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**DOL WAGE RATE CLAIMS AGAINST SURETIES
and
A SOUTHERN SURVEY: MY PAYCHECK BOUNCED OR
DIDN'T GET HERE - THEM PAYMENT BONDS SOUND NICE.**

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DOL Wage Rate Claims Against Sureties

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I. Introduction

This paper does not provide a detailed rendition of the history and application of the Davis-Bacon Act¹ to federal contracts.² Rather, it is intended to focus on issues that arise when the Department of Labor seeks to extend its authority to direct withholding of monies due and payable under “federally funded contracts”³. These contracts and the companion bonds are generally otherwise governed by state law.⁴ Interesting conflicts can arise concerning the extent and term of the surety’s liabilities under a state statutory or case law framework when compared to federal law. So, what will be the DOL approach?

II. Battleground History

Over the last decade, sureties have challenged the right of the Department of Labor to set off wage rate claim assessments against government contract proceeds, where such setoffs prevented the surety that paid claims under the corresponding federal contract bonds from collecting such proceeds. To that end, sureties have done battle with the DOL under various theories, none of which have prevailed. To date, here is a sampling of unsuccessful arguments used by sureties:

- The surety’s payment bond claim payments gave the surety equitable subrogation rights that were prior and superior to the Department of Labor’s right of set off.⁵
- Takeover surety is entitled to collect contract funds as a matter of priority over a DOL set off because:
 - i. the surety is subrogated to government’s right to use funds for completion of the project.⁶

¹ 40 USC §3142, et seq. (2003).

² An excellent discussion of the history and application of the Davis-Bacon Act to federal contracts was authored by Michael A. Stover and Susan Getz-Kerbel, *Look Who is Bringing Home the Bacon – How Recent Decisions Interpreting the Davis-Bacon Act Can Negatively Affect the Surety*, Northeast Surety and Fidelity Claims Conference, New Jersey, 2003.

³ 29 CFR§5.5.

⁴ State agencies and authorities ranging from housing authorities to transportation departments receive oodles of federal money, with more to come due to our recent and various “stimulus” packages.

⁵ *National Fire Insurance Company of Hartford v. Fortune Construction Company*, 320 F.3rd 1260 (11th Cir. 2003).

⁶ *Westchester Fire Insurance Company v. United States*, 52 Fed. Cl. 567 (2002).

- ii. the obligee misrepresented the status of contract funds at takeover.⁷
- iii. the DOL's right of setoff only extends to payments actually due to the contractor and not payments to become due.⁸
- iv. the surety's takeover agreement provided for payments to the surety without offset due to a claim by any party not a signatory to the Takeover Agreement.⁹
- v. the surety's rights "accrued" prior to the DOL claim as the takeover agreement was executed prior to the DOL claim assertion.¹⁰
- vi. the surety is not subject to a DOL wage rate claim because the corresponding laborers and mechanics did not file payment bond claims.¹¹

In other words, in just about every forum the surety has pursued an equitable subrogation priority to federal contract funds over a claim of setoff against the contract funds by the DOL, the DOL has prevailed. However, when considering federally funded contracts, state statutes may often apply to the surety's obligations. This begs the question if the state statutes and/or case law favor a surety confronted with a contractual setoff by another creditor of the principal, what impact will the state law peculiarities have with respect to DOL claim? The authors' recent case experience may shed some light on the DOL's response to one or more of these questions.

III. Potential State Law Anomalies When Compared to Federal Contract Law

A. Limitations

Many states have prescribed limitations periods for performance bond claims on performance bonds issued in connection with public works projects.¹² Obviously, some of these projects will be built with federal funds or federal financial assistance of some type, meaning, the Davis-Bacon Act will apply.¹³ If

⁷ *Reliance Insurance Company v. United States*, 27 Fed. Cl. 815 (1993).

⁸ *Matter of Liberty Mutual Insurance Company*, ARB. Case Number 00-018 (June 30, 2003).

⁹ *Id.*

¹⁰ *Id.*

¹¹ *Id.*

¹² Texas, by way of example, provides that any action under a public works performance "may not be brought after the first anniversary of the date of final completion, abandonment or termination", §2253.078(a) Texas Government Code.

¹³ 29 CFR §5 *et seq.*, which outlines the labor standards provisions applicable to contracts covering federal financed and assisted construction. §5.5 specifically requires that "any contract in excess of \$2,000.00 which is entered into for the actual construction, alteration, and/or repair

the state law provides that any state governmental entity must bring suit against a performance bond surety in a period shorter than the general six (6) year statute applying to contract actions by the federal government¹⁴, which limitations period will apply? The DOL's response will likely be that even though the bonds were issued pursuant to state law authority, the case of wage rate setoff involves "uniquely federal interest" as the Department of Labor is the sole authority that is allowed to pursue actions under the Davis-Bacon Act. Accordingly, the DOL will assert that federal law governing the application of the Davis-Bacon Act is applicable. Result, (in the usual case where enforcement remedies of the Davis-Bacon Act are not incorporated in the contract but only the wage determination requirements) the government has six (6) years to bring a suit to determine the right of setoff under applicable federal law. In the case in which the authors were involved, where a local school district was the obligee on the bond and awarded the federally funded contract, the DOL actually took the position that the contract was improperly let as a state law contract and that the bonds should have been issued as "Miller Act" bonds.¹⁵

B. Express Coverage Limitations Provided by State Statute

Some states may have statutes that prescribe express coverage limitations afforded under performance bonds.¹⁶ Once again, the Department of Labor is likely to respond with the federal law preemption of state law when confronted with this argument.¹⁷ In other words, the DOL position will be that it does not care what the underwriting basis for the bond was, if a federally funded or assisted contract is involved, the Davis-Bacon Act will apply, as will the DOL's right to direct withholding and set off against the contract proceeds regardless of state law limitations as to what coverage performance bond is intended to provide.

C. Release of Claims Under the Completion Document

In many instances, the surety's completion document will provide for a release of the surety from any and all claims in existence at the time of takeover and/or a complete release in connection with the tender of a new contractor.

... of a public building or public work, or public work financed in whole or in part from federal funds ..." contain provisions requiring compliance with the Davis-Bacon Act.

¹⁴ 28 USC 2415. See also *U.S. v. Deluxe Cleaners and Laundry, Inc.*, 511 F 2nd 926 (4th Cir. 1975).

¹⁵ Say what?

¹⁶ By way of example, §2253.021(b) of the Texas Government Code expressly limits proper claimants under performance bond, "the performance bond is solely for the protection of the state or governmental entity awarding the public contract."

¹⁷ In the authors' experience, the DOL makes no distinction between a federal contract and federal funded or assisted contract as respects the federal preemption. Hence, the surety can expect the DOL to rely on *Boyle v. United Technologies Corp.*, 487 U.S. 500 (1988), citing *Lake Misere Land Company*, 412 U.S. 580 (1973). Likewise, the DOL will contend that the claim and case itself involves "uniquely federal interest", as the DOL is the sole authority that is allowed to pursue actions under the Davis-Bacon Act.

While the release may be enforceable under state law, the DOL looks to provisions in the completion document whereby a party assumes the obligations of the original contract, set off against funds dedicated to completion of the work and claim the original contractor's duty to make prevailing wage payments was assumed by the surety or competing contractor. Of course, this language is almost always found in the surety's completion document, such as words to the effect that "completing contractor agrees to assume all of the obligations and responsibilities of the original contractor under the original contract." Alternatively, the surety might state, in a takeover agreement, that it agrees to "arrange for the completion of the original contract in strict accordance with the terms and conditions thereof." In these instances, the DOL's position will be the surety and/or completing contractor have assumed the wage rate compliance obligation of the original contractor.¹⁸ Next, the DOL is likely to assert the release of the claims by the contracting entity does not alter the statutory framework for recovery of unpaid wages, which vests enforcement authority solely with the DOL, thus placing the surety in the difficult position of fending off litigation from the obligee and/or completing/tendered contractor to recover the setoff.

D. State Law Priorities to Contract Proceeds Statutes

Sureties have worked hard in numerous jurisdictions to obtain statutes and case law according the surety superior rights to the collection of contract proceeds due under a bonded contract.¹⁹ Confronted with such state law priority arguments, the DOL will insist the surety is thwarted by the federal preemption. Meaning, of course, the DOL, not surety, is entitled to a priority claim against the contract proceeds.²⁰

IV. Conclusion

Prevailing wage rate disputes and claims are not all that uncommon on state and federal funded work. Clearly, this often unknown and unanticipated risk will surface in circumstances where the sureties' original underwriting basis involved an entirely different set of liability considerations. As can be seen from *Liberty*²¹ and *Westchester*,²² it would seem there is only one completion option

¹⁸ *Matter of Liberty Mutual Insurance Co.*, ARB. Case Number 00-018 (2003). In *Liberty Mutual*, the surety took over the contract and the Administrative Review Board held that this included the requirement to ensure proper payment of prevailing wages. In *Westchester Fire Insurance Co. v. United States*, 52 Fed. Cl., 567 (2002), the Court of Federal Claims ruled the government was entitled to include the wage violations as support of its excess cost for contract completion.

¹⁹ In Texas, the priority is codified at §2253.071(c), which provides "a surety that completes a public work contract or incurs the loss under a performance bond ... has a claim to the proceeds of the contract prior to all other creditors of the prime contractor to the full extent of the surety's loss."

²⁰ Notably, in a decision issued by the predecessor to the current Administrative Review Board, the Wage Appeals Board (WAB) made the broad determination that "the Department of Labor has priority rights to all funds remaining to be paid on a federal or federally assisted contract ...".

²¹ *Matter of Liberty Mutual Insurance Co.*, ARB. Case Number 00-018 (June 30, 2003).

that might avoid this liability, that being a bond buy back and release prior to the DOL's discovery and assertion of any wage rate violations under the bonded contract. Otherwise, it would appear the surety only can shift this risk, by way of an indemnification or other suitable contractual risk shifting device. If the surety is unable to shift the risk, it appears clear that the surety will be faced with a federal administrative review of its rights to contract proceeds in connection with what would otherwise be bonds that are entirely governed by state law.

²² *Westchester Fire Insurance Co. v. United States*, 52 Fed. Cl., 567 (2002).

A SOUTHERN SURVEY: MY PAYCHECK BOUNCED OR DIDN'T GET HERE – THEM PAYMENT BONDS SOUND NICE.

BY

JASON STONEFELD, TOM BARBER, AND JOHN RYAN

Introduction

The cliché ‘living paycheck by paycheck’ seems to have a greater relevance these days given the current economic climate. For many individual laborers “living paycheck by paycheck” is less a cliché statement, and more a way of life. Unfortunately, it is an all too real possibility that these laborers will finish their work, put down the hammer, put down the saw, and never receives a paycheck. However, in many states, under the statutes applicable to public work, these laborers are proper claimants under a payment bond.

When making a bond claim, these individual laborers are faced with very specific and strict rules. The rules change from state to state. This paper seeks to provide an abbreviated review of the rules which pertain to Alabama, Arkansas, Florida, Georgia, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, Tennessee, and Texas, as well as the Federal government. It sets forth a state by state survey discussing the statutory authority for laborer bond claims. The survey will also discuss the laborer’s ability to make a bond claim based on how far removed from the general contractor the individual laborer is. Also covered are any notice deadlines and statute of limitations deadlines for each listed state. Finally, we conclude with a brief discussion as to types of compensation the surety may be liable to the laborer for as well as a discussion on Federal tax liabilities the surety may face if it directly pays a bond claim.

State by State Survey

Alabama

Who May Sue Surety Directly?

Statutory Authority

Ala. Code § 39-1-1 – “Any person that has furnished labor, materials, or supplies for or in the prosecution of a public work and payment has not been made may institute a civil action upon the bond and have their rights and claims adjudicated in a civil action and judgment entered thereon.” “The claimant may bring a civil action in the claimant’s name on the bond against the contractor and the surety, or either of them...”

Case Law

May an Employee of the General Contractor Sue Surety?

An employee of the general contractor may almost certainly bring suit against the surety. See *Sparks Const., Inc. v. Newman Bros., Inc.*, 288 So. 2d 749 (Ala. 1974). The Alabama Supreme Court in *Sparks* stated that one who contracts with a general contractor to perform a substantial portion of the work is protected by the payment bond for public works projects. While not directly on point, this case coupled with the statutory language indicated an employee may sue the surety directly on the payment bond.

May an Employee of a Subcontractor Sue the Surety?

Yes. Alabama courts hold that labor furnished to a subcontractor is covered by the bond furnished by the surety for the general contractor. *Pettus v. State*, 137 So. 466 (Ala. 1937).

May an Employee of a Sub-Subcontractor Sue the Surety?

Unclear, but possibly yes. There is no Alabama case on point, however a federal court applying Alabama law provides some indication on how the law might be applied. See *Price v. H.L. Coble Const. Co.*, 317 F.2d 312 (5th Cir. (Ala.) 1963). In *Price*, the 5th Circuit stated that in any case the person entitled to sue is, by the statute, authorized to sue for the amount "claimed to be due." In the case of a subcontractor, what is "due" is generally fixed by a contract. The court then acknowledged that the same must be said to be true for a sub-subcontractor. It appears to follow then that if the amount due to a laborer of a sub-subcontractor is "fixed" it is "due" and the laborer is entitled to sue the surety on the bond.

Time Requirements

Notice Requirements

Claimant must give surety 45 days notice before bringing suit. See *Lloyd Wood Const. Co. v. Con-Serv, Inc.*, 232 So.2d 649 (Ala. 1970).

Statute of Limitations

1 year from the time the contract for work is finally settled. Ala. Code 39-1-1(b).

Arkansas

Who May Sue Surety Directly?

Statutory Authority

- A.C.A. §§ 18-44-506; 22-9-401 – “All persons, firms, associations, and corporations who have valid claims against the bond may bring an action on the bond against the corporate surety...” “Claims for labor and materials shall include...payments...on account of...wages earned by workers on the project covered by the bond.”

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *Oliver Const. Co. v. Williams*, 238 S.W. 615 (Ark. 1922). By holding that the language of the statute was broad enough to cover laborers of subcontractors, the Court implied that the statute covers laborers of the general contractor and would thus be proper claimants on the bond could sue the surety directly. This implication, coupled with the statutory language, indicates employees of the general contractor may sue the surety on a wage claim.

May an Employee of a Subcontractor Sue Surety?

Yes. *Id.* “The language [of the statute requiring the payment bond] is broad enough to include laborers who have performed work for a subcontractor, who furnished labor and materials which the original contractor had obligated himself to furnish.”

May an Employee of a Sub-Subcontractor Sue Surety?

Unclear, but most likely not. See *B. Sweetser Construction Co. v. Newman Bros., Inc.*, 371 S.W.2d 515 (Ark. 1963). The Court in *B. Sweetser* quoted and agreed with the reasoning of a Missouri case which stated, in effect, that a laborer of the subcontractor is the last person in the chain that may sue on a payment bond.

Time Requirements

- Notice Requirements

Does not appear to be required, but is recommended to be give 90 days from last furnishing in order to trap funds.

Statute of Limitations

Suit must be brought within 12 months of final payment by owner to contractor, except when final approval by government entity is required in which suit may not be brought within 12 months after final approval is given. A.C.A. §§ 22-9-403, 18-44-503.

- **Florida**

Who May Sue Surety Directly?

Statutory Authority

- F.S.A. § 255.05; F.S.A § 713.01 – The claimant shall have a right of action against the contractor and surety for the amount due him or her. The bond ensures that contractors and their laborers and materialmen, subcontractors and their laborers and materialmen, and sub-subcontractors are protected.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *Warren v. Glen Falls Indemnity Co.*, 66 So.2d 54 (Fla. 1953). In *Warren*, the Court permitted a materialman of the general contractor (considered in the same light as a laborer of the general contractor, as evidenced by the statute) to sue the surety on a payment bond.

May an Employee of a Subcontractor Sue Surety?

Yes. “One who supplies labor or materials to a subcontractor is within the class of those required to be protected by a § 255.05 bond.” *Trustees, Florida West Coast Trowel Trades Pension Fund v. Quality Concrete Co.*, 385 So.2d 1163 (Fla. DCA 1980).

May an Employee of a Sub-Subcontractor Sue Surety?

No. Permitting a materialman of a subcontractor would go against the statutory language of the public works bonding statute and would also go against the clear expressed intent of the legislature. *City of Ft. Lauderdale v. Hardrives Co.*, 167 So.2d 339 (Fla. App. 1964). See also *North Broward Hospital Dist. v. Crosewell*, 188 So.2d 54 (Fla. App. 1964) (clarifying that the sub-subcontractor itself is not precluded from recovering on the bond by the *Ft. Lauderdale* holding, just the laborers and materialmen of the sub-subcontractor are precluded.

Time Requirements

- Notice Requirements

A claimant not in privity with the contractor and who has not received payment for labor must first give notice that it will look to the bond no later than 45 days *commencing* furnishing labor and materials. If still not paid, the claimant must provide notice of nonpayment no earlier than 45 days after *commencing* furnishing labor and no later than 90 days after *finally* furnishing labor and materials. F.S.A. § 255.05.

Statute of Limitations

1 year after the labor is performed, but may not be brought until after one of the following events occurs

Public entity has paid out the claimant's retainage to the contractor and time to pay retainage has expired,

Claimant has completed all work required and 70 days have passed since contractor sent its final payment request to public entity,

160 days have passed since reaching substantial completion of the construction services purchased, or

Claimant asked contractor, in writing, for information regarding whether the project has reached substantial completion, whether the contractor has received payment of claimant's retainage, or whether the contractor has sent its final payment request to the public entity, and the contractor has not responded in ten days.

F.S.A. § 255.05.

- **Georgia**

Who May Sue Surety Directly?

Statutory Authority

- O.C.G.A § 13-10-60 – Payments bonds shall be required for the protection of all subcontractors and all persons supplying labor. "Subcontractor" is not limited to parties in direct privity with the general contractor.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *Tom Barrow Co. v. St. Paul Fire & Marine Ins. Co.*, 421 S.E.2d 85 (Ga. 1992). This case is not directly on point, but states that a person who, pursuant to a contract with a prime contractor, performs services is a subcontractor and protected by the payment bond. This coupled with the statutory language indicates that a laborer for the general contractor may sue the surety on a payment bond.

May an Employee of a Subcontractor Sue Surety?

Yes. "Each of the [subcontractor's] laborers...had two distinct rights. One was the [right to receive payment on a negotiable instrument]. The other was the right...to recover under the payment bond in the event he was not otherwise paid for his work on the project covered by the contract." *Miller v. New Amsterdam Casualty Co.* 123 S.E.2d 717 (Ga. 1961).

May an Employee of a Sub-Subcontractor Sue Surety?

Yes. See *Tom Barrow Co.*, 421 S.E.2d 85. The court in *Tom Barrow* held that a materialman of a sub-subcontractor, analogous to a laborer of a sub-subcontractor, is protected under Georgia's statute requiring payment bonds.

Time Requirements

- Notice Requirements

A person in a direct contractual relationship with a subcontractor but not with the general contractor must provide preliminary notice to general contractor within 30 days of the later of either the general contractor's notice of commencement or when labor or material is first furnished. Notice of nonpayment must be made within 90 days after labor was last furnished. O.C.G.A § 13-10-63

Statute of Limitations

A person must bring suit within one year after project completion. O.C.G.A § 13-10-65.

- **Louisiana**

Who May Sue Surety Directly?

Statutory Authority

- L.S.A. §§ 38.2241; 38.2242 – The public entity shall require the contractor to furnish a bond for the payment by the contractor or subcontractor for

claimants. Claimants are defined as any person to whom money is due pursuant to a contract with owner, contractor or subcontractor for doing work or performing labor.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. A person who contracted directly with the general contractor to perform work is within the payment bond coverage and may sue the surety on the bond. *Harvey Canal Towing Co., Inc. v. Gulf South Dredging Co., Inc.*, 345 SW.2d 567 (La. App. 4th 1977).

May an Employee of a Subcontractor Sue Surety?

Yes. The language from the statute embraces only those claimants for whose benefit the surety bond is required. This includes those who are seeking payment for labor performed for a subcontractor. *Thurman v. Star Electric Supply, Inc.* 307 So.2d 283 (La. 1975).

May an Employee of a Sub-Subcontractor Sue Surety?

No. A claimant must demonstrate a contractual relationship with either the prime contractor or a subcontractor before they may bring a cause of action against the surety on the payment bond. *Thurman v. Star Electric Supply, Inc.* 307 So.2d 283 (La. 1975).

Time Requirements

- Notice Requirements

A claimant must first give notice to the general contractor with 75 days after the last day of the month the labor was performed. Claimant must record a sworn statement of account within 45 days of acceptance of work by governmental entity or notice of default of the general contractor. A claimant in direct contractual privity with a subcontractor but not the general contractor must also give the general contractor notice within 45 days after acceptance of work by the owner. L.S.A. §§ 2242, 2247.

Statute of Limitations

A claimant must bring an action on the bond within one year of final acceptance of work or of notice of default of the general contractor.

Mississippi

Who May Sue Surety Directly?

Statutory Authority

- Miss. Code Ann. § 31-5-51 – The only people protected by payment bonds are subcontractors and material suppliers of the contractor, sub-subcontractors and material suppliers of the subcontractor, and laborers who have performed work on the project site.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *U.S. Fidelity & Guaranty Co. of Baltimore, Md. v. Marathon Lumber Co.*, 81 So. 492 (Miss. 1919) (affirming a lower court decision to permit persons providing labor to the general contractor to sue the surety on the payment bond).

- May an Employee of a Subcontractor Sue Surety?

Yes. "...appellant was a materialman to a subcontractor and therefore under the provisions of [the payment bond statute]...the appellant was authorized to bring its demand for the materials *and labor it had expended* and for which it had not been compensated. See *O'Neal Steel Co. v. Leon C. Miles, Inc.*, 187 So.2d 19 (Miss. 1966) (emphasis added).

- May an Employee of a Sub-Subcontractor Sue Surety?

Unclear. There does not appear to be any Mississippi case law on the direct issue. Looking at the statute it appears that the important factor is not how far down the chain the laborer is, but rather whether the laborer actually provided labor at the worksite. It would arguably follow that a laborer of a sub-subcontractor or even a sub-sub-subcontractor would be able to sue the surety on the payment bond if they actually performed work at the worksite.

Time Requirements

- Notice Requirements
 - A person not in direct privity with the contractor providing the payment bond must provide the contractor with notice within ninety days from the date in which the laborer performed the last of the labor or supplied the last of the material

for which the claim is made. Miss. Code Ann. § 31-5-51(3).

Statute of Limitations

Suit must be brought within 1 year after the last labor was performed. Miss. Code Ann. § 31-5-53.

- **North Carolina**

Who May Sue Surety Directly?

Statutory Authority

- N.C.G.S. §§ 44A-25-27 – The payment bond is for the protection of persons performing labor for which a contractor or subcontractor is liable. A subcontractor is any person who contracted to furnish labor or materials to, or has performed labor for, a contractor or another subcontractor.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *Pittsburgh Plate Glass Co. v. Fidelity & Deposit Co. of Maryland*, 138 S.E. 143 (N.C. 1927), *rev'd on other grounds*. The court held that a materialman of a general contractor may bring a direct cause of action against the surety on a payment bond. Again, this case dealt with a materialman as opposed to a laborer, but both are often considered as essentially the same for payment bond purposes.

May an Employee of a Subcontractor Sue Surety?

Yes. Laborers and materialmen to subcontractors are able to sue a surety on a payment bond. *Overman & Co. v. Great American Indemnity Co.*, 155 S.E. 739 (N.C. 1930).

May an Employee of a Sub-Subcontractor Sue Surety?

Yes. A supplier to a sub-subcontractor is a “subcontractor” under the terms of the statute and a supplier of labor or materials to a sub-subcontractor is entitled to sue the surety on the payment bond. *HIS North Carolina, LLC v. Diversified Fire Protection of Wilmington, Inc.*, 611 S.E.3d 225 (N.C. 2005). Note: the court explicitly stated that it had no opinion on whether the same result would occur if the plaintiff was a supplier of a sub-sub-subcontractor.

Time Requirements

- Notice Requirement

- 120 days from the day labor was last performed. N.C.G.S. § 44A-27(b).

Statute of Limitations

Suit must be brought within the longer of one year after the labor was last performed or one year after the contact with the general contractor has been finally settled. N.C.G.S. § 44A-28(b)

Oklahoma

Who May Sue Surety Directly?

Statutory Authority

- 61 O.S. §§ 1, 2 – The payment bond shall ensure that the contractor shall pay all indebtedness the contractor incurs for the contractor’s subcontractors and all suppliers of labor used in the performance of the contract. Any person to whom there is due any sum for labor furnished as stated previously may bring an action on the bond.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. See *Amerman v. State*, 239 P. 146 (Okla. 1925). There the court held that materials used in construction of a public work, whether furnished under the contract directly to the contractor or to a subcontractor must be deemed within the obligation of the surety. This line of reasoning is not limited to material suppliers, but also to laborers. See *Tom P. McDermott, Inc. v. Bennett*, 395 P.2d 566 (Okla. 1964).

May an Employee of a Subcontractor Sue Surety?

Yes. See *Amerman v. State*, 239 P. 146 (Okla. 1925). As stated above, the court held that materials used in construction of a public work, whether furnished under the contract directly to the contractor or to a subcontractor must be deemed within the obligation of the surety. This line of reasoning is not limited to material suppliers, but also to laborers. See *Tom P. McDermott, Inc. v. Bennett*, 395 P.2d 566 (Okla. 1964).

May an Employee of a Sub-Subcontractor Sue Surety?

Yes. See *Richards & Conover Steel Co. v. Nielsons, Inc.* 755 P.2d 644 (Okla. 1988). There the court held that the purpose of the statute can only be served by allowing the

materialman (again, seen in same light as a laborer) to a third tier contractor, or sub-subcontractor, to recover on the payment bond.

Time Requirements

- Notice Requirement
 - 90 days from the date the labor was last performed. 61 O.S. § 2(b).

Statute of Limitations

One year from the date on which the labor was last performed. 61 O.S. § 2(a).

- **South Carolina**

Who May Sue Surety Directly?

Statutory Authority

- S.C. ST §§ 29-6-250, 11-1-120 – Every person who has furnished labor to a bonded contractor or its subcontractors who has not been paid in full has a right to sue on the payment bond. “Bonded contractor” is defined as a contractor or subcontractor furnishing a payment bond. A “remote claimant” is defined as a person having a contractual relationship with a subcontractor of a bonded contractor, but no contractual relationship with the bonded contractor.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. A contractor and its surety are liable for labor provided to the contract and that a materialman (analogous to a laborer) may bring a direct cause of action against the surety on the bond. See *Dominion Culvert & Metal Corp. v. U.S. Fidelity & Guaranty Co.*, 120 S.E.2d 518 (S.C. 1961).

May an Employee of a Subcontractor Sue Surety?

Yes. See *Dominion Culvert & Metal Corp. v. U.S. Fidelity & Guaranty Co.*, 120 S.E.2d 518 (S.C. 1961). As stated above, a contractor and its surety are liable for labor provided to the contract and that a materialman (again, analogous to a laborer) may bring a direct cause of action against the surety on the bond.

May an Employee of a Sub-Subcontractor Sue Surety?

No, unless the subcontractor secured its own payment bond. A supplier to a sub-subcontractor (similar to a laborer to a sub-subcontractor) did not have a direct contractual

relationship with a bonded contractor as required by statute, and was not a proper claimant and was not entitled to sue on the bond. *William H. Bird & Co. v. Whitmire*, 413 S.E.2d 804 (S.C. 1992). But see *Frost v. Williams Mobile Offices, Inc.* 343 S.E.2d 441 (S.C. 1986) (permitting a supplier of a sub-subcontractor to sue on subcontractor's surety for unpaid amounts).

Time Requirements

- Notice Requirement
 - 90 days from which the last labor was performed. S.C. ST. § 11-1-20.

Statute of Limitations

One year from the day labor was last performed.
S.C. ST. § 11-1-20.

- **Tennessee**

Who May Sue Surety Directly?

Statutory Authority

- T.C.A §§ 12-4-201 – 12-4-208 – Any laborer of the contractor or any immediate or remote subcontractor may bring an action on the bond.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. While there do not appear to be any Tennessee cases to answer this question directly on point, the statutory language explicitly states that any laborer of the contractor may bring an action on the bond.

May an Employee of a Subcontractor Sue Surety?

Yes. See *J. A. Jones Construction Co. v. Lawrence Bros., Inc.*, 419 S.W.2d 186 (Tenn. App. 1966) (permitting a supplier to a subcontractor (analogous to a laborer of a subcontractor) to sue the surety on the payment bond.

May an Employee of a Sub-Subcontractor Sue Surety?

Possibly. There does not appear to be any Tennessee cases directly on point. Recently, a Tennessee Court of Appeals reversed a trial court ruling that had permitted a supplier to a sub-subcontractor to recover on a payment bond. See *Nashville Ford Tractor, Inc. v. Great American Ins. Co.*, 194 S.W.3d 415 (Tenn. Ct. App. 2005). However, the Court of Appeals

reversed not because the supplier was a supplier to a sub-subcontractor, but rather because the supplier had fraudulently altered terms of its contract to fall under the payment bond. This raises an implication that had it not been for this fraudulent alteration, the supplier would still have been able to bring the action on the bond. This implication, combined with the statutory language, provides an argument for laborers of a sub-subcontractor to be permitted to sue on the payment bond, at the very least.

Time Requirements

- Notice Requirement
 - 90 days after the completion of the public work.
T.C.A. § 12-4-205.

Statute of Limitations

6 months from the completion of the public project.
T.C.A. §12-4-206.

Texas

Who May Sue Surety Directly?

Statutory Authority

- V.T.C.A Gov. Code §§ 2253.021, 2253.073 – The payment bond is solely for the protection and use of payment bond beneficiaries who have a direct contractual relationship with the prime contractor or a subcontractor to supply public work, labor, or material. Further a payment bond beneficiary may sue the principal or surety, jointly or severally.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. In holding that a prime contractor itself can file suit under the McGregor Act, the Austin Court of Appeals reiterated that those having a direct contractual relationship with the general contractor are also protected by the Act, and may thus sue the surety directly. See *Poth Corp. v. Marble Falls Independent School Dist.*, 673 S.W.2d 648 (Tex. App.—Austin 1984). A laborer having a direct contractual relationship with the general contractor would fall under this holding.

May an Employee of a Subcontractor Sue Surety?

Yes. Those who perform labor for a subcontractor under a public works contract are entitled to

sue on the payment bond. *Huddleston & Work v. Kennedy*, 57 S.W.2d 255 (Tex. Civ. App. 1931). See also *J.W.D. Inc. v. Federal Insurance Co.*, 806 S.W.2d 327 Tex. App.—Austin 1991) (permitting assignees of a subcontractor’s laborers’ unpaid wage claims to stand in the shoes of the subcontractor’s laborers and sue the surety on the payment bond).

May an Employee of a Sub-Subcontractor Sue Surety?

Most likely yes. There is no Texas case law directly on point. However, there is an argument that can be made to support a finding that a laborer to a sub-subcontractor would be entitled to sue the surety on the payment bond. Chapter 2253 states that payment bond beneficiaries with a contractual relationship with a subcontractor can sue on the bond. Chapter 2253 then defines “subcontractor” as one who provides labor to fulfill an obligation to a general contractor or a subcontractor for performance of any work under a public works contract. Thus, a laborer is considered a subcontractor under Chapter 2253 and should be able to bring suit against the surety on a payment bond claim.

Time Requirements

- Notice Requirements
 - A laborer with a direct contractual relationship with the general contractor must provide notice to the general contractor and surety by the 15th day of the third month after the last month the labor was performed. If the laborer does not have a direct contractual relationship with the general contractor, they must give the general contractor notice by the 15th day of the second month after the month in which the last labor was performed AND give notice to the general contractor and surety by the 15th day of the third month after the month in which the labor was last performed.

Statute of Limitations

Suit may be brought no earlier than the 60th day after notice was given and no later than one year after the claim was filed.

Federal

Who May Sue Surety Directly?

Statutory Authority

- 40 U.S.C.A §§ 3131, 3133 – A payment bond is required for the protection of all persons supplying labor and material in carrying out the work of the contract. Every person providing labor who has not been paid for that labor may bring suit on the payment bond.

Case Law

- May an Employee of the General Contractor Sue Surety?

Yes. In *MacEvoy Co v. United States ex rel. The Calvin Tomkins Co.*, 322 U.S. 102 (1944), the United States Supreme Court indicated that the protection afforded by the statute is not limited to laborers who provide labor to the general contractor. It follows then that if the statutory protection is not limited to those laborers, the statute does in fact protect laborers to the general contractor.

May an Employee of a Subcontractor Sue Surety?

Yes. Laborers with a direct contractual relationship with a subcontractor may bring suit on a payment bond. *MacEvoy Co v. United States ex rel. The Calvin Tomkins Co.*, 322 U.S. 102 (1944).

May an Employee of a Sub-Subcontractor Sue Surety?

No. While the sub-subcontractor itself may recover under the payment bond, a laborer for the sub-subcontractor is too remote and may not sue the surety on the payment bond. *J.W. Bateson Co. v. United States ex rel. Board of Trustees of the National Automatic Sprinkler Industry Pension*, 434 U.S. 586 (1978).

Time Requirements

- Notice Requirement
 - A laborer for a subcontractor, who has no direct contractual relationship with the general contractor must provide the general contractor with notice within 90 days after the labor was last performed. 40 U.S.C.A. § 3133(b)(2).

Statute of Limitations

Suit may be brought within 1 year from the day the labor was last performed. 40 U.S.C.A. § 3133(b)(4).

Payments and Liabilities Involved with Individual Laborer Payment Bond Claims

Despite the name, a “wage claim” against a surety is not limited to the direct wages the employer owes its employees. Rather the surety could also be liable for any other indirect “wages” the employer owes. These indirect “wages” include health benefits and union dues. Not many states have expressly ruled on a surety’s liability for these “indirect wages”, but the states that have all ruled that the surety is indeed liable and have used essentially the same reasoning in reaching this conclusion. These states, and the federal courts, have focused less on the name the payment to the employee is given, whether “wage” or “fringe benefit” and more on the substance of the payment as compensation in consideration for labor performed.²³

When faced with the issue of whether its payment bond covers payments made to a health and welfare fund, some surety companies have made the argument that since the payment is made directly to the health and welfare fund and not directly to the employee, the payment cannot be considered “wages.” This argument has long been rejected by the federal courts.²⁴ In *United States, ex rel. Sherman v. Carter*, the general contractor was obligated to pay 7 ½ cents per hour of labor to a health and welfare fund established for the laborers. The general contractor was unable to make this payment, forcing the trustees of the fund to sue the surety for the money. The surety made the argument that contributions to the fund should be treated differently from wages and that the laborers had already received all the wages the laborers were due. The United States Supreme Court rejected this argument, finding that the protection given by the Miller Act is not limited to the surety’s definition of “wages.” Rather, the unpaid contributions were part of the consideration the general contractor agreed to pay for the services of the laborers. Thus, the employees were not paid in full for their work until the fund contributions were paid. “[T]hese contributions are in substance as much ‘justly due’ to the employees who earned them as are the wages payable directly to them in cash.”²⁵

The states that have been presented with this issue have followed the path set by the United States Supreme Court. In *Pipeline Industry Benefit Fund v. Aetna Casualty & Surety Co.* an Oklahoma Court of Appeals was asked whether a surety was liable for costs for hospital care and pension benefits.²⁶ The contractor was obligated under contract to pay direct labor costs as well as pay 55 cents an hour for a health and welfare fund. The Oklahoma Court of

²³ See *United States ex rel. Sherman v. Carter*, 353 U.S. 210 (1957).

²⁴ *Id.*

²⁵ *Id.* at 220.

²⁶ *Pipeline Industry Benefit Fund v. Aetna Casualty & Insurance Co.*, 503 P.2d 1286, 1287 (Okla. Ct. App. Div. 1 1972).

Appeals first defined “wages” as remuneration for services from whatever source, including commissions, bonuses, tips, and the cash value of all payments in any medium other than cash.²⁷ Thus, the Court of Appeals found that the surety was liable for the unpaid health and welfare payments which are considered wages as part of the labor costs.²⁸ “Simply because some of the workman’s pay goes into a fund or his sickness [sic] and old-age security instead of in a paycheck does not alter the fact that the fringe benefits are a result of his own efforts the same as the money he puts in his pocket.”²⁹

Similarly, a Florida Court of Appeals has found that a surety is liable for any default union benefit payments.³⁰ In *Trustees, Florida West Coast Trowel Trades Pension Fund v. Quality Concrete Co.*, the general contractor was contractually obligated to pay union benefits. These payments were not made and the union for the employees looked to the surety for these payments. The surety took the position that no Florida authority required the surety to make the union benefit payments. While acknowledging that no Florida court had previously ruled on whether a surety is liable for these payments under the Florida public works payment bond statute, the Court of Appeals noted when there are no Florida court interpretations of the statute, Florida courts should look to the Miller Act interpretations. Thus, the Florida Court of Appeals looked to the above *Sherman* case for guidance. Agreeing with the holding given by the United States Supreme Court in *Sherman*, the Florida Court of Appeals found that if these funds could not be recovered on a payment bond claim, large portions of the laborers’ compensation would be unprotected.³¹ As the purpose of the public works payment bond statute is to protect these laborers, the surety is liable for the union benefit payments.

Once a surety satisfies a wage payment claim, a new issue is raised regarding the surety’s liability for employment and payroll taxes. The Miller Act provides that a surety must cover taxes owed to the federal government in their *performance* bonds.³² The Miller Act does not, however, explicitly state whether a surety must provide the same coverage in their *payment* bonds. This has not stopped federal courts from holding that surety companies must provide such coverage. Rather than falling back on the Miller Act to support their position, federal courts (and the Internal Revenue Service) have recognized the ability to tax a surety for payroll and employment taxes through the Internal Revenue Code.³³

²⁷ *Id.* at 1288.

²⁸ *Id.* at 1289.

²⁹ *Id.* (citing *Genix Supply Co. v. Board of Trustees of H. & I. Fund*, 84 Nev. 246, 438 P.2d 816 (1968)).

³⁰ See *Trustees, Florida West Coast Trowel Trades Pension Fund v. Quality Concrete Co.*, 385 So.2d 1163 (Fla. DCA 1980)

³¹ *Id.* at 1166.

³² 40 U.S.C.A § 3131(c).

³³ *Fidelity and Casualty Co. of New York v. United States*, 490 F.2d 960, 964 (Ct. Cl. 1974).

The Internal Revenue Code provides that a surety who is not an employer with respect to an employee or group of employees pays wages directly to such an employee or group of employees, employed by one or more employers, such surety shall be liable in his own person and estate to the United States in a sum equal to the taxes required to be deducted and withheld from such wages by such employer.³⁴ In other words, if a surety pays wage claims directly to the contractor's employees, the surety is responsible for any of the withholding taxes the contractor would have been required to pay to the employees had the contractor paid the wages. This tax payment is made by sending two copies of Form 4219, a copy of which is attached at the end of this paper, as well as a check made out to "United States Treasury" for the applicable tax amount to the IRS Service Center where the employer would be required to file its tax returns. A surety must repeat this procedure for each employer the surety provides payroll for during the applicable tax period.

A surety would not necessarily be able to escape its payroll and employment tax liability by financing the contractor so the contractor would be able to directly pay the employees. If a surety supplies funds to the account of an employer for the purpose of paying wages of the employees of the employer with actual notice or knowledge that such employer does not intend to or will not be able to make timely payments of the payroll and employment taxes, the surety is liable for the sum equal to the taxes owed by the employer.³⁵

This tax liability exists even if no wage claim is filed, but rather can exist simply if the contractor informs the surety that the contractor is under financial stress and needs some assistance from the surety. A majority of the cases dealing with a surety's liability to pay payroll and employment taxes arise in this context. The contractor informs the surety that it will not be able to finish a project. Faced with the decision to either help fund the contractor or face a work shutdown, the surety, like most do, will provide some financial assistance to the contractor to keep the project going. In exchange for this financial support, the surety will usually seek control of funds from the owner and will then disburse money from those funds to pay for labor, supplies, and material. The contractor will continue to perform the work, but the surety now controls the payment. With this added control comes with it payroll and employment tax liabilities. A surety company that has taken control of funds from a contractor is liable for payment of all taxes to be withheld on wages paid to the contractor's employees.³⁶

³⁴ 26 U.S.C.A § 3505(a).

³⁵ 26 U.S.C.A. § 3505(b).

³⁶ See *Fidelity and Casualty Co. of New York v. United States*, 490 F.2d 960 (Ct. Cl. 1974). See also *United States v. Falino*, 441 F. Supp. 153 (E.D.N.Y. 1977).

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Short Summary of Sub-Subcontractor Employee's Ability to Sue Surety