

**TWENTIETH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE**

Clearwater, Florida
APRIL 30th & MAY 1st, 2009

ARBITRATION AND THE MILLER ACT SURETY

PRESENTED BY:

**DAVID J. KREBS , ESQ.
MARC L. DOMRES, ESQ.
KREBS, FARLEY & PELLETERI, PLLC
400 Poydras Street, Suite 2500
New Orleans, LA 70130
504-299-3570**

ARBITRATION AND THE MILLER ACT SURETY

by

David J. Krebs and Marc L. Domres

The Miller Act provides a right of action for every person, with the requisite contractual relationship, that has furnished labor or material on a federal works project that has not been paid in full within 90 days after the day on which that person last provided work on that project. Congress created the Miller Act because federal property is not subject to a state's mechanics lien laws, and therefore the Act was needed to protect persons who supply labor and materials for the construction of federal buildings.¹ The Miller Act provides for exclusive jurisdiction in federal court.² Proper venue is in the federal district court where the work was performed. The Miller Act states, in pertinent part:

- (3) Venue - A civil action brought under this subsection must be brought -
 - (A) in the name of the United States for the use of the person bringing the action; and
 - (B) in the United States District Court for any district.³

The Federal Arbitration Act, on the other hand, provides:

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceedings is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been held in accordance with the terms of the agreement . . .⁴

At least one court has held that in light of the exclusive jurisdiction granted by the Miller Act for claims against a surety, a federal Miller Act should not be stayed pending arbitration despite such a stay being provided for under the Federal

¹ See *United States ex rel. B&D Mech. Contractors, Inc. v. St. Paul Mercury Ins. Co.*, 70 F.3d 1115, 1117 (10th Cir. 1995).

² See *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116 (1974).

³ 40 U.S.C. § 3133(b)(3)(B).

⁴ 9 U.S.C. § 3.

Arbitration Act.⁵ However, the tension between the exclusive jurisdiction provided under the Miller Act and the requirement of a stay under the Federal Arbitration Act has been resolved in numerous other Miller Act cases, finding a stay appropriate.⁶ What remains unresolved, and the concern of this paper, is the preclusive effect of an arbitration between a subcontractor/supplier and a contractor on a Miller Act surety. At this point, federal law is unclear as to whether and in what circumstances a Miller Act surety may be liable for an arbitration award against its contractor. This lack of clarity creates greater risk for the surety in issuing Miller Act bonds.

In light of the federal policy favoring arbitration, courts seem increasingly willing to forego Congress' mandate in the Miller Act that federal courts be given exclusive jurisdiction over such claims. This willingness increases the potential liability of sureties, as an arbitrator's award is difficult to reverse absent fraud, corruption or undue means.⁷ An arbitrator can also ignore jurisprudential limitations on the extent of a surety's liability under the Miller Act, including awarding state law penalties for failing to make prompt payment, interest, and attorney's fees, which further increases the risk of the surety. Additionally, time limitations provided by the Miller Act may not be strictly enforced.

Considering the limited grounds for vacating an arbitration award, such vacillations of well settled Miller Act jurisprudence may be enforceable against the surety pursuant to an arbitration award. Such a result is in conflict with the protection granted sureties under the Miller Act.

I. The Hendry Decision and its Progeny.

There is a split among the circuits as to the preclusive effect of an arbitration against a Miller Act surety. However, despite this split, the terms of the Miller Act are clear and should be enforced. The Miller Act expressly provides that suits against a surety are restricted to the "United States District Court for any district in which the contract was to be performed and executed."⁸ Permitting the enforcement of an arbitration award against a surety would be in contravention of the Miller Act

⁵ *United States of America for the use and benefit of Pensacola Construction Co. v. St. Paul Fire and Marine Ins. Co.*, 705 F.Supp. 306, 313 (W.D.La. 1989).

⁶ *U.S. ex rel. Newton v. Neumann Caribbean Intern., Ltd.* 750 F.2d 1422 (9th Cir. 1985); *U.S. ex rel. Portland Const. Co. v. Weiss Pollution Control Corp.*, 532 F.2d 1009 (1976); *J.S. & H. Const. Co. v. Richmond County Hosp. Authority*, 473 F.2d 212 (5th Cir. 1973); *Warren Bros. Co. v. Cardi Corp.*, 471 F.2d 1304 (1st Cir. 1973); *U.S. ex rel. Capolino Sons, Inc. v. Electronic & Missile Facilities, Inc.*, 364 F.2d 705 (2nd Cir.), *cert. denied* 385 U.S. 924 (1966).

⁷ 9 U.S.C. § 10.

⁸ 40 U.S.C.A. § 3133(b)(3)(B).

and renders this venue provision, expressly provided for by Congress, meaningless. As such, certain federal courts have found no preclusive effect of an underlying arbitration or, similarly, state court ruling on a Miller Act surety.

In *United States Fidelity & Guar. Co. v. Hendry Corp.*, 391 F.2d 13 (5th Cir. 1968), the cornerstone case concerning the exclusivity of federal jurisdiction over Miller Act sureties, a subcontractor attempted to enforce a state court ruling against a Miller Act surety. The Fifth Circuit stated that:

This principle is inapposite when the plaintiff's recovery depends upon a Miller Act bond . . . If a Miller Act surety is bound by a state court judgment recognizing a supplier's claim against the principal - it is mere word-juggling to say that the suit in state court is not a suit under the Miller Act. The assumption that the Act permits such suits attributes to Congress an obtuseness sufficient to destroy the statutory scheme . . . In short, the surety is entitled to stand on the congressional decision that the United States district court independently determine the facts and the extent of a surety's liability under a Miller Act bond.⁹

Similarly, to permit the enforcement of an arbitration award against a surety would also necessarily destroy the congressional protection provided a surety under the Miller Act.

When the party being vouched into warranty is a Miller Act surety . . . there is an important federal interest at stake. The jurisdiction and venue requirements of the Miller Act were established in order to protect the surety from the inconsistent results of a multiplicity of lawsuits in different jurisdictions. If the surety were forced to defend his bond in every arbitration proceeding that his indemnitee might be involved in, he would lose the protection that Congress granted the Miller Act surety. The surety would face the possibility of inconsistent results in the different forums and might end up being made liable for more than the amount of the bond.¹⁰

These courts view the mandate of exclusive jurisdiction, given in the Miller Act to sureties, as a statutory right that cannot be overridden merely because of the federal policy favoring arbitration.

⁹ *Id.* at 17-18.

¹⁰ *United States of America for the use and benefit of Pensacola Construction Co. v. St. Paul Fire and Marine Ins. Co.*, 705 F.Supp. 306, 313 (W.D.La. 1989).

Furthermore, despite certain courts viewing the claimant's contract as being incorporated in the Miller Act payment bond, a Miller Act payment bond only makes reference to the prime contract, not the contracts of subcontractors or suppliers, let alone those subcontract's arbitration provisions. Thus, as arbitration is a matter of consent, and as the bond does not incorporate a subcontract's arbitration provision, the surety has not waived its Miller Act right to federal jurisdiction.¹¹

Thus, under the *Hendry* construct, a claimant may avail itself of its Miller Act remedy against a surety only by way of a Miller Act suit in federal court.¹²

II. The *Aurora* and *Kirchdorfer* Decisions.

The United States' Sixth and Ninth Circuits, on the other hand, have enforced arbitration awards against Miller Act sureties.¹³ Like in *Hendry*, the Ninth Circuit decision in *Aurora* did not directly involve arbitration, but the enforcement of a state court ruling, albeit one confirming an arbitration award. The *Aurora* Court, despite recognizing the exclusive federal jurisdiction granted a surety by the Miller Act, held that the Miller Act, by its terms, does not create an exception to the full faith and credit statute, and thus the confirmation of the arbitration award by the Alaska state court was enforceable against the Miller Act surety.

Considering the express language of the Miller Act providing jurisdiction solely in the federal courts, it is unclear how the Ninth Circuit determined that no exception existed to the full faith and credit statute. Under this reasoning, federal questions can be determined by state courts even when Congress mandates they be heard in federal courts.

Despite the Ninth Circuit's apparent reliance on the full faith and credit statute in *Aurora*, the decision itself evidences an uncomfortableness with using the full faith and credit statute as the sole basis for its decision. As such, the Ninth Circuit distinguishes its holding from the holding in *Hendry* by stating that the surety in *Aurora* may also be bound by res judicata principles.¹⁴

¹¹ *United States ex rel. Capital Electric Constr. Co., Inc. v. Pool and Canfield, Inc.*, 778 F.Supp. 1088, 1091-92 (W.D. Mo. 1991).

¹² See also *United States ex rel. Owens-Corning Fiberglass Corp. v. Brandt Constr. Co.*, 826 F.2d 643, 645 (7th Cir. 1987); *United States ex rel. Portland Constr. Co. v. Weiss Pollution Control Corp.*, 532 F.2d 1009, 1012 (5th Cir. 1976).

¹³ See *United States ex. rel. Skip Kirchdorfer v. M.J. Kelley Corp.*, 955 F.2d 656 (6th Cir. 1993); see also *United States ex. rel. Aurora Painting, Inc. v. Fireman's Fund Ins. Co.*, 932 F.2d 1150 (9th Cir. 1987).

¹⁴ *Aurora*, 932 F.2d at 1153.

The *Aurora* Court contends that as the surety, a privy of the principal, was provided an opportunity to arbitrate the dispute and refused, the surety was therefore bound to the arbitration award and subsequent state court confirmation of that award. Although it appears that the surety attempted to preserve its rights and defenses under the Miller Act prior to arbitration, the surety in *Aurora* did tender its defense to the principal, as well as use the same counsel as principal.

The *Kirchdorfer* decision does not discuss the exclusive federal jurisdiction granted by the Miller Act at all. It is unclear from the decision whether the individual sureties even raised the issue or were aware of the exclusive jurisdiction provided by the Act. The sureties in *Kirchdorfer* were two individuals, one of whom was a corporate officer of the corporate contractor. Although aware of the arbitration, it appears neither the insolvent contractor nor the sureties appeared at the arbitration, instead, informing the arbitrator that the contractor “has no funds and, thus, cannot pay for the transportation of witnesses or attorneys, or attorneys fees.”

Although the *Kirchdorfer* Court cites to the *Aurora* decision, the *Kirchdorfer* holding appears based on the general rule enunciated in *Frederick v. United States* that “a judgment against a principal conclusively establishes the liability of a surety, as long as the surety had notice of the proceedings against the principal.”¹⁵ The *Kirchdorfer* Court also cites to similar state law in reaching its holding.

Thus, despite the congressional mandate granting exclusive federal jurisdiction to a suit against a Miller Act surety, the *Aurora* and *Kirchdorfer* decisions, which have formed the basis for any claimant’s attempts to enforce an arbitration award against a Miller Act surety, ignore, in reaching their decisions, the purpose effectuated by the grant of exclusive jurisdiction. Exclusive jurisdiction ensures consistent results and protection, not only of the surety, but also claimants in those instances where the claimed amounts exceed the amount of the bond.

Under the Heard Act, the precursor to the Miller Act, to effectuate this protection, the surety was not only entitled to federal jurisdiction, but all claims against the bond were to be brought in one suit to protect the surety. The Miller Act, concerned about the due process of claimants, created individual actions for claimants, but still required that the suits be brought in federal court with venue in the district where the work was performed. The *Aurora* and *Kirchdorfer* decisions have eviscerated that protection, and have done so without an analysis of the congressional purpose in enacting the Miller Act.

¹⁵ 386 F.2d 481, 485 n.6 (5th Cir. 1967).

III. Full Notice and Opportunity

In *United States ex. rel. Frontier Construction, Inc. v. Tri-State Management Co.*, 262 F.Supp.2d 893 (N.D. Ill. 2003), the district court engaged in a lengthy discussion of the preclusive effect of an arbitration against a Miller Act surety, where the principal failed to appear at the arbitration. Although admitting that federal law is far from clear as to whether and in what circumstances a Miller Act surety may be liable for an arbitration award against its principal, the *Frontier* court held that where the principal fails to appear for the arbitration and the surety is provided only initial notice that arbitration proceedings were going to occur, that the surety could be bound neither under the *Hendry/Pensacola Construction* or *Kirchdorfer/Aurora Painting* rules.¹⁶ The *Frontier* court explained that under the *Hendry/Pensacola Construction* rule a surety cannot be bound under the Miller Act to an arbitration award, and under the *Kirchdorfer/Aurora Painting* rule a surety is not liable where it did not have an opportunity to defend itself.¹⁷

In reaching this decision, the *Frontier* Court cited to the Eleventh Circuit holding in *Drill South, Inc. v. International Fidelity Ins. Co.*, 234 F.3d 1232 (11th Cir. 2001) that “ a surety is bound by any judgment against its principal ... when the surety had full knowledge of the action against the principal and an opportunity to defend it.” The *Drill South* decision did not concern the confirmation of an arbitration award, but rather a default against a surety’s principal where the surety despite “numerous opportunities” to defend the principal failed to do so, rendering the default judgment preclusive as to the surety’s liability.

Just as in *Frontier*, other courts have followed the *Drill South* general rule in holding that a surety would be bound to an arbitration between its principal and a claimant if provided full knowledge of the arbitration and an opportunity to defend.¹⁸ However, this standard raises a myriad of new issues in defining what constitutes “full knowledge” and “an opportunity to defend.” Does notice of an arbitration demand constitute “full knowledge?” Or does the claimant need to keep the surety abreast of all goings on in the arbitration? If the principal fails to appear in the arbitration, does the claimant have a greater obligation to keep the surety informed?

¹⁶ *Id.* at 895-96.

¹⁷ *Id.* (It should also be noted that *Frontier’s* reading of *Aurora* may not be entirely accurate. It appears that under *Aurora* the claimant merely needed to seek enforcement of the arbitration award against the principal in state court, and then necessarily under the full faith and credit statute, the decision would have been binding on the surety).

¹⁸ *U.S. ex. rel. MPA Construction, Inc. v. XL Specialty Ins. Co.*, 394 F.Supp. 2d 934 (D.Md. 2004).

Conclusion

It is not uncommon for an insolvent federal contractor to fail to pay multiple claims. Under many federal subcontracts, that failure would be subject to arbitration. The Miller Act, although providing individual actions to claimants, was not enacted to divest the Miller Act surety of its right to have these claims adjudicated in federal court, and specifically in the district court where the work occurred. By enforcing arbitration agreements against Miller Act sureties, the federal courts risk doing just that. In doing so, the courts risk the protection afforded those who supply and perform labor on federal projects.

Multiple arbitration awards against an absent principal may be enforced against the surety without any trial on the merits of these claims. Furthermore, state law claims for failing to make prompt payments, interest and attorney's fees may be granted by the arbitrator, despite the questionable attributes of such claims against a Miller Act surety.¹⁹ Faced with these de facto defaults for questionable claims, real risk exists that the penal sum of the bond may be expended on merit less claims, while proper claimants are subsequently excluded from recovery.

Despite federal policy favoring arbitration, the Miller Act's grant of exclusive federal jurisdiction should be enforced. Absent that enforcement, the Supreme Court needs to reconcile the split decisions of the Courts of Appeal, providing the Miller Act surety a clear roadmap of when, and under what circumstances, it will be bound to an arbitrator's award against its federal contractor.

¹⁹ *F.D. Rich Co., Inc. v. U.S. for the Use and Benefit of Industrial Lumber Co.*, 417 U.S. 116 (1974).