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Oh No! The Surety Went Belly Up! Now What?

Here at Construction Law Musings, I have often discussed payment bond claims under the federal Miller Act and its state specific analogs (so called "Little Miller Acts"). Most of these discussions have assumed without actually stating that the surety carrying the payment bond would be solvent and available to pay any judgment against it. Unfortunately, given the general economy (and the construction economy specifically), such an assumption may not be warranted in all cases.

The reality of the situation is that sureties, like every other company in today's world, are subject to the same economic pressures as the rest of us. The economic slowdown has affected them and some of the well known ones have gone into receivership or worse. Such news can and should give general contractors, subcontractors and material suppliers pause before performing low bid government projects.

Before bidding these types of construction jobs, all of the parties should work together to assure, as best is possible, that the surety posting any payment or performance bond on the project is on sound financial ground. This is particularly true where the parties may not have a long standing relationship with the bonding agent proposing to sell them the bond. Cheapest is not always best even in a low bid situation. Taking the steps to investigate the surety is a great first step in avoiding disaster.

You've done your due diligence, you've worked with the Owner to assure a financially sound surety, and even with this investigation the heretofore solid and respected surety goes belly up. What now?

From the general contractor's perspective, your risk is that you could be on the hook for any damages incurred by a second tier subcontractor with whom you have no relationship. The law, at least in Virginia, seems to point toward subcontractors and suppliers being third party beneficiaries under that bond (and possibly under the Prime Contract). In short, without the surety to back it up, the general contractor could end up paying twice in an even more direct fashion than the bond's indemnification provisions would allow.

From a subcontractor's perspective, the lack of a solvent surety lowers the probability of collection of course. However, with the possible third party claim against the general contractor a subcontractor could have a claim against what is hopefully a solvent party (assuming that the party that didn't pay is now insolvent or refusing to make payment). With the help of an experienced construction attorney, a subcontractor or supplier may be able to at least bring more money to the table by making a valid claim against a general contractor under a third party beneficiary theory. More folks at the table should mean a better chance of at least partial recovery.

Hopefully you will never be in this position, however, at least in the Commonwealth of Virginia, hope is not completely lost when a surety goes under.

I would love to hear from attorneys or contractors in other states, and in Virginia, with any ideas and insight into how to best deal with this unfortunate situation.

Image via Wikipedia

Please check out my Construction Law Musings Blog for more on Virginia construction law and other topics.