

PAYMENT BONDS: PROTECTION FOR SUBCONTRACTORS

Payment bonds protect subcontractors' right to get paid. But few truly understand their value. Consider a few key points.

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PURPOSE

The payment bond assures that the principal will promptly pay certain subcontractors, material suppliers and laborers. The obligee pays for the bond by including its cost in the contract price. On private projects, subcontractors and material suppliers may file liens against the property. With a payment bond, if the contractor fails to pay these subcontractors, the surety will pay, thus protecting the owner's property. Because liens are not allowed on public projects, the payment bond meets the owner's equitable obligation to persons who worked on the project.

WHO MAY FILE A CLAIM

The project owner has no right to make a claim under a payment bond.

First-tier claimants are parties that have a direct relationship with the prime contractor. Suppliers, material suppliers and subcontractors with a written or implied contract with the prime contractor have protection under the federal Miller Act.

Second-tier claimants—parties that have no expressed or implied contractual relationship with the prime contractor but have a direct contractual relationship with a subcontractor—may bring suit against the payment bond if certain criteria are met.

Third-tier claimants are not entitled to recover under the federal Miller Act and have no recourse under the bond. On other projects, however, if the bond language states that the bond covers remote claimants, they may have recourse under the bond.

Definitions

Payment Bond

assures that certain subcontractors, laborers and material suppliers will be paid

Principal

the contractor or subcontractor who is required to furnish the bond

Obligee

if the principal is the prime contractor, the owner is the obligee; if the prime contractor requires its subcontractor to furnish a payment bond, then the prime contractor is the obligee

Subcontractor

one who has a contract with the prime contractor and takes over performance of a specific part of the work

Material Supplier

one who furnishes material for use in performance of the bonded contract but does not have responsibility for a specific part of the contract

NOTICE

The notice requirement alerts the prime contractor that a sub-subcontractor or supplier to a subcontractor demands payment from the prime contractor's bond. The prime contractor may have already paid the subcontractor for work or material for which the claim is being made. Thus, one purpose of the notice requirement is to enable the contractor to avoid double liability by fixing a date beyond which it can release payment to the subcontractor.

First-tier claimants are not required to give notice prior to making a claim or fil-

ing suit against a Miller Act payment bond because, having a contractual relationship, the contractor should already know that the subcontractor has not been paid or is claiming not to be paid.

If the claimant has no direct contractual relationship with the prime contractor, he must give written notice of the bond claim to the principal. The principal can then withhold payments to the subcontractor until that subcontractor pays the debt. Under the Miller Act and most state bond statutes, written notice must be given to the prime contractor. The American

Institute of Architects' (AIA) A311 payment bond form specifies that written notice must be given to any two of the owner, contractor or surety. The notice must "state with substantial accuracy the amount claimed and the name of the party to whom" the labor or material was furnished. Notice must be given within 90 days of the last date on which the claimant furnished the last of the labor or material for which the claim is made.

Most bonds require that suit be filed within one year of the last date of furnishing labor or material for use in performance of the bonded contract. The AIA A311 form, however, requires that suit be filed within one year of the date on which the principal ceased work on the bonded project.

WHAT IS COVERED

The bond language may provide specific limitations on the types of claims allowed. In some states, the statute will dictate what is covered and what is not. The terms

Advice to Subcontractors, Suppliers, and Laborers

- Obtain a copy of the bond from the project owner
- Read the bond form and applicable state statutes
- Prepare documentation of your claim
- Notify the surety in writing

and conditions of the contract also may affect what types of claims are allowed.

While claims for labor are covered, few claims are made for wages. Most laborers are employees of the contractor or subcontractor and are paid weekly for the performance of their work.

Material ordered for use on the bonded project but used on another project may be covered if the claimant believed that it was intended for use on the bonded project.

Fuel, groceries, utilities, transportation and tires may be covered if the items were used or consumed during the performance of the work.

Equipment generally is not covered because equipment can be used on many jobs. However, rental charges for equipment used on the bonded project are usually covered.

Delay damages generally are covered as a cost of furnishing the labor and material, but profit on such increased costs is not covered.

Attorney's fees are covered only if provided for in the bond or applicable state law. Prejudgment interest is usually awarded if allowed by contract or state law.

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