

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

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**SUBDIVISION & MAINTENANCE BONDS -
WHAT KIND OF CRITTER IS THIS ANYWAY?**

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I. Why Do Subdivision Performance and Maintenance Bonds Exist?

Most local governments now require developers to provide subdivision bonds. The reason for this is pretty straightforward: local governments found that they needed a more effective financial mechanism to make certain that the infrastructure required for subdivision would be built and that it would comply with certain minimum standards. In most instances, the roads, drainage systems, and other infrastructures in a subdivision are dedicated to the local government which then owns them, treats it as public property, and is responsible for the maintenance and care of the infrastructure. Cities and counties needed a way to make certain that this infrastructure construction meets their requirements and is installed to certain minimum standards.

Local governments developed ways to enforce these requirements, and one of the chief mechanisms is a subdivision bond. Of course, most statutory schemes allow for other sorts of collateral, such as a letter of credit. However, by far, the most common technique used to secure compliance with subdivision standards is a bond.

As the Virginia Supreme Court stated in *Board of Supervisors of Fairfax County v. Ecology I, Inc.*, 219 Va. 29, 245 S.E.2d 425 (1978), the main purpose of a subdivision ordinance requiring a bond is to require that the subdivide lay out and construct streets and improvements in accordance with the state and county standards before maintenance is taken over by the public agency and to relieve the public of the burden which would otherwise exist.

Typically, there are two bonds: a performance bond and a maintenance bond. In generic terms, the performance bond has as its condition the requirement that the infrastructure be put in place, and the maintenance bond requires that the infrastructure be maintained for some period of time, often on the order of 18 to 24 months.

We have all heard the admonition over and over to “RTFB” - Read the Fool Bond. This is especially important to do in the case of subdivision bonds since there are no standard forms and what is seen varies tremendously from jurisdiction to jurisdiction.

II. Statutory Schemes – Legal Underpinning of the Bonds

Local governments have enacted ordinances requiring subdivision developers to provide bonds related to the construction of subdivisions. Many city and county ordinances can be found online at <http://www.municode.com/Resources/OnlineLibrary.asp>. Courts will often look to the applicable ordinance, in addition to the state enabling statute and the bond itself, in construing the subdivision bond.

Having read the bond, there is one other important requirement, and that is to read the statutory scheme under which the bond is adopted. It is absolutely mandatory to know what the local government requires. These requirements run the gamut from describing the nature and character of the bonds, the minimum requirements for infrastructure construction, and a host of other topics. In most instances, there is no way to determine what is required by the bond without reviewing the local ordinance. As we will see below, there are a great many cases in which local governments have tried to stretch bond liability beyond the local

ordinance. Where they try to do so, the court will find that the requirements beyond the statute are *ultra vires* (that is, an act beyond the scope of powers granted to the local government).

Courts generally recognize that local governments can only exercise subdivision controls pursuant to enabling legislation and that any exercise of that power must be consistent with that legislation. See *New Jersey Shore Builders Association v. Township of Marlboro*, 591 A.2d 950 (N.J. Super. 1991). As discussed below, a government's *ultra vires* demands pertaining to the principal's work in the subdivision and the related bonds will generally be unenforceable. Some courts also will apply the "read in/read out" rule, reading into the bond the requirements of the ordinance or other legislation under which the bond is issued, and reading out of the bond any requirements not required by the legislation.

A. *Ultra Vires* Bond Demands by the Municipality

In *New Jersey Shore Builders Association v. Township of Marlboro*, 591 A.2d 950 (N.J. Super. 1991), the enabling statute at issue provided that no performance or maintenance guarantee would be required for subdivision utilities that would be owned by public utilities upon installation. Because a public utility would own the subdivision's electric facilities upon their completion, the town could not require a performance bond from the developer for the installation of those facilities. The court also held that the state legislature did not grant to the municipality the authority to charge developers for the cost of lighting the streets prior to the town's acceptance of the improvements.

A developer sued a township for the release of performance bonds in *Eastern Planned Communities at Lincroft, Inc. v. Middletown Township*, 563 A.2d 81 (N.J. Super. 1989). The town opposed the release of the bonds, arguing that the improvements and obligations secured by the bonds had not been fully performed since the developer failed to form a homeowner's association as required by a planning board resolution. The court concluded that the town lacked the power to require a bond to ensure the formation of a homeowner's association because there was no statutory authority allowing the town to require such performance guarantees. The town's attempt at requiring such a bond was *ultra vires*, and the developer was entitled to the release of the bonds.

The case of *J.D. Land Corp. v. Allen*, 277 A.2d 404 (N.J. Super. App. Dir. 1971) arose when a subdivision developer sought a declaratory judgment that an ordinance relating to certificates of occupancy was invalid. The court held that where the subdivider posted a bond guaranteeing the completion of subdivision site improvements, the municipality could not require the posting of an additional cash deposit to ensure completion of the improvements as a condition to issuing a certificate of occupancy. Although the court held that a municipality may withhold certificates of occupancy to enforce its land subdivision ordinance, it stated that this power must be reasonably exercised and be related to the residences for which certificates of occupancy are sought. The court ruled that the ordinance at issue was not a valid exercise of the municipality's power because it provided no standards for the issuance of certificates of occupancy. Withholding a certificate of occupancy as a subdivision control must be related to the health, welfare, and safety of the occupants for which the certificate is sought.

In *Town of Poughkeepsie v. Holden Construction Co., Inc.*, 419 N.Y.S.2d 531 (App. Div. 1979), the court held that a town lacked the authority to require a cash deposit in addition to a performance bond where the town ordinance mandated a performance bond sufficient to cover

the full cost of the improvements. The court noted that the legislation provided the procedure by which site plans were to be approved and must be strictly complied with. The court further held, however, that the town's *ultra vires* act had no deleterious effect upon the surety and did not discharge the surety of its obligation under the performance bond.

The court in *Bama, Inc. v. Anne Arundel County*, 451 A.2d 1261 (Md. Ct. Spec. App. 1982), held that a county's requirement that a developer reconstruct an existing road was an unenforceable, *ultra vires* act. The county exceeded its authority because the ordinance enabling the county to impose such conditions for subdivision approval was enacted after the "Public Works Agreement" at issue was executed by the parties.

A county brought an action against a subdivision developer and its surety for the developer's failure to complete its work under performance agreements for the development of a proposed subdivision in *Board of County Supervisors of Prince William County v. Sie-Gray Developers, Inc.*, 334 S.E.2d 542 (Va. 1985). The trial court ruled that the county had no authority to require the subdivider to construct certain improvements to an existing state-maintained road that abutted the subdivision, that the subdivider agreed to make those improvements under protest, and that damages resulting from the failure to make those improvements were not recoverable. The Supreme Court of Virginia found that there was no support in the evidence concerning the subdivider's agreement being made under the protest and that any reluctance or unwillingness of the subdivider was never communicated to the county. The subdivider and surety argued that because the county did not have the power to require the improvements to the existing road as a condition for subdivision approval under a previous decision of the Supreme Court of Virginia,¹ the agreement, even if voluntarily executed by the subdivider, was *ultra vires* and therefore void and unenforceable. The court held that because the subdivider entered into a contract with the county for the improvements to the existing road, it was estopped to assert that it was *ultra vires*, and that because the defense was unavailable to the subdivider, it was also unavailable to the surety.

B. Read In/Read Out Rules

Courts in some states will apply the read-in/read-out rule in interpreting bonds and will interpret the terms of the statute, ordinance, or other legislation requiring the bond, without regard to bond terms that are not required by the legislation. As stated by the Georgia Supreme Court:

When a bond is given under the authority of a statute in force when it is executed, in the absence of anything appearing to show a different intention it will be presumed that the intention of the parties was to execute such a bond as the law required, and such statute constitutes a part of the bond as if incorporated in it, and the bond must be construed in connection with the statute and the construction given to the statute by the courts.... Whatever is included in the bond, and is not required by the law, must be read

¹ In *Hylton Enterprises, Inc. v. Prince William County*, 258 S.E.2d 577 (Va. 1979), the Supreme Court of Virginia found no authority in the statutes governing the enabling statutes, local subdivision ordinances, or statutes governing the state highway system to require a subdivision developer to construct improvements to existing public roads. Therefore, the court held that the county could not refuse to approve an otherwise acceptable subdivision plan on the subdivider's refusal to improve those roads. *Hylton*, 258 S.E.2d at 580-81.

out of it, and whatever is not expressed, and ought to have been incorporated, must be read as if inserted into it; but such rule applies only to matters of substance and not to mere matters of form.

Campbell v. Benton, 122 S.E.2d 223, 226 (Ga. 1961), quoting 11 C.J.S. Bonds § 40(e), p. 420. This rule can help and/or hurt the surety, depending on the language of the bond, the language of the legislation, and whether that language is beneficial or detrimental to the surety. In evaluating the scope of a subdivision bond's coverage, a surety should carefully review the requirements of the legislation under which the bond was given and determine if the state in which the bond was issued has adopted the read-in/read-out rule.

The Supreme Court of Oklahoma applied the read-in/read-out rule in the context of a subdivision bond in *W.S. Dickey Clay Mfg. Co. v. Ferguson Investment Co.*, 388 P.2d 300 (Okla. 1963). In that case, a supplier to a subcontractor of a subdivision developer filed suit against a subdivision bond surety, the developer, and the subcontractor. The subdivision bond was conditioned upon the developer's installation and completion of all improvements and utilities and payment of all bills for contractors, subcontractors, and labor and materials incurred in the completion of the bonded work. A state statute and an ordinance of the City of Oklahoma provided that, in lieu of the completion of subdivision improvements and utilities prior to the final approval of the plat, the city could accept a surety bond securing the actual construction of the improvements or utilities. The court found that there was no language in the statute or ordinance requiring a bond to provide that the principal will pay all bills for contractors, subcontractors, and labor and materials. Because this was a statutory bond, the liability of the surety was "confined to the measure of liability as contemplated by the law requiring [the] bond," even though the bond's terms provide for more expansive coverage.

A bond which contains the conditions required by statute, and also conditions in excess of those specified by statute, is valid, so far as it imposes obligations authorized by statute; but the stipulations which are in excess of it may be rejected as surplusage.

Id. at 304, quoting *Lowe v. City of Guthrie*, 44 P.198, 200 (Okla. 1896) Since neither the statute nor the ordinance contemplated requiring the developer to guarantee payment for labor and materials, the court held that such a condition in the subdivision at issue was invalid, beyond the authority of the statute, the ordinance, and the city, and provided no relief to suppliers to the subdivision.

Although some courts will read statutory requirements into a bond, the many will not read out bond provisions providing more protection to the obligee than what is statutorily required. For example, in *Mount Florence Group v. City of Peekskill*, 652 N.Y.S.2d 814 (App. Div. 1997), the surety provided a subdivision performance bond which provided a longer time for the obligee to file suit to recover under the bond than the three years provided by the city's ordinance. The surety claimed the bond was issued to meet the requirements of the city's ordinance and, therefore, the bonds should be considered statutory bonds, subject to the ordinance's statute of limitations. The court recognized that a bond issued to meet a statutory obligation cannot dilute the minimum statutory protections provided to statutory beneficiaries, and minimum requirements are read into the bond. However, a bond that furthers public policy by providing greater protections to the statutory beneficiary will be enforced according to its

terms as a common law bond and will not be restricted by the statute. “[A] surety’s promise which goes beyond the statutory requirements to provide the statutory beneficiary with greater rights and benefits than the minimum set forth by statute is a common-law bond and is an enforceable common-law obligation as written.” *Id.* at 789.

III. Where’s the Money?

The short answer to this question is that typically there is no money to be paid to the principal. The developer ordinarily is responsible for funding the costs of the subdivision improvements. By the time the developer has abandoned the subdivision or otherwise failed to comply with the requirements for the subdivision improvements, the developer has little or no funds to cure the default or to reimburse the surety for bond expenditures. Unlike a typical construction performance bond, there will be no contract balance in the hands of the obligee which the surety can use to reduce its losses. The local government is not indebted to the principal for the subdivision improvements, and it will not be indebted to the surety if the surety completes the improvements. Therefore, the surety must be proactive in securing itself against potential losses. Obtaining collateral and letters of credit from the principal and indemnitors are ways this can be done.

IV. Scope of Bond Liability

In construing the scope of subdivision bonds, courts generally consider the enabling legislation, the local ordinance or other legislation under which the bond is given, the terms of the principal’s contract with the local government, and the terms of the bond. As discussed above, courts will often read into a subdivision bond the requirements of the legislation under which the bond is given.

As with other surety bonds, some states will strictly construe the surety’s obligation under subdivision bonds in the surety’s favor. See e.g. *R.J. Griffin & Co. v. Continental Ins. Co.*, 497 S.E.2d 586, 587 (Ga. App. 1998) (“In contrast to the general rule that policies of insurance are construed strictly against the insurer, the obligation of a surety is construed strictly in the surety’s favor.”). Other jurisdictions disregard the principle of *strictissimi juris* in construing the obligations of compensated sureties.

A. Forfeiture Bonds vs. Performance/Indemnity Bonds

In seeking to recover pursuant to subdivision bonds, some local governments have argued that the entire penal sum is due for a principal’s breach of the conditions of the bond, essentially asserting that the bonds are forfeiture bonds or penalty bonds. Courts have been unreceptive to these arguments and generally will limit the amounts recoverable to damages actually sustained.

Section 13-6-3(a) of the Official Code of Georgia provides that bond provisions that state the damages to be paid in the event of a breach are unenforceable penalties “unless the amount stipulated is reasonably related to the amount of the loss resulting from the breach and the damages resulting from the breach are uncertain in nature or amount or are difficult of ascertainment.” Where bond provisions stipulating the damages to be paid do not comply with these requirements, “only actual damages shall be recoverable in the event of a breach.” O.C.G.A. § 13-6-3(b). In Georgia, the amount of money named in a bond that is conditioned

on the faithful performance of contract obligations is presumed to be a penalty, not liquidated damages, and a recovery on the bond will be limited to actual damages sustained. *City of Brunswick v. Aetna Indem. Co.*, 62 S.E. 475 (Ga. App. 1908).

Not all courts are so enlightened. In *General Insurance Co. of America v. City of Colorado Springs*, 638 P.2d 752 (Colo. 1982), the City of Colorado Springs sued to recover on a surety bond filed in connection with the construction of subdivision street improvements and argued that the bond was either a penalty bond or a contract for liquidated damages. The Supreme Court of Colorado noted that the character of the bond could not be determined from its own terms, but when considered in light of the ordinance under which it was issued, it was clear the bond contemplated indemnification to the city to cover the cost of the incomplete work up to the amount of the bond. The ordinance stated that the purpose of requiring the bond was “to secure to the city the actual construction and installation of all required street improvements if the improvements are not installed.” The court interpreted the language as indicating an intent to secure to the city the cost necessary to complete improvements upon a subdivider’s default, as opposed to an intent to exact a penalty for the total amount of the bond regardless of the loss or damage to the city. The court reasoned that that if the city intended to impose a penalty for a subdivider’s nonperformance, it could have required a penalty bond in its subdivision ordinance. “A contrary construction could result in an unjustified windfall to the city by requiring a forfeiture of the entire amount of the bond no matter how trivial or insignificant the developer’s nonperformance might be.” *Id.* at 758.

The Virginia Supreme Court considered a surety bond guaranteeing the construction of public improvements in *Board of Supervisors of Fairfax County v. Ecology One*, 245 S.E.2d 425 (Va. 1978). The court stated that its determination of whether the bond was a penal bond or an indemnity bond must be based upon the language of the state enabling statute, the county ordinance, and the bond itself. One of the main purposes of the enabling act and the Fairfax County ordinance was to require a subdivider to construct streets and other improvements in accordance with state and county standards before maintenance is taken over by a public agency and to relieve the public of any such burden. The court found that there was nothing in the bond, the state statutes, or the county ordinance to suggest the bond was intended as a punishment for nonperformance. On the contrary, the bond was intended to be an amount sufficient to pay construction costs. Upon the failure of the subdivider to complete the public improvements, the bond provided funds to the extent of the amount of the bond to cover the cost of completion. The bond’s provision that the surety would be liable for no more than the “penal” amount of the bond did not make it a penal bond instead of an indemnity bond, and the court did not construe the word “penal” as used in the bond to mean that the bond was a penal or forfeiture bond in light of the bond’s other language. The court concluded that the bond was a performance or indemnification bond instead of a penal bond.

In *Board of County Supervisors of Prince William County v. Sie-Gray Developers, Inc.*, 334 S.E.2d 542 (Va. 1985), Prince William County contracted with another developer to complete work in certain sections of a subdivision after the initial subdivider failed to complete the work. The Supreme Court of Virginia set forth the rule that the damages recoverable under a performance bond are limited to the reasonable costs of completion, not to exceed the face amount of the bond. The court stated that if a county proves the costs of completion exceed the face amount of the bond, it can recover the full bond amount even if the work has not yet been performed in view of the presumption that public officials will lawfully perform their duties. However, if the evidence shows the county assigns its rights under the bond for a purpose

other than completion of the contemplated construction, the presumption is rebutted. “Recovery on the bond should not be permitted for damages that are not the result of breach of the bonded agreement.” *Id.* at 547.

The evidence indicated that the replacement developer agreed to complete the work for sections 2C and 2D of the subdivision and convey certain easements required to complete improvements in section 1 of the subdivision in exchange for county agreeing to pay the face amount of the performance bond for sections 2C and 2D upon the completion of 70% of the required improvements. The easements did not relate to the bonded work in sections 2C and 2D, but instead related to work in a separate section of the subdivision covered by a separate bond. At the time of trial, no work had been done to install improvements or construct houses in sections 2C and 2D. The court found that the bond covering sections 2C and 2D, which guaranteed performance only in those sections, was not implicated in an action for the cost of the easements. Because the county failed to demonstrate what portion of the consideration corresponded to the cost of completing sections 2C and 2D and what portion was for the easements, the county failed to show the full bond amount (or any specific portion thereof) was committed to the replacement developer for a proper purpose, i.e. completing the work covered by the bond. The evidence rebutted the presumption that the bond amount would be used to complete sections 2C and 2D, and the county could not recover on the bond because it failed to show the amount it would pay for the construction guaranteed by the bond.

In *West Norriton Township v. Abel Investment Co.*, 1960 WL 6028 (Pa. Ct. of Common Pleas 1960), Abel Investment Corporation provided a township with two bonds with sums totaling \$68,000 for the satisfactory construction and installation of all required public improvements appearing on its subdivision plan, as required by the township’s land subdivision control ordinance. The township argued the sums in the bonds were penalties and the full sums were recoverable upon the developer’s breach of the bond’s conditions. The court disagreed, finding the purpose of the bonds was not to punish the developer or to bring a windfall to the township, but to assure the subdivision residents that “they will receive the public improvements which were among the inducement to buy in the tract. . . . The paramount interest of the public and of these new home owners is ‘performance,’ and not ‘forfeiture.’” *Id.* The court found that the bonds were intended to indemnify the town for the cost and expense of completing the public improvements in the event the developer failed to do so. It further noted that, by law, the township could not impose fines or penalties exceeding \$300 for the violation of its ordinances, and “[i]t seems anomalous to argue that by the device of a penal bond the township may impose penalties of \$68,000 for the violations of a subdivision ordinance.” *Id.*

B. Subdivision Performance Bonds

The most common bond required from a subdivision developer is a performance bond, which generally guarantees that the construction will meet the requirements and regulations of the subdivision agreement and that work will be done in the time specified. Illustrative cases addressing the scope of such bonds are discussed below.

(1) The Scope of the Principal's Work

In determining the scope of the principal's work, the lesson the cases teach is to read the bond and read the ordinance requiring the bond. These two documents dictate the outcome in most of the cases.

In *City of O'Fallon v. Bank of Belleville*, 525 N.E.2d 1162 (Ill. App. 1988), the city sued to recover from the surety and other parties based on the developer's failure to complete a portion of the subdivision in accordance with the development agreement. The surety argued that the portion of the development that was not completed (a culvert) was not covered under the subdivision bond and that the bond only covered streets and sidewalks. The bond conditioned the surety's liability on the principal's failure to "complete the installation as prescribed and required by [the city]." The city's subdivision ordinance defined "street" to include "all facilities which normally occur within the right-of-way," and the court interpreted this phrase to include culverts and other drainage devices essential for the functionality of a street. The court therefore held that the bond covering "streets and sidewalks" also covered culverts.

A town sued a subdivision developer and its surety on a performance bond based on the failure to complete certain roads and drainage improvements in *Town of Brookfield v. Greenridge, Inc.*, 418 A.2d 907 (Conn. 1979). The court held that even though an underdrain was not specifically referred to in the town's road specifications nor indicated on the approved subdivision plats, the developer and surety were still liable for the developer's failure to install the underdrain. The court found (and the defendants conceded) that an underdrain was an integral part of road construction, basic to proper road building wherever wet field conditions exist, as was the case here. The court held that the developer failed to meet all the requirements of the subdivision regulations because the roads were not constructed in accordance with its implied obligation to conform with good road building practice.

Purchasers of three unimproved subdivision lots sought to recover their down payments from a surety in *Fleck v. National Property Management, Inc.*, 590 P.2d 1254 (Utah 1979). The purchasers claimed to be third party beneficiaries of the subdivision performance bond. The court held that the purchasers of the lots could not recover their down payments from either the surety or the principal after the lots were foreclosed upon under trust deeds and the purchasers lost their interest in the land, because it could not have been foreseen that the consequence of not constructing the subdivision improvements would result in foreclosure of the trust deeds and the loss of title. The court found that the parties to the bond did not contemplate the risk of such losses, particularly when the losses were not correlated with the cost of improvements guaranteed by the bond. The bond was not given to guard against this kind of damage.

(2) What If the Principal Has Not Started the Subdivision?

What if the principal has completed little or no work on the subdivision before abandoning a project? In *County of Yuba v. Central Valley Nat'l Bank, Inc.*, 97 Cal. Rptr. 369 (Cal. Ct. App. 1971), a subdivision developer obtained an instrument of credit from the defendant bank, expressly providing a guarantee that the \$35,020 on deposit "was pledged to meet the performance of completed street improvements" and that if the work was not completed in accordance with the appropriate county ordinance and within the time limits of the subdivision agreement, the bank would pay the \$35,020 for the completion of the

improvements. Because of a considerable reduction in force at a nearby Air Force base, there was no market for the subdivision, and the developer never began the work. Yuba County therefore sought to recover on the bank's instrument of credit. The court denied recovery on the theory that "at least partial improvement of the land and construction of the streets was contemplated as a prerequisite to the emergence of the obligations" of the bank and the developer. The court found that Yuba County suffered no damage and to permit recovery under such circumstances would uphold an illegal forfeiture.

County of Yuba was later examined in *City of Sacramento v. Trans Pacific Industries, Inc.*, 159 Cal. Rptr. 514 (Cal. Ct. App. 1979), in which a developer promised to install certain improvements in a subdivision. After partially completing the work, the developer had financial problems. To avoid having to complete the improvements itself, the developer sold several parcels to a third party. Since he wanted to use the land as soon as possible, the purchaser agreed to complete the improvements himself. In return, the City of Sacramento promised to reimburse him, using any money it recovered on the developer's bond. The court allowed recovery on the bond and distinguished *County of Yuba* on the ground that there was no indication that the county had any need or any intention to use any money recovered in the lawsuit to install the improvements; since the land in *County of Yuba* was still uninhabited farmland, there was no need for roads. In *Sacramento*, on the other hand, development of some parcels had started, and development was planned for the remaining land. The County of Yuba suffered no damages, while Sacramento would suffer damages in the amount it would need to pay the purchaser to complete the improvements. Furthermore, unlike in *County of Yuba*, there was no showing of any unfulfilled condition precedent to the surety's obligation to pay such as a developer's failure to initiate construction. The court further held that it was permissible for a city to contract with the purchaser of the property to complete the improvements subject to reimbursement by the city out of any money recovered against the bond.

In *City of Los Angeles v. Amwest Surety Insurance Co.*, 73 Cal.Rptr.2d 729 (Cal. Ct. App. 1998), the City of Los Angeles sued the surety on a performance bond ensuring a developer's completion of subdivision improvements. The developer began to undertake the improvements in obtaining soil to perform some of the grading work and in relocating utility poles. However, before significant progress was made, he ran out of funds and lost the property through judicial foreclosure. A subsequent purchaser of the property relied upon the city's intention to go against the surety bond to pay for the improvements. The city declared the bond in default and filed suit against the surety, who cross-claimed against the current property owner for "equitable indemnity" based on unjust enrichment. The court held that where improvements have been undertaken and later abandoned, a surety on the performance bond is indebted to pay where the language of the performance bond does not contain any unfulfilled condition precedent to the surety's obligation to pay (such as requiring that the work commence, but did not), and the city intended to utilize any money recovered from the surety to install the improvements (rather than place the money in city coffers).

In *Board of Supervisors of Stafford County v. Safeco Insurance Co. of America*, 310 S.E.2d 445 (Va. 1983), the only work performed by a subdivider before abandoning a subdivision development and filing bankruptcy was on-site clearing and grading for roads. No work was ever started on installation of water or sewer lines. The county subsequently prepared a development plan placing the subdivision property outside the areas designated for dense population. Under the plan, the land was not intended to receive central water and

sewer service. Nevertheless, the county called the subdivision bonds because the roads and water and sewer lines had not been completed. The court held that the county made out a *prima facie* case that it was entitled to recover the face amount of subdivision bonds by showing that the bonds had been properly executed, that the principal failed to fulfill its obligations, that proper notice of default and a demand for payment were given to the surety, and that the cost of completing the improvements exceeded the face amount of the bonds. Although the surety did not say the county had to complete the improvements before recovering on the bonds, it argued that the county had to first establish a feasible plan to construct the improvements. The surety urged that the county should not be permitted to recover and expend funds on a failed project, when the public interest will be served by maintaining the status quo. The court held that such determinations were for the county, not the surety. “[The surety] voluntarily entered into a contractual relationship based upon the implicit assumption that the project was feasible, and regardless of its present concern for the public welfare, it will be held to its contractual obligation as a professional surety.” The court also noted the presumption that public officials will perform their duties in accordance with the law and that the county would properly use the bond proceeds. Finally, the court ruled that the county could not claim consequential damages (other than interest) because the bonds expressly limited recovery to their face amounts.²

A township planning board, township council, and mayor sought the enforcement of a developer’s agreement pertaining to the development of a building and land to use as multi-tenant property in *River Vale Planning Board v. E & R Office Interiors, Inc.*, 575 A.2d 55 (N.J. Super. 1990). The developer agreement contained a detailed schedule of site improvements, along with performance guarantees, and required the posting of a performance bond to ensure completion of public improvements with two years in the amount of \$102,088 and the posting of a cash performance bond of \$10,208 with the township. The performance bond for public improvements was never posted, and none of the improvements were ever installed. The developer sold the property and asked the township to return his cash bond. The town did not return the bond and declared the developer in default of the developer’s agreement. The court held that the installation of the improvements contemplated by the developer’s agreement was subject to an implied or constructive condition that those improvements were only required if the developer proceeded with the project. Since the developer abandoned the project, and the site plan was not going to proceed as proposed, the municipality could not enforce the developer’s agreement and was required to return the bond. Although this case was decided outside of the context of a subdivision performance bond, courts might find an implied condition that subdivision improvements are only required if a developer begins the bonded project.

The ordinance at issue in *Town of New Windsor v. Inbro Development Corp.*, 448 N.Y.S.2d 99 (Sup. Ct. 1982), restricted the recovery under a subdivision performance bond to an amount “commensurate with the extent of building development that has taken place in the

² The dissent in *Board of Supervisors of Stafford County v. Safeco Insurance Co. of America*, 310 S.E.2d 445 (Va. 1983), noted that the bonds and the subdivision ordinances created an obligation to indemnify the county for uncompleted improvements and implicitly indicated that the parties intended to provide security for full completion of the improvements once construction had begun. According to the dissent, only *de minimus* work was done in the subdivision, and “[a]s a matter of fact, the streets and utility lines in this aborted development will never be constructed.” Therefore, no damages had been or would be suffered by the county. The dissent viewed the majority as converting the performance bond into a contract of liquidated damages. “This inequitable result amounts to a forfeiture, penalizing the surety under the guise of enforcing the terms of an indemnity bond.” *Id.* at 452.

subdivision.” The plain meaning of the statute required “the payment of the face amount of the bond to the town so that it could complete improvements reasonably justified by that part of the subdivision which had been developed followed by a refund of any amount not needed to complete that portion of the work. *Id.*, quoting *Shawangunk v. Goldwil Props.*, 403 N.Y.S.2d 784 (App. Div. 1978). The court found that the developers failed to commence any improvements in the subdivision. Therefore, the condition of the bond had not eventuated, and the surety received summary judgment.

In *City of Peekskill v. Continental Insurance Co.*, 999 F. Supp. 584 (S.D.N.Y. 1998), the court held that a surety was not liable to the city under a subdivision performance bond where the contractor who procured the bond did not complete enough of the project to require completion of the public improvements covered by the bond. The surety’s liability to the city could not exceed an amount commensurate with the extent of the development completed by the developer. The court further ruled that because new developers agreed to complete the project, and because the city expended no funds to complete the public improvements, the city had no damages that would entitle it to the bond proceeds.

C. Maintenance Bonds

Local governments also often require maintenance bonds, which typically guarantee that the developer will maintain, and correct any defects in, the public improvements at his or her expense for one year following the government’s approval of the construction. What if a surety has issued a maintenance bond for a subdivision, but not a performance bond, and the county-obligee brings a claim under the maintenance bond for original work, i.e. work that was not completed by the principal during the original construction? In most cases, the surety could properly deny the claim on the basis that the work is not within the scope of the maintenance bond. A maintenance bond generally only covers maintaining work that has been completed and accepted or correcting defects in that work and does not extend to work that was not a part of the original construction. If, however, the principal and the surety’s agent who issued the bond knew that the government accepted the principal’s work as complete when work was not actually completed, a court might be inclined to reform the maintenance bond to include the incomplete work.

In *Legion Manor, Inc. v. Municipal Counsel of Township of Wayne*, 231 A.2d 201 (N.J. 1967), the Supreme Court of New Jersey discussed the differences between performance bonds and maintenance bonds. After noting that the applicable statute empowered the governing body to require adequate performance guarantees, the court stated:

Performance contemplates not only that the work be completed but also that it be done correctly. The municipality properly protected itself upon both scores. It could have required a single performance bond calling for completion and for continued liability, surviving acceptance, with respect to defective work and materials, or it could provide for two bonds, one to deal with the completion of the work and the other to continue liability with respect to defects in work or material. The municipality took the latter course. The so-called ‘maintenance’ bond which in amount is 10% of the performance bond, is limited to ‘all defects of material or workmanship in the said work’ which may develop during the

ensuing three years. The use of a second bond benefits the developer by reducing the amount of the secured liability in harmony with the spirit of N.J.S.A.40:55-1.22. It also avoids an issue of construction which sometimes arises under a single performance bond as to whether acceptance of the work was intended to end liability for defects which later appear.

This case could be used to support a surety's argument that a maintenance bond only covers defects in work that has been completed and accepted.

D. Payment Bonds

Subdivision bonds typically are not payment bonds, and the bond does not extend to provide coverage for unpaid subs and suppliers. However, here again it is critical to RTFB and RTFO. It should be no surprise that bond's terms and the local ordinance will govern the scope of bond liability. Local governments will sometimes require a subdivision developer to provide a payment bond or labor and material bond, guaranteeing that the developer will pay suppliers, workers, and subcontractors involved in the particular project. Subdivision developers may also provide payments bonds on their own accord.

In *Evola v. Wendt Construction Co.*, 338 P.2d 498 (Cal. Dist. Ct. App. 1959), a contractor sued a subdivider and his surety on a bond to recover amounts owed to him for constructing the paving, curb, gutters, and tract drainage in a subdivision. Although the bond named only the county as the obligee, the contractor claimed that the bond was a labor and materials payment bond running in favor of third party labor and material claimants. In construing the statutory bond at issue, the court interpreted California's Subdivision Map Act, which provided, "In the event an agreement for the improvement of the streets or easements is entered into, the governing body may require that the agreement shall be secured by a good and sufficient bond, or it may accept in lieu thereof a cash deposit, which bond or cash deposit shall be in an amount not in excess of the estimated cost of the improvement." The court noted that the purpose of the legislature in enacting this provision was to protect counties, cities, and the public, and it was not to protect the suppliers of labor and materials. "Nowhere in the act is there the slightest intimation that the governing body could protect by bond third persons such as suppliers of labor and materials on the project." *Id.* at 26. Accordingly, the court concluded that the bond required by the act was "a performance bond and none other." *Id.*

A subcontractor sued the surety to recover the cost of labor and materials furnished in constructing subdivision streets and roads at the request of the subdivider principal in *Rexroth and Rexroth, Inc. v. General Casualty Co. of America*, 51 Cal. Rptr. 505 (Cal. Dist. Ct. App. 1966). The subdivider had agreed to construct streets and roads according to the proposed subdivision map and to post a surety bond "as prescribed by law" to guarantee the completion of the subdivision. California's Subdivision Map Act and the Kern County ordinance required subdividers to furnish a performance bond in favor of the applicable public entity. The developer provided a performance bond and contemporaneously provided a "Material and Labor Bond," which was on the reverse side of the performance bond. The surety argued the bond was obtained to meet the requirement of the ordinance and Subdivision Map Act, while the subcontractor argued the developer wished to protect those who provided labor and material for his subdivision. The court surmised, "It is just as probable that an enthusiastic

bonding agent advised [the developer] he could protect laborers and materialmen with a material and labor bond at no extra cost.” In the absence of evidence, the court concluded the reason for the bond was pure speculation, and the surety’s liability had to be determined from the four corners of the bond. The court distinguished *Evola*, 338 P.2d 498, on the grounds that the parties in that case conceded that the bond at issue was a statutory bond, while the parties in *Rexroth* did not, and there was no extrinsic evidence that the county demanded a material an labor bond or that the developer obtained it to comply with the Kern County ordinance or the Subdivision Map Act. The court held that although a material and labor bond was not required by the Subdivision Map Act or the county ordinance at the time that the bonds were issued, that fact does not necessarily invalidate the material and labor bond or mean that the two bonds constitute one statutory performance bond. The court concluded that there was no reason why the material and labor bond was not a valid common-law bond. Finally, the court held that the subcontractor was properly within the class of people referred to by the material and labor bond, and that he could recover as a third-party beneficiary.

E. Who’s the Claimant?

In *Norton v. First Federal Savings*, 624 P.2d 854 (Ariz. 1981), the court held that purchasers of subdivision lots upon which the developer failed to complete the required improvements could not recover from the surety as third-party beneficiaries because nothing in the statute that required the bond, nor in the bond itself, created any rights in the purchasers. The court also held the purchasers could not seek damages from the surety for the delay in completion of the off-site improvements, because nothing in the assignment of rights from the developer to the surety indicated that the surety assumed the developer’s promise to the purchasers to complete the improvements on their lots by a certain date.

In *Town of Southington v. Commercial Union Insurance Co.*, 805 A.2d 76 (Conn. App. 2002), the town sued the surety of a bankrupt subdivision developer for the cost of completing the development. The surety argued that the town, which had purchased the subdivision at a foreclosure sale and had become a successor developer, was precluded from bringing a claim against the bond because it was a successor developer. The court rejected the argument, holding that pursuant to the terms of the bond and the statutory authority, the town was entitled to the proceeds of the bond to pay for the work needed to complete the subdivision, and the town’s status as a successor developer did not change the result.

The purchaser of a subdivision lot determined that his lot did not fully conform with the approved subdivision plan in *Parikh v. Creative Realty of CT, LLC*, 2009 WL 416087 (Conn. Super. 2009). The town decided to release the subdivision performance bond, and the plaintiff filed suit to prohibit the town from releasing the bond. The court held that, regardless of whether the subdivision was properly completed, the lot purchaser could not obtain money damages from the town and could not seek to enjoin the town’s release of the bond. The bond was for the town’s benefit, and there was no authority for a third party to maintain a right of action against the bond or to compel the town to continue to hold the bond when the town deemed it no longer necessary.

F. May the Local Government Assign Its Rights Under the Bond?

May the local government assign its interest under a subdivision bond to a bank or a succeeding developer? The cases are split on this issue, and a sampling of these cases is discussed below.

After a subdivision developer failed to perform grading work and defaulted on its promissory note, the subsequent owner sought a declaratory judgment that, if he completed the grading work, the original developer's surety would not be exonerated on its bond due to his performance in *Berman v. Aetna Casualty & Surety Co.*, 115 Cal. Rptr. 566 (Cal. Ct. App. 1974). The court noted that if the city enforced payment of the faithful performance bond, then the successor developer would normally be able to share in the proceeds to the extent of the reasonable value of the required improvements he provided. However, the city alone is entitled to institute the legal action to collect on the bond, and the city is not entitled to treat as a windfall the proceeds of a faithful performance bond realized as a consequence of work not performed.³

In *Morro Palisades Co. v. Hartford Accident and Indemnity Co.*, 340 P.2d 628 (1959) (Cal. 1959), a contractor failed to complete roads in a subdivision. The county assigned its interest to a new owner of some of the subdivision property, and the new owner filed suit to recover under a performance bond as the assignee of the county. The court held that the county could not assign its rights under the performance bond because if a public improvement faithful performance bond runs to a public body, action on the bond must be brought in that body's name. The new owner had no right to recover under the performance bond, because the bond was conditioned for the benefit of the obligee county and in no way was furnished for the direct benefit and protection of the principal or other landowners in the tract.

The Monee Township Highway Commissioner assigned his rights under subdivision bonds and claims against the developer and its surety to a bank in exchange for the bank's funding of the completion of the subdivision in *County of Will v. Woodhill Enterprises*, 274 N.E.2d 476 (Ill. App. Ct. 1971). The surety argued that the commissioner could not assign his claims or rights under the subdivision bond. The court found the commissioner had the implied power to make contracts necessary to enable him to exercise the powers conferred and duties given to him by law and held that the assignment was a valid exercise of that power. The court distinguished the *Morro Palisades Co.* case by noting that the assignment in that case was not made to secure the improvements covered by the bond but was for the sole benefit of the assignee and was intended to relieve a public body of its duties and obligations under law. The Monee Highway Commissioner, however, did not abdicate his duties and obligations or assign his duties and obligations but instead used the assignment to fulfill his statutory duties and obligations.

In *Board of Supervisors of Fairfax County v. Ecology One*, 245 S.E.2d 425 (Va. 1978), a follow on developer obtained title to subdivision lots from the original developer through a

³ The new owner's declaratory action was barred by the doctrine of res judicata because a court had denied his complaint-in-intervention in the city's action against the surety and the original developer. The new owner asserted the same grounds for relief in that case that he subsequently asserted in the later case. The trial court denied intervention and found that the owner was not a proper claimant under the bond, and the owner failed to appeal that decision. The *Berman* court held that the owner's failure to appeal the order in the earlier case conclusively barred his subsequent action grounded on the same allegations.

foreclosure. The county issued permits to the new developer, conditioned upon its completion of the street and drainage work in the subdivision. The county also assigned any money it received from the original developer and its surety to the new developer, not to exceed the amount he actually spent on the project. The court agreed with the rule that a local government may assign its rights under a bond for the purpose of obtaining a performance guaranteed by the bond and upon showing the improvements have been made. The assignment by Fairfax County was to obtain the performance guaranteed by the bond and was therefore valid.

V. Bond Defenses

In evaluating claims against subdivision bonds, the surety should consider the standard payment bond defenses, e.g. a material alteration in the underlying contract, time limitations, and the defenses that would be available to the principal. A few of the unsuccessful attempts at asserting such defenses are discussed below.

In *City of Sacramento v. Trans Pacific Industries, Inc.*, 159 Cal. Rptr. 514 (Cal. Ct. App. 1979), the subdivision developer's surety argued that it was exonerated on its bond because the city materially altered the developer's obligations under the subdivision agreement without the surety's consent. The basis of the defense was the change of the location of a water main from beneath the street to beneath the sidewalk and the installment of an additional fire hydrant. The court found that such alterations were necessary because the developer failed to perform its work in a workmanlike manner (i.e. the developer paved the road without first putting in the water main beneath it as required by the subdivision plans) and it was more economical to install the main in bare ground where the sidewalks were to be located rather than to dig through the road pavement and repave. Therefore, the surety's exoneration defense was unavailing.

In *Town of Poughkeepsie v. Holden Construction Co., Inc.*, 419 N.Y.S.2d 531 (App. Div. 1979), the court held that although a town was not authorized to require a cash deposit in addition to a performance bond from a subdivision developer, such an act did not affect the surety's obligation under the performance bond. The town's requirement, although illegal, had no deleterious effect upon the surety and did not discharge the surety on the bond.

Even though the surety can show a change in the nature of the underlying work, that may not constitute a change which will provide a discharge to them. In *Board of Supervisors of Fairfax County v. Southern Cross Coal Corp.*, 238 Va. 91, 380 S.E.2d 636 (1989), the principal commenced construction of the subdivision streets, but then ran into site conditions which required revisions to the plans. These revisions were submitted to the county which then agreed to the changes. The surety contended that when the county completed the streets in a different manner from that described under the original plans, it was discharged. The court flatly rejected this argument, refused to apply the rule of *strictissimi juris* rule and required that the surety must show a material variation before it can be discharged. Since the changes put in place by the municipality were not shown to have materially impacted the cost or the surety's obligation, the surety's defenses were denied.

A municipality issued tentative approval to a subdivision developer for streets of 30-foot width with no sidewalks, but later modified its ordinance to change the requirement to streets that were 34 feet wide, with sidewalks 4 feet wide, in *Pennyton Homes, Inc. v. Planning Board*

of *Borough of Stanhope*, 197 A.2d 870 (N.J. 1964). The court addressed whether improvements which a municipality may require a developer to install at his expense are confined to those specified by ordinance at the time tentative approval of the subdivision is granted. New Jersey's Municipal Planning Act provided that the general terms and conditions upon which tentative approval of a subdivision is granted will not be changed. The court concluded that such "minor upgrading" of improvements was not part of the general terms and conditions upon which tentative approval was granted and which the municipality was not permitted to change. The court noted that a subdivider could protect itself against changes of improvement requirements between tentative approval and final approval by promptly obtaining final approval of the plat after tentative approval and furnishing a performance bond based on the ordinance requirements in place at that time.

A construction company which furnished labor and materials for subdivision improvements brought an action to recover under a subdivision bond guaranteeing payment in *Commercial Standard Insurance Co. v. Tab Construction, Inc.*, 583 P.2d 449 (Nev. 1978). The surety argued the action was barred because the company failed to commence suit with "six months from the date of completion of improvements," as required by the terms of the bond. The work was substantially completed by February 1974, but Clark County directed additional work to be performed by the company in November 1974 to bring its portion of the improvements to county specifications. The construction company filed suit against the surety in January 1975. The court held that the six month limitation period in the surety bond began to run at the time that the developer's improvements met county standards, and not thirty days after the construction company's work had been substantially completed, because the construction company was entitled to be paid only upon completion of the work according to county standards.

The City of Norman, Oklahoma approved plans for the subdivision and platting of property for a mobile home park in *City of Norman v. Liddell*, 596 P.2d 879 (Okla. 1979), contingent upon the construction of improvements in the subdivision, including sidewalks. The city sued the subdivision developers and their surety, alleging the developers failed to construct and install the sidewalks. A city ordinance stated that in the event that sidewalks are not constructed in the manner contemplated by the ordinance, the city must institute an action against both the principal and surety prior to the expiration of the bond. The court held that this was not a statute of limitations, but was merely a directory provision because an action will not ordinarily lie upon a bond until a breach of the condition of a bond occurs. A statute of limitations will not begin to run until that time because the cause of action does not accrue until that time. Under the facts of the case, construing the ordinance as a statute of limitations would bar the remedy before the cause of action accrued, something which is clearly unconstitutional. Therefore, non-compliance by the city with that portion of the ordinance did not bar the action.

VI. Conclusion

Many of us have seen very uneven treatment by various Federal agencies making Miller Act claims; however at least there is a body of cases dealing with these bonds and regulations which provide guidelines in some instances. Unlike the Federal Government with its FAR's, there are no local government regulations; in lots of instances there is no case law on point. For the most part, these folks are making it up as they go.

There may be an exception to this rule in some instances however. Sometimes there are impact fees, special tax districts, and perhaps even bond money which was collected in a manner directly related to and intended for the infrastructure construction. In those instances it may be that those this money can be viewed as a source for funding the improvements and subrogation and assignment theories available to allow the surety to reach these funds.

Local governments sometimes try to stretch payment bonds into performance bonds (and sometimes vice versa - they try to stretch performance bonds into maintenance bonds). The surety may have issued a maintenance bond which recites that improvements were complete, yet the city or county obligee may contend that the paving of the roadways in the subdivision is not complete, and that the final lift of asphalt must be installed and is the responsibility of the surety. Here, the “read in - read out” rule becomes terrifically important. By looking at the local ordinance, you may be able to determine that the maintenance bond has nothing to do with requirements to complete the subdivision, and there is no responsibility on the surety on a maintenance bond to complete it. Indeed, if the subdivision bond recites in its text that “whereas work has been completed . . .,” you may have even stronger arguments for refuting the contention there is any coverage under a maintenance bond for completion of items of work.

There are several themes that we have seen running throughout the topic of subdivision bonds and obligee’s claims against these bonds. These themes are going to play out over the next few years, and should be kept in mind.

First, there is very little uniformity in the manner in which local governments handle claims on subdivision bonds. For a great many of them, the subdivision bond claim they are making may be the very first one. The local city/county engineer may have some ideas as to what he thinks is in the bond, but may not have a well grounded understanding of the legal obligations when he reached his conclusion. The local government’s attorney is probably not a construction or bond lawyer, and has likely has spent little time researching and understanding surety law.

Second, the bond language varies enormously. The terms contained in many local government subdivision bonds are not uniform in the way they are written or interpreted. There simply is no uniformity from jurisdiction to jurisdiction.

Third, the statutory underpinning for these bonds varies a great deal. These subdivision ordinances need to be read and understood carefully in evaluating rights.

Fourth, courts in many instances do not understand these bonds, most of these cases will be decided in the courts involved with the local subdivisions, decided by judges and juries who reside there, and finally decided by a decision maker who may be concerned about local government finances.

All of these factors create a complex mix in managing these claims. In each instance, you will find yourself having to go back to basics: RTFB and RTFO.