

FIDELITY & SURETY REVIEW

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Spotlight on the Author

Sam Arena has been a recognized leader in the fidelity and surety law practice for more than 20 years. As chair of the firm's Fidelity and Surety Law Group, he has advised clients in all areas of fidelity and surety law. A resident of our Philadelphia office, Sam also is licensed in New Jersey and often represents our clients in Delaware fidelity and surety matters with the assistance of our Delaware licensed attorneys.

Mr. Arena currently serves as the chair of the American Bar Association's Fidelity and Surety Law Committee. He also serves as vice chair of the International Association of Defense Counsel – Fidelity and Surety Committee, and is a member of the Federation of Defense and Corporate Counsel, and the Defense Research Institute.

Mr. Arena frequently writes and speaks on fidelity and surety law topics. He co-authored the ABA's publication of "The Manifest Intent Handbook" and co-edited "The Fidelity and Surety Law Topical Indexes and Bibliographies, Third Editions." In addition, Mr. Arena contributed to the ABA's reference book titled "The Surety's Indemnity Agreement."

Mr. Arena was named to Philadelphia Magazine's list of "Pennsylvania Super Lawyers" for 2004.

Pennsylvania Public Works Contractors' Bond Law: An Overview and Update

By: *Samuel J. Arena, Jr. and Michael D. O'Mara*

Introduction

Surety claim professionals are responsible for bond claims in a great variety of jurisdictions, each with its own Little Miller Act and body of interpretive case law. This issue will provide surety claims professionals with an overview of the fundamentals of the Pennsylvania Public Works Bond Law and a quick reference guide for use in handling claims.

The Bond Law

Pennsylvania's Public Works Contractors' Bond Law of 1967¹ (the "Bond Law") governs bonds on public works projects in the Commonwealth of Pennsylvania. The Bond Law is similar to the federal Miller Act² in its purpose and language.³ Pennsylvania courts have found that, because of the similarity of purpose between the Miller Act and the Bond Law, analogizing and following Miller Act decisions often makes sense. Accordingly, courts interpreting the Bond Law have relied upon decisions interpreting similar provisions of the Miller Act.⁴

The Bond Law provides that for all public contracts exceeding \$5,000 for the construction, reconstruction, alteration or repair of any public building, other public work or improvement including highway work, the prime contractor must furnish to the contracting body a performance bond and a payment bond. Each bond must be in a penal sum of one hundred percent (100%) of the contract amount⁵ and each bond must be issued by a surety company that is authorized to do business in Pennsylvania.⁶ The payment bond protects those claimants

supplying labor or materials either to the prime contractor or to a subcontractor to the prime contractor and is conditioned on the prompt payment of all labor performed or materials supplied in the performance of the work.⁷ The performance bond is conditioned on the faithful performance of the bonded contract in accordance with its plans, specifications and conditions. This bond solely protects the contracting body that awarded the public contract.⁸

Payment Bonds

In Pennsylvania, a claimant with a direct contractual relationship with a subcontractor, but with no express or implied contractual relationship with the prime contractor, must give written notice of a claim to the prime contractor within ninety (90) days of last supplying labor or materials.⁹ The notice must state with “substantial accuracy” the amount claimed and the name of the party for whom the work was performed or to whom the material was furnished.¹⁰ The claimant must serve the notice, by prepaid registered or certified mail, to the prime contractor’s regular place of business.¹¹

A claimant may not bring an action on a public works project payment bond until at least ninety days after the claimant last performed labor or supplied materials covered by the bond.¹² There is a one-year statute of limitations for actions under payment bonds.¹³ For claims against payment bonds on public works contracts, however, the one-year statute of limitations does not begin to run until the ninety day waiting period expires. Effectively, the statute of limitations for actions against payment bonds on public contracts is one year and ninety days from the date that the claimant last performed labor or furnished materials.¹⁴ Unless the payment bond provides otherwise, the claimant has one year from the accrual of the cause of action to bring suit under a payment bond on a private contract.¹⁵

The Bond Law provides a substitute remedy for subcontractors that supply labor and materials on public projects, but that do not receive the protections afforded by the Pennsylvania Mechanics’ Lien Law.¹⁶ Accordingly, courts have found the scope of the Bond Law to be

similar to the scope of the Mechanics’ Lien Law.¹⁷ Consistent with cases decided under the Mechanics’ Lien Law, a payment bond surety is not liable for any consequential damages not specifically included in the language of the bond.¹⁸ In particular, courts have found that as long as the express language of the bond does not state to the contrary, a payment bond claimant cannot recover delay damages, loss of future profits, attorneys’ fees, service or finance charges, cancellation fees or escalated material costs, penalty interest and attorneys’ fees under the Pennsylvania Procurement Code or penalties, interest and attorneys’ fees under the Pennsylvania Contractor and Subcontractor Payment Act.¹⁹ Where bond language does not limit the payment bond surety’s obligation to “labor and materials,” but expressly permits suit against the surety for “such sum or sums as may be justly due” to the supplier of labor or materials, courts have held payment bond sureties liable for the full amount owed by their principals, including interest.²⁰ If the bond language permits recovery of interest, a surety may limit the accrual of interest by placing a notice provision in the bond.²¹

Pennsylvania courts have found a payment bond surety liable for the cost of materials purchased by a subcontractor for use in a project but later rendered non-usable due to deletions in the project.²² The Pennsylvania Supreme Court has stated that the proper test to be applied is whether “there is a reasonable and good faith expectation by the supplier at the time of delivery that the material under all the circumstances would be substantially used-up in the project under way.”²³ If so, the surety is liable. Notwithstanding the mandate of the Bond Law requiring payment bonds on all public works contracts exceeding \$5,000, a public owner will not be held liable to a laborer or “materialman” for failing to require the prime contractor to procure a payment bond.²⁴

Performance Bonds

When interpreting a surety’s liability under a performance bond, Pennsylvania courts will look to the actual language of the bond, but also will consider the surrounding circumstances.²⁵ Because the Bond Law language regarding performance bonds is considered to be much

broader than the language regarding payment bonds,²⁶ courts will not rely upon payment bond cases to decide performance bond issues.²⁷ As a general principle, when a performance bond surety fails to complete its properly defaulted principal's work, the surety is liable (in an amount not to exceed the amount of the bond) for the loss sustained by the obligee in completing the principal's work.²⁸ A surety will be obligated to pay attorneys' fees in instances where the performance bond explicitly provides for such damages.²⁹

Pennsylvania law provides for a one-year statute of limitations for actions under performance bonds. The statute begins to run when the obligee discovers, or reasonably should have discovered, the deficient work.³⁰ However, when the bond principal is under a contractual obligation to remedy deficient work, the obligee's cause of action under the performance bond accrues, and the one-year period begins to run, when the bond principal refuses to remedy the deficient work.³¹

“Bad Faith” Claims

Prior to the July 1, 1990 effective date of Pennsylvania's so-called “bad faith” statute,³² Pennsylvania law held that an insured could not maintain a cause of action against an insurer based on the insurer's alleged “bad faith” conduct in denying the insured's first party claim.³³ Pennsylvania's “bad faith” statute provides that in an “action arising under an insurance policy,” if a court finds that an “insurer” acted in “bad faith,” the court may award interest (prime rate plus 3%), punitive damages, court costs and attorney fees to the “insured.”³⁴ The Pennsylvania Supreme Court has not addressed the application of this statute to claims under surety bonds. Although several early federal decisions applying Pennsylvania law extended the application of the “bad faith” statute to sureties, the more recent, and better reasoned opinions,³⁵ have declined to do so.³⁶ The cases holding that the “bad faith” statute does not apply to sureties set forth an analysis of the plain language of the statute and the statutory construction, whereas the cases holding that the statute does apply to sureties provide no analysis at all.

¹ 8 P.S. §§ 191-202 (West 1999).

² 40 U.S.C.A. §§ 270a-270d (West 1986 & Supp. 1999).

³ See *Walters Tire Service, Inc. v. National Union Fire Ins. Co.*, 434 Pa. 235, 239-40, 252 A.2d 593, 595 (1969); *Visor Builders, Inc. v. Devon E. Tranter, Inc.*, 470 F. Supp. 911, 920 (M.D. Pa. 1978); *Lite-Air Products, Inc. v. Fidelity & Deposit Co. of Maryland*, 437 F. Supp. 801, 803 (E.D. Pa. 1977).

⁴ *Lite-Air Products*, 437 F. Supp. at 803.

⁵ 8 P.S. § 193(a) (West 1999).

⁶ 8 P.S. § 193(b) (West 1999).

⁷ 8 P.S. § 193(a)(2) (West 1999). See *Webster Brick Co., Inc. v. Fidelity & Deposit Co. of Maryland*, 27 Pa. D.&C.3d 7 (Erie Co. C.C.P. 1983) (brick company that supplied bricks to material supplier middleman who in turn had contract with bonded prime contractor is not entitled to recover under statutory payment bond where bond defines “claimant” as “one having direct contract with the Principal [prime contractor] or with a subcontractor of the Principal for labor, material, or both, used or reasonably required for use in the performance of the contract;” material supplier middleman with whom brick company contracted, determined not to be a “subcontractor” under the Bond Law.)

⁸ 8 P.S. § 193(a)(1) (West 1999). See also *Van Cor, Inc. v. American Casualty Co. of Reading, Pa.*, 417 Pa. 408, 208 A.2d 267 (1965) (co-prime general contractor not permitted to recover under performance or payment bonds of defaulted electrical co-prime contractor).

⁹ 8 P.S. § 194(b) (West 1999).

¹⁰ Id.

¹¹ Id.

¹² 8 P.S. § 194(a) (West Supp. 2003).

¹³ 42 Pa. Cons. Stat. Ann. § 5523(3) (West Supp. 2004).

¹⁴ *Centre Concrete Co. v. AGI, Inc.*, 522 Pa. 27, 31-32, 559 A.2d 516, 518-19 (1989).

¹⁵ Id.

¹⁶ *Valley Forge Industries, Inc. v. Armand Construction, Inc.*, 248 Pa. Super. 53, 58, 374 A.2d 1312, 1315 (1977); *Can-Tex Industries v. Safeco Insurance Co. of America*, 460 F. Supp. 1022, 1024-25 (W.D. Pa. 1978). The Mechanics' Lien Law permits suppliers of labor or materials to hold liens on the improved property under certain circumstances. See 49 P.S. §§ 1101-1902 (West 2001). That law specifically provides, however, that no lien may be held on public or government properties. Id. at § 1303.

¹⁷ *Can-Tex Industries v. Safeco Insurance Co. of America*, 460 F. Supp. 1022, 1024-25 (W.D. Pa. 1978).

¹⁸ *Downingtown Area School District v. International Fidelity Ins. Co.*, 671 A.2d 782, 785 and n.5 (Pa. Cmwlth. 1996).

¹⁹ See, e.g., *J.C. Snively & Sons, Inc. v. WEB M&E, Inc.*, 406 Pa. Super. 271, 277-78, 594 A.2d 333, 336-37 (1991) (finance charges and attorneys' fees accrued under bonded contractor's business credit applications); *Salvino Steel & Iron Works, Inc. v. Fletcher & Sons, Inc.*, 398 Pa. Super. 86, 92, 580 A.2d 853, 856 (1990) (delay damages); *Reliance Universal, Inc. v. Ernest Renda Construction Co., Inc.*, 38 Pa. Super. 98, 107-111, 454 A.2d 39, 44-46 (1982) (service and finance charges agreed upon as part of the underlying contract); *R.W. Sidley v. United States Fidelity & Guaranty Co.*, 319 F.Supp.2d 554 (W.D. Pa. 2004) (penalty interest and attorneys' fees under the Pennsylvania Procurement Code (62 Pa. Cons. Stat. Ann. §§3931-3939) and penalties, interest, attorneys' fees under the Pennsylvania Contractor and Subcontractor Payment Act (73 Pa. Cons. Stat. Ann. §503 et seq.); *Can-Tex Industries v. Safeco Insurance Co. of America*, 460 F. Supp. 1022, 1025 (W.D. Pa. 1978) (finance charges and attorneys' fees owed by the bonded contractor); *Lite-Air Products, Inc. v. Fidelity & Deposit Co. of Maryland*, 437 F. Supp. 801, 804 (E.D. Pa. 1977) (charges for lost profits, cancellation fees, and escalated material costs due to delay).

²⁰ See *Commonwealth v. Continental Cas. Co.*, 429 Pa. 366, 370, 240 A.2d 493, 494-95 (1968) (“[t]he fact that the bond does not specifically refer to interest is not controlling; what is controlling is that the surety has expressly agreed to make good the ‘sum justly due’ by the defaulting principal”). But see *Ragan v. Tri-County Excavating, Inc.*, 62 F.3d 501, 514-15 (3d Cir. 1995) (the “sums justly due” language utilized in a surety bond does not, as a matter of law, extend coverage under the bond to include attorneys' fees or penalties).

²¹ *Commonwealth v. Continental Cas. Co.*, 429 Pa. 366, 370, 240 A.2d 493, 494-95 (1998) (where notifying the surety of the contractor's default was not required by the terms of the payment

bond, and payment bond language permitted recovery of interest, surety was liable for interest from the time of the default and not from the date when surety had notice of the default.

²² *Roman Mosaic and Tile Co. v. Thomas P. Carney, Inc.*, 729 A.2d 73, 78-79 (Pa. Super. 1999) (rejecting the surety's argument that costs of materials not used in the project fall outside the scope of the bond).

²³ *Walters Tire Service, Inc. v. National Union Fire Ins. Co.*, 434 Pa. 235, 240, 252 A.2d 593, 595 (1969).

²⁴ *Cassady-Pierce Co., Inc. v. Spagnol*, 160 Pa. Cmwlth. 666, 669-70, 635 A.2d 746, 748 (1993); *Penstan Supply, Inc. v. Pennsylvania State University*, 44 Pa. Cmwlth. 347, 403 A.2d 1054 (1979).

²⁵ See *Downingtown Area School District v. International Fidelity Ins. Co.*, 671 A.2d 782, 786 (Pa. Cmwlth. 1996) (citing *Lite-Air Products, Inc. v. Fidelity and Deposit Company of Maryland*, 437 F. Supp. 801 (E.D. Pa. 1977)).

²⁶ *Id.* at 785-86 and n.6 (“[U]nlike the narrow statutory language of 8 P.S. § 193(a)(2), the wording of 8 P.S. § 193(a)(1) is extremely broad, covering faithful performance of the underlying contract in accordance with that contract’s plans, specifications and conditions.”)

²⁷ *Id.* at 785-87.

²⁸ See *Downingtown Area School District v. International Fidelity Ins. Co.*, 671 A.2d 782, 786- 88 (Pa. Cmwlth. 1996).

²⁹ See *Department of Transportation v. Manor Mines, Inc.*, 117 Pa. Cmwlth. 342, 544 A.2d 538 (1988).

³⁰ *Altoona Area School Dist. v. Campbell*, 152 Pa. Cmwlth. 131, 143, 618 A.2d 1129, 1135 (1992) (citing 42 Pa. Cons. Stat. ann. §5523 and stating: “section 5523 is a statute of limitations, not a statute of repose, and is thus subject to the discovery rule. The discovery rule tolls the running of a statute of limitations until the plaintiff knows or reasonably should know that an injury has occurred.”)

³¹ *Turner Constr. Co. v. American States Ins. Co.*, 397 Pa. Super. 29, 37, 579 A.2d 915, 919 (1990).

³² 42 Pa. Cons. Stat. Ann. §8371 (West 1998).

³³ *D’Ambrosio v. Pennsylvania National Mutual Casualty Ins. Co.*, 494 Pa. 501, 431 A.2d 966 (1981).

³⁴ 42 Pa. Cons. Stat. Ann. §8371 (West 1998).

³⁵ See e.g., *Reading Tube Corp. v. Employers Ins. of Wausau*, 944 F. Supp. 398, 403 (E.D. Pa. 1996) (citing *Turner Constr. Co. v. First Indem. of America Ins. Co.*, 829 F. Supp. 752 (E.D. Pa. 1993) and stating without analysis that “courts have extended this statute to actions against sureties for failure to honor performance bonds”); *Turner Constr. Co. v. First Indem. of America Ins. Co.*, 829 F. Supp. 752, 763 (E.D. Pa. 1993) (facts insufficient to support a finding of bad faith conduct of performance bond surety; no discussion or analysis of the applicability of the statute to sureties).

³⁶ *M.A. Bruder & Sons, Inc. v. Williams*, 47 Pa. D.C. 4th 243, 246049 (Monroe County C.C.P. 2000); *Collier Development Company, Inc. v. Jeffco Construction Company*, 25 D.&C. 4th 193, 143 Pgh. L.J. 385 (April 13, 1995); *The Norwood Company v. RLI Insurance Company*, 2002 WL 485694 (E.D. Pa. April 1, 2002); *Superior Precast, Inc. v. Safeco Ins. Co. of America*, 71 F.Supp.2d 438 (E.D. Pa. 1999); *Pullman Power Products Corp. v. Fidelity and Guaranty Ins. Co.*, No. 96-636, 1997 WL 33425288 (W.D. Pa. Feb. 21, 1997); *Allegheny Valley Joint Sewerage Authority v. The American Ins. Co.*, No. 94-2105, 1995 WL 1944748 (W.D. Pa. Aug. 17, 1995).

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About Stradley Ronon’s Fidelity and Surety Practice Group

Stradley Ronon attorneys have helped define fidelity and surety law over the past six decades. During that span, our lawyers have advised clients on and have litigated nearly every issue regarding fidelity and surety law.

When not applying surety law, our lawyers write it. Recommended because of their knowledge and reputation, our partners served as American Bar Association Fidelity and Surety Law Committee Advisors for the Restatement of the Law of Suretyship and Guaranty. In addition, our attorneys maintain the Fidelity and Surety Law Committee library and database of articles and conference proceedings.

As a full-service firm with more than 140 attorneys in six offices throughout the mid-Atlantic region, we are large enough to provide the technical sophistication required in today’s market, yet small enough to respond quickly to client needs. Employing the “client first” approach has enabled Stradley Ronon to effectively represent clients of all sizes – from the largest companies in the industry to smaller specialty market companies.

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