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“SURETY LAW UPDATE”

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I. SURETY LIABILITY AND DEFENSES

A. DECLARATION OF DEFAULT AND/OR NOTICE REQUIREMENTS

1. Performance Bonds

In *Aggrow Oils, LLC v. Nat’l Union Fire Ins. Co.*,\(^1\) the United States Court of Appeals for the Eighth Circuit held that former Fed. R. Civ. P. 53(e)(4) precluded it from reviewing a panel of special masters’ conclusion that the obligee had satisfied the conditions precedent to the surety’s liability under a performance bond. The principal was the prime contractor for the design and construction of an oil seed processing plant in Carrington, North Dakota. After the obligee declared the principal to be in default, the surety advised the obligee that the principal had “completed its work” and the surety “declined to complete performance.” The obligee subsequently filed suit against the principal and the surety, and the parties agreed that all disputes would be heard initially by a panel of special masters, whose findings of fact would be final. The panel of special masters specifically determined that “the performance bond . . . was properly invoked,” and the district court adopted the masters’ determination. Upon the surety’s appeal, the Eighth Circuit concluded that whether the conditions precedent to the surety’s obligation to perform had been satisfied presented an issue of fact, not an issue of law, which precluded the Eighth Circuit from disturbing the masters’ determination that the conditions precedent had been satisfied pursuant to former Fed. R. Civ. P. 53(e)(4). The Eighth Circuit also concluded that the surety’s unequivocal declaration that it was not going to perform rendered the additional bond conditions a “useless formality.”

In *Crystal Lake Condo Ass’n v. Colonial Sur. Co.*,\(^2\) the Connecticut Superior Court denied the surety’s motion for summary judgment against the obligee. In its motion, the surety claimed that (a) it fulfilled its obligations under its performance bond, (b) it was discharged from its obligations under the performance bond due to the obligee’s untimely notice of the principal’s default, and (c) its obligations were discharged because it was not permitted to complete the project. The Court determined that genuine issues of material fact existed as to whether the surety had fulfilled its performance obligations by tendering a takeover agreement, which the obligee rejected. The obligee had argued that the surety had knowingly tendered a takeover agreement the obligee could not accept. With respect to the surety’s untimely notice of default defense, the surety argued that the principal had defaulted at least eight months before the obligee declared the principal to be in default. In rejecting the surety’s argument, the Court interestingly stated “[t]he failure of the surety to establish any of the claimed grounds for ‘default’ constituted a material breach of the contract between [the obligee] and [the principal]—thereby invoking [the surety’s] obligations under the Performance Bond—dispenses with the need to consider whether [the surety’s] claim of untimely notice discharged the surety or its obligations under that bond.”

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\(^1\) 420 F.3d 751 (8th Cir. 2005).
2. Payment Bonds

a. Public Works Payment Bonds

In Gerhold Concrete Co. v. St. Paul Fire & Marine Ins. Co., the Nebraska Supreme Court affirmed the trial court’s denial of the surety’s motion for a directed verdict, which was based upon the claimant’s failure to give four-months’ written notice to the principal before proceeding against the public works payment bond. Neb. Rev. Stat. § 52-118.01 provides as follows:

Any person having a direct contractual relationship with a subcontractor but no contractual relationship, expressed or implied, with the contractor furnishing such bond or bonds shall have a right of action upon the bond or bonds upon giving written notice to the contractor within four months from the date on which such person did or performed the last of the labor or furnished or supplied the last of the materials through which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the materials is furnished or supplied or for whom the labor was done or performed.

It was undisputed that the claimant did not provide the principal with notice of its claim. Therefore, the claim was barred unless the claimant had an express or implied contractual relationship with the principal. The Court concluded that a jury could conclude that the principal had an express or implied contractual relationship with the claimant based upon the principal’s alleged promises to “take care of” its paving subcontractor’s unpaid invoices if the claimant continued to supply concrete.

In Capitol Idem. Corp. v. Kirby Rest. Equip. & Chem. Supply Co., the Texas Court of Appeals affirmed summary judgment in a public works payment bond claimant’s favor despite the surety’s assertion that the claimant failed to comply with the notice requirements contained in Tex. Gov’t Code Ann. § 2253.041(c). The Court rejected the surety’s argument that the claimant’s notice must strictly conform to the exact language provided by the statute. The Court stated “while [the claimant] did not use the exact language of the statute, we conclude that the documentation provided to [the surety] was sufficient to fulfill the statute’s purpose—to provide the surety with knowledge of the substance of the claim and to protect claimants who furnish labor and materials in the construction of public works with a simple and direct method of providing notice of their claims.”

In LRS Elec. Controls, Inc. v. Hamre Constr., Inc., the Washington Supreme Court held that a second-tier subcontractor’s failure to provide the public works payment...
bond surety with pre-claim notice of its material claim barred the second-tier subcontractor from recovering the cost of the materials it had supplied for the project. The second-tier subcontractor installed the public works project’s HVAC system for a contract price of $16,500.00, representing $9,017.00 for materials and $7,483.00 for labor. Washington law requires subcontractors to provide the prime contractor with notice of any material furnished for the project, but the subcontractor is not required to give notice for labor. The Court rejected the second-tier subcontractor’s argument that the notice requirements should be read narrowly to apply only to claimants that are true “materialmen,” who provide only materials and not labor. Furthermore, the Court held that the second-tier subcontractor could not apply the prime contractor’s partial payment to the barred materials claim on a pro rata basis. Instead, the second-tier subcontractor could only apply the partial payment to its valid claim for labor.

In *Redland Ins. Co. v. Southwest Stainless L.P.*, the Texas Court of Appeals held that the principal’s supplier under a public works contract had substantially complied with the notice requirements contained in Texas’s McGregor Act. The McGregor Act requires claimants to send notice of their claim to the prime contractor and the surety by certified or registered mail. The parties stipulated that the supplier had sent the surety notice of its claim by certified mail, but the supplier copied its notices to the prime contractor by first-class mail. The prime contractor admitted that it received two of the four notices. The Court determined that the supplier’s notice substantially complied with the McGregor Act although the notice should have been sent via certified or registered mail.

In *Joba Constr. Co. v. V & Y Constr. Serv., Inc.*, the Michigan Court of Appeals held that a second-tier subcontractor had complied with the 90-day notice requirement contained in the public works payment bond although the second-tier subcontractor failed to comply with the 30-day notice requirement under Mich. Com. Laws Section 2.116(C)(10). The Court explained that “where the drafter of a bond chooses to provide more liberal standards for paying claims, statutory requirements should not be imposed later to limit liability to claimants.” Therefore, although a surety may not impose more restrictive notice requirements than those contained in the public works bond statute, a surety may grant less restrictive notice conditions under Michigan law.

### b. Miller Act Payment Bonds

In *United States v. James N. Gray Co.*, the United States District Court for the District of Maine granted a Miller Act surety’s motion for summary judgment with respect to a payment bond claim filed by a subcontractor’s supplier who had filed notice of its claim three days late. The supplier provided a crane and crane operators to the subcontractor, but the supplier only charged the subcontractor for the time the crane

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was actually used. According to the surety’s motion for summary judgment, the crane was last used on February 8, 2005 although the crane remained at the worksite until February 17, 2005 at the subcontractor’s request. The supplier did not provide notice of its claim until May 12, 2005, which was 93 days after the crane was last used but was less than 90 days from the date upon which the crane was removed from the worksite. The District Court held that the Miller Act required the supplier to give notice within 90 days of the date on which it last physically worked or supplied materials and that the supplier’s notice was untimely because it was filed 93 days after the crane was last used on the project.

c. Private Payment Bonds

In *Sil-Kemp Concrete, Inc. v. Conte & Ricci Constr. Co.*, the Superior Court of New Jersey, Appellate Division, reversed judgment in favor of concrete suppliers and held that the suppliers’ claim against the payment bond was barred because the suppliers failed to provide proper notice of their claims. The payment bond defined “claimants” as those who had a direct contract with the principal or a subcontractor of the principal for the provision of labor or materials required for use in performance of the bonded contract. The payment bond required claimants to give notice to two of the three parties to the payment bond: the surety, the obligee, and/or the principal. Notice was required to be given within 90 days of the claimant’s cessation of work, to state with substantial accuracy the amount of the claim and the party to whom the materials were furnished, and to be served by registered or a certified mail. The suppliers timely gave notice of their claim to the principal, the principal’s subcontractor, and the property owner (not the obligee). Therefore, only one of the parties to the bond (the principal) received notice of the suppliers’ claims. The suppliers did not give the surety notice of their claim until the 94th day after they last supplied concrete, and there was no proof in the record that the suppliers’ notice was sent by certified or registered mail. Therefore, the Court held that the suppliers’ claim against the payment bond must be dismissed.

**B. SCOPE AND LIMITATION OF BONDED OBLIGATION**

1. Performance Bonds

In *Mid-State Sur. Corp. v. Louisville & Jefferson County Metro. Sewer Dist.*, the Kentucky Court of Appeals affirmed summary judgment for the public works obligee where the completing surety argued that the obligee increased its exposure by paying the principal for defective or incomplete work. The underlying contract stated that the obligee “shall review the Payment Request and may also review the work at the Project Site” before progress payments were to be made to the principal. The surety argued that the obligee failed to properly inspect the principal’s work before making progress payments. The Court affirmed the trial court’s ruling that the above quoted language did not impose an affirmative duty on the obligee to review and approve work.

for which payment was requested. Instead, the obligee had the contractual right to reject any completed work, whether paid for or not, and to require the surety to remediate or complete the work. The Court also rejected the surety’s unjust enrichment claim because there was a valid contract in place.

2. Payment Bonds

In Nat’l Union Fire Ins. Co. of Pittsburgh v. David A. Bramble, Inc., the Maryland Court of Appeals held that a surety’s failure to comply with Paragraph 6 of the form A312 Payment Bond results in the entirety of the underlying claim being deemed undisputed. Paragraph 6 of the A312 Payment Bond provides as follows:

When the Claimant has satisfied the conditions of Paragraph 4, the Surety shall promptly and at the Surety’s expense take the following actions:

1. Send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.

2. Pay or arrange for payment of any undisputed amounts.

As construed by the Maryland Court of Appeals, a payment bond claim will be deemed undisputed unless the surety strictly complies with Paragraph 6.1. Therefore, a failure to respond or a general denial will estop a surety from defending the claim.

In Beckwith Mach. Co. v. Asset Recovery Group, Inc., the Pennsylvania Superior Court held that the installation and/or replacement of an engine and various engine components for heavy construction equipment constituted capital improvement repairs, which were not covered by the underlying public works payment bond. The Court concluded that the unpaid invoices related to major repairs in the nature of capital improvements to heavy construction equipment, which the subcontractor would be expected to “take away with him on the completion of the work, to be used by him in like manner on subsequent contracts.” Since the repairs could not be classified as ordinary maintenance performed for consumption over the course of the project, the repairs were not covered by the public works payment bond.

C. STANDING

In No Fault Tennis & Track, LLC v. A-1 Asphalt Paving and Repair, Inc., the Louisiana Court of Appeals held that the St. James Parish School Board, the obligee on a public works payment bond, had no right of action under the payment bond. The

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879 A.2d 101 (Md. 2005).
Court determined that the obligee did not constitute a “claimant” as defined by La. Rev. Stat. Ann. § 38:2242. The Court specifically explained that the performance bond was “not at issue” because there was nothing in the record to show that the obligee declared the principal to be in default or notified the surety that a default had occurred.

In *HIS North Carolina, LLC v. Diversified Fire Protection of Wilmington, Inc.*, the North Carolina Court of Appeals held that an unpaid supplier to a second-tier subcontractor was a proper public works payment bond claimant under N.C. Gen. Stat. § 44A-25(6), which defines a “subcontractor” as “any person who has contracted to furnish labor or materials to, or who has performed labor for, a contractor or another subcontractor in connection with a construction contract.” The Court explained that the first-tier subcontractor, the second-tier subcontractor, and the second-tier subcontractor’s supplier were considered “subcontractors” under N.C. Gen. Stat. § 44A-25(6). The Court also rejected the surety’s estoppel and accord and satisfaction defenses.

In *Quantum Corporate Funding, Ltd. v. Westway Indus., Inc.*, the New York Court of Appeals held that an assignee of a subcontractor’s accounts receivable had a right of action against a public works payment bond. The Court explained that allowing subcontractors to assign their right to recover against a public works payment bond would allow laborers and material suppliers to obtain financing that would otherwise be unavailable.

In *Triad Elec. & Controls, Inc. v. Firemens Fund Ins. Co.*, the United States District Court for the Northern District of Texas held that a subcontractor had no right of action against a bond issued to the obligee with respect to the obligee’s release of “statutory retainage.” The Texas Property Code required the obligee to withhold 2% of the contract price as security for the benefit of third-party beneficiaries. The obligee released the “statutory retainage” to the prime contractor after the prime contractor posted a bond naming the obligee as the beneficiary thereof. The District Court rejected the subcontractor’s third-party beneficiary argument and stated that “[u]nder the clear terms of the Bond, it was issued solely to protect the owner . . . from any liability arising from the release of retainage to [the prime contractor].”

In *United States Fid. & Guar. Co. v. Garbriel Fuentes Jr. Constr.*, the United States District Court for the District of Puerto Rico, applying Puerto Rico law, denied a surety’s motion to dismiss a counterclaim filed by a third party who had no right of action against the underlying bond. Under Puerto Rico law, a third party who is not in privity with two contracting parties may be entitled to recover consequential damages based on a violation of law or breach contract between the contracting parties. The counterclaimant argued that the surety breached its obligations to its principal resulting in ...
in increased completion costs, which, in turn, prejudiced the claimant who could not recover payment for work and services it rendered at the project. The District Court concluded that a surety may be responsible for damages suffered by a third party injured by the surety’s conduct.

In *United States v. Pinnacle Elec.*, the United States District Court for the Middle District of Pennsylvania dismissed a third-tier subcontractor’s claim against the first-tier subcontractor’s surety and dismissed a first-tier/second-tier subcontractor’s indemnity claims against the prime contractor’s sureties. The District Court’s ruling primarily involved security installations and fiber optic installations at a federal penitentiary in Canaan, Pennsylvania. The prime contractor subcontracted the security installation work to Howard Organization, Inc. (“Howard”), and the prime contractor subcontracted the fiber optics installation to Pinnacle Electronic Systems (“Pinnacle”). Howard subcontracted portions of the security installation to Pinnacle, who subsequently subcontracted this work to RJE Telecom (“RJE”). Pinnacle also subcontracted portions of the fiber optics installation to RJE. Therefore, Pinnacle was a first-tier subcontractor with respect to the fiber optics installation and a second-tier subcontractor with respect to the security installations. RJE was a second-tier subcontractor with respect to the fiber optics and a third-tier subcontractor with respect to the security installations.

After it was terminated by Pinnacle, RJE asserted a claim against a payment bond issued on Howard’s behalf with respect to the security installations. Howard’s surety moved to dismiss RJE’s claim because the payment bond expressly limited claimants to those having a direct contractual relationship with Howard, and it was undisputed that no such direct contractual relationship existed. RJE conceded that it was not a proper claimant under the bond. Nevertheless, RJE argued that it was entitled to assert a “pass-through” claim against the bond because Pinnacle had a direct contract with Howard and RJE’s contract with Pinnacle allowed it to “pass-through” Pinnacle to recover under the bond. In rejecting RJE’s “pass-through” claim, the Court explained that RJE had no contract claim against Howard because it did not have a contractual relationship with Howard and RJE was not a third-party beneficiary of a Howard contract.

Pinnacle asserted a claim for indemnification against the prime contractor’s sureties relating to Pinnacle’s potential liability to RJE. In dismissing Pinnacle’s claim against the prime contractor’s sureties, the District Court explained that the surety had not entered into a contractual agreement to indemnify Pinnacle and Pinnacle had not, and could not, argue that the sureties were primarily responsible for the condition of the project.

In *N. Star Terminal & Stevedore Co. v. Nugget Constr., Inc.*, the United States Court of Appeals for the Ninth Circuit reversed the District Court’s award of

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19 2005 WL 487313 (9th Cir. Mar. 3, 2005).
summary judgment in the Miller Act surety’s favor and concluded that genuine issues of material fact remain as to whether the suppliers had an implied contractual relationship with the prime contractor, which would give them standing to recover under the payment bond. Since recovery under the Miller Act is limited to those who have a direct contractual relationship, expressed or implied, with the prime contractor or a subcontractor, the suppliers to a materialman, who had never entered into an expressed contract with the prime contractor, could recover under the Miller Act unless it established an implied contractual relationship with the prime contractor. The Ninth Circuit explained that it would find an implied contractual relationship between the suppliers and the prime contractor if the suppliers could demonstrate subterfuge or collusion between the prime contractor and the materialman or circumstances indicating the interposition of the materialman as a straw man for the purpose of insulating the prime contractor and its surety from liability under the Miller Act. The Ninth Circuit concluded that genuine issues of material fact existed because the evidence tended to show that the prime contractor has secretly converted the materialman into a straw man during its ongoing dealings with the suppliers. The prime contractor had apparently directed the materialman to conceal the terms of its agreement with the prime contractor and the prime contractor actually performed some of the materialman’s functions relating to the project.

However, the Ninth Circuit affirmed the District Court’s ruling that the suppliers would not be entitled to recover their attorney’s fees even if they succeeded upon remand. The Ninth Circuit held that attorney’s fees are not available under the Miller Act unless expressly provided for by the terms of the direct contracts between the parties or in the Miller Act bond itself. In other words, an attorney fee award cannot be based upon an implied contractual relationship.

In Tradesmen Int’l., Inc. v. Wal-Mart Real Estate Bus. Trust,20 the Kansas Court of Appeals held that an entity that had provided skilled laborers who were used in the prosecution of work by a subcontractor was a proper payment bond claimant. Tradesmen International, Inc. (“Tradesman”) had entered into a “Client Services Agreement” with Construction Services Corp. (“CSC”), a subcontractor on the underlying project, under which Tradesman provided skilled laborers to CSC on an hourly rate. CSC used Tradesman’s laborers to prosecute the work under its subcontract with the principal. The underlying payment bond provided, in pertinent part, “this Bond shall inure to the benefit of all persons or entities supplying labor, material, services, utilities and equipment in the prosecution of the work provided for in said Contract as well as to the Obligee, and that any of such persons or entities may maintain independent actions upon this Bond in the name of the persons or entities bringing such action.” In affirming summary judgment in Tradesman’s favor, the Court concluded that Tradesman should be permitted to recover under the payment bond because it was an entity that supplied skilled laborers who were used in the prosecution of the work provided for in the general contract between the principal and the obligee.

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The Court rejected the surety’s argument that the services Tradesman provided to CSC were administrative in nature, which would be beyond the scope of the payment bond.

The Kansas Court of Appeals also held that the subcontractor’s mechanic lien was “vitally defective” under Kan. Stat. Ann. § 60-1103(a)(1) because the subcontractor failed to correctly name the prime contractor as Merit General Contractors, Inc., and instead named Merit Construction Co., Inc. as the prime contractor. The Court determined that the trial court had erred in allowing the subcontractor to amend its mechanic’s lien statement to correctly name the prime contractor after the statutory filing period had expired. The Court also concluded that the trial court had not abused its discretion in denying Tradesman’s claim for attorney’s fees because a bona fide and reasonable factual ground existed for contesting Tradesman’s payment bond claim.

D. DAMAGES RECOVERABLE FROM THE SURETY

In Commonwealth v. Selective Ins. Co., the Virginia Circuit Court for Loudoun County held that the Virginia Department of Transportation (“VDOT”) could recover sums that were overpaid to the principal under a public works performance bond. The underlying contract required the project to be constructed in accordance with VDOT’s Metric Road and Bridge Specifications, which provided for monthly progress payments based upon estimates of the quantities and value of the principal’s work. After the work was completed and accepted, VDOT determined that it had overpaid the principal by $56,954.50 and that the principal owed liquidated damages of $79,800.00. VDOT and the principal ultimately reached a settlement whereby the principal agreed to reimburse VDOT for the overpayment and VDOT released its liquidated damages claim. After the principal filed bankruptcy without reimbursing VDOT for the overpayment, VDOT made a claim against the performance bond for reimbursement. In holding that the performance bond obligated the surety to reimburse VDOT for its overpayment, the Virginia Circuit Court stated that “repayment of any overpayment is just as much a contractual obligation of [the principal] under the Contract and the Specifications as is the performance of the roadwork” and that “therefore, any required repayment of an overpayment is covered by the Performance Bond.” The Circuit Court also concluded that VDOT’s overpayment did not constitute a material alteration of the bonded obligation sufficient to discharge the surety.

In First Nat’l Ins. Co. of Am. v. D.P.S. Indus., Inc., the United States Court of Appeals for the Eleventh Circuit held that the district court erred by not reducing the principal and surety’s liability to a subcontractor by the amount the obligee paid directly to the subcontractor. The subcontractor notified the obligee that it had not received payment for work it had performed in relation to a public works project. The obligee agreed to issue joint checks to the principal and the subcontractor for all remaining and outstanding funds relating to the subcontract work, and the obligee further agreed to issue direct payments to the subcontractor if the principal failed to endorse the joint

checks. After the principal refused to execute the joint checks, the obligee made two direct payments to the subcontractor totaling $275,000.00 in exchange for a release, which expressly reserved the subcontractor’s claims against the principal and the surety. After litigation ensued, the subcontractor asserted a claim against both the principal and the surety in the amount of $294,481.80, and the trial court ruled that the subcontractor was “entitled to retain the $275,000.00 [received from the obligee] without restriction or any other deductions or credits.” In reversing and remanding, the Eleventh Circuit explained that the district court’s ruling contravened Georgia’s law of contract damages because it allowed the subcontractor to earn more money than it would have earned had the subcontract not been breached. The Eleventh Circuit also vacated a judgment against the principal’s president because the subcontractor had not asserted a claim against him.

In Cosmopolitan Eng’g Group, Inc. v. Ondeo Degremont, Inc., the Washington Court of Appeals held that the attorney fee shifting provision contained in Washington’s Contractor Registration Act imposes liability for a prevailing party’s attorney’s fees on both contractors and their sureties. The trial court had ruled that the prevailing party provision only imposed attorney’s fees upon the surety. Under this interpretation, the public works bond’s penal sum would cap the claimant’s attorney’s fee award. The Court explained that allowing claimants to recover attorney’s fees from the contractor would further the purpose of the Contractor Registration Act.

In Aero-Metric, Inc. v. Centro de Recaudaciones de Ingresos Municipales, the United States Court of Appeals for the First Circuit construed Puerto Rico law and held that the surety’s total liability under a performance bond and a separate labor and material payment bond, each with a penal sum of $501,750.00, was only $501,750.00 as opposed to $1,003,500.00. After the separate bonds were issued, the principal and surety executed an endorsement that was “to be attached to and form a part of [the bond] issued on behalf of [the principal] and in favor of [the obligee] in the amount of ONE MILLION THREE THOUSAND FIVE HUNDRED AND 00/100 DOLLARS ($1,003,500.00).” In ruling that the surety’s liability was discharged upon deposit of $501,750.00, the First Circuit relied heavily upon the Supreme Court of Puerto Rico’s decision in Caguas Plumbing, Inc. v. Cont’l Constr. Corp., which stated in dicta that a surety’s liability under similar, simultaneously issued performance and labor and material bonds was the single amount listed on each bond.

In Lexicon, Inc. v. Safeco Ins. Co. of Am. Inc., the United States Court of Appeals for the Sixth Circuit held that genuine issues material fact precluded summary judgment in the surety’s favor with respect to a second-tier subcontractor’s recovery of its “self-styled” “delay and impact claims” against a payment bond. The underlying payment bond defined a “claimant” as “one having a direct contract with the Principal or

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24 2005 WL 1594720 (1st Cir. 2005).
26 436 F.3d 662 (6th Cir. 2006)
with a Subcontractor of the Principal for labor, material or both, used or reasonably required for use in the performance of the Contract.” The payment bond did not define “work,” “labor,” or “materials,” other than to indicate that “labor and material [are] construed to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental equipment directly applicable to the Contract.” After the second-tier subcontractor completed its work, it sought payment for what the it termed “cost impacts that [the second-tier contractor] has suffered . . . due to the action or inaction of other companies” including the first-tier subcontractor, the principal, and the obligee. The second-tier subcontractor and the first-tier contractor entered into a written settlement agreement “in full and final settlement of [the second-tier subcontractor’s] pending contract claims, including contract balances and approved [extra work authorizations].” The settlement agreement expressly reserved the second-tier subcontractor’s “delay and impact related claims and [the second-tier subcontractor’s] right and ability to pursue such claims.”

The United States District Court for the Eastern District of Kentucky granted the surety’s motion for summary judgment and held that the second-tier subcontractor’s “delay and impact claims” were not related to labor and material costs and were therefore not recoverable under the bond and that the settlement agreement between the second-tier subcontractor and the first-tier contractor precluded the second-tier subcontractor’s claim against the payment bond. Although it reversed the District Court’s summary judgment award due to the existence of material issues of fact, the Sixth Circuit explained that, in general, if a bond guarantees payment for labor and materials, a subcontractor may recover under the bond for increased labor and material expenses caused by delay. Conversely, the Sixth Circuit explained that a subcontractor may not recover for other non-labor or materials related expenses and that a subcontractor may not recover for a breach of contract under the bond. The Sixth Circuit agreed that the surety was entitled to summary judgment with respect to the second-tier subcontractor’s non-labor and materials based expenses. However, the Sixth Circuit also noted that implicit in the District Court’s ruling was its recognition that a portion of the second-tier subcontractor’s claim consisted of labor and material costs necessitated by delay, which would be covered by the payment bond. With respect to the settlement agreement between the second-tier subcontractor and the first-tier subcontractor, the Sixth Circuit held that the settlement agreement was ambiguous under Kentucky law and that a fact finder must determine whether the settlement agreement released all claims except those relating to non-labor and material based costs, which would not be covered under the payment bond, or whether the second-tier subcontractor reserved its claim for labor and material related costs.

**E. PAY WHEN PAID CLAUSES**

In *Wellington Power Corp. v. CNA Sur. Corp.*, the West Virginia Supreme Court of Appeals held (1) that an unambiguous “pay-if-paid condition precedent clause” contained in a subcontract for a public construction project does not violate West

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Virginia’s public policy articulated in West Virginia’s Public Bond Statute, W. Va. Code St. R. § 38-2-39 and (2) that an unambiguous “pay-if-paid clause” prevents a subcontractor from maintaining an action against the public works surety when the principal had not received payment from the obligee. The Court confronted two competing public policies, the public policy of securing payment to the materialmen and laborers in the building of structures to be used by the public and the public policy of freedom to contract freely. The Court stated, “After carefully weighing these policies, we conclude that the public policy of freedom of contract is more compelling and outweighs the public policy found in [the Public Works Bond Statute].” The Court also rejected the subcontractors’ argument that they could maintain a suit against the payment bond irregardless of the pay-if-paid clause. The Court explained:

[I]t is plain that [the surety] cannot have liability under the [payment] bond, as [the principal’s] surety, where [the principal] has no liability. Under the clear and unambiguous terms of [the principal’s] contracts with [the subcontractors], [the principal] has no liability for any amounts due to [the subcontractors] except to the extent that [the principal] actually has received funds from [the obligee]. Our law provides that ‘[a] surety does not insure its principal against loss but agrees to be answerable for any debts, default or miscarriage of such principal.’ Because [the principal] has not received funds from [the obligee], it has not incurred debt owed to [the subcontractors] nor defaulted or miscarried on a debt owed to [the subcontractors].

Therefore, the subcontractors could not recover against under the payment bond because they could not recover against the principal as it had not received payment from the obligee.

In *Hartford Accident & Indem. Co. v. Cochran Plastering Co.*,28 the Alabama Court of Civil Appeals held that final payment by the public works owner to the principal was not a condition precedent to the principal’s final payment to a subcontractor, and, accordingly, the subcontractor could recover under the public works payment bond. The subcontract in question provided, in pertinent part:

Final payment constituting the entire balance of the Subcontract Sum shall be made by the Contractor to the Subcontractor when the Subcontractor’s work is fully performed in accordance with the requirements of the contract documents, the Architect has issued a Certificate for Payment covering the Subcontractor’s completed work, and the Contractor has received payment from the owner. Final payment shall then be made to [the Subcontractor] within fifteen (15) days following [the Contractor’s] receipt of payment from [the owner].

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The subcontract also provided for progress payments subject to 5% retainage. After the subcontractor completed its work, it submitted its final payment request to the principal seeking payment in the amount of $12,849.27, which did not include $9,341.92 in retainage held by the principal. The subcontractor subsequently executed a form entitled “final release and waiver of lien from subcontractor,” which stated that the amount of the final periodic payment amount “paid in full” the subcontract and that “this waiver is contingent on the payment of the above-listed amount.” Although the release was executed on August 14, 2002, the principal did not tender the $12,849.27 payment to the subcontract until August 6, 2003, which was approximately one year after the subcontractor signed the release and over five months after the subcontractor had filed suit against the surety.

The surety argued, *inter alia*, that the subcontractor could not recover under the payment bond because a condition precedent to the subcontractor’s right to payment under the subcontract had not been satisfied and that the subcontractor’s claims were barred by the release and accord and satisfaction. With respect to the pay-when-paid condition precedent, the Court held that the subcontract “clearly establishes” that the principal was to pay the subcontractor after the architect submitted the certificate of payment to the obligee and that the obligee had paid the principal for the portion of the work completed by the subcontractor. In other words, the Court concluded that the pay-when-paid condition precedent had been satisfied.

However, the Alabama Civil Court of Appeals went further and stated that it “must also reject [the surety’s] ‘condition precedent’ argument on other grounds.” The Court explained that under Alabama law a pay-when-paid clause is “merely a timing mechanism” for the final payment under a subcontract rather than a condition precedent to the subcontractor’s right to receive payment. The Court stated that “a surety could not assert pay-when-paid clause contained in a contract between a contractor and the subcontractor as a defense to its liability under a payment bond” because “the payment bond and the subcontract are separate contracts.” The Court explained that allowing a surety “to assert a pay-when-paid clause as a defense to an action seeking payment on the bond would defeat the very purpose of a payment bond issued to guarantee payment to a subcontractor, which is to shift the ultimate risk of nonpayment from workmen and suppliers to the surety.” (Internal citations omitted). Ironically, the Court had previously stated that the surety “cannot be liable to [the subcontractor] unless [the subcontractor] was entitled to recover from [the principal].

The Court also rejected the surety’s release and accord and satisfaction defenses. The Court found that the release was not supported by consideration since the principal failed to tender payment within a reasonable time after the release was executed. The Court also held that the subcontractor’s negotiation of the principal’s check did not constitute an accord and satisfaction because the memo line on the check did not indicate that the check was intended to be a full satisfaction of the parties’ dispute. Finally, the Court concluded that the trial court had not abused its discretion in awarding attorney’s fees to the subcontractor.
F. LIMITATION OF ACTIONS

1. Statutory Bond v. Common Law Bond

In Bridgeport, Inc. v. Tampa Roofing Co., the Florida District Court of Appeal reversed the trial court’s holding that the underlying payment bond was a common law bond rather than a statutory bond. The trial court had concluded that the underlying payment bond was a statutory bond because the surety did not strictly comply with the provisions contained in Fla. Stat. Ann. § 712.23. However, the Court of Appeal held that the underlying payment bond was a statutory bond because “the bond does not provide more expansive coverage than the statutory bond described in [Fla. Stat. Ann. § 713.23].” The Court then held that a surety’s failure to strictly comply with Fla. Stat. Ann. § 712.23 does not excuse a claimant’s obligation to give notice of nonpayment before filing suit and to file suit within one year from completion of its performance. Therefore, the Court held that the underlying claim was barred because the subcontractor failed to file suit against the surety within one year of completing its performance under the subcontract.

In Am. Home Assurance Co. v. Plaza Materials Corp., a four-three decision, the Florida Supreme Court crafted a new rule regarding the applicable limitations period for payment bonds on public projects. According to the majority, Fla. Stat. Ann. § 255.05 contained two inherently conflicting provisions. First, Fla. Stat. Ann. § 255.05(4) provides “the payment bond provisions of all bonds requires by subsection (1) shall be construed and deemed statutory payment bonds furnished pursuant to this section and such bonds shall not under any circumstances be converted into common law bonds.” Fla. Stat. Ann. § 255.05(6) provides, “all payment bond forms used by a public owner and all payment bonds executed pursuant to this section by a surety shall make reference to this section by number and shall contain reference to the notice and time limitations provisions in subsection (2).” The bond claimant, who had failed to comply with Florida’s statutory notice provision, argued that the underlying public works payment bond should be construed as a common law bond because it failed to reference the notice and time limitation provisions contained in Fla. Stat. Ann. § 255.05(2).

In refusing to classify a payment bond that failed to reference the applicable notice provisions as a common law bond, the majority ruled that a surety’s failure to reference the applicable notice provisions could estop the surety from relying upon the claimant’s failure to comply with the notice provisions to defeat the claimant’s claim. The majority explained that a surety, who had issued a bond that failed to incorporate all statutorily required information relating to notice, would be estopped from asserting the claimant’s noncompliance with the notice provisions if the claimant’s noncompliance

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30 908 So. 2d 360 (Fla. 2005)
resulted from the bond’s failure to contain the information required by Fla. Stat. Ann. § 22.05(6).

In *Mullin v. Hartford Accident & Indem. Co.*, the United States District Court for the Eastern District of Tennessee held that the public works payment bond at issue was a “statutory bond” and, therefore, the subcontractor’s claim was barred by the six month statute of limitations contained in Tenn. Code in § 12-4-206. Under Tenn. Code in § 12-4-206, suit must be commenced against a public works payment bond “within six (6) months following the completion of such public work, or the furnishing of such labor or materials.” The subcontractor provided no labor or material following August 16, 1999, the date upon which the certificate of substantial completion was issued for the project. However, the subcontractor did not file suit against the surety until September 30, 2004. The subcontractor argued that the surety’s “Consent to Final Payment,” which stated that final payment to the contractor would not relieve the surety of any of its obligations “including any outstanding or potential claims,” transformed the statutory bond into a common law bond. In rejecting this argument, the District Court stated that the subcontractor failed to cite any authority suggesting that a statutory bond could be transformed into a common law bond by any document other than the bond itself. Furthermore, the surety’s Consent to Final Payment merely restated the surety’s existing statutory obligations, including the duty to pay for all labor and material used by the contractor. Although the subcontractor claimed that the payment bond afforded more protection than was required by Tennessee’s public work statutes, the subcontractor failed to point out any bond language that went “above and beyond that contemplated by the statute.” Therefore, the District Court deemed this argument to be waived.

2. Public Works Projects

In *Masonry Specialists of Georgia, Inc. v. United States Fid. & Guar.*, the Georgia Court of Appeals held that Ga. Code Ann. § 36-91-95 barred a subcontractor’s public works payment bond claim because the subcontractor failed to file suit against the surety within one year from the date upon which the public works project was completed and accepted by the proper public authorities. The Court also rejected the subcontractor’s argument that Ga. Code Ann. § 36-91-95 was unconstitutionally vague because subcontractors who have claims against sureties on payment bonds may not be able to determine when construction contracts have been completed and accepted for purposes of triggering the one year statute of limitations.

In *Beachcrete, Inc. v. Water Street Ctr. Assoc., LLC*, the North Carolina Court of Appeals held that a subcontractor’s failure to file suit within one year following the date upon which the principal ceased work on the project barred the subcontractor’s claim against a public work’s payment bond. The parties stipulated that the

subcontractor failed to file his action prior to the expiration of the one year contractual limitation period contained in the payment bond. The Court rejected the subcontractor’s various arguments relating to the unenforceability of the contractual limitation period. For example, the subcontractor argued that the one year contractual limitations period was void under N.C. Gen. Stat. § 58-3-35, which prohibits insurers from the limiting the time in which their insureds may commence suit to less than the period prescribed by law. The North Carolina Court of Appeals explained that a payment bond is a contract of suretyship, not insurance.

In *Pat’s Constr. Serv., Inc. v. Ins. Co. of the West*, the Colorado Court of Appeals held that a subcontractor’s claim against a public works payment bond was time barred because the subcontractor did not file suit against the surety within six months after completion of the work. The surety issued performance bonds and payment bonds on behalf of the principal with respect to two separate public works projects. Colo. Rev. Stat. § 38-27-105(1) provides subcontractors with a right of action against a public works payment bond provided that they file suit “within six months after the completion of the work at not afterwards.” The Court rejected several arguments put forth by the subcontractor as to why more a general statute of limitations should apply as opposed to the specific limitation period contained in Colo. Rev. Stat. § 38-26-105(1). The subcontractor had timely filed his claim against the surety with respect one of the public works projects, but the Court vacated and remanded the trial court’s prejudgment interest award so that the trial court could determine the date upon which prejudgment interest would accrue, i.e. the date upon which the subcontractor submitted its “bill of costs.”

3. Private Projects

In *Reliance Ins. Co. v. Polyvision Corp.*, the United States District Court for the Eastern District of New York held that the surety’s claim against a supplier, who had allegedly provided defective insulated curtain wall panels, was barred by New York’s statute of limitations. Reliance Insurance Company, a Pennsylvania corporation (“Reliance Pennsylvania”), was the parent corporation of the Reliance Insurance Company of New York (“Reliance New York”). Reliance Pennsylvania was the surety for the underlying construction project. However, Reliance New York filed suit against the supplier in 1994, and this suit was dismissed approximately 10 years later when the parties realized that the litigation was commenced by the wrong corporate entity. Reliance Pennsylvania subsequently filed suit against the supplier and the United States District Court for the Eastern District of New York asserting that the savings provisions found in Section 205(a) of New York’s civil practice law and rules rendered its claim timely. The District Court disagreed and held that the saving provision did not allow a parent company to file a claim outside of the limitations period where an action commenced by a subsidiary was dismissed.

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In *S. Win-Dor, Inc. v. RLI Ins. Co.*[^36] a 6-3 decision, the Mississippi Court of Appeals rejected a supplier’s relation-back and estoppel arguments and held that the supplier’s payment bond claim was barred by the limitations period set forth in Miss. Code Ann. § 31-5-53. The principal filed suit against the supplier in December of 1999. In March of 2000, the supplier filed a counterclaim against the principal, and the supplier also filed a proof of claim with the surety under the Form A312 Payment Bond. The surety responded to the proof of claim by stating, *inter alia*, “pending the outcome of [the principal’s] litigation against you this claim is denied by the Surety. [The Surety] makes no waivers and reserves all rights and defense.” The principal filed for bankruptcy in March 2003, and the trial court entered an order allowing the supplier to substitute the surety for the principal and allowed the supplier to file an amended counterclaim. The surety filed a motion to dismiss based upon the one-year statute of limitations contained in Miss. Code Ann. § 31-5-53(b), which the trial court granted. The Court held that the amendment to substitute the surety for the principal did not relate back to the filing of the supplier’s original complaint because the supplier admitted that it was not mistaken as to the identity of any party to the lawsuit. The Missouri Court of Appeals also rejected the supplier’s equitable estoppel argument.

4. Miller Act Projects

In *Subterranean Constr. Co. v. W.D. Curran & Assoc., Inc.*[^37] the United States District Court for the District of Maryland granted the surety’s motion for summary judgment with respect to a subcontractor’s Miller Act payment bond claim because the subcontractor failed to file suit against the surety within one year after the day upon which the subcontractor provided labor or materials to the principal. The subcontractor had provided labor and materials with respect to both the bonded contract and other unbonded projects located onsite. The subcontractor argued that its claim against the payment bond was timely because it was filed within one year of the date upon which the subcontractor ceased to perform work on the unbonded projects. In rejecting the subcontractor’s argument, the District Court explained that there is no language in the payment bond to suggest that it encompassed anything other than the bonded contract and that Miller Act claims arise only out of work performed under these specific contracts for which the payment bond was furnished.

In *United States v. St. Paul Fire & Marine Ins. Co.*[^38] the United States District Court for the Eastern District of Michigan rejected a payment bond claimant’s equitable estoppel and equitable tolling arguments and held that the Miller Act’s one-year statute of limitation barred the payment bond claim. The principal had contracted with the United States Government for a construction project at the Felfridge Air National Guard Base, which also houses the Michigan Air National Guard. The payment bond claimant timely filed suit against the surety and the principal in state court, but the payment bond claimant did not articulate whether the underlying payment bond was a Miller Act Bond

or a Michigan public works bond. The trial court “granted summary disposition” in favor of the surety and entered judgment against the principal.

Upon appeal, the Michigan Court of Appeals affirmed the judgment against the principal but reversed the “summary disposition” for the surety. In its decision, the Michigan Court of Appeals raised the issue of whether the trial court had subject matter jurisdiction over the payment bond claim as the federal court would have exclusive jurisdiction over the dispute if the project was governed by the Miller Act. The Michigan Court of Appeals directed the trial court to consider whether the Miller Act controlled. On remand, the surety filed a motion to dismiss asserting that the state court lacked subject matter jurisdiction, and the parties stipulated to an order of dismissal without prejudice to allow the payment bond claimant to file suit in federal court. The payment bond claimant subsequently filed suit against the surety in federal court on August 1, 2005, approximately six years after the payment bond claimant last provided labor or materials and over five years after the payment bond claimant initially filed suit against the surety in state court.

The surety moved to dismiss for failure to state a claim upon which relief can be granted based upon the Miller Act’s one-year statute of limitations. The claimant had not received a copy of the payment bond until 2005, at which point the surety asserted, for the first time, that the payment bond was governed by the Miller Act. The claimant argued that the surety should be estopped from relying upon the one year statute of limitations because the surety had made repeated representations that the Miller Act was not applicable. The claimant argued that it would have timely filed suit in federal court had the surety raised the Miller Act in its answer, affirmative defenses, or interrogatory responses in the state court action. The surety argued that it was not responsible for assisting the claimant’s counsel to formulate its legal strategy. The District Court agreed and stated that “while possibly ambiguous, determining whether state or federal law applied to this case was the responsibility of [the claimant].” The District Court also noted that the claimant did not acquire a copy of the bond until 2005 and that the claimant permitted almost four years to pass from the state court’s “summary disposition” of the surety until the time it saw the bond and discovered that the Miller Act applied to its claim against the surety.

In United States v. United States Fid. & Guar. Co.,39 the United States Court of Appeals for the Fourth Circuit rejected a subcontractor’s equitable estoppel argument and affirmed summary judgment in favor of the Miller Act surety because the subcontractor failed to file suit against the surety within one year of providing labor or materials. The subcontractor had completed its work in July 2002, and it submitted a claim of $145,397.08 to the surety in September 2002. In January 2003, the surety “apologized” that its principal’s bankruptcy had delayed the surety’s response, and the surety asked for the subcontractor’s patience as the surety reviewed claims. The surety requested additional information from the subcontractor in April 2003, which the subcontractor provided in May 2003. In August 2003, thirteen months after the

subcontractor had completed its work, the surety denied the subcontractor’s claim as untimely under the Miller Act’s one-year statute of limitations.

In support of its equitable estoppel argument, the subcontractor argued that it had reasonably relied on the surety’s promise to investigate its claim as the subcontractor “knew” the investigation would result in the claim being paid. In rejecting this argument, the Fourth Circuit noted that the surety never acknowledged that it would pay anything and each of its letters to the subcontractor expressly reserved the statute of limitations defense. Furthermore, the subcontractor did not agree to forebear suit while negotiating its claim with the surety.
G. DISCHARGE OF SURETY

In *Nashville Ford Tractor, Inc. v. Great Am. Ins. Co.*, the Tennessee Court of Appeals held that the claimant’s fraudulent act of altering equipment leases barred the claimant from recovering under a public works payment bond. The surety issued public works performance bonds and payment bonds for two separate projects in which the principal served as general contractor. Nashville Ford Tractor, Inc. (“NFT”) leased equipment to the principal’s subcontractors, and this equipment was used for both of the public works projects. However, NFT altered the equipment leases in an effort to create the appearance that the equipment was only used for one of the public works projects. Although the trial court ultimately allowed NFT to recover a portion of the unpaid lease expenses from the surety, the trial court specifically found that NFT had deliberately altered the unpaid lease agreements in its attempt to collect under the payment bond. In reversing the trial court’s judgment for NFT, the Court explained:

Although we have been unable to find Tennessee authority directly on point, it is clear that the trial court should not have allowed Nashville Ford Tractor to recover anything on the payment bond after finding that it intentionally falsified documents in an attempt to collect the unpaid balances on the equipment leases under the Lockfor Road Payment Bond. It has long been the policy of this state that fraud will vitiate any type of transaction.

The courts will not aid individuals in enforcing their legal rights where those rights arise from a transaction that is tainted by fraud. Thus, in the analogous context of mechanics and material suppliers’ liens, both the Tennessee Supreme Court and this court have squarely held that falsifying accounts will preclude a party from enforcing a construction lien. We have concluded that the same rule should apply where, as here, a supplier of labor or materials cements alter documents in an attempt to collect on the payment bond for the project.

(Internal citations omitted).

H. SOVEREIGN IMMUNITY

In *Meigs Local Sch. Dist. Bd. of Educ. v. Riverside & Masonry, LLC*, the Ohio Court of Appeals reversed the Ohio Court of Claims and held that Ohio Rev. Code Ann. §2743.02(D) did not bar the surety’s subrogation claim against Ohio government entities for unpaid contract funds. Ohio Rev. Code Ann. § 2743.02(D) provides in pertinent part that “[r]ecovery against the state shall be reduced by the aggregate of insurance proceeds, disability award, or other collateral recovery received by the claimant.” The Court of Claims construed this statute to bar subrogation claims against

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state entities. In reversing the Court of Claims, the Ohio Court of Appeals explained that the purpose of Ohio Rev. Code Ann. § 2743.02(D) was to prevent injured parties from getting a windfall by recovering both from an insurer and the state for the same injury and that there was no risk of double recovery with respect to the sureties claim against the state. Instead, the surety was stepping into the shoes of the principal for purposes of recovering money the state entities owed under the contract.

In Electrical Electronic Control, Inc. v. Los Angeles Unified School District, the California Court of Appeals held that unpaid subcontractors could recover damages against the public entity that awarded a public works contract without requiring the contractor to post a payment bond as required by California law. The Court of Appeals also concluded that the completion contractor’s payment bond did not obligate the surety to satisfy the defaulting contractor’s payment obligations.

II. CIVIL PROCEDURE

A. NECESSARY AND INDISPENSABLE PARTIES

In Cleland Constr. Co. v. Balfour Beatty Constr., Inc., the United States District Court for the District of South Carolina held that a first-tier subcontractor was a necessary and indispensable party to a second-tier subcontractor’s suit against the prime contractor and its surety, in which the second-tier subcontractor asserted (1) a breach of contract and breach of the implied warranty of plans and specifications against the prime contractor and (2) a payment bond claim against the prime contractor’s surety. The prime contractor terminated the first-tier subcontractor for failure to cure various performance defects, including failure to comply with the project schedule and delaying other aspects of the project. The first-tier subcontractor subsequently sued the prime contractor and its surety in South Carolina state court. The prime contractor and its surety removed the case to federal court in which the prime contractor filed a counterclaim against the first-tier subcontractor and a third-party complaint against the first-tier subcontractor’s surety. The first-tier subcontractor then implead the second-tier subcontractor as a third-party defendant pursuant to Fed. R. Civ. P. 14(b), which destroyed complete diversity and the case was remanded to state court. After the case was remanded, the first-tier subcontractor and the second-tier subcontractor agreed to stay the state court litigation between them and submitted their disputes to arbitration as required by the subcontract.

The second-tier subcontractor subsequently filed suit against the prime contractor and its surety in federal court, but the second-tier subcontractor did not name the first-tier subcontractor as a party in this action. The prime contractor and its surety moved to dismiss the second-tier subcontractor’s suit for failure to join a necessary and indispensable party. The District Court determined that the first-tier subcontractor was a necessary party because the primary issue in the case related to who was responsible

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for the delays in the subcontract work. The District Court concluded that prime contractor and its surety could face highly inconsistent obligations if the Court ruled that the prime contractor was responsible for the delays and the state court determined that the prime contractor was not responsible for the delays. The District Court also determined that the first-tier subcontractor was an indispensable party because the Court’s rulings would be highly prejudicial to both the prime contractor and the first-tier subcontractor as both could be subject to competing obligations in the District Court and in the state court. Furthermore, the District Court emphasized that the second-tier subcontractor was free to pursue its claims against the prime contractor and its surety in the already pending state court litigation, or the second-tier subcontractor could institute a new proceeding in state court if it so desired.

B. SUBJECT MATTER JURISDICTION

In Ohio Cas. Ins. Co. v. E. Cent. Coll.,44 the United States District Court for the Eastern District of Missouri held that a surety’s declaratory judgment action was not ripe and, therefore, dismissed the surety’s declaratory judgment action for lack of subject matter jurisdiction. The surety received a claim from its performance bond obligee in excess of $500,000.00. Before acting on the obligee’s performance bond claim, the surety filed a complaint for declaratory relief naming, inter alia, the obligee, the principal, the architect, engineers, subcontractors, and indemnitors as defendants. The obligee and principal filed a motion to dismiss. In dismissing the surety’s complaint for declaratory relief, the Court stated “while a precise line between ripe actions and premature actions is not an easy one to draw, this case is clearly not ripe, because the threat of injury is not certainly impending, there is no hardship to [the surety] in denying review, and the development of additional facts would focus the dispute.” (Internal quotations and citations omitted).

In Regal Indus. Corp. v. Crum & Forster, Inc.,45 the Pennsylvania Superior Court affirmed dismissal of a subcontractor’s payment bond claim because the state court lacked subject matter jurisdiction as the payment bond claim was governed by the Miller Act. The underlying contracts related to the design, construction, testing, and delivery of four inland “river style” barges to the United States Army Corps of Engineers. The subcontractor argued that the design, construction, testing, and delivery of the barges did not constitute a “public work” under 40 U.S.C. § 3133. The Court explained:

Our review of the relevant case law causes us to conclude that in defining the term “public work” within the meaning of the Miller Act the courts have placed importance on whether the United States is a party to the contract, whether the bond runs in favor of the United States, whether the United States has interest in the work being completed, and, whether the work serves the interest of the general public.

The Court concluded that the principal had contracted with an agency of the United States, the payment bond “runs in favor of” the United States, and both the United States and the general public had an interest in the completion of the barges as they benefit interstate commerce. For those reasons, the Court concluded that the barges constituted a “public work,” so the state court lacked subject matter jurisdiction over the Miller Act payment bond claim.

In *Leo Finnegan Constr. Co. v. Northwest Plumbing & Pipefitting Indus. Health, Welfare & Vacation Trust*, the United States District Court for the Western District of Washington granted a prime contractor’s motion to remand to state court for lack of federal subject matter jurisdiction. The prime contractor had received a demand from a union benefit fund that alleged that a subcontractor had failed to make contributions to the fund as required by the union’s collective bargaining agreements. The prime contractor subsequently filed suit in state court seeking a declaration that the union benefit fund did not have any enforceable claims against the prime contractor’s public works payment bond. The union benefit fund then removed the case to federal court alleging, *inter alia*, that the federal court had original jurisdiction under either ERISA or the Federal Declaratory Judgment Act. In remanding the case to state court, the District Court concluded that neither ERISA nor the Federal Declaratory Judgment Act created federal jurisdiction with respect to the union benefit fund’s claim against the public works payment bond.

C. IMPROPER VENUE/FORUM NON CONVENIENS

In *Braspetro Oil Serv. Co. v. UK Guar. & Bonding Corp.*, the New York Appellate Division affirmed the trial court’s dismissal of a performance bond claim on the ground of *forum non conveniens*. The obligee, a Brazilian government agency, had filed suit against a Bahamian surety in New York although the underlying construction contract was executed in Brazil, performed in Brazil and Singapore, most of the witnesses and documentary evidence was located in Brazil and Singapore, and the case was to be governed by Brazilian law.

In *United States v. Cajun Contractors, Inc.*, the United States District Court for the District of Kansas denied the principal and surety’s motion to dismiss for improper venue or to transfer venue to the Middle District of Louisiana, which was based solely upon a forum selection clause contained in a subcontract for a Miller Act project. The subcontract’s forum selection clause stated that the subcontract would be governed by Louisiana law and that any action arising out of the subcontract must be brought in the Nineteenth Judicial District Court for the Parish of East Baton Rouge. The District Court held that the forum selection clause was invalid because the parties could not contractually change the Miller Act’s jurisdictional requirements. Since the forum selection clause attempted to divest federal courts of jurisdiction over the Miller

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Act claim, the forum selection clause was invalid in its entirety. Therefore, venue was proper in the District of Kansas because it was the district in which the contract was to be performed and executed.

D. PLEADING CONDITIONS PRECEDENT

In *City and County of San Francisco v. Tutor-Saliva Corp.*, the United States District Court for the Northern District of California denied the surety’s motion to dismiss the obligee’s claim against a public works performance bond. The surety argued that the obligee’s claim should be dismissed on the ground that the obligee’s complaint did not allege that the obligee had performed the conditions precedent to the surety’s liability under the performance bond as required by Fed. R. Civ. P. § 9(c), which provides in pertinent part that “[i]n pleading the performance or occurrence of conditions precedent, it is sufficient to aver generally that all conditions precedent have been performed or have occurred.” The District Court concluded that the obligee’s “are not required to plead that they have fulfilled the conditions precedent set forth in the Bonds at all” under the Ninth Circuit’s authority.

E. RES JUDICATA/RETRAXIT

In *Alpha Mach. Heating & Air Conditioning, Inc. v. Travelers Cas. & Sur. Co. of Am.*, the California Court of Appeals held that *res judicata* barred the principal from asserting its affirmative defenses to a subcontractor’s claim. The subcontractor filed suit against the principal seeking $199,000.00 in unpaid retainage. The principal asserted several affirmative defenses to the subcontractor’s claim including allegations that the subcontractor’s negligence and unlawful conduct disrupted other trades and damaged the principal in an amount exceeding the retainage. The principal also filed a counterclaim against the subcontractor seeking over $800,000.00 in damages. The principal and the subcontractor subsequently entered into a settlement agreement and mutual release relating to the principal’s counterclaim under which the principal dismissed its counterclaim with prejudice in exchange for payment of $162,500.00. Although the release expressly stated that the principal’s “acceptance of said money, in no way affects [the subcontractor’s] ability to prosecute its lawsuit against [the principal] or [the principal’s] ability to defend against a lawsuit pursuant to its general denials... by refuting elements of [the subcontractor’s] causes of action,” the California Court of Appeals determined that the voluntary dismissal constituted a “retraxit”, which barred the principal from relying upon the allegations contained in its counterclaim to form the basis of its affirmative defense to the subcontractor’s claim.

III. BAD FAITH

In *Smyrna Rebar Co. v. United States Fid. & Guar.*,\(^1\) the Massachusetts Appeals Court dismissed a subcontractor’s suit for unfair settlement practices against the surety under Mass. Gen. Laws Chapter 176D, § 3 because the record demonstrated that the surety’s liability was not reasonably clear. The surety had issued a payment bond for a Massachusetts public works project. The subcontractor filed suit against the surety and its principal claiming that it was owed at least $90,300.60 for work completed, and the principal filed a counterclaim against the subcontractor for $1,443,231.91. In affirming the trial court’s dismissal of the unfair settlement practice claim, the Massachusetts Appeals Court determined that the surety’s liability was certainly not reasonably clear in light of the principal’s counterclaim, which far exceeded the subcontractor’s payment bond claim.

IV. BANKRUPTCY

A. SURETY’S RIGHT TO RECOVER ATTORNEY’S FEES

In *Ins. Co. of N. Am. v. Sullivan*,\(^2\) the United States District Court for the District of Maryland concluded that the surety was not entitled to recover attorney’s fees it had incurred in prosecuting an appeal on behalf of its principal because those attorney’s fees were not covered by the underlying indemnity agreement. The District of Columbia terminated the principal for an alleged default. The principal appealed the termination for default to the District of Columbia’s Department of Administrative Services and then to the District of Columbia’s Contract Appeals Board (“D.C. CAB”). The surety made a provisional payment to the District of Columbia under its performance bond in the amount of $12,869,460.00 whereby the surety received a complete release of its obligations under the bond. Under the surety’s agreement with the District of Columbia, the surety’s tender was subject to a full reservation of rights and the surety was entitled to recover the tendered sum plus interest if the D.C. CAB determined that the principal was terminated for convenience. The principal’s Chapter 7 Bankruptcy Trustee allowed the surety to prosecute the D.C. CAB appeal on behalf of the principal/debtor, and the surety ultimately prevailed on its appeal. The surety then sought to recover the attorney’s fees it incurred while prosecuting the principal’s appeal before the D.C. CAB.

After the trustee objected to the surety’s claim for legal fees and expenses, the Bankruptcy Court determined that the surety’s fees were not recoverable under 11 U.S.C. § 506(b) and that the underlying indemnity agreement did not contemplate the reimbursement of legal fees and expenses incurred by the surety in prosecuting the principal’s appeal. On the one hand, the District Court disagreed with the Bankruptcy Court’s conclusion that the surety’s claim for attorney’s fees “incurred post petition.” The District Court explained that the underlying indemnity agreement was entered into pre-petition and, therefore, the surety’s claim for attorney’s fees arising from litigation spawned by the indemnity agreement should be considered a pre-petition claim.

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\(^2\) 333 B.R. 55 (D. Md. 2005)
However, the District Court concluded that the indemnity agreement did not cover the surety’s fees and expenses related to prosecuting the principal’s D.C. CAB appeal because the fees and expenses were neither incurred (1) by reason of having executed or procured the execution of the bonds or (2) enforcing any of the covenants and conditions of the indemnity agreement.
B. PREFERENCES

In *In re McShane, Inc.*, the United States Bankruptcy Court for the District of Maryland held that the principal’s direct payment of $80,000.00 to a supplier of its subcontractor did not constitute a preference for purposes of the subcontractor’s Chapter 11 bankruptcy proceeding because the principal had an independent obligation to pay the subcontractor’s supplier under the construction contract and/or the payment bond. The subcontractor argued that the principal’s $80,000.00 payment to its supplier constituted an avoidable preference under 11 U.S.C. § 547(b) or that the payment constituted a post-petition transfer of estate property in violation of 11 U.S.C. § 549(a). In rejecting the subcontractor’s arguments, the Bankruptcy Court concluded that the principal’s execution of the payment bond required the principal to pay the supplier, not on behalf of the subcontractor or the subcontractor’s bankruptcy estate, but as an independent obligation owed by the principal to the supplier. Therefore, the $80,000.00 payment was neither property of the subcontractor’s bankruptcy estate nor an avoidable preferential transfer.

C. ADEQUATE PROTECTION

In *In re Maxon Engineering Services, Inc.*, the United States Bankruptcy Court for the District of Puerto Rico granted the surety’s motion for adequate protection and ordered the principal/debtor to segregate all bonded contract proceeds on a project-by-project basis so that the funds would be used to discharge the principal/debtor’s obligations on said projects. Although the Court ultimately granted the surety’s motion for adequate protection, the Court concluded that the surety had not become equitably subrogated to the bonded contract proceeds because the principal/debtor had not defaulted on any of the projects. The Court concluded that the principal/debtor held the bonded contract proceeds in trust for unpaid materialmen and laborers pursuant to the terms of the underlying indemnity agreement. Nevertheless, the bonded contract proceeds constituted property of the principal/debtor’s estate.

D. FINANCIAL ACCOMMODATIONS

In *In re Maxon Engineering Services, Inc.*, the United States Bankruptcy Court for the District of Puerto Rico refused to grant the surety relief from the automatic stay so that the surety could “cancel certain bonding contracts” issued on behalf of the debtor. The surety argued that the bonds constituted “financial accommodations” under § 365(c)(2) of the Bankruptcy Code. The Bankruptcy Court rejected this argument and held that the bonds were not executory contracts and, therefore, did not constitute “financial accommodations.”

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E. PROPERTY OF THE DEBTOR’S ESTATE

In *In re Jazzland, Inc.*, the United States District Court for the Eastern District of Louisiana affirmed the bankruptcy court’s award of summary judgment in the surety’s favor and concluded that funds the owner/debtor held in escrow were not property of the debtor’s estate. The underlying design/build contracts required the owner/debtor to deposit one-half of the contract retainage into an interest bearing account. The design/build contracts provided that the owner/debtor would pay the remaining retainage to the contractor provided that the contractor’s final invoice reasonably met the criteria contained in the design/build contracts. As required by the design/build contracts, the owner/debtor established an escrow account, which was specifically referenced in the project’s loan documents. Prior to the owner/debtor’s petition, the contractor submitted its final bill for retainage. After the owner/debtor filed for bankruptcy, the contractor assigned its rights to the retainage to its surety.

In holding that the retainage was not part of the owner/debtor’s estate, the District Court concluded that the retainage constituted funds “held in escrow” for payment to the principal under Louisiana law. The escrowed retainage did not become part of the owner/debtor’s estate because the contractor had satisfied the “suspensive conditions” to the release of the retainage before the owner/debtor’s petition, and, therefore, the contingency that terminated the owner/debtor’s interest in the retainage occurred prior to the owner/debtor’s bankruptcy.

In *In re Jones Constr. & Renovation, Inc.*, the United States Bankruptcy Court for the Eastern District of Virginia, Richmond Division, held that funds owed to a Chapter 7 principal/debtor for its pre-petition work on two public works projects did not constitute property of the debtor’s estate to the extent necessary to reimburse the surety for expenditures the surety was required to make under its performance and payment bonds. The Bankruptcy Court concluded that the remaining contract funds held by the common obligee did not constitute property of the estate based upon equitable subrogation, which vested right to said funds to the surety before the principal/debtor filed its Chapter 7 petition. Furthermore, the Bankruptcy Court concluded that the surety was entitled to have all remaining contract funds dedicated to reimbursement for any payments made under its bonds, with any excess belonging to the bankruptcy estate, by virtue of the debtor’s pre-petition failure to satisfy its payment obligations to its subcontractors, laborers, materialmen. Finally, the Bankruptcy Court held that the underlying indemnity agreement unambiguously assigned all rights the principal/debtor had to the contract funds. Although the Bankruptcy Court concluded that the principal/debtor’s assignment was absolute, the Bankruptcy Court ordered that any funds collected by the surety in excess of the surety’s obligations under its bonds to be turned over to the bankruptcy trustee “in the interest of equity.”

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V. SUBROGATION AND ASSIGNMENTS

A. PRE-DEFAULT PROGRESS PAYMENT

In Acuity v. Planter’s Bank, Inc., the United States District Court for the Western District of Kentucky held that a bank properly seized a pre-default progress payment to offset the principal’s unpaid line of credit. In 1999, the surety and the principal entered into a general indemnity agreement that contained a trust fund provision. The surety subsequently issued a performance bond and payment bond on the principal’s behalf. Soon thereafter, the principal obtained a line of credit with Planter’s Bank. As a condition of the line of credit, the principal agreed to keep its general business accounts at Planter’s Bank and to allow Planter’s Bank to setoff funds from those accounts if the principal defaulted on the line of credit. In early 2003, the principal defaulted on its line of credit, and Planter’s Bank subsequently seized a $410,602.34 progress payment that was deposited into the principal’s account to reduce the principal’s debt under the line of credit. The principal subsequently defaulted on the bonded project, and the surety performed the principal's performance and payment obligations under its bonds.

After the surety completed the project, it filed suit against Planter’s Bank to assert its rights to the funds taken from the principal’s account under a trust theory and an equitable subrogation theory. Under Kentucky law, a bank may seize funds maintained at the bank to offset a debt owed by its depositor. However, a bank may not offset a deposit consisting of trust funds or funds belonging to one other than the depositor if the bank “knows or can properly be charged with knowledge of the trust character or true ownership of the funds.” As it was undisputed that Planter’s Bank was otherwise entitled to seize the progress payment, the surety argued that the principal held the progress payment in trust for the benefit of its subcontractors on the bonded project and that Planter’s Bank either knew or should have known of this.

In holding that Planter’s Bank was entitled to the progress payment it had seized, the District Court rejected each of the surety’s trust based arguments. The surety asserted a statutory trust argument, an express trust argument based upon the general indemnity agreement, and an equitable trust argument, each of which was rejected by the court. The District Court first concluded that the Kentucky legislature had not created a statutory trust for construction contract progress payments. With respect to the express trust argument, the District Court determined that the trust provision contained in the general indemnity agreement alone was not sufficient to create an express trust under Kentucky law for two reasons. First, the principal could only act as both a settlor and a trustee only if it took some specific action to create a trust by declaration, which the principal did not do. Second, the District Court concluded that a trust was not created when the indemnity agreement was executed because a trust cannot exist under Kentucky law without a corpus. The District Court concluded that the principals’ intent to place certain assets in trust, which did not yet exist and over which

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the principal held no right, title, or interest, was insufficient to create an express trust. Finally, the District Court concluded that Kentucky law did not impose an equitable trust on the progress payment.

The District Court also rejected the surety’s equitable subrogation argument pertaining to the progress payment. The District Court distinguished contract proceeds that were due and already paid to the principal and contract proceeds that were due and unpaid. The District Court concluded that the surety has a specific equitable right to all due and unpaid contract proceeds. However, the District Court concluded that a surety does not have an equitable right to contract proceeds that were due and already paid to the principal once the principal had allowed those funds to be used to satisfy another debt.

B. GOVERNMENT’S STATUTORY OFFSET RIGHT

In Dunn & Black P.S. v. United States,59 the United States District Court for the Eastern District of Washington held that the United States’ statutory setoff rights trumped both an attorney’s lien and a surety’s equitable subrogation rights. Prior to the principal’s termination for default, Dunn & Black represented the principal regarding a road project in which the Government was refusing to grant time extensions or to increase the contract price. After the principal was terminated for default, the surety satisfied the principal’s obligations under its performance and payment bonds. Dunn & Black subsequently filed suit against the Government for wrongful termination on the principal’s behalf. The principal and the Government settled this litigation by converting the termination for default into a termination for convenience, and a judgment was entered against the Government in the principal’s favor for $450,000.00.

The District Court had to determine who was entitled to recover the $450,000.00 judgment. The Government argued that it was entitled to offset the $450,000.00 judgment against the principal’s unpaid taxes. Dunn & Black argued that its lien for attorney’s fees had super-priority over the government’s offset rights. The surety argued that it was entitled to recover the $450,000.00 judgment because its equitable subrogation rights dated back to the date upon which the bonds were issued, which was before the principal failed to pay its taxes. In holding that the government was entitled to offset the entire $450,000.00 judgment, the District Court relied primarily upon 31 U.S.C.A. § 3728, which provides, in pertinent part, that “the Secretary of the Treasury shall withhold paying that part of a judgment against the United States Government presented to the Secretary that is equal to a debt the plaintiff owes the Government.” The District Court distinguished unpaid contract balances, to which a surety’s equitable subrogation rights would trump the Government’s setoff rights, from a judgment against the Government obtained by the principal. The District Court stated, “if the Government had not raised statutory setoff, the [surety] likely would have prevailed, as to a portion of the judgment fund, under the Federal Priority Statute. Based on equitable subrogation

and the relation back doctrine, [the surety] could recover any amount paid on behalf of [the principal] for the [project].”

C. GOVERNMENT’S OVERPAYMENT TO PRINCIPAL

In Lumbermens Mut. Cas. Co. v. United States, the United States Court of Federal Claims dismissed the surety’s equitable subrogation claims relating to the government’s alleged overpayment to the principal. The Court held that a surety must notify the government that the principal cannot complete the contract if the surety expects the government to withhold or divert funds prior to the principal’s default. The Court explained that the government’s equitable duty to retain contract funds on the surety’s behalf is triggered upon notice from the surety that the principal is in default or that payment should be made to the surety.

D. ASSIGNMENT OF RIGHTS TO WHICH SURETY IS SUBROGATED

In Ecor Solutions, Inc. v. Malcolm Pirnie, Inc., the United States District Court for the Northern District of New York denied the principal’s motion to amend its complaint against the public works obligee’s designee and/or site consultant, which sought to add “direct contractual and tortious claims” against the consultant. Although the principal had no direct contractual relationship with the consultant, the principal argued that it was entitled to step into the shoes of the obligee to assert the obligee’s contractual rights against the consultant through equitable subrogation. The principal had defaulted on the underlying environmental remediation project and its surety completed the project pursuant to the terms of its performance bond. The principal subsequently indemnified the surety, and the surety assigned its rights to the principal. Under the principal’s theory, the surety had assigned its equitable right to step into the obligee’s shoes, which included the obligee’s right to sue the consultant.

Although the defendants did not oppose the principal’s motion to amend, the District Court denied the motion to amend, sua sponte, as futile. The District Court stated that the flaw with the principal’s argument was that the surety had no claim against the consultant based on the equitable subrogation. According to the District Court, the surety became subrogated to all the rights and remedies that were available to the obligee against the principal for the enforcement of the principal’s obligations. The District Court stated that it had found “no legal support for [the principal’s] leap frog-like proposition that upon payment of [the principal’s] contractual obligation to [the obligee], its surety [had] a right of subrogation to all of the rights and remedies which were available to [the obligee] against third parties such as [the consultant].” The District Court held that the surety could only step into the shoes of its principal or the obligee’s shoes with respect to asserting claims related to the principal’s default, but that the surety could not “step into a better pair of shoes.”

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60 67 Fed. Cl. 253 (Fed. Cl. 2005).
E. CGL POLICIES

In *Ryan, Inc. E. v. Cont’l Cas. Co.*, the Florida District Court of Appeal, Second District, held that a completing surety is subrogated to any rights its principal may have against the principal’s CGL carriers, including the right to recover attorney’s fees under Fla. Stat. Ann. § 627.428. The principal and surety filed suit against the principal’s primary and excess CGL carriers seeking a declaration that the CGL policies required the primary and the excess insurers to defend and indemnify the principal and the surety for damages to a golf course constructed by the principal. The trial court awarded summary judgment in favor of the primary and excess carriers finding that the “products-completed operations hazard” exception to the “your work” exclusion does not apply to “work that has not yet been completed or abandoned” and that the undisputed facts demonstrated that the alleged damage to the golf course occurred before the principal had completed its work. The Florida District Court of Appeal concluded that there were genuine issues of material fact concerning whether the alleged damage to the golf course occurred before or after the principal had completed its work on the project. After explaining that the surety was equitably subrogated to the principal’s rights under the CGL policies, including the right to recover its attorney’s fees, the Court granted the surety’s motion for appellate attorney’s fees conditioned upon the ultimate entry of judgment in favor of the principal and surety upon remand. The Court also certified that its holding relating to the surety’s entitlement to appellate attorney’s fees was in direct conflict with the first district’s decision in *W. World Ins. Co. v. Travelers Indem. Co.*, 3

IV. MISCELLANEOUS

In *Jerry Bennett Masonry, Inc. v. Crossland Constr. Co.*, the Missouri Court of Appeals held that the trial court properly entered judgment against the surety only “to the extent that [the principal] is unable to satisfy this judgment.” The underlying payment and performance bond provided, “with respect to Claimants, this obligation shall be null and void if the contractor promptly makes payment directly or indirectly, for all sums due.” The Court held that the claimant had “made no showing [the principal] was unable to satisfy the judgment against it” and, therefore, the trial court did not err by entering judgment against the surety containing this language. Furthermore, the Court rejected the claimant’s “vexatious refusal to pay” claim against the surety and explained “Missouri courts have expressly held that a surety for a solvent principal need not independently investigate a claim on a bond to avoid a penalty for vexatious refusal.”

In *ZP No. 54 Ltd. P’ship v. Fid. & Deposit Co. of Maryland*, the Florida District Court of Appeals affirmed dismissal of the obligee’s claims against the surety for aiding and abetting fraud, gross negligence, and negligent misrepresentation. The

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64 171 S.W.3d 81 (Mo. Ct. App. 2005).
obligee planned to build three shopping areas in the Orlando area. To that end, the obligee assigned one of its employees to oversee the contractor bidding process. This employee conspired with the prime contractor to “rig the bidding process in order to inflate the prices of the projects and consequently to pocket large sums of money for themselves.” Instead of competitively bidding the work, the obligee’s employee and the prime contractor allegedly negotiated vastly inflated prices on the projects in exchange for kickbacks. In its suit against the surety, the obligee alleged, inter alia, that the surety aided and abetted the underlying fraud by issuing the performance and payment bonds upon which the obligee relied in awarding the construction contracts to the prime contractor, that the surety was gross negligently in its underwriting process, and that the surety had made negligent misrepresentations.

The Court explained that, assuming arguendo that Florida law recognized a tort for aiding and abetting fraud, the surety had not aided and abetted the alleged fraud because the surety did not provide substantial assistance to advance the commission of the alleged fraud by merely issuing the bonds. The Court explained:

[The surety] had no duty to look behind the contracts to determine whether [the obligee’s] own employee was committing a fraud. Its function was to issue performance bonds, and to pay on the bonds if properly called upon to do so. It was not in the business of supplying information to third parties about the qualifications of the general contractor, or about the morality or honesty of the [obligee’s] employees.

With respect to the obligee’s gross negligence and negligent misrepresentation claims, the Court concluded that the surety did not owe a duty to the obligee with respect to its underwriting practices. Instead, “[t]he only legal duty [the surety] had to [the obligee] discernable from the specific facts of this case was to fulfill its expressed obligations under the performance bonds.”

In Mid-State Sur. Corp. v. Diversified Enter., Inc., the United States District Court for the Southern District of West Virginia dismissed a completion contractor’s counterclaim against the surety for increased completion costs because the underlying completion agreement was for a fixed price and the completion contractor established no basis for increasing the completion contract price. Furthermore, the Court dismissed the completion contractor’s quantum merit claim against the surety because the completion contract covered the identical subject matter and an implied contract and an expressed contract covering identical subject matter cannot exist at the same time under West Virginia law. The Court found that genuine issues of material fact precluded summary judgment on the remaining issues put forth by both the surety and the completion contractor.

In *Ed Kimber Heating & Cooling, Inc. v. Travelers Cas. & Sur. Co.*, the United States District Court for the District of Connecticut held that a surety could not recover excess completion costs from a subcontractor under New York law because the subcontractor was justified in ceasing work under the subcontract after the principal failed to make a single progress payment. The subcontract required the principal to make a monthly progress payments to the subcontractor, and it was undisputed that the principal did not make a progress payment to the subcontractor in January 2003. The subcontractor subsequently ceased from performing work under the subcontract. Although it is unclear as to why the principal was removed from the project, the surety tendered a completion contractor to complete the project including the subcontractor’s unfinished work. The subcontractor filed suit against the surety, and the surety asserted a counterclaim seeking damages for, *inter alia*, the excess cost to complete the subcontractor’s unfinished work.

Applying New York law as required by the choice of law provision contained in the subcontract, the District Court held that the subcontractor’s obligation to pay the excess completion costs accrued only upon the subcontractor’s termination for default. Since it was undisputed that neither the principal nor the surety formally terminated the subcontractor, the District Court held that the “contractual prerequisite” had not been met. Furthermore, the District Court concluded that the subcontractor was justified in ceasing work under the subcontract under New York law because the principal had failed to make its January 2003 progress payment. The surety argued that the principal was justified in refusing to make the progress payment due to the subcontractor’s numerous breaches of the subcontract. However, the District Court concluded that the principal had waived these alleged breaches by continuing to accept the subcontractor’s performance, and the surety could not assert a breach of the subcontract that had been waived by its principal.

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