

# CHAPTER 7

## PUBLIC BONDS ©

§7.1I.SCOPE OF THE CHAPTER

§7.2II.MILLER ACT BONDS: FEDERAL PUBLIC PROJECTS

§7.3III.KANSAS PUBLIC BUILDINGS AND WORKS BONDS

By: Charles E. Millsap

### §7.1 I. SCOPE OF THE CHAPTER

Persons engaged in providing labor or materials for the construction of public projects are deprived of the payment protection afforded by state mechanic's lien laws because liens are not allowed against government properties. To address this lack of protection, federal and state governments have enacted public works bond laws which generally provide that a surety must be retained to offer an alternative remedy to the mechanics' liens ordinarily available on private construction projects. This chapter discusses such bonds, and includes discussion of their application to both federal and state projects.

### §7.2 II. MILLER ACT BONDS: FEDERAL PUBLIC PROJECTS

§7.2.1A.Nature and Purpose of Act

§7.2.2B.Contracts to Which Bonding Requirements Apply

§7.2.3C.Persons Entitled to Protection of Bonds

§7.2.4D.Preliminary Notice Requirements

§7.2.5E.Procedural Rights of Persons Covered by Bonds

§7.2.6F.Filing Suit to Collect on the Payment Bond

§7.2.7G.Amounts Recoverable Under Act

§7.2.8H.Rights and Obligations of Surety

§7.2.9I.Effect of Other Contractual Terms on Bond Claims

#### §7.2.1 A. Nature and Purpose of Act

§7.2.1.21.Performance Bonds

§7.2.1.32.Payment Bonds

In 1935, Congress, in response to the delays and hardships suppliers endured in collecting money from defaulting contractors on public construction contracts, enacted the Miller Act (the "Act"). In a typical private construction project, a supplier of labor, services, or material can secure a mechanic's lien against the improved property if the prime contractor defaults on its payments. This lien allows an unpaid supplier to secure priority in receiving payment under its contract. However, because a lien cannot attach to government property, this remedy is not available to a supplier on a construction project owned by the United States. The Miller Act was created to provide suppliers on government contracts with a remedy that is comparable to a mechanic's lien. Through the

“Construction Industry Payment Protection Act of 1999,” Congress enacted amendments to the Miller Act in order to provide further protection to suppliers. 113 Stat. 231. In the fall of 2002 Congress enacted a codification law to revise and restate the Miller Act. Formerly located at 40 U.S.C. § 270a, et seq., the Act is now found at 40 U.S.C. § 3131, et seq. There are several instances where the wording of the Act was changed. Nevertheless, Congress did not intend, with its 2002 revisions in language, to effect any substantive change in the general and permanent laws of the United States related to public buildings, property and works. H.R. REP. No. 107-479, at 2-3, reprinted in 2002 U.S.C.C.A.N. 827, 827-29.

When Congress enacts ordinary, amendatory legislation, an intent to change substantive law can be inferred from language revisions. However, with the enactment of a codification law, the presumption is that the law is intended to remain unchanged, rendering no impairment to the precedent value of earlier judicial decisions and other interpretations. *Finley v. United States*, 490 U.S. 545, 554, 109 S. Ct. 2003, 104 L. Ed. 2d 593 (1989).

#### **§7.2.1.2 1. Performance Bonds**

Before any prime contractor is awarded a construction contract with the United States, it is required to furnish the United States with a performance bond. The performance bond requirement, now found at 40 U.S.C. § 3131(b)(1), requires the “contractor” to furnish “[a] performance bond with a surety satisfactory to the officer awarding the contract, and in an amount the officer considers adequate, for the protection of the Government.”

#### **§7.2.1.3 2. Payment Bonds**

Before any prime contractor is awarded a construction contract with the United States, it must furnish the United States with “[a] payment bond with a surety satisfactory to the officer for the protection of all persons supplying labor and material . . .” 40 U.S.C. § 3131(b)(2). The amount of the payment bond is determined by the amount of the contract. The requirements for the payment bond are as follows:

1. The bond must be equal to the total amount payable under the terms of the contract, unless the contracting officers make a written determination, with specific findings, that a bond in that amount is impracticable.

2. In no event may the amount of the payment bond be less than the amount of the performance bond.

If the government waives or negligently fails to enforce the requirement for a payment bond on a project, a subcontractor or supplier which is not paid by the prime contractor may be left without a remedy. In *Dept. of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 119 S. Ct. 687, 142 L. Ed. 2d 718 (1999), an insolvent contractor failed to pay a subcontractor for work performed on a public construction project. The Army failed to require the contractor to post a Miller Act payment bond, and the Army paid out

substantial funds to the contractor, even after being notified by the subcontractor that it was not being paid. The subcontractor asserted an equitable lien on certain funds held by the Army. Reversing a Ninth Circuit decision, the Supreme Court held that the doctrine of sovereign immunity shielded the Army from this equitable claim.

In *Arvanis v. Noslo Eng'g Consultants, Inc.*, 739 F.2d 1287, 1290 (7th Cir. 1984), *cert. denied*, 469 U.S. 1191 (1985), the court considered the plight of an unpaid Miller Act claimant. When the government failed to require a payment bond, the court, noting a defect in the Miller Act, stated:

Perhaps the Miller Act does no more than encourage government contracting officers to insist that contractors obtain Miller Act Bonds. . . . There does seem to be a gap in the statute; There is no provision for the contingency that both the contractor and the government contracting officer will ignore the bonding requirement. . . . The statute requires only that contractors obtain performance and payment bonds. The statute places no affirmative obligation on the government and says absolutely nothing about what happens when the contractor fails to furnish the bond. The Act grants a very narrow and specific right to those in appellant's position: the right to sue on a bond (if there happens to be one).

*See also McMann v. Northern Pueblos Enterprises*, 594 F.2d 784, 785 (10th Cir. 1979) (“Federal district courts have no jurisdiction under the Federal Tort Claims Act over subcontracting suits alleging negligent failure of the federal government or its officers to require a prime contractor to post a Miller Act bond.”)

Practice Tip: A subcontractor or supplier should confirm the existence of a Miller Act payment bond on jobs for which it intends to supply labor or materials.

Case law interpreting the word “labor” as used in the Miller Act is sparse. The word has been construed to include physical toil, but not work by a professional, such as an architect or engineer. However, the term may include an architect or other professional who actually superintends the works as it is done on the job site (or the engineer who inspects the job while in progress). *United States ex rel. Naberhaus-Burke, Inc. v. Butt & Head, Inc.*, 535 F. Supp. 1155, 1158-59 (S.D.Ohio 1982).

Claims for taxes do not involve “labor and material” within the meaning of the Miller Act. The government, therefore, cannot recover from the surety on the payment bond for the contractor's unpaid taxes. *Nickell v. United States ex rel. Texas Vitriified Pipe Co.*, 340 F.2d 117, 119 (10th Cir. 1965).

While it remains incumbent upon a subcontractor or supplier to confirm the existence of a Miller Act payment bond on any project for which it intends to supply labor or materials, there are potential avenues of recovery where a Miller Act bond was not obtained. In *Tradesmen International v. United States Postal Service*, 234 F. Supp. 2d 1191 (D. Kan.

2002), the United States Postal Service inadvertently left the Miller Act payment bond requirement out of a federal postal facility construction contract. The plaintiff provided labor on the project to a subcontractor of Lockheed Martin (the general contractor), and that subcontractor failed to pay the plaintiff about \$86,000. The defaulting subcontractor was later deemed to be insolvent and judgment proof.

Tradesmen International commenced an action in federal district court against the general contractor and the Postal Service. It pled three causes of action: (1) an unjust enrichment claim against the Postal Service and the general contractor; (2) a third-party beneficiary breach of contract claim against the general contractor; and (3) an equitable lien claim on funds held by the Postal Service and the general contractor. The defendants' motions to dismiss were granted by the court. However, the court granted Tradesmen International leave to amend its first and third claims against the general contractor.

In dismissing the subcontractor's claim against the Postal Service, the court noted that the enactment of the Contract Disputes Act [41 U.S.C. § 601, et seq.] "preempts the entire field of government contract remedies such that a subcontractor is prevented from availing itself of the 'sue or be sued' clause of the [Postal Reorganization Act of 1970] to obtain jurisdiction to file an action against the Postal Service in district court." 234 F. Supp. 2d at 1197.

Tradesmen International also argued that the general contractor breached its contractual obligation to obtain a Miller Act payment bond (although the contract with the Postal Service contained no such requirement). It relied on a generic contract provision that required the general contractor to comply with applicable federal law. The court rejected this argument, however, and found that a Miller Act bond requirement will not be implied so as to allow a subcontractor to assert a third-party beneficiary claim. 234 F. Supp. 2d at 1201-04.

Following the amendment of the complaint, the district court found that Tradesmen International had stated a claim for an equitable lien on the funds retained by Lockheed Martin. The allegations that supported such a claim for relief were as follows: (1) that the general contractor wrongfully failed to obtain a Miller Act bond despite its knowledge that it should have been required to do so; (2) that the general contractor was aware of the financial difficulties of its subcontractor - the one that hired the plaintiff; (3) that the Postal Service paid the general contractor substantially all of the money owed to it under the contract; (4) that the general contractor actively encouraged the plaintiff to continue to provide labor on the project; (5) that the general contractor had refused repeated demands to make direct payments to the plaintiff; and (6) that the general contractor was withholding substantial monies owed to the subcontractor. *Tradesmen International v. Lockheed Martin Corp.*, 241 F. Supp. 2d 1337, 1339-40 (D. Kan. 2003).

#### **§7.2.2 B. Contracts to Which Bonding Requirements Apply**

The Miller Act applies to contracts for the construction, repair, or alteration of any "public work." The United States Supreme Court, in *United States ex rel. Noland Co. v.*

*Irwin*, 316 U.S. 23, 62 S. Ct. 899, 86 L. Ed. 1241 (1942), adopted the definition of “public work” found in the National Industrial Recovery Act, in which Congress had defined the term to include “any projects of the character heretofore constructed or carried on either directly by public authority or with public aid to serve the interests of the general public.” 316 U.S. at 28.

Although the Miller Act applies to “public works,” it does not apply to a contract that is for less than \$100,000. 40 U.S.C. § 3131(b). Additionally, the bond requirements of the Miller Act may be waived for a construction contract with any branch of the military. 40 U.S.C. § 3134(a). There is also a bond waiver provisions for contracts to be performed in a foreign country. 40 U.S.C. § 3131(d).

For public construction projects where the contract sum is between \$25,000 and \$100,000, the contracting officer must select, from options provided by the Federal Acquisition Regulations, one or more alternatives to payment bonds, for the purpose of protection of suppliers of labor and materials. 40 U.S.C. § 3132(b). The alternatives include the following: (1) a payment bond; (2) an irrevocable letter of credit; (3) a tripartite escrow agreement; (4) a certificate of deposit; or (5) the deposit of a security. 48 C.F.R. § 28.102-1 (2003).

Practice Tip: As with larger projects on which Miller Act bonding requirements apply, a subcontractor or supplier on a small federal project should confirm that the contracting officer has included a payment bond alternative in the government’s agreement with the general contractor.

### **§7.2.3 C. Persons Entitled to Protection of Bonds**

#### §7.2.3.11. Performance Bonds

#### §7.2.3.22. Payment Bonds

Under the Miller Act, the performance bond and the payment bond represent separate obligations running to separate obligees, to the United States in the case of the performance bond, and to persons supplying materials and labor in the case of the payment bond.

#### **§7.2.3.1 1. Performance Bonds**

Miller Act performance bonds are required solely for the protection of the United States. 40 U.S.C. § 3131(b)(1). These bonds help ensure the government that the project will be properly completed, and also provide coverage for taxes which are to be collected, deducted, or withheld for wages paid by the contractor in fulfilling the contract. The government must give the surety timely notice of any unpaid taxes. 40 U.S.C. § 3131(c)(2). Subcontractors and suppliers are not entitled to recovery under performance bonds. *United States Fidelity & Guaranty Co. v. American State Bank*, 372 F.2d 449, 450 (10th Cir. 1967).

## **§7.2.3.2 2. Payment Bonds**

§7.2.3.2.1a. Direct Contractual Relationship Requirement

§7.2.3.2.2b. Subcontractors

§7.2.3.2.3c. Suppliers

§7.2.3.2.4d. Employees

A payment bond is for “the protection of all persons supplying labor and material in carrying out the work provided for in the contract for the use of each person.” 40 U.S.C. § 3131(b)(2).

### **§7.2.3.2.1 a. Direct Contractual Relationship Requirement**

The Miller Act provides a cause of action for all subcontractors and any “. . . person having a direct contractual relationship with a subcontractor but no contractual relationship, express or implied, with the contractor furnishing the payment bond . . . d1. “ when proper notice is given. 40 U.S.C. § 3133(b)(2). This “contractual relationship” prerequisite means that a supplier to a subcontractor has rights under the Miller Act, while a supplier to another supplier does not.

### **§7.2.3.2.2 b. Subcontractors**

The Miller Act payment bond must provide for payment of all persons supplying labor or material for the project. 40 U.S.C. § 3131(b)(2). These “persons” include the subcontractors of the prime contractor (first-tier subcontractors) and sub-subcontractors (second-tier subcontractors). The United States Supreme Court, in *MacEvoy v. United States ex rel. Calvin Tomkins Co.*, 322 U.S. 102, 64 S. Ct. 890, 88 L.Ed. 1163 (1944), defined a “subcontractor” as “. . . one who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract, thus excluding ordinary laborers and materialmen.” 322 U.S. at 109. This meaning was borrowed from the definition of “subcontractor” used in the building trades, as was intended by Congress when it enacted the Miller Act.

Congress intended to draw a clear line between sub-subcontractors and all relationships more remote from the prime contractor. H.R. Rep. No. 1263, 74th Cong., 1st Sess., 3 (1935); S. Rep. No. 1238, 74th Cong., 1st Sess., 2 (1935). While mindful of their obligation to liberally construe the highly remedial Miller Act in order to protect those whose labor and materials go into public projects, courts will not extend the coverage of the act beyond the sub-subcontractor level. *Bateson v. United States ex rel. Board of Trustees*, 434 U.S. 586, 593-94, 98 S. Ct. 873, 55 L. Ed. 2d 50 (1978).

The Miller Act is not designed to protect prime contractors. Therefore, a partner or joint venturer of the prime contractor falls outside the group of persons protected by the Act. *St. Paul-Mercury Indemnity Co. v. United States ex rel. H.C. Jones*, 238 F.2d 917, 921 (10th Cir. 1956).

### §7.2.3.2.3 c. Suppliers

Under the Miller Act, a supplier who has a direct contractual relationship with a subcontractor has a right of action on the payment bond for its claim against that subcontractor, provided it gives proper notice. *United States ex rel. Olmstead Elec., Inc. v. Neosho Const. Co.*, 599 F.2d 930, 932 (10th Cir. 1979). However, a material supplier who has not supplied either the prime contractor or a first-tier subcontractor is not entitled to recover under the payment bond. *MacEvoy*, 322 U.S. at 106. Under the Miller Act, the prime contractor is secondarily liable to suppliers of its subcontractors. *Southern Construction Co. v. Pickard*, 371 U.S. 57, 58, n. 1, 83 S. Ct. 108, 9 L. Ed. 2d 31 (1962).

A person supplying materials to a mere materialman, rather than a subcontractor, is not protected by the Miller Act. *MacEvoy v. Tompkins*, 322 U.S. at 104. Therefore, Miller Act coverage may hinge on a determination of whether a person having a relationship with the prime contractor is a “subcontractor” or a “materialman.” As articulated by the Supreme Court, the “substantiality and importance” of the relationship with the prime contractor will determine whether a person is a subcontractor. *F.D. Rich Co., Inc. v. United States ex rel. Industrial Lumber Co., Inc.*, 417 U.S. 116, 123-124, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974).

One may ponder why the Miller Act makes a distinction between “subcontractors” and “materialmen.” The Supreme Court answered this question in *MacEvoy v. Tompkins*:

Congress cannot be presumed, in the absence of express statutory language, to have intended to impose liability on the payment bond in situations where it is difficult or impossible for the prime contractor to protect himself. The relatively few subcontractors who perform part of the original contract represent in a sense the prime contractor and are well known to him. It is easy for the prime contractor to secure himself against loss by requiring the subcontractors to give security by bond, or otherwise, for the payment of those who contract directly with the subcontractors. (Citations omitted) But this method of protection is generally inadequate to cope with remote and undeterminable liabilities incurred by an ordinary materialman, who may be a manufacturer, a wholesaler or a retailer. Many such materialmen are usually involved in large projects; they deal in turn with innumerable sub-materialmen and laborers. To impose unlimited liability under the payment bond to those sub-materialmen and laborers is to create a precarious and perilous risk on the prime contractor and his surety. To sanction such a risk requires clear language in the statute and in the bond so as to leave no alternative.

322 U.S. at 110.

When dealing with equipment suppliers and repair costs, the ability to recover under the Miller Act is governed by the nature of the repairs. Repairs required by the negligent act of a subcontractor, which add materially to the value of the equipment and render it

available for other work, are not within the coverage of the payment bond. However, repairs which are necessary to, and wholly consumed, in the performance of the work, caused by ordinary wear and tear, are within the coverage of the bond. *United States ex rel. Rent It Company v. Aetna Cas. & Sur.*, 988 F.2d 88, 90 (10th Cir. 1993); *Continental Casualty Co. v. Clarence L. Boyd Co.*, 140 F.2d 115, 116 (10th Cir. 1944).

The Miller Act permits recovery when materials have been furnished in the prosecution of the work, and it does not require that labor or materials furnished be actually used or incorporated into the work. In *Fourt v. United States ex rel. Westinghouse Electric Supply Co.*, 235 F.2d 433 (10th Cir. 1956), a supplier was allowed to pursue a Miller Act payment bond claim where it had furnished materials to a contractor which were not actually used in the performance of the contract, but which replaced identical items withdrawn from the subcontractor's inventory and actually used on the project. *See also, Commercial Standard Ins. Co. v. United States ex rel. Crane Co.*, 213 F.2d 106, 109 (10th Cir. 1954).

#### **§7.2.3.2.4 d. Employees**

To determine whether an employee is entitled to the protection of the Miller Act, courts have commonly looked to the Davis Bacon Act, which contains a list of job classifications entitled to Miller Act protection. 40 U.S.C. § 276a, et seq. Although the Davis Bacon Act only lists “mechanics and laborers” as protected employees, at least one court has held that on-site supervisors are afforded the same Miller Act protections. *United States ex rel. Olson v. W.H. Cates Const. Co.*, 972 F.2d 987, 991 (8th Cir. 1992). An employee of a subcontractor can recover against the prime contractor's payment bond whether the employee worked at the construction job site or not. 40 U.S.C. § 270b; *John Gruss Co., Inc. v. Paragon Energy Corp.*, 22 B.R. 236, 242 (D. Kan. 1982).

Although employees can be protected under the Miller Act, they must have a direct contractual relationship with the prime contractor or a first-tier subcontractor. *Bateson*, 434 U.S. at 592. Therefore, the protection does not extend to employees of a second-tier subcontractor, because those employees have no direct contractual relationship with the first-tier subcontractor. *Id.*

In *United States ex rel. Sherman v. Carter*, 353 U.S. 210, 77 S. Ct. 793, 1 L. Ed. 2d 776 (1957), the Court established the right of trustees of union trust funds to make direct claims against a Miller Act payment bond on behalf of employees. The Court noted that assignees of persons who furnished labor or material in the construction of federal public projects must be allowed to sue on Miller Act bonds, for to fail to allow this would deprive those for whom the security was intended of a fair chance to realize upon their claims by assignment. 353 U.S. at 218-220. *See also, Nickell v. United States ex rel. D. W. Falls*, 355 F.2d 73, 76 (10th Cir. 1966) (“It is apparent under the Miller Act (40 U.S.C. § 270a) the protection of the payment bond is available to a party to whom is assigned the debt of the prime contractor, and who gives proper notice.”).

## **§7.2.4 D. Preliminary Notice Requirements**

§7.2.4.11. Persons Required to Provide Notice

§7.2.4.22. Form of Notice

§7.2.4.33. Timing of Notice

§7.2.4.44. Service of Notice

Under the Miller Act, a person has a right of action upon the payment bond only if that person gives proper notice of intent to exercise that right. 40 U.S.C. § 3133(b)(2). The purpose of this provision is to protect the prime contractor by fixing a date beyond which it will not be liable for any first-tier subcontractors' debts. *United States ex rel. Moody v. American Ins. Co.*, 835 F.2d 745, 747 (10th Cir. 1987). As noted by the Supreme Court, the manner of notice specified in the Act is merely "to assure receipt of the notice, not to make the described method mandatory so as to deny the right of suit when the required written notice within the specified time had actually been received." *Fleisher Engineering & Constr. Co. v. United States ex rel. Hallenbeck*, 311 U.S. 15, 19, 61 S. Ct. 81, 85 L. Ed.12 (1940).

### **§7.2.4.1 1. Persons Required to Provide Notice**

A person who has a direct contractual relationship with the prime contractor (whether a subcontractor or a supplier) need not send a preliminary notice. All other persons who have a direct contractual relationship with a first-tier subcontractor but no direct contractual relation with the prime contractor must, in order to establish a right of action against the payment bond, give the prime contractor sufficient notice of the claim. 40 U.S.C. § 3133(b)(2).

The 90-day notice requirement permits the prime contractor, after waiting ninety days, to safely pay its subcontractors without fear of additional liability to sub-subcontractors or materialmen. *United States ex rel. Munroe-Lang-Stroth, Inc. v. Praught*, 270 F.2d 235, 238 (1st Cir. 1959). The notice provision thereby prevents both "double payments" by prime contractors and the alternative of "interminable delay in settlements between contractors and subcontractors." *United States ex rel. J.A. Edwards & Co. v. Thompson Const. Co.*, 273 F.2d 873, 875-76 (2nd Cir. 1959), *cert. denied*, 362 U.S. 951 (1960).

### **§7.2.4.2 2. Form of Notice**

Any person with a legitimate cause of action must provide written notice to the prime contractor. 40 U.S.C. § 3133(b)(2). This notice must state the amount claimed and the name of the party to whom the material was supplied or for whom the labor was performed. *Id.* Notice must also convey to the prime contractor that the claimant is looking to the prime contractor's payment bond for recovery. *United States ex rel. Kinlau Sheet Metal Works Inc. v. Great American Ins. Co.*, 537 F.2d 222, 223 (5th Cir. 1976). Under the Miller Act, a notice is sufficient if it states "with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed." 40 U.S.C. § 3133(b)(2). Notices

will be liberally construed and will satisfy requirements under the Miller Act where the contractor has actual knowledge of the claim against it, regardless of technical compliance with statutory requirements. *McWaters & Bartlett v. United States ex rel. Wilson*, 272 F.2d 291, 295 (10th Cir. 1959).

### **§7.2.4.3      3.      Timing of Notice**

The Miller Act has a 90-day expiration period for delivering notice. The Act states that the preliminary notice requirement for claims on a Miller Act payment bond must be satisfied within “90 days from the date on which the person did or performed the last of the labor or furnished or supplied the last of the material for which the claim is made.” 40 U.S.C. § 3133(b)(2). If notice is not served within the 90-day period, the claimant may not seek recovery from the payment bond. *Olmstead Elec. v. Neosho Const. Co.*, 599 F.2d at 932. Although courts have liberally applied other portions of the Act, the 90-day notice requirement is always a condition precedent to suit on a Miller Act claim. *United States ex rel. State Elec. Supply Co. v. Hesselden Const. Co.*, 404 F.2d 774, 777 (10th Cir. 1968).

When considering the claim of a supplier of materials, the critical date for the 90-day notice, as well as the one-year limitation on actions described below, is when the last material was supplied as a part of the original contract, not the date on which material was supplied to correct defects or make repairs. *Id.* at 776.

The same general standard is used for determining when labor was last performed. Repairs made on the original project are not counted as “labor” for the purpose of the Miller Act. *United States ex rel. Dillon Const. v. Continental Ins. Co.*, 776 F.2d 962, 964 (11th Cir. 1985). *See also, General Ins. Co. of America v. United States ex rel. Audley Moore and Sons*, 406 F.2d 442 (5th Cir. 1969), *cert. denied*, 396 U.S. 902 (1969) (final measurements, final inspection and clean up did not constitute “labor” within the meaning of the Miller Act); *United States ex rel. Austin v. Western Electric Co.*, 337 F.2d 568, 572-73 (9th Cir. 1964) (the test is not one of “substantial completion,” but whether additional work was performed as part of the original contract, or merely for the purpose of correcting defects or making repairs following inspection of the project.).

Practice Tip: For an excellent discussion of notice requirements under the Miller Act, *see United States ex rel. Water Works Supply Corp. v. George Hyman Const. Co.*, 131 F.3d 28, 32-35 (1st Cir. 1997).

### **§7.2.4.4      4.      Service of Notice**

40 U.S.C. § 3133(b)(2)(A) and (B) provide the guidelines for proper service. In order to satisfy the Act, notice must be:

1. Sent by means which provides written, third-party verification of delivery;
2. To the prime contractor at:

- a. any place it maintains an office or conducts its business, or
- b. the prime contractor's residence.

In the alternative, the notice may be served in any manner in which the United States marshal of the district in which the public improvement is situated is authorized by law to serve a summons.

Although the statute provides that the notice must be sent by means such as registered mail, the United States Supreme Court has liberally construed that requirement and in *Fleisher Eng'g & Const. Co. v. Hallenbeck, supra*, notice sent by first class mail was deemed effective service. 311 U.S. at 18. The Court drew a distinction between an explicit condition precedent to the right to sue (such as the requirement to bring suit within the one-year period) and the manner of serving notice. 311 U.S. at 18-19.

#### **§7.2.5 E. Procedural Rights of Persons Covered by Bonds**

If a person “. . . submits an affidavit that the person has supplied labor or materials for work described in the contract and payment for the work has not been made,” that person is entitled to receive a certified copy of the payment bond and the contract for which the payment bond was given. 40 U.S.C. § 3133(a). As suggested earlier, a cautious person will have a copy of that bond and contract before supplying the labor or materials.

#### **§7.2.6 F. Filing Suit to Collect on the Payment Bond**

- §7.2.6.11. Timing
- §7.2.6.22. Jurisdiction
- §7.2.6.33. Venue
- §7.2.6.44. Pleading Requirements
- §7.2.6.55. Proof Requirements
- §7.2.6.66. Construction of Act

Both the Miller Act and case law interpreting the Act provide important guidance on timing of a suit, jurisdiction, venue, and pleading and proof requirements.

##### **§7.2.6.1 1. Timing**

A suit on a Miller Act bond cannot be brought within the first 90 days after the amount becomes due (the last furnishing of labor, supplies, equipment or materials). However, “[a]n action brought under this subsection must be brought no later than one year after the day on which the last of the labor was performed or material was supplied by the person bringing the action.” 40 U.S.C. § 3133(b)(4).

The one-year limitation of actions is an integral part of the Miller Act, and compliance with it is a condition precedent to maintaining an action. Neither a demand for arbitration

nor actual arbitration tolls the statute of limitations. *United States ex rel. Portland Const. Co. v. Weiss Pollution Control Corp.*, 532 F.2d 1009, 1012-13 (5th Cir. 1976). However, the Tenth Circuit has recognized that, under certain circumstances, a defendant in a Miller Act case may be estopped from asserting the statute of limitations as a defense. *United States ex rel. Nelson v. Reliance Ins. Co.*, 436 F.2d 1366, 1370-72 (10th Cir. 1971).

Demobilization from a construction project will be considered “labor performed” for the purpose of the one-year limitation of actions where a subcontract provides a lump sum price for both mobilization and demobilization for the work. *Steenberg Const. Co. v. Prepekt Concrete Co.*, 381 F.2d 768, 774 (10th Cir. 1967).

Remedial work will not extend the one-year limitation period for commencing an action on a Miller Act payment bond. In *United States ex rel. Mid-West Painting v. Hartford Accident & Indemnity*, No. 99-1308-JTM, 2000 U.S. Dist. LEXIS 10882 (D. Kan. July 14, 2000), a painting subcontractor performed a few hours of repainting and touch-up work in order to satisfy a punch list generated by an inspection. Applying the majority rule “requires the trier of fact to distinguish whether the work was performed as a part of the original contract or for the purpose of correcting defects, or making repairs following inspection of the project,” and the court found that the repainting and touch-up work did not extend the running of the limitation period. The subcontractor, therefore, failed to commence its action within the Miller Act’s limitation period.

Practice Tip: Cases such as *Mid-West Painting* emphasize the need for subcontractors and suppliers to keep careful track of the one-year anniversary of the last day on which labor was performed or material was supplied. Such persons should never rely on post-inspection or punch list activities in identifying that date.

## **§7.2.6.2      2.      Jurisdiction**

“A civil action brought under [the Miller Act] must be brought . . . in the United States District Court . . . regardless of the amount in controversy.” 40 U.S.C. § 3133(b)(3)(B). Parties cannot contractually change the Miller Act’s exclusive jurisdictional requirements. *United States ex rel. B & D Mechanical Contractors, Inc. v. St. Paul Mercury Ins. Co.*, 70 F.3d 1115, 1117 (10th Cir. 1995), *cert. denied*, 517 U.S. 1167 (1996). If a party chooses to pursue a Miller Act claim, it must do so in federal court. Pursuant to the Contract Disputes Act, 41 U.S.C. § 601, *et seq.*, construction claims or disputes in which the government is a party are submitted first to the contracting officer. Following a decision by the contracting officer, the Act then authorizes either an appeal to a board of contract appeals or a direct action suit in the United States Court of Federal Claims. 41 U.S.C. §§ 605, 606, 609(a)(1). Although a Miller Act claim is brought in the name of the United States for the benefit of the claimant, the government is not considered to be a party to the dispute for the purposes of the Contract Disputes Act. *United States ex rel. Tech Coatings v. Miller-Stauch Const. Co., Inc.*, 904 F. Supp. 1209, 1212 (D. Kan. 1995) (the CDA does not govern contract disputes between the prime contractor and the subcontractor.).

Ordinarily, the fact that the prime contractor has a claim pending under the Contract Disputes Act, for the same amounts being sought by a subcontractor or supplier, does not affect a Miller Act case brought by the subcontractor or supplier. For a discussion of the effect of a pending administrative claim by the prime contractor, see *Fanderlik-Locke Co. v. United States ex rel. M.B. Morgan*, 285 F.2d 939 (10th Cir. 1960), *cert. denied*, 365 U.S. 860 (1961). The Fifth Circuit Court of Appeals, relying in part on *Fanderlik-Locke v. Morgan, supra*, held that a subcontractor’s Miller Act rights trump a “pay-when-paid” clause found in a subcontract:

[T]he “pay-when-paid” clause in the Subcontract does not preclude TMS’s recovery on its contract work and change order claim because under the Miller Act, the liability of the contractor is to the subcontractor, despite non-payment by the government to the contractor. See *Fanderlik-Locke Co. v. United States ex rel. Morgan*, 285 F.2d 939, 942 (10th Cir. 1960) (“ordinarily the fact that a prime contractor has a claim for the same amounts pending under the ‘disputes clause’ of the prime contract, does not affect Miller Act cases”), *cert. denied*, 365 U.S. 860, 81 S. Ct. 826, 5 L. Ed. 2d 823 (1961). The federal legislation conditions payment of the subcontractor not on payment by the government to the contractor, but rather on the passage of time from completion of the work or provision of materials. *F.D. Rich Co., Inc. v. United States ex rel. Indus. Lumber Co.*, 417 U.S. 116, 127, 94 S. Ct. 2157, 2146, 40 L. Ed. 2d 703 (1974) (scope of remedy and substance of rights created under Miller Act are matters of federal, not state, law); see 40 U.S.C.A. § 270b(a) (1986).

*United States ex. rel. T.M.S. Mechanical Contractors v. Millers Mut. Fire Ins. Co.*, 942 F.2d 946, 949, n. 6 (5th Cir. 1991). See also, *Moore Bros. Construction Co. v. Brown & Root, Inc.*, 962 F. Supp. 838, 841 (E.D.Va. 1997) (“Most of the courts which have dealt with this argument do not allow sureties to invoke ‘pay-when-paid’ defenses appearing in subcontracts, especially when the subcontract is not explicitly incorporated into the payment bond”).

For further discussion of the effect of a pay-when-paid or pay-if-paid clause on a Miller Act claim, see Silberman, Aaron P., *Pay-If-Paid Clause Is Not A Defense To A Miller Act Payment Bond Claim*, 37-SUM Procurement Law 15 (2002) (discussing the case of *United States ex rel. Walton Technology v. Westar Engineering*, 290 F.3d 1199 (9th Cir. 2002), in which the circuit court held that a “pay when and if paid” clause in a construction subcontract is not a defense to a Miller Act payment bond action).

**Practice Tip:** In a Miller Act action, the general contractor may wish to assert counterclaims against the claimant/subcontractor. In that instance, the general contractor must identify and assert an independent ground for subject matter jurisdiction for the counterclaim. “The Miller Act does not itself provide jurisdiction for [the general contractor’s] counterclaim against [the subcontractor]. See generally 40 U.S.C. §

3133.” *Cache Valley Electric Co. v. Metric Const. Co.*, 159 Fed. Appx. 15, 18, 2005 U.S. App. LEXIS 27969 (10th Cir. 2005).

### **§7.2.6.3 3. Venue**

Miller Act claims must be brought in any district in which the contract was to be performed. 40 U.S.C. § 3133(b)(3)(B). Although this standard appears to require strict compliance, several courts have held otherwise.

In *B & D Mechanical v. St. Paul*, *supra*, 70 F.3d at 1117, the court stated that section 270b(b) [the predecessor of 40 U.S.C. § 3133(b)(3)(B)] was “merely a venue requirement” and could be superseded by a valid forum selection clause. In *Tech Coatings*, *supra*, 904 F. Supp. at 1213-14, the court transferred a Miller Act claim involving an Olathe, Kansas, project to the Western District of Missouri due to a forum selection clause designating the Circuit Court of Jackson County, Missouri. However, referring back to *B & D Mechanical v. St. Paul*, *supra*, 70 F.3d at 1118, the Court held that a state court forum selection clause was void and unenforceable, since it attempted to divest the federal courts of their exclusive jurisdiction over Miller Act claims. Finally, in *United States ex rel. Cal’s A/C v. Famous Const. Corp.*, 982 F. Supp. 1219 (W.D.La. 1997), the Court found that the venue provision of the Miller Act was exclusive and non-waivable. The forum selection provision in a contract between a Texas prime contractor and a subcontractor on a Louisiana project which called for exclusive venue of any dispute in Texas was null and void, being contrary to public policy and the Miller Act. See *Quality Trust v. Cajun Contractors*, No. 04-4157-SAC, 2005 U.S. Dist. LEXIS 5795 (D. Kan. Mar. 31, 2005) (while a valid forum selection clause supersedes the Miller Act’s venue provisions, a contractual clause requiring that suits be brought in a specific, named state court are “void and unenforceable” as they might be applied to a Miller Act claim).

Practice Tip: If you are drafting a construction contract and want to include a forum selection clause that would apply to and govern venue for a subsequent Miller Act claim, you must be certain not to refer to state courts or a specific state court. Examples of language that will be void and unenforceable in connection with a Miller Act claim include: (a) “exclusive venue shall be proper in Bexar County, Texas”; or (b) “any action arising out of the Agreement must be brought in the 19th Judicial District court for the Parish of East Baton Rouge.”

### **§7.2.6.4 4. Pleading Requirements**

Every Miller Act claim must be brought in the name of the United States on behalf of the person suing. 40 U.S.C. § 3133(b)(3)(A). In bringing the action, the claimant is only required to join the bonding company (the surety). *Henderson v. Nucon Const. Co.*, 49 F.3d 1421, 1423 (9th Cir. 1995). However, the claimant may also recover from the prime contractor if it so chooses. *United States ex rel. Statham Instruments v. Western Casualty & Surety Co.*, 359 F.2d 521, 524 (6th Cir. 1966).

In pursuing a Miller Act claim, the plaintiff must plead and prove that it gave the appropriate 90-day notice, if the claimant was required by the Act to do so. *United States ex rel. Telcot Elec. Supply Co. v. New Amsterdam Casualty Co.*, 185 F. Supp. 316, 317 (E.D. Pa. 1960). In addition, the plaintiff must plead and prove:

1. the work done or materials supplied were a part of the federal contract for the construction of the public work;
2. the bond was executed to ensure payment of his or her claim; and
3. the claim has not been paid.

*Blanchard v. Terry & Wright, Inc.*, 331 F.2d 467, 469 (6th Cir. 1964), cert. denied 379 U.S. 831 (1964).

#### **§7.2.6.5 5. Proof Requirements**

In order to recover from a surety, a material supplier is required to prove:

1. that it supplied the material in prosecution of the work covered by the government contract;
2. that it has not been paid;
3. that it had a good faith belief that the materials were intended for the work specified in the contract; and
4. that the jurisdictional requirements were met.

*United States ex rel. Westinghouse Electric Corp. v. Jomac Const. Co., Inc.*, 1991 U.S. Dist. LEXIS 16100, \*5 (D. Kan. Sept. 30, 1991). *See also, United States ex rel. Pro Controls Corp. v. Conectiv Services, Inc.*, No. 00-40214-JAR, 2003 U.S. LEXIS 14970, \* 38 (D. Kan. Aug. 27, 2003).

#### **§7.2.6.6 6. Construction of Act**

In construing the Miller Act, courts have established different standards, depending upon the portion of the Act being construed. With regard to its substantive provisions, the Miller Act should be liberally construed to accomplish its purpose of protecting those who furnish labor and material for public construction projects. *F. D. Rich Co. v. Indus. Lumber, supra*, 417 U.S. at 124. However, a requirement which is clearly a condition precedent to the right to sue must be strictly construed. *Fleisher Eng'g & Const. Co. v. Hallenbeck, supra*, 311 U.S. at 18-19. Procedural portions of the Act requiring strict compliance include written notice of a claim and time limitations on the right to bring suit. However, even within these procedural provisions, the form of written notice is often liberally construed to benefit the claimant. *Id.*

Recovery under the Miller Act is not a supplier's or subcontractor's exclusive remedy against a prime contractor. Whether or not a Miller Act claim is available, the supplier or subcontractor can seek a personal judgment against the prime contractor, sometimes even where there is a lack of privity. In *United States ex rel. Sunworks v. Ins. Co. of North America*, 695 F.2d 455 (10th Cir. 1982), a supplier of solar collectors to a subcontractor was not paid for the materials supplied and used on a federal project. The supplier sought recovery under the Miller Act and, in the alternative, recovery from the contractor under a quantum meruit theory. 695 F.2d at 456. Reversing a district court dismissal of the action, the circuit held that since (i) the prime contractor used the solar collectors on the project, (ii) the prime contractor had been paid for the collectors by the government, and (iii) the prime contractor had not paid either the subcontractor or the supplier for the collectors, the supplier could pursue a quantum meruit claim, regardless of the availability of a Miller Act remedy. 695 F.2d at 458.

A supplier or subcontractor may be able to proceed against a bid bond where the prime contractor breaches his contract with the government by failing to procure the required Miller Act payment bond. *United States ex rel. Empire Plastics Corp. v. Western Casualty Co.*, 429 F.2d 905, 907 (10th Cir. 1970).

With the inclusion of the United States as the named plaintiff in a Miller Act case, the government is considered to be a real party in interest. *United States ex rel. Petrofsky v. Van Cott, Bagley, Cornwall McCarthy*, 588 F.2d 1327, 1328 (10th Cir. 1978), *cert. denied*, 444 U.S. 839 (1979). One result from having the government as a real party in interest is that, under Fed. R. App. P. 4(a), a notice of appeal from a Miller Act judgment may be filed by any party within 60 days, rather than 30 days, after entry of judgment. *United States ex rel. Romero v. Douglas Const. Co.*, 531 F.2d 478, 481 (10th Cir. 1976). While federal law governs the standards under which a Miller Act claim is prosecuted, the Act "does not replace generally accepted principles of commercial litigation." *Valley Asphalt v. Stimpel Wiebelhaus Associates*, No. 00-4000, 3 Fed. Appx. 838, 839, 2001 U.S. App. LEXIS 1707, at \*3-4 (10th Cir. (Utah) Feb. 5, 2001). The circuit court affirmed the entry of summary judgment against a Miller Act payment bond claimant who had accepted and deposited a check tendered to it in full payment of a disputed amount. The court applied the state law of accord and satisfaction, rejecting the plaintiff's suggestion that the application of such law would result in its waiver of its Miller Act rights.

### **§7.2.7 G. Amounts Recoverable Under Act**

§7.2.7.11.Types of Recoveries Allowed on Contract

§7.2.7.22.Interest

§7.2.7.33.Attorneys' Fees

The Miller Act generally takes the place of a mechanic's lien, and should not be viewed as the exact equivalent of a guarantee of a subcontract. Some contractual claims which a

supplier might have against a prime contractor are not covered by a Miller Act payment bond.

### **§7.2.7.1 1. Types of Recoveries Allowed on Contract**

The Miller Act provides that suit may be brought for the amount “unpaid at the time the civil action is brought.” 40 U.S.C. § 3133(b)(1). This means that the claimant may recover either the contract price for work performed or the reasonable value of the labor and materials furnished, depending on the stage of completion at the time of the breach. In *McAmis Industries of Oregon, Inc. v. M. Cutter Co.*, 130 F.3d 440 (9th Cir. 1997), the court found that a Miller Act claimant could obtain judgment for the amount due at the time of entry of that judgment, and that it would be contrary to the purpose of the Act to require the plaintiff to file a new suit in order to obtain money that became due after the suit was filed. 130 F.3d at 441.

When one party breaches the contract and demands that the other party cease work, the claimant may forego suing for the contract price and seek the reasonable value of services and supplies provided. The standard for measuring the “reasonable value of performance” is “that percentage of the subcontract price equal to the percentage of work [plaintiff] completed . . .” *Towerridge, Inc. v. T.A.O., Inc.*, 111 F. 3d 758, 762 (10th Cir. 1997). However, if the claimant has fully performed the contract, the claimant is limited to the contract price as its measure of damages.

In addition to damages incurred from a breach of contract, a subcontractor may recover the reasonable value of its services when it has performed work outside of the terms of the contract that benefits the prime contractor. *United States ex rel. C.J.C., Inc. v. Western States Mechanical Contractors, Inc.*, 834 F.2d 1533, 1550 (10th Cir. 1987). In *United States ex rel. D & P Corporation v. Transamerica Ins. Co.*, 881 F. Supp. 1505 (D. Kan. 1995), the Court reviewed the types of recoveries available against a Miller Act payment bond:

A subcontractor may recover in quantum meruit from the prime contractor and surety where there is a substantial breach of the contract and where it has performed work outside the terms of the contract that benefit the prime contractor. A contractor who bids work has the right to rely on the plans and specifications submitted to him for bidding purposes, and burdens beyond those contemplated by those plans and specifications may not be placed upon the contractor without additional compensation.

Increased out-of-pocket costs caused by unanticipated delays (delay damages), even where caused by the government, may be recovered from a Miller Act surety.

In the Tenth Circuit, the claimant can recover for overhead and lost profits, including recovery for the use of equipment owned by plaintiff.

881 F. Supp. at 1508-09. *See also, United States ex rel. Joseph Stowers Painting v. Harmon Const. Co.*, 1989 U.S. Dist. LEXIS 3492 (D. Kan. March 27, 1989).

### **§7.2.7.2      2.      Interest**

The Miller Act does not provide any standards for determining the allowance of prejudgment interest. The Tenth Circuit Court of Appeals employs a two-step analysis to determine whether to award prejudgment interest in cases arising under federal law:

- (1)      Would an award of prejudgment interest serve to compensate the injured party?
- (2)      Even when an award would serve the compensatory function, is it equitable?

If both requirements are satisfied, then interest is appropriate to compensate the claimant for the true costs of damage incurred. *Towerridge v. T.A.O.*, *supra*, 111 F.3d at 764. Prejudgment interest falls within the “scope of the remedy” available under the Miller Act. Its allowance must initially be determined as a matter of federal law. However, the court will look to state law. In *United States ex rel. National Roofing Services, Inc. v. Lovering-Johnson, Inc.*, 53 F. Supp. 2d 1142 (D. Kan. 1999), the court borrowed an interest rate from K.S.A. 60-201 to award prejudgment interest at the rate of 10% per annum in a Miller Act claim settled by arbitration and confirmed by the court. 53 F. Supp. 2d at 1148.

Under Kansas law, as would be applied in a Miller Act claim, interest is not recoverable on unliquidated claims until the amount due has been ascertained. However, an exception to this rule is recognized where there has been an unreasonable and vexatious delay in the settlement of accounts. *Southern Painting Co. v. United States ex rel. Silver*, 222 F.2d 431, 434-35 (10th Cir. 1955).

In *United States ex rel. Concrete Specialists of Omaha*, No. 98-1390-JTM, 2001 U.S. Dist. LEXIS 6933 (D. Kan. May 22, 2001), a concrete finishing subcontractor on an Air Force base housing project prevailed in a Miller Act payment bond claim against the general contractor and its surety. The court awarded prejudgment interest to the plaintiff. While noting that the allowance of prejudgment interest in cases brought under the Miller Act is a matter of federal law, the court borrowed from the Kansas statute governing prejudgment interest (K.S.A. 16-201) in awarding such interest at the rate of ten percent per annum. The interest accrued from the date on which the general contractor received an invoice from another subcontractor for repairs of the claimant’s work.

### **§7.2.7.3      3.      Attorneys’ Fees**

Generally, attorneys’ fees cannot be recovered under a Miller Act bond. Miller Act suits are treated as plain and simple commercial litigation, to which the American Rule applies. *F.D. Rich Co. v. Indus. Lumber*, *supra*, 417 U.S. at 129-31. There are exceptions

to the general rule. When the losing party in a Miller Act case has “acted in bad faith, vexatiously, wantonly, or for oppressive reasons” during the course of the lawsuit, the courts have the inherent power to assess attorneys’ fees. *Id.* See also, *United States ex rel. D & P Corp. v. Transamerica Ins. Co.*, 881 F. Supp. 1505, 1510 (D. Kan. 1995). However, the bad faith of the party must occur during the course of the lawsuit, and an award of attorneys’ fees in a Miller Act case cannot be premised solely on prelitigation conduct. *Towerridge*, 111 F.3d at 765.

Prior to concluding that attorney’s fees are not recoverable in a Miller Act claim, particularly if the project is in a state other than Kansas, you may wish to consider a recent decision from the Western District of Louisiana. In *United States ex rel. Cal’s A/C Electric v. The Famous Const. Corp.*, 34 F. Supp. 2d 1042 (W.D.La. 1999), the court found that a 1988 amendment to the federal Prompt Payment Act, found at 31 U.S.C. § 3905(j), expressly allows subcontractors on federal projects to sue for the award of attorneys’ fees and penalties for late payment or nonpayment on the payment bond, provided that state law allows for such causes of action. *Id.* at 1044.

If the contract between the prime contractor and the subcontractor provides for attorneys’ fees, however, the subcontractor may recover on the Miller Act bond within the terms of that contract. *United States ex rel. C.J.C., Inc. v. Western States Mechanical Contractors, Inc.*, 834 F.2d 1533, 1548 (10th Cir. 1987).

Practice Tip: In contrast, an attorney’s fee provision in an agreement between the subcontractor and its supplier does not entitle the supplier to recover fees against the Miller Act payment bond.

In *United States ex rel. Concrete Specialists of Omaha*, No. 98-1390-JTM, 2001 U.S. Dist. LEXIS 6933 (D. Kan. May 22, 2001), a subcontractor prevailed on a Miller Act payment bond claim. The underlying subcontract did not contain a provision for the recovery of attorneys’ fees. Recognizing the “bad faith” exception to the general rule that each party should bear the costs of its own legal representation, the court awarded attorneys’ fees to the subcontractor. The court found that the general contractor, Lovering-Johnson, Inc., asserted a “colorless defense” and raised issues “in bad faith as part of its litigation strategy . . .” 2001 U.S. Dist. LEXIS 6933, at \*25.

#### **§7.2.8 H. Rights and Obligations of Surety**

In addition to the terms of the bond itself, a court will examine the terms of the accompanying contract to determine the full scope of a surety’s obligation under the Miller Act. *Cortez III Service Corp. v. PMR Const. Services*, 117 Fed. Appx. 661, 665, 2004 U.S. App. LEXIS 24942 (10th Cir. 2004).

Sureties may be liable for attorneys’ fees if they agree to a contractual “fee-shifting provision.” However, “the trial court has the discretion to adjust or even deny a contractual award of fees if such an award would be inequitable or unreasonable.” *United*

*States ex rel. Rent It Co. v. Aetna Casualty & Surety Co.*, 988 F.2d 88, 91 (10th Cir. 1993).

Sureties can be held liable on both the performance and payment bonds. If the prime contractor breaches its agreement with the subcontractor, the subcontractor may recover the reasonable value of his or her service from the surety. Additionally, a subcontractor may recover from the surety if it has performed work outside the terms of the agreement that benefits the prime contractor. *C.J.C. v. Western States Mechanical Contractors*, *supra*, 834 F.2d at 1539. However, the recovery is generally limited to the face amount of the payment bond.

If the prime contractor defaults on its contract with the United States, the surety has three options:

- (1) It may stand on the bond and be liable to the government for the penal obligation of the bond.
- (2) It may finance the prime contractor until the project is completed.
- (3) It may take over and complete the work with another contractor.

When the surety satisfies the obligation of its principal, the surety is entitled to reimbursement from the prime contractor as a matter of law. The surety may seek reimbursement in any of three ways:

- (1) by a separate lawsuit against the prime contractor;
- (2) by a counterclaim against the prime contractor within the subcontractor's Miller Act suit; or
- (3) by exercising its right to compel the prime contractor to pay the underlying obligation to the obligee. If the prime contractor pays the obligation, the surety is "exonerated."

Gordon Hunt, *Construction Surety and Bonding Handbook* §§ 7.1 to 7.2 (1990).

In *Firemen's Fund Ins. Co. v. United States*, 362 F. Supp. 842 (D. Kan. 1973), a Miller Act payment bond surety claimed that the government had wrongfully paid the prime contractor when it was under a duty to retain such funds for the benefit of the surety. On this government project, the surety and the contracting officer were made aware of the fact that the prime contractor was not making timely payments to subcontractors and suppliers. The surety demanded that the government refrain from paying the prime contractor, and the government refused the demand. Later, the surety was required to pay certain claims by suppliers. *Id.* at 844.

Rejecting the surety's claim against the government, the Court began by noting that in circumstances such as this, "the government's prime interest is in the timely and efficient completion of the contract work." *Id.* at 845. While the project is still under construction, the government must balance its interest in getting the project completed against possible harm to the surety. Once the surety makes a payment pursuant to the Miller Act bond, it unequivocally becomes subrogated against the government to the extent of that payment. *Id.* at 846-47.

What if a supplier to a subcontractor makes a claim against the Miller Act payment bond under circumstances where it is alleged that the supplier caused damages to the prime contractor due to untimely delivery and nonconforming goods? Is offset available as a defense in a Miller Act supplier claim? It appears that in Kansas the answer is no. In *United States ex rel. Westinghouse Electric Corp. v. Jomac Const. Co.*, 1991 U.S. Dist. LEXIS 16100 (D. Kan. Sept. 30, 1991), Judge Saffels wrote:

Although the court's finding that a genuine issue of material fact exists as to the jurisdictional element is dispositive of this motion, the court will address one further matter. Jomac and Safeco argue, in conjunction with Indiana Lumberman, that WESCO's alleged breach of contract in delivering untimely and nonconforming goods entitles them to set-off losses or expenditures incurred against payments due WESCO. The court notes, as a matter of law, the defense of set-off is not available in an action under the Miller Act in the absence of privity. *Avanti Constructors*, 750 F.2d at 762. Jomac and Safeco, therefore, may not avail themselves of the defense of set-off against WESCO's claims. Even though Jomac and Safeco may have suffered harm as a result of WESCO's alleged breaches, their recourse, if any, lies against their subcontractor and its surety. 750 F.2d at 762-63. *Id.* at \* 7-8 (emphasis added).

Other jurisdictions appear to allow a set-off defense, even in the absence of privity. *See United Structures of America, Inc. v. G.R.G. Engineering*, 9 F.3d 996, 999-1000 (1st Cir. 1993).

A surety may take an appeal in a Miller Act case in the absence of an appeal by the prime contractor. *United States ex rel. Eddies Sales and Leasing v. Federal Ins. Co.*, 634 F.2d 1050, 1051, n. 2 (10th Cir. 1980).

While a Miller Act payment bond surety is generally neither bound by nor entitled to rely upon an arbitration agreement between the general contractor and the claimant subcontractor, it is entitled to obtain a stay of the action against it pending the outcome of an arbitration between the bond principal and the claimant. *United States ex rel. Humbarger v. Law Co.*, No. 01-4156-SAC, 2002 U.S. Dist. LEXIS 4702, \*11 (D. Kan. Feb. 20, 2002).

### §7.2.9 I. Effect of Other Contractual Terms on Bond Claims

Often there is an arbitration clause within a subcontract. When such a clause exists, the prime contractor may compel the subcontractor to arbitrate its claim against the prime contractor, effectively waiving the right of the claimant to a judicial determination. *United States ex rel. Chicago Bridge & Iron Co. v. Ets-Hokin Corp.*, 397 F.2d 935, 938 (9th Cir. 1968). However, arbitration clauses are not effective if induced by fraud or coercion. In addition, a surety is not permitted to enforce an arbitration clause against a subcontractor where there is no direct contractual relationship between the two parties. *United States ex rel. N.U., Inc., v. Gulf Ins. Co.*, 650 F. Supp. 557, 559 (S.D. Fla. 1986). In *United States ex rel. Humbarger v. Law Co.*, No. 01-4156-SAC, 2002 U.S. Dist. LEXIS 4702 (D. Kan. Feb. 20, 2002), a flooring subcontractor on a construction project at Fort Riley brought an action against the general contractor and its Miller Act payment bond surety. The plaintiff included within its complaint a claim under the Miller Act, as well as three state law claims (breach of contract, quantum merit, and unjust enrichment). *Id.* at \* 1.

The subcontract contained a clause requiring that this dispute between the general contractor and subcontractor be resolved through binding arbitration. The general contractor and surety filed a motion to stay the action and compel arbitration. The subcontractor claimed that enforcement of the arbitration clause would result in an impermissible waiver of its Miller Act rights. The court rejected that claim, finding that Miller Act claims are subject to arbitration:

Plaintiff's agreement to arbitrate his dispute does not effect a waiver of his Miller Act claim, as plaintiff's remedy of a suit under the Miller Act is unchanged by the arbitration procedures mandated by the parties' agreement. See e.g., *United States ex rel. Nat. Roofing Services, Inc. v. Lovering-Johnson, Inc.*, 53 F. Supp. 2d 1142 (D.Kan.1990) (ruling on motions to confirm or vacate arbitration award and enter judgment, after having stayed Miller Act case pending arbitration.)

2002 U.S. Dist. LEXIS 4702, at \*8.

The subcontractor also objected to the motion to stay since there was no agreement to arbitrate with the surety. While the court agreed that "a contractor's surety is not bound by an arbitration agreement between the subcontractor and the general contractor," the court nevertheless found that the entire action should be stayed pending the outcome of the arbitration proceeding. *Id.* at \* 11. The court noted that the result of the arbitration proceeding could be that the subcontractor was owed nothing, in which case it would have no Miller Act claim to assert against the surety. On the other hand, if it was determined that the subcontractor was owed something, and if the general contractor did not pay that debt, the subcontractor would still have the right to proceed in court against the surety under the Miller Act.

### **§7.3 III. KANSAS PUBLIC BUILDINGS AND WORKS BONDS**

- §7.3.1A.Purpose of Statute
- §7.3.2B.Contracts to Which Bonding Requirements Apply
- §7.3.3C.Amount of Bond
- §7.3.4D.Effect of Filing Bond
- §7.3.5E.Limitation of Actions
- §7.3.6F.Class of Persons Covered by Bond
- §7.3.7G.Certificate of Deposit in Lieu of Bond
- §7.3.8H.Recovery Against Bond or Certificate of Deposit
- §7.3.9I.Other State Public Work Bonds
- §7.3.10J.Interpretation of Bond Language and Statute
- §7.3.11K.Litigating Claim Against Bond

#### **§7.3.1 A. Purpose of Statute**

K.S.A. 60-1111 is the Kansas equivalent of the federal Miller Act. Its purpose is to protect suppliers of labor and material used to construction public improvements. *Cedar Vale Co-Op Exch., Inc. v. Allen Utilities., Inc.*, 10 Kan. App. 2d 129, 131, 694 P.2d 903 (1985). In Kansas, contractors’ bonds furnished on public works and improvements are substitutes for mechanics’ liens. The actual effect of the Kansas bond is similar to the Miller Act bond furnished for federal public construction projects.

The 2002 Kansas legislature amended K.S.A. 60-1111, the state equivalent of the Miller Act, used to protect suppliers of labor and materials on public improvement projects. See § 7.36 for a description of the amendments to this statute.

#### **§7.3.2 B. Contracts to Which Bonding Requirements Apply**

- §7.3.2.11.Monetary Threshold
- §7.3.2.22.Public Improvements and Public Buildings

K.S.A. 60-1111(a) sets forth the circumstances which require the issuance of a public works bond.

##### **§7.3.2.1 1. Monetary Threshold**

Whenever a public official enters into a contract for an amount greater than \$100,000 for the purpose of “making any public improvements” or “constructing any public building,” the prime contractor is required to give a bond to the State of Kansas. K.S.A. 60-1111(a).

##### **§7.3.2.2 2. Public Improvements and Public Buildings**

In *State ex rel. Fatzner v. Board of Regents of State of Kansas*, 167 Kan. 587, 207 P.2d 373 (1949), the Kansas Supreme Court provided a loose definition of “public improvements” and “public buildings.” “The state . . . may construct a state house, court

house, penitentiary or buildings for its penal, eleemosynary and state educational institutions. These, and others of like character, are public buildings [and/or] public improvements.” *Id.* at 597. In addition, the Court looked to the meaning of “public improvement” within Article 11, Section 5 of the Kansas Constitution: “[t]he term ‘public improvements,’ used in section 5, meant public buildings which the state should need in carrying on its functions . . .”*Id.* at 598. Using these definitions, one can broadly conclude that any construction project which furthers a state function is covered by K.S.A. 60-1111.

### **§7.3.3 C. Amount of Bond**

Once a construction project meets the monetary threshold, the prime contractor is required to give a bond “in a sum not less than the sum total of the contract . . .” K.S.A. 60-1111(a). The bond is conditioned on the prime contractor and its subcontractors paying for all labor, supplies and materials used or consumed in the completion of the project.

In 2002, K.S.A. 60-1111 was amended, and now includes the following section which prevents the government from requiring the use of a particular bond surety, agent, broker or producer:

A contract which requires a contractor or subcontractor to obtain a payment bond or other bond shall not require that such bond be obtained from a specific surety, agent, broker or producer. A public official entering into a contract which requires a contractor or subcontractor to obtain a payment bond or other bond shall not require that such bond be obtained from a specific surety, agent, broker or producer.

K.S.A. 60-1111(a).

### **§7.3.4 D. Effect of Filing Bond**

Public works bonds are filed with the district court clerk of the county in which the improvement is to be made. K.S.A. 60-1111(b). After the bond is filed, no lien can attach to the project, and any liens filed before the bond are discharged. Although laborers and materialmen are prevented from filing liens on the improvement, they are still protected against loss. Once the bond is filed, persons who would be entitled to a mechanic’s lien may look to the bond itself for recovery. *Cedar Vale Co-Op v. Allen Utilities, supra*, 10 Kan. App. 2d at 132.

### **§7.3.5 E. Limitation of Actions**

§7.3.5.11. When Is an Improvement “Completed”  
§7.3.5.22. Deadline for Bringing Action on Bond

Although both the Miller Act and the state public works bond statute have timing provisions, these portions of the two statutes are drastically different. K.S.A. 60-1111(b) sets forth the limitations period for suits based on the public works bond. The limitations period under the Kansas act begins to run upon completion of the project.

#### **§7.3.5.1 1. When Is an Improvement “Completed”**

As provided in K.S.A. 60-1111(b), and as recognized by the Kansas Supreme Court, the period of limitations does not begin to run against materialmen and subcontractors until the entire project is completed. *Joplin Cement Co. v. White-Layton Mechanical Contractors, Inc.*, 187 Kan. 268, 272, 356 P.2d 820 (1960).

#### **§7.3.5.2 2. Deadline for Bringing Action on Bond**

An action based on the public works bond must be commenced within six months of the project’s completion. K.S.A. 60-1111(b). If the action is not brought within that time period, the surety may use the period of limitations to bar the suit. All suits to recover on public works bonds must be timely.

Practice Tip: This differs from the federal standard, where the period of limitations begins to run after the last furnishing of labor or materials for the project by the claimant. A party may lose a Miller Act claim before the project is completed. However, the period of limitations on a Kansas public works bond claim is tolled until all work is actually completed.

#### **§7.3.6 F. Class of Persons Covered by Bond**

§7.3.6.11.Privity Requirement

§7.3.6.22.Remote Materialmen

§7.3.6.33.Subcontractor or Materialman

§7.3.6.44.“Used Or Consumed” Requirement

“[I]n order to claim protection under a public works bond, the claimant must first establish that it is within a class in whose favor liens might accrue.” *Wichita Sheet Metal Supply v. Dahlstrom and Ferrell Const. Co.*, 246 Kan. 557, 562, 792 P.2d 1043 (1990).

#### **§7.3.6.1 1. Privity Requirement**

As stated above, Kansas public works bonds are essentially substitutes for mechanics’ liens. “The protection afforded by mechanics’ liens is legislatively granted to those within a well-defined area - those in privity with the owner, contractor, or subcontractor to the contractor.” 246 Kan. at 562. Accordingly, only those suppliers and materialmen in privity with the prime contractor or its subcontractors may bring suit on the bond.

### **§7.3.6.2 2. Remote Materialmen**

“Remote materialmen” are basically suppliers to suppliers. Their goods are furnished to the subcontractor through another party (a second-tier or sub-subcontractor). Remote materialmen are not in privity with subcontractors or prime contractors. Therefore, they are not within the protection afforded by mechanics’ liens and contractors’ public works bonds. 246 Kan. at 562. *See also, Leidigh & Havens Lumber Co. v. Bollinger*, 193 Kan. 600, 603, 396 P.2d 320 (1964).

### **§7.3.6.3 3. Subcontractor or Materialman**

“[A] person, to become a subcontractor rather than a materialman, must generally do something more than furnish materials. It has been said that he must actually construct with such materials some part of the structure which the contractor has agreed to erect. . . .” *J.W. Thompson Co. v. Welles Prods. Corp.*, 243 Kan. 503, 510, 758 P.2d 738 (1988).

To be a subcontractor, a person must construct a definite and substantial part of the project. One who simply supplies materials to the prime contractor is a materialman, and not a subcontractor. *Id.*

### **§7.3.6.4 4. “Used Or Consumed” Requirement**

§7.3.6.4.1a.The General Requirement

§7.3.6.4.2b.Rule of Presumptive Use

Contrary to law developed in dealing with Miller Act claims on federal projects, supplies on a Kansas project must actually be used or consumed in the project in order to create protection under the Kansas bond act. K.S.A. 60-1111(a).

#### **§7.3.6.4.1 a. The General Requirement**

In order to establish a claim under the public works bond statute, it is essential to prove that at least some of the materials supplied were actually used in the construction of the improvement. *Cedar Vale Co-Op v. Allen Utilities, supra*, 10 Kan. App. 2d at 133. If the materials are not “used or consumed” in the project, the claimant has no right to recover. This is true even if the materials were custom built and fit only for the purposes of that specific project. *Hope’s Architectural Prods., Inc. v. Lundy’s Const., Inc.*, 762 F. Supp. 1430, 1433 (D. Kan. 1991), *aff’d* 1 F.3d 1249 (10th Cir. 1993) (“under K.S.A. 60-1111 only the value of goods and services actually expended in connection with the public improvement are recoverable against the bond”).

#### **§7.3.6.4.2 b. Rule of Presumptive Use**

Since state public works bonds take the place of mechanics’ liens, rules regarding the burden of proof in mechanics’ lien cases may be applied in contractor bond cases. *Cedar Vale Co-Op v. Allen Utilities, supra*, 10 Kan. App. 2d at 132. One such rule is known as

the “rule of presumptive use.” Under this rule, proof of delivery of materials to a building site is prima facie evidence that the materials were used in the project. Once this presumption is established, it is the burden of the surety to rebut the presumption (to prove that the materials were not used on the project). However, an exception to the rule exists. If there is a “well-grounded suspicion” the contractor used the materials purchased for some other project, more stringent proof is required (proof beyond the establishment of a prima facie case). *Id.* at 133.

### **§7.3.7 G. Certificate of Deposit in Lieu of Bond**

§7.3.7.11.Process

§7.3.7.22.Procedure For Making Claim

Instead of requiring a surety bond from the prime contractor on construction and repair projects, the State Director of Purchases may accept a certificate of deposit payable in accordance with K.S.A. 60-1112. The certificate of deposit must be equal to the contract price and is subject to forfeiture under the same conditions as a surety bond. K.S.A. 60-1112(a).

#### **§7.3.7.1 1. Process**

After the final acceptance of the construction project, the certificate of deposit is retained for an additional six months. K.S.A. 60-1112(b). The certificate is kept to protect laborers and suppliers who may develop valid claims against the prime contractor and the subcontractor during the six-month period in which they may bring suit under K.S.A. 60-1111(b). Once the six-month period is over, the certificate of deposit may be endorsed back to the prime contractor if no claims have developed. Interest accrued on the certificate will belong to the prime contractor. *Id.*

#### **§7.3.7.2 2. Procedure For Making Claim**

Any person to whom payment is due for labor, materials, or equipment used in connection with the contract must make a claim against the certificate of deposit with the Director of Purchases. K.S.A. 60-1111(c). The Director of Purchases determines the amount of money needed to remedy any breach of performance under the construction contract (such money would go to the benefit of the state). The money may also be used to satisfy claims of subcontractors and suppliers. If the prime contractor does not dispute the claim, following notice, the Director of Purchases may pay the claim from the certificate of deposit. K.S.A. 60-1112(c)(2). If the prime contractor disputes the claim, the director of purchases may interplead in the district court in the county where the construction is located (if a claim has already been filed by the subcontractor or supplier) or it may file an original action (if neither party has filed a claim). K.S.A. 60-1112(c)(2).

### **§7.3.8 H. Recovery Against Bond or Certificate of Deposit**

Under K.S.A. 60-1111, only the value of goods and services actually expended in connection with the public improvements are recoverable against the bond. *Blinne Contracting Co. v. Bobby Goins Enterprises, Inc.*, 715 F. Supp. 1044, 1046 (1989). Additional expenses incurred as a result of the breach are not recoverable under public works bonds. These damages flow from the breach of contract and require a contract claim against the party responsible for the breach. Lost profits are recoverable on goods actually supplied during the course of the contract. They are not, however, recoverable on goods “which would have been supplied if the materialman ‘were permitted to go ahead’ and complete the contract.” *Id.* at 1047.

### **§7.3.9 I. Other State Public Work Bonds**

Bonds given pursuant to K.S.A. 60-1111 are commonly referred to as “contractor’s statutory” bonds. In addition to these contractor’s bonds, there are instruments commonly known as a “faithful performance” bonds, which are required in most state highway construction contracts. K.S.A. 68-410.

The faithful performance bond is similar to the contractor’s statutory bond in several ways, and its coverage is interpreted much like the coverage created by a K.S.A. 60-1111 public works bond or a Miller Act bond. *Trestle & Tower Engineering, Inc. v. Star Ins. Co.*, 13 F. Supp. 2d 1166, 1171 (D. Kan. 1998).

There are some significant differences between contractor’s statutory bonds and faithful performance bonds. K.S.A. 68-410 bonds include the following requirements:

- (1) The bond is approved and filed with the Secretary of Transportation.
- (2) The claimant has six months after completion of the contract to file with the secretary a sworn and itemized statement of the indebtedness.
- (3) Any civil action against the bond must be filed within one year after completion of the contract.

### **§7.3.10 J. Interpretation of Bond Language and Statute**

As stated in *Wichita Sheet Metal v. Dahlstrom*:

The protections required by the statute controls over the language of the bond only where the bond contains language purporting to provide less than the statutorily mandated protection. If the bond provides greater protection than is required by statute, then the language of the bond is controlling. Put another way, the statute sets forth the minimum protection required to be provided in a public works bond.

246 Kan. at 561.

Practice Tip: This means that when considering the scope of coverage provided by a public works bond, you must carefully study both the statute mandating the bond as well as the exact wording of the bond.

The purpose of K.S.A. 60-1111 is to protect the contributions of those persons who assist in the construction of public improvements and works, and a bond given in compliance with this statute must be construed “to accomplish the end which the legislature has in mind.” *Cedar Vale Co-Op v. Allen Utilities, supra*, 10 Kan. App. 2d at 131.

### **§7.3.11 K. Litigating Claim Against Bond**

As stated above, an action based on the public works bond (a K.S.A. 60-1111 bond) must be commenced within six months of the project’s completion. This deadline varies from the federal Miller Act standard, which requires a claimant to litigate its claim within one year of its last furnishing of labor or materials. Although the Kansas statute appears to provide less time for the filing of a suit, one must remember that the statute of limitations does not begin to run until all work is completed on the entire project, whereas the Miller Act statute of limitations begins to run once the claimant does its last work.