurance carrier, but refused to disclose the terms of the settlement to the surety pursuant to the confidentiality provisions of the settlement agreement. Relying upon the assignment provisions of the indemnity agreement, the Court held that the surety was entitled to know the terms of the confidential settlement and to recover the proceeds of the settlement.

In *Mountbatten Sur. Co., Inc. v. Szabo Contracting, Inc.*,¹⁰ the Appellate Court of Illinois, Second Division, held that a general contractor's breach of the underlying contract was not a condition precedent to a surety's rights under the indemnity agreement. The general contractor argued that because it had not been declared in default by an obligee on any of the bonded projects, its obligations to the surety under the indemnity agreement had not been triggered. As such, the general contractor argued that the entry of summary judgment in favor of the surety was inappropriate. The Appellate Court disagreed, holding that the receipt of claims for non-payment by material suppliers and the general contractor's failure to post collateral with the surety upon demand constituted a default under the terms of the indemnity agreement.

The United States District Court for the Northern District of Illinois, in *Travelers Cas. & Sur. Co. v. Ockerlund*,¹¹ granted a preliminary injunction in favor of a surety requiring the defendants to post collateral in the amount of the surety's loss reserves and prohibiting the defendants from transferring or dissipating their assets. Following the receipt of bond claims totalling \$500,000.00, the surety requested that the defendants post collateral in accordance

⁹ 2004 WL 2537349 (W.D. Tex. Oct. 25, 2004)

¹⁰ 812 N.E.2d 90 (Ill. App. Ct. 2004)

¹¹ 2004 WL 1794915 (N.D. Ill. Aug. 6, 2004)

with the provisions of the indemnity agreement. The defendants failed to post collateral and the surety filed suit seeking exoneration, *quia timet*, specific enforcement of the indemnity agreement and a preliminary injunction.

In granting the surety's motion for a preliminary injunction, the District Court held that "a *quia timet* action recognizes that any judgment for money damages without 'according [the surety] relief of specific enforcement pursuant to the . . . indemnity agreement is not an adequate remedy and would irreparably harm [the surety] by depriving it of prejudgment relief to which it is contractually entitled.'" The District Court also distinguished the decision of the United States Supreme Court in *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*,¹² which precludes the issuance a preliminary injunction against the transfer of assets pending adjudication of a contract claim for money damages, holding that to deprive the plaintiff of its right of specific performance of the indemnity agreement "would deny a surety of the security position for which he specifically bargained."

In *First Int'l Bank v. Continental Cas. Co.*,¹³ the Massachusetts Supreme Court held that a surety's right of equitable subrogation was superior to a bank's prior perfected security interest under the Uniform Commercial Code. Following the default and bankruptcy of the principal, the surety recovered all net proceeds from a public auction of the principal's equipment and machinery. The bank, which had previously perfected a security interest in all of the principal's assets, filed suit against the surety to recover the auction proceeds. In entering summary judgment in favor of the surety, the Massachusetts Supreme Court held that the bank's prior perfection of a security interest under the UCC was "irrelevant to an analysis of the [s]urety's rights under the doctrine of equitable subrogation."

II. SURETY'S LIABILITY AND DEFENSES

A. Declaration of Default.

In *Elm Haven Constr. Ltd. Partnership v. Neri Construction, LLC*,¹⁴ a general contractor sued a subcontractor and its surety under its performance and payment bonds issued on a construction project in New Haven, Connecticut. The surety moved for summary judgment on the grounds that the general contractor, as obligee, failed properly to declare a default and give sufficient notice of the alleged default, as required by the bond and the underlying subcontract.

¹² 527 U.S. 308 (1999)

¹³ 2004 WL 1049068 (Mass. Apr. 16, 2004)

¹⁴ 281 F.Supp. 2d 406 (D.Conn. 2003), *aff'd*, 376 F.3d 96 (2d Cir. 2004)

The trial court granted the surety's summary judgment motion. Although the general contractor did send numerous letters to the subcontractor and surety expressing its displeasure with the subcontractor's performance of its work, the trial court found the contractor's complaints were not enough to trigger the surety's obligations under the performance bond. Absent a clear, direct and unequivocal declaration of default, the surety is not required to act under the performance bond. The Court also rejected the general contractor's attempts to recover under the payment bond since the general contractor, as obligee, was not a proper "claimant" as defined by the bond. The trial court's judgment was affirmed on appeal by the Second Circuit Court of Appeals.

In *153 Hudson Development, LLC v. DiNunno*,¹⁵ the New York Supreme Court, Appellate Division, held that an owner's failure to comply with the pre-default notice provisions of the performance bond precluded it from recovering damages against the surety. Additionally, the Supreme Court held that the owner's failure to comply with the claim resolution mechanism in its construction contract with the principal contractor prior to filing suit precluded it from pursuing the surety for damages.

In *United States ex rel. James Cape & Sons Co. v. American Home Assur. Co.*,¹⁶ the United States District Court for the Northern District of Illinois held that, upon receipt of a payment bond claim, a surety may claim a right to remaining contract funds and intercede in the bonded contract even if there has been no declaration of default by the owner. There, a subcontractor, which was also an indemnitor, sued the general contractor's Miller Act surety asserting a claim under the payment bond, a breach of contract claim relative to the indemnity agreement and a claim for bad faith, all alleging that the surety failed to timely investigate the claim and intercede to prevent the government from disbursing additional contract funds. The surety filed a motion to dismiss the breach of contract and payment bond claims on the grounds that, because the principal had not been declared by the government to be in default, any action the surety could have taken to interfere with the prime contract or intercede in the contract funds would have subjected it to liability to the principal under *L&A Contracting v. Southern Concrete Services*. The Court distinguished *L&A Contracting* and denied the motion to dismiss holding that exposure to payment bond claims under a public works bond is sufficient in itself to justify the surety's notification to the owner of its interest in the contract balances. With very little discussion and no analysis of "bad faith" claims against sureties, the Court also denied the surety's motion to dismiss the bad faith claim and allowed the claim to proceed.

¹⁵ 778 N.Y.S.2d 482 (2004)

¹⁶ 2004 WL 3119029 (N.D.Ill. Dec. 3, 2004)

The Washington Court of Appeals, in *Colorado Structures, Inc. v. Insurance Co. of the West*,¹⁷ held that a surety's liability under a performance bond is not conditioned upon the obligee's declaring the principal in default under the subcontract. The Court specifically rejected the holding of *L&A Contracting v. Southern Concrete Services*. The performance bond contained the following standard language:

Whenever Principal shall be, and declared by the Obligee to be in default under the subcontract, the Obligee having performed Obligee's obligations thereunder, Surety may. . . .

The Court held that this provision merely recognizes and describes the remedies that follow from a declaration of default, but that by failing to declare a default, the obligee did not breach its obligations under the bond so as to discharge the surety's obligations. The Court stated that the Fifth Circuit Court of Appeals erred in *L&A Contracting* by holding that a declaration of default was a condition not only of the use of remedies by the surety in the event of default, but also a condition of the surety's liability.

B. Change in Bonded Obligation Resulting in Discharge of Surety.

In *95 Lorimer, LLC v. Insurance Co. of the State of Pa.*,¹⁸ the Supreme Court, Kings County, New York, held that the surety was discharged from liability under a performance bond because the owner allowed a separate and distinct contractor to complete the project and accelerated payments to the contractor. During the course of the project, the principal, Iroquois Demolition Corporation, told the owner that it had changed its name to Irondequoit Corporation and that all future payments should be made to Irondequoit. Irondequoit, with many of the same employees and equipment, began work to complete the project and shortly thereafter incorporated in New York. Iroquois remained a separate corporation and was never dissolved. The owner paid the remaining contract funds to Irondequoit before the work was completed. The surety was not notified of the change in the contractor or of the advanced payments. A dispute arose between the owner and Irondequoit, and the owner made a claim to the surety under the performance bond, which the surety denied. The Court held that "mere formalistic changes in the identity of a principal obligor, such as its name and location, do not discharge the surety," but the surety cannot be bound to answer for a totally distinct entity such as Irondequoit. Also, the Court held that the acceleration of payments and the disbursement of all contract funds before work was completed resulted in a substantial alteration of the underlying contract such that the surety was discharged of liability under the bond.

¹⁷ 106 P.3d 815 (Wash. Ct. App. Feb. 15, 2005)

¹⁸ 789 N.Y.S.2d 833 (N.Y.Sup. Nov. 17, 2004)

The First Circuit Court of Appeals, in *Seaboard Sur. Co. v. Town of Greenfield*,¹⁹ held that an obligee on a construction project materially breached the terms of the performance bond by hiring a completing contractor and preventing the surety from exercising its right to complete the project. After terminating the principal contractor, the obligee notified the surety and requested that the surety complete the project. The surety requested reasonable time to investigate and requested documents from the obligee regarding the termination of the principal contractor. Even though the principal contested the termination, the surety agreed to perform emergency work on the project in an effort to mitigate damage to the existing work. The surety then began negotiating with the obligee for the completion of the project and exchanged draft takeover agreements. During the course of these negotiations, however, the obligee retained another contractor to complete the project without involving the surety in the decision.

The terms of the performance bond required the obligee to notify the surety if the obligee contended the surety had failed to perform its obligations under the bond with reasonable promptness. The obligee was further required to give the surety fifteen days to cure any alleged default under the bond before undertaking to complete the project on its own. Because the obligee did not notify the surety that it considered the surety to have breached the bond obligations or of its intent to engage another contractor to complete the project, the Court of Appeals held that the surety was discharged as a matter of law of any obligations under the performance bond.

In *United States ex rel. Johnson Pugh Mech., Inc. v. Landmark Constr. Corp.*,²⁰ the United States District Court for the District of Colorado held that the claimant, an alter ego of the principal, was not entitled to recover under the Miller Act. This ruling was based, in part, upon the District Court's findings that (1) the principal was controlled by the sole shareholder of the claimant, (2) that the owner of the claimant was a director or officer of the principal, (3) that the principal financed the claimant's business operations, (4) that the claimant was undercapitalized, (5) that 70% of the claimant's business was for the principal, (6) that the claimant operated as a de facto subsidiary of the principal, (7) that the directors or executives of the claimant did not act independently in the interest of the principal and (8) the claimant did not abide by its corporate by-laws. The District Court also concluded that the claimant did not complete its work during the effective dates of the bonds and, therefore, was not a *bona fide* subcontractor entitled to payment.

In *Citibank v. Grupo Cupey, Inc.*,²¹ the First Circuit Court of Appeals held that the plaintiff, which obtained rights of the obligee by assignment, could not pursue a performance bond claim against the surety. After the principal defaulted under the contract, the obligee

¹⁹ 370 F.3d 215 (1st Cir. 2004)

²⁰ 318 F.Supp.2d 1057 (D.Colo. 2004)

²¹ 382 F.3d 29 (1st Cir. 2004)

sued the surety to recover under the performance bond. During the course of the litigation, the obligee assigned “any and all rights, claims and causes of action” arising from the bonded project to a third-party. The District Court permitted the third-party to substitute for the obligee, but then granted the surety’s motion to dismiss for failure to state a claim upon which relief can be granted.

On appeal, the third-party argued that as an assignee and successor of the obligee, it was entitled to maintain a claim against the surety under the performance bond. The Court of Appeals disagreed, noting that the terms of the bond’s dual obligee rider provided that “[n]o right of action shall be accrue [sic] on this bond to or for the use of benefit [sic] of any person or corporation other than the Owner and Lender herein named” The Court of Appeals held that the third-party could not maintain any claim against the surety under the performance bond because the third-party was neither the “Owner” nor Lender” as defined by the rider, and because the rider did not extend rights to successors.

C. Pay When Paid Clause No Defense to Surety.

In *American Bldg. Supply Corp. v. Avalon Prop., Inc.*,²² the New York Supreme Court, Appellate Division, held that subcontractors and material suppliers were entitled to recovery from the general contractor’s surety notwithstanding provisions in the payment bond which conditioned recovery upon the general contractor’s receipt of payment from the owner. In reaching this decision, the Supreme Court reiterated that “pay-when-paid” clauses are void and unenforceable as against public policy under New York law.

D. Statute of Limitations (Miller Act).

In *United States ex rel. Rentals, Inc. v. Hartford Fire Ins. Co.*,²³ the United States District Court for the Western District of Texas held that the filing of an action against a surety in state court does not toll the one-year statute of limitations prescribed by the Miller Act. Within one-year of the date that it last provided equipment for use in the construction of a facility for the United States Army Reserve, the claimant filed suit against the general contractor’s surety in state court seeking recovery for non-payment under the Texas Public Bond Statute, commonly referred to as the McGregor Act.²⁴ The surety moved for summary judgment, arguing that the claim was subject to the Miller Act and could not be resolved in state court. The claimant then filed a separate action in federal court seeking recovery against

²² 779 N.Y.S.2d 517 (2004)

²³ 339 F.Supp.2d 799 (W.D.Tex 2004)

²⁴ *Tex. Gov’t Code Ann.* §2253.001-079 (West 2002)

the surety, but more than one-year had passed since the date on which the claimant last provided equipment to the project.

The Court granted the surety's motion for summary judgment holding that the one-year filing requirement was a jurisdictional limitation on the substantive rights conferred by the Miller Act. Because the one-year limitations period had expired, the claimant was barred from asserting its bond claim for material or equipment rental provided to the project.

E. Surety Not Liable for Interest and Attorney's Fees.

R.W. Sidley, Inc. v. United States Fid. & Guar. Co.,²⁵ involved a suit by a subcontractor under a payment bond issued pursuant to Pennsylvania's Public Works statute. In addition to seeking the principle sum allegedly owed, the subcontractor also sought interest of 1.5% per month under the subcontract, plus penalties for late payments and attorney's fees pursuant to the State's "Contractor and Subcontractor's Payment Act." The surety moved for partial summary judgment on the grounds that its bond did not cover interest, penalties and attorney's fees. The trial court agreed with the surety and granted its motion. Although the subcontractor could seek penalties and attorney's fees against the contractor, such charges were not "sums justly due," and therefore, were not recoverable against the surety.

The scope of permissible recovery under the Miller Act²⁶ was addressed by the Ninth Circuit Court of Appeals in *Didomenico v. North American Constr. Corp.*²⁷ In that case, a claimant sought to recover penalties and attorney's fees, which were recoverable under applicable California law, as "sums justly due" against a payment bond issued pursuant to the Miller Act. In support of this contention, the claimant argued that because the Prompt Payment Act²⁸ allows supplemental state law claims to be asserted against a contractor, the Prompt Payment Act and the Miller Act must also incorporate state law remedies. The Court of Appeals rejected this argument, holding that neither the Miller Act nor the Prompt Payment Act permit the recovery of state law remedies.

²⁵ 319 F.Supp 2d 554 (W.D. Pa. 2004)

²⁶ 40 U.S.C. §§270b(a) (2001)

²⁷ 2004 WL 759550 (9th Cir. (Cal.) April 8, 2004)

²⁸ 31 U.S.C. §3905(j)

F. Judgment Against Principal Binding on Surety.

The Supreme Court of Virginia, in *American Safety Cas. Ins. Co. v. C.G. Mitchell Constr., Inc.*,²⁹ ruled that a surety was conclusively bound by a default judgment entered against its defunct principal, even though the judgment was entered as a discovery sanction for the principal's repeated failure to tender a corporate representative for a deposition. Initially, the principal was represented by counsel who filed an answer on the principal's behalf and raised a number of defenses to the plaintiff's claim. The principal's counsel was later allowed to withdraw, after which the plaintiff noticed the deposition of the principal's corporate designee. When no one appeared for the principal, the plaintiff filed a motion for sanctions and/or to compel a corporate representative of the principal to appear for a deposition, which the trial court granted. The plaintiff's corporate representative again failed to appear, notwithstanding proper service of the deposition notice, and the court entered a default judgment against the principal.

The plaintiff then filed a motion for summary judgment against the surety. The trial court granted the plaintiff's motion, finding that the surety had notice of the plaintiff's claim against its principal and had the right and opportunity to defend the principal, but failed to do so. Accordingly, the court held that the judgment by default entered against the principal was binding and conclusive upon the principal. On appeal, the Supreme Court of Virginia agreed and affirmed the entry of judgment against the surety.

G. Waiver of Defenses by Surety.

National Union Fire Ins. Co. of Pittsburgh v. Wadsworth Golf Constr. Co. of the Midwest,³⁰ involved the construction of the forty-five (45) day period for responding to a payment bond claim set forth in the AIA A312 payment bond. There, the sureties issued AIA A312 payment and performance bonds for the construction of a golf course. An excavating subcontractor maintained it was not paid amounts due for work performed on the project and asserted a claim against the payment bond. At the sureties' request, the subcontractor submitted a proof of claim, after which the sureties advised the subcontractor it would address the claim with their principal and respond in due course. After not receiving any response, the subcontractor filed suit against the sureties.

The subcontractor moved for summary judgment based on the deadline specified in the payment bond which obligated the sureties to respond to a claim within 45 days of its receipt "stating the amounts that are undisputed and the basis for challenging any amounts that are disputed." Because the sureties failed to act upon the claim within the specified deadline, the subcontractor argued the sureties had waived their right to challenge the claim under the

²⁹ 601 S.E.2d 633 (Va. 2004)

³⁰ 863 A.2d 347 (Md. Ct. Spec. App. 2004)

payment bond. The trial court agreed and granted the subcontractor's summary judgment motion.

The Maryland Court of Special Appeals affirmed the trial court's judgment in favor of the subcontractor. In so doing, the Court rejected the sureties' argument that payment was not yet due because the principal had not received final payment from the owner. According to the Court, this defense could have been raised within 45 days of the receipt of the claim and, because it was not, the sureties waived the defense. Although the sureties also argued they should not be liable since the language of the payment bond did not set forth any consequences for the failure to answer a claim within 45 days of its receipt, the court noted there was not a "non-forfeiture of defenses" provision in the bond, and accordingly, any defenses not timely asserted were waived. Finally, although the court agreed that the sureties did not expressly waive their right to dispute the subcontractor's claim, the court found that the sureties' silence supported the inference they intended to relinquish their rights under the payment bond.

III. BAD FAITH CLAIMS

In *Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co.*,³¹ the Eleventh Circuit Court of Appeals certified several questions to the Supreme Court of Florida concerning an obligee's claims of "bad faith" against performance bond sureties. In that case, the obligee and the bonded principal on a construction project arbitrated various disputes regarding the principal's performance of work. The arbitration panel entered an award against the bonded principal and also determined its sureties were bound by the award. The obligee subsequently filed a civil action alleging the sureties were liable for their bad faith refusal to settle and otherwise fulfill their obligations under the bond. The trial court found in the sureties' favor, and the obligee appealed.

On appeal, the Eleventh Circuit found that a threshold issue in the case was whether Fla. Stat. § 624.155(1)(b)(1), which provides a cause of action against insurers for failing in good faith to settle claims, applies to claims by obligees against sureties. Because Florida courts have not yet addressed that issue, the Court certified to the Supreme Court of Florida the question of whether the obligee is an "insured" for purposes of the Florida statute such that it has a right to sue a surety for bad faith. The Court also certified certain questions regarding the effect of the arbitration award upon the obligee's claims for bad faith refusal to settle and breach of contract and the sureties' defenses to these claims. To date, the Supreme Court of Florida has not acted on the various certified questions.

³¹ 383 F. 3d 1273 (11th Cir. 2004)

In *Worldlogics Corp. v. Chatham Reinsurance Corp.*,³² the Oklahoma Court of Civil Appeals held, as a matter of first impression, that a surety owes a duty of good faith and fair dealing to its obligee and that a breach of that duty can give rise to a tort claim for bad faith. Following the alleged default of the principal contractor, the obligee demanded that the surety take over construction and complete the project. The surety refused. The surety's investigation of the obligee's claim consisted of reviewing correspondence between the obligee and the principal, discussing the obligee's allegations with the principal and speaking with counsel for the obligee and the principal. The surety did not send a representative to inspect the construction site until months after first receiving the claim.

Although the Oklahoma Court of Civil Appeals acknowledged that a performance bond is fundamentally different from an insurance contract, it noted that every contract in Oklahoma contains an implied duty of good faith and fair dealing. The court held that a surety's obligations regarding the investigations and payment of claims should be construed under the same laws and standards that are applicable to insurers. In reaching this conclusion, the Court relied heavily upon *Dodge v. Fidelity & Deposit Co. of Maryland*³³ and *TransAmerica Premier Ins. Co. v. Brighton School District 27J*.³⁴

IV. MISCELLANEOUS BONDS

In *Hinkle Metals & Supply Co., Inc. v. Ohio Cas. Ins. Co.*,³⁵ the Alabama Court of Civil Appeals held that a license bond issued in favor of the Board of Heating and Air Conditioning Contractors did not cover a claim of a material supplier for non-payment of materials supplied to the bonded contractor. Under Alabama law, all prospective heating and air conditioning contractors are required to post a \$10,000 performance bond in favor of the licensing agency as a prerequisite to certification.³⁶ The claimant, a material supplier, sought recovery for non-payment under the performance bond after the licensed contractor became insolvent.

In affirming the decision of the trial court, the Court of Civil Appeals held the license bond was not intended to cover claims for non-payment by material suppliers of licensed heating and air conditioning contractors. Rather, the Court of Civil Appeals held that the bond was issued to guarantee performance and "to protect the public with regard to the installation, service, and repair of heating and cooling systems."

³² 2004 WL 3239630 (Okla. Civ. App. June 1, 2004)

³³ 778 P.2d 1240 (Ariz. 1989)

³⁴ 940 P.2d 348 (Colo. 1997)

³⁵ 2005 WL 628885 (Ala. Civ. App. Mar. 18, 2005)

³⁶ ALA. CODE §34-31-19 (1975)