

# Contractors' Payment Bonds in Maryland

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# CONTRACTORS' PAYMENT BONDS IN MARYLAND

CHARLES CAHN II\*

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During recent years there has been a large amount of public, industrial and commercial construction, involving projects such as schools, highways, hospitals, factories, apartment houses and office buildings. Large amounts of money are usually involved in these types of projects. If a contractor goes out of business, or for some other reason fails to perform the contract, substantial losses may be suffered, both by the owner who is left with an uncompleted project, and by suppliers and subcontractors who have extended credit. For this reason, contractors are usually required to supply performance bonds, to ensure that the project will be completed, and payment bonds, to protect the subcontractors and materialmen.

Historically, most contractors were relatively small, closely held businesses. They were able to build larger projects than their capitalization would otherwise permit by obtaining progress payments ("draws") from the owners to pay debts incurred on the project, and by obtaining goods and services on credit from suppliers and subcontractors.

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However, if the contractor was undercapitalized, some of his draws had to be used to pay bills left from previous jobs. Occasionally the contractor's financial condition deteriorated to the point where he was unable to pay some suppliers on a particular project even though he had drawn all the money due from the owner. At common law, the suppliers were without recourse. They had no lien on the project and no claim against the owner. In order to protect these creditors, as well as encourage construction, statutes have been enacted granting them alternative remedies.

The best known alternative remedy is the mechanics' lien, which subjects buildings to liens in favor of suppliers of labor or material. The first mechanics' lien statute in the United States was enacted by the Maryland legislature in 1791, to encourage the construction of houses in the proposed capital city of Washington.<sup>1</sup> Since then, statutes have been passed extending the mechanics' lien to all areas of the state.<sup>2</sup>

Public projects are exempt from mechanics' liens in most jurisdictions.<sup>3</sup> For many years, suppliers on public projects were without any remedy. Although performance bonds were required, they protected only the government. To give the suppliers relief comparable to the mechanics' lien, statutes were passed requiring that the performance bonds contain a provision protecting suppliers. However, this technique tended to put the suppliers in competition with the owner when both had claims under the bond. To avoid that problem, new laws were enacted requiring separate payment bonds for the benefit of the subcontractors and materialmen.<sup>4</sup> Bonds for private

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1. Ch. 45, § 10, [1791] Md. Laws.

2. The present Maryland mechanics' lien statute is found in MD. ANN. CODE art. 21, §§ 9-101 to -111 (Supp. 1972). For a comprehensive study of mechanics' liens in Maryland see Cutler and Shapiro, *The Maryland Mechanics' Lien Law — Its Scope and Effect*, 28 MD. L. REV. 225 (1968).

3. See, e.g., *Cities Serv. Oil Co. v. Longerbone*, 232 Iowa 850, 6 N.W.2d 325, 326 (1942); *Noland Co. v. Trustees of S. Pines School*, 190 N.C. 250, 129 S.E. 577, 578 (1925); *Providence Pipe & Sprinkler Co. v. Aetna Cas. & Sur. Co.*, 69 R.I. 51, 31 A.2d 1 (1943); *Fidelity & Deposit Co. v. County Court*, 123 W. Va. 409, 15 S.E.2d 302 (1941). While the Maryland Court of Appeals has not ruled specifically that public projects are exempt from mechanics' liens, the court's decisions proceed upon this assumption. See *Grinnell Co. v. City of Crisfield*, 264 Md. 552, 287 A.2d 486 (1972). The United States District Court for the District of Maryland so held in *In re Fowble*, 213 F. 676 (D. Md. 1914).

4. The exemption of public projects from mechanics' liens seems to have come full circle. The original argument was that suppliers needed bond protection because they were not entitled to mechanics' liens. The Court of Appeals now seems to decide the question of whether suppliers are entitled to a mechanics' lien on the basis of its resolution of the issue of whether or not the bond statute applies to the project in question. See *Grinnell Co. v. City of Crisfield*, 264 Md. 552, 287 A.2d 486 (1972).

projects have followed the path set by statutory bonds, and the usual practice at the present time is to require a separate payment bond on such a project. While the private bond does not prevent the filing of mechanics' liens, it discourages their filing by making an easier remedy available to the claimants.

A few surety companies write most of the payment bonds. Their employees and attorneys are usually very familiar with the requirements of the statutes and the private bond forms. On the other hand, it is quite likely that a subcontractor or a supplier may be represented by an attorney who has not handled many claims before. This article will examine the major legal and practical problems which a claimant may face, in the hope that it will arm him and his attorney with sufficient information to compete equally with the surety's representatives.

Any claimant hoping to recover on a bond should determine the following: first, whether there is a valid bond; second, whether it covers the work performed or items supplied; and third, what steps must be taken in order to recover. In doing this, particular attention must be paid to the form of the bond to ensure that it complies with the statute or the contract, whichever is applicable. Often, there is a marked difference between the bond required and the bond furnished. Solving the legal questions involved may be complicated by two factors. First, despite the fact that there are many characteristics common to both statutory and private bonds, the courts have tended to segregate the treatment of the two types of bonds.<sup>5</sup> Second, some understanding of the law and practice prior to the enactment of the bond statute is essential to comprehension of the law relating to payment bonds, since much of this law is a carry over from the time when suppliers' protection was contained in the performance bond.

## STATUTORY BONDS

### *The Statute*

In 1959, Maryland adopted its present statute requiring bonds on public construction contracts.<sup>6</sup> A review of this Act is the neces-

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5. A further difficulty arises in research for precedent due to the classifications of reporting systems. For instance, the West system classifies cases on contractors' payment bonds under such diverse subjects as "Schools & School Districts," "Principal & Surety," "Highways," "Mechanics' Liens," "Municipal Corporations" and "Bonds."

6. Ch. 10, [1959] Md. Laws 13 (codified at MD. ANN. CODE art. 21, § 9-112 (Supp. 1972)). In 1972, the Maryland General Assembly revised and codified all laws relating to real property [Ch. 349, § 1, [1972] Md. Laws 1010], resulting in the present Article 21. The bond statute was formerly codified in MD. ANN. CODE art. 90, § 11 (1969).

sary starting point for an understanding of all payment bonds, since the two types of bonds follow the same general pattern, and since most of the case law of the past thirteen years has resulted from statutory bond cases. Maryland's 1959 enactment was modeled upon the federal statute, known as the Miller Act,<sup>7</sup> and is commonly referred to as the Little Miller Act. The Act contains many specific, technical requirements. Of particular interest to claimants are the requirements as to the circumstances under which a bond must be furnished, the coverage it should contain, the parties to whom it is to be payable, where it is to be kept, how certified copies may be obtained, and where and when suit is to be filed.

The Act applies to any contract for the construction, alteration or repair of a public building, work or improvement owned by the state or a local government which exceeds five thousand dollars in amount.<sup>8</sup> Before such a contract is awarded the contractor is required to furnish a payment bond executed by a surety authorized to do business in Maryland.<sup>9</sup> The bond is for the protection of all persons supplying labor and material to the contractor or his subcontractors in the prosecution of the work provided for by the contract.<sup>10</sup> It must be not less than fifty percent of the contract price in amount.<sup>11</sup> Bonds payable to the state are to be filed with the State Comptroller, and all other bonds are to be filed in the office of the applicable public

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7. 40 U.S.C. §§ 270a-d (1970).

8. MD. ANN. CODE art. 21, § 9-112(a) (Supp. 1972). Until recently, no claimant ever questioned the application of the statute to any project titled in the name of a political entity. In *Grinnell Co. v. City of Crisfield*, 264 Md. 552, 287 A.2d 486 (1972), the claimant tried to enforce a mechanics' lien against property titled in the name of the city. The city had entered into a sale-leaseback arrangement with a local business to promote employment. Pursuant to this agreement, the city purchased part of the company's property, built an addition to the company's plant, and leased it back to the company. The claimant argued that the contract was not a public construction contract, and therefore not within the provisions of the bond statute. The court seemed to agree that the mechanics' lien could be enforced if a public construction contract were not involved and that mere title in the city was not enough. However, it held the contract to be a public construction contract on the basis of the public interest in promoting employment. It thus seems that legal title in the name of a governmental unit is not in itself sufficient to bring a project within the Act; however, *Grinnell* also seems to indicate that the presence of some public objective will result in the finding that a public construction contract is involved where a close case is presented.

9. MD. ANN. CODE art. 21, § 9-112(a) (2) (Supp. 1972). Although the statutory requirement of a payment bond applies only to contracts which exceed \$5,000 in amount, the Board of Public Works requires bonds on all contracts with the State of Maryland which exceed \$2,000 in amount.

10. MD. ANN. CODE art. 21, § 9-112(a) (2) (Supp. 1972).

11. *Id.*

body.<sup>12</sup> The office in which the bond is filed must furnish a certified copy to any applicant who pays a reasonable fee set by that office and submits an affidavit stating that he either supplied labor or material for which he has not been paid or is being sued on the bond.<sup>13</sup> Suit is to be brought in the political subdivision where the contract was performed or where the contractor's principal place of business is located.<sup>14</sup> It must be filed within one year after the date of the project's final acceptance, regardless of when the last of the labor or materials was supplied.<sup>15</sup>

The statute places two limits on the right to bring suit, both of which involve time periods of ninety days. The first prohibits suit until at least ninety days after the date on which the last of the labor or materials was supplied.<sup>16</sup> This seldom presents a problem because it is unlikely that the claimant will be ready to file suit within ninety days. The other ninety day limit is far more troublesome and has given rise to a large volume of litigation. When the claimant has dealt solely with a subcontractor rather than directly with the contractor, he is required to give the contractor written notice of his claim within ninety days after the date on which the

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12. MD. ANN. CODE art. 21, § 9-112(f) (Supp. 1972).

13. MD. ANN. CODE art. 21, § 9-112(g) (Supp. 1972).

14. MD. ANN. CODE art. 21, § 9-112(d) (Supp. 1972). The act contemplates that suit be brought in a state court. However, several cases have been brought in the United States District Court alleging jurisdiction by virtue of diversity of citizenship. See 28 U.S.C. § 1332 (1970). Such a suit is only available if the amount claimed is more than \$10,000. See *Maryland v. W.E. Dunn Constr. Co.*, 191 F. Supp. 297 (D. Md. 1961).

15. MD. ANN. CODE art. 21, § 9-112(d) (Supp. 1972).

16. MD. ANN. CODE art. 21, § 9-112(c) (Supp. 1972) states in part:

Every person who has furnished labor or material in the prosecution of the work . . . who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or material was furnished or supplied by him for which such claim is made, shall have the right to sue on the payment bond for the amount, or the balance thereof, unpaid at the time of institution of such suit . . . provided, however, that any person having direct contractual relationship with a subcontractor . . . , or with any sub-subcontractor . . . but no contractual relationship expressed or implied with the contractor furnishing said payment bond, shall have a right of action upon the payment bond upon giving written notice to the contractor within ninety (90) days from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating 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. Such notice shall be served by mailing the same by registered or certified mail, postage prepaid, in an envelope addressed to the contractor at any place he maintains an office or conducts his business, or his residence.

last labor or materials were supplied to the subcontractor.<sup>17</sup> This requirement is intended to give the contractor an opportunity to pay the claim from money still owed to the subcontractor. The notice must state with substantial accuracy the amount claimed, and the name of the party to whom the materials or labor were supplied, and must be served by registered or certified mail addressed to the contractor's office, place of business or residence.

### *Influence of Other Statutes*

In interpreting the statute, the Court of Appeals has often relied upon its decisions under earlier Maryland contractors' bond statutes and the Maryland mechanics' lien law, as well as decisions under the federal Miller Act and mechanics' lien and contractors' bond statutes of other states.<sup>18</sup> Because these laws all have similar purposes, decisions interpreting them are often helpful in construing the bond statute. However, past decisions also indicate that the court may rely on differences in statutory language or purpose, or upon judicial interpretations of prior Maryland statutes, to reject analogies to these other statutes.

The present Maryland statute was enacted with language substantially identical to the Miller Act as that law was then worded.<sup>19</sup> Although there have been some amendments to both the federal and the state statutes, they continue to have the same basic coverage and procedure. When the Little Miller Act was passed, many people assumed that, thereafter, the Court of Appeals would find the state policy to be the same as the federal policy; and, in fact, the court has indicated that as a general rule it will look to Miller Act deci-

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17. *Id.*

18. The Court of Appeals has cited decisions from other states in several cases. *See, e.g.*, *Baltimore County Dep't of Educ. v. Henry A. Knott, Inc.*, 234 Md. 417, 199 A.2d 369 (1964); *Glens Falls Ins. Co. v. Baltimore County*, 230 Md. 524, 187 A.2d 875 (1963). Such referral is usually made only in situations where there is no prior Maryland decision on the issue in question.

19. Ch. 10, § 1, [1959] Md. Laws 13. Formerly, the essential parts of the Maryland payment bond statute simply stated:

In all cases where any bond or undertaking, conditioned for the faithful performance of any contract for construction, installation or repair work, is given to the State of Maryland, or any of its agencies, such bond or undertaking shall not be approved or accepted unless the obligors bind themselves therein to the payment of all just debts for labor and materials incurred, through sub-contract or in any other manner, by or in behalf of the person, firm or corporation to whom such contract has been given, and who is named as principal in such . . . bond . . . . Provided, that in the event that there is a liability to the State, or any agency thereof, under any such bond . . . and also a liability thereunder for labor and materials, then the liability of the State shall be preferred . . . .

Ch. 127, § 1, [1918] Md. Laws 278.

sions for guidance in interpreting the language of the state act.<sup>20</sup> However, the Maryland court may refuse to follow the federal interpretation where the court has reason to believe that the purpose of the state statute is different.<sup>21</sup> For instance, in *Williams Construction Co. v. Construction Equipment, Inc.*,<sup>22</sup> the court followed one of its decisions under an earlier Maryland bond statute<sup>23</sup> in holding that equipment rental was not covered under the Little Miller Act. The federal courts had held to the contrary under the Heard Act, the predecessor of the Miller Act, and followed this interpretation under the later act. The Court of Appeals stated that an intent on the part of the Maryland legislature to reverse the earlier Maryland decision and follow the federal precedent could not be imputed solely from the passage of the Little Miller Act. Instead, the court said that "[w]e must ascribe to the Legislature an intent to have words mean what . . . [the Maryland court] . . . has said they mean, rather than to have them mean what the Supreme Court may have said they mean, particularly since . . . [the earlier Maryland court] . . . chose not to follow the Supreme Court."<sup>24</sup> Thus, Maryland decisions under prior statutes may still be important in construing the present statute.

The mechanics' lien statutes also have had a strong influence on payment bond decisions. In the first bond case in which the Court of Appeals referred to a mechanics' lien decision, the court, lacking state precedent as to the treatment of equipment rental under statutory bonds, looked at the mechanics' lien law and decisions under it on the same question. Suppliers of leased equipment had been held not to be entitled to mechanics' liens, and the court held, likewise, that the statutory bond provided no such coverage.<sup>25</sup> Two years later, how-

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20. See, e.g., *Ruberoid Co. v. Glassman Constr. Co.*, 248 Md. 97, 106, 234 A.2d 875, 880 (1967); *Montgomery County Bd. of Educ. ex rel. Carrier Corp. v. Glassman Constr. Co.*, 245 Md. 192, 202, 225 A.2d 448, 454 (1967).

21. Such decisions were perhaps more common in the past when the language of the state acts was different from that contained in the federal act. See, e.g., *Mayor and City Council of Baltimore ex rel. Lehigh Structural Steel Co. v. Maryland Cas. Co.*, 171 Md. 667, 190 A. 250 (1937). In that case the court refused to follow federal decisions under the Heard Act in interpreting a Baltimore City ordinance.

22. 253 Md. 60, 251 A.2d 864 (1969).

23. *State ex rel. Gwynns Falls Quarry Co. v. National Sur. Co.*, 148 Md. 221, 128 A. 916 (1925).

24. 253 Md. at 64, 251 A.2d at 868. The Court of Appeals may also refuse to follow federal decisions rendered after the passage of the Little Miller Act, since these decisions could not have been within the legislative "intent" in enacting the state statute. See *Westinghouse Elec. Corp. v. Minnix*, 259 Md. 305, 269 A.2d 580 (1970).

25. *State ex rel. Gwynns Falls Quarry Co. v. National Sur. Co.*, 148 Md. 221, 128 A. 916 (1925).



ever, the court said that it had not intended by its earlier decision to limit bond coverage only to lienable items.<sup>26</sup> The court seemed to adopt a "liberal construction" favoring recovery, quoting an earlier federal statutory bond case:

The underlying equity of the lien statutes relates to a direct addition to the substance of the subject matter of the building or other things to which the lien attaches, while the statute in question concerns every approximate relation of the contractor to that which he has contracted to do. Plainly the Act of Congress and the bond in the case at bar are susceptible of a more liberal construction than the lien statutes referred to, and they should receive it.<sup>27</sup>

Subsequent decisions have eroded this liberality and have indicated that as to coverage a close analogy between the two statutes may be drawn. In the first of these decisions, the court said, in dictum, that since the purpose of the bond is to protect subcontractors or materialmen on public projects where they have no lien, the bond is required to give protection substantially similar to that afforded by the mechanics' lien statute.<sup>28</sup> A short time later it said, "[a]though the statute giving laborers and materialmen the right to mechanic's liens is not controlling [in a bond case], the similarity of purpose between it and [the bond statute] is so close that an analogy can be drawn."<sup>29</sup> Most recently, in the *Williams* case, the court, in denying recovery, stated that the claimant would not have been entitled to a mechanics' lien on like items, and that the granting of bond coverage would therefore "destroy the symmetry which has existed for years between rights under the mechanics' lien law and rights under a public works bond."<sup>30</sup> At present, therefore, mechanics' lien decisions seem to have great force where the terms of the bond statute are not clear.

### *The Bond*

Often, the first problem confronting the claimant's attorney is that of obtaining a copy of the bond. Even if the claimant has ex-

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26. *London & Lancashire Indem. Co. v. State ex rel. International Harvester Co.*, 153 Md. 308, 138 A. 231 (1927).

27. 153 Md. at 310, 138 A. at 232, quoting *American Sur. Co. v. Lawrenceville Cement Co.*, 110 F. 717, 719 (C.C.D. Me. 1901).

28. *Montgomery County Bd. of Educ. ex rel. Carrier Corp. v. Glassman Constr. Co.*, 245 Md. 192, 201, 225 A.2d 448, 453 (1967).

29. *Peerless Ins. Co. v. Prince George's County ex rel. Ben Dyer Associates, Inc.*, 248 Md. 439, 442, 237 A.2d 15, 18 (1968).

30. 253 Md. at 67, 251 A.2d at 868.

tended thousands of dollars of credit believing, or hoping, that a bond exists, he may not have a copy by the time he consults his attorney.

### Where is the Bond Filed?

Finding the bond can be quite difficult. The Maryland Act does not designate a central depository for contractors' bonds,<sup>31</sup> although it does provide that bonds payable to the State of Maryland are to be filed in the office of the State Comptroller.<sup>32</sup> Within the cities and the counties bonds are to be filed in the office of the public body concerned.<sup>33</sup> However, even if the claimant knows the name of the local agency or entity for which the improvement is being made, the bond may not be on file there.<sup>34</sup> For example, in Baltimore City most of the new construction is handled by the Division of Public Building Construction, and a bond for a school project will be on file with that agency, rather than with the Department of Education.<sup>35</sup>

### Bonds Which Do Not Comply With the Statute

The claimant cannot assume that the bond conforms to the requirements of the statute. There are agencies that accept bonds which do not comply with the Act; in fact, some local officials seem to be unaware of the statute, despite the fact that its provisions have applied to their contracts since 1959.

That improper bonds are sometimes accepted is well documented. The Court of Appeals was presented with four cases involving such bonds during 1969 and 1970. Three of these suits were brought against the Charles County Board of Education, which had accepted

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31. In this respect the state statute differs from the federal act, which specifies that all bonds are to be kept by the Comptroller General. The distinction arises from the fact that under the Miller Act all bonds are payable to the United States, while under the state Act the bond is payable to the political entity which owns the project.

32. MD. ANN. CODE art. 21, § 9-112(f) (Supp. 1972). Although all bonds are filed with the State Comptroller, it is advisable for a claimant who wishes to obtain information about a specific state project to consult the Department of General Services, since all state bonds are awarded by that department, with the exception of those involving highways, which are awarded by the State Roads Commission.

33. *Id.*

34. This lack of a central filing place has produced one slight advantage for the claimant. Many of the agencies do not know that the law requires a person who wishes to obtain a copy of a bond to submit an affidavit and a fee. They consider the bonds to be public records, and usually will give a copy at no charge to anyone who asks for it.

35. However, some important construction contracts are handled by other offices. For example, the Bureau of Engineering has three separate divisions, the Division of Highways, the Division of Water and the Division of Waste Water, each of which lets contracts and holds bonds.

a bond naming a surety which was not licensed to do business in Maryland and which was apparently non-existent.<sup>36</sup> The fourth case involved a bond intended for use on a private project which was accepted on a public school being built in Montgomery County.<sup>37</sup>

The absence of a proper bond can be important because the claimant may be without any practical remedy if he cannot recover on the bond. All of the claimants who brought suit against the Charles County Board of Education lost because the bond was invalid.<sup>38</sup> Therefore, the claimant should be careful to verify that there is a valid and enforceable bond before extending credit.

Where the bond is valid and enforceable, but does not comply with the requirements of the statute, the claimant will have to decide whether he thinks the bond or the statute controls. Prior to the 1970 decision in *Westinghouse Electric Co. v. Minnix*,<sup>39</sup> there was reason to believe that if a bond which conflicted with the requirements of the Act was accepted on a public project, the rights of the claimant would be controlled by the terms of the bond.<sup>40</sup> However, *Minnix* rejected this proposition, at least insofar as notice requirements are concerned. It held that the failure of the claimant to give the notices called for in the bond would not prohibit recovery, if the notice actually given satisfied the requirements of the statute.<sup>41</sup> In reaching this

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36. See *Board of Education of Charles County v. Alcrymat Corp. of America*, 258 Md. 508, 266 A.2d 349 (1970); *Thomas L. Higdon, Inc. v. Board of Educ. of Charles County*, 256 Md. 595, 261 A.2d 783 (1970); *Bolick v. Board of Educ. of Charles County*, 256 Md. 180, 260 A.2d 31 (1969).

37. *Westinghouse Elec. Corp. v. Minnix*, 259 Md. 305, 269 A.2d 580 (1970). It is unlikely that improper bond forms will be accepted by the State of Maryland. The Department of General Services supplies the form to be executed by the contractor and his surety, and the State Roads Commission checks all bonds supplied to insure that they comply with the requirements of the Act. Both agencies have the bonds reviewed by an Assistant Attorney General. However, it is possible that bonds accepted by the State may have been executed by sureties not licensed to do business in Maryland. Neither department submits bonds to the State Insurance Department, nor does either obtain a periodic listing of qualified sureties from the State Insurance Department.

38. For a discussion of the decisions see notes 91-97 *infra* and accompanying text.

39. 259 Md. 305, 269 A.2d 580 (1970).

40. See *Mayor and City Council of Baltimore ex rel. Warren Webster & Co. v. Maryland Cas. Co.*, 146 Md. 508, 126 A. 880 (1924). In that case it was held that a subcontractor could not recover on the bond. The court, citing the absence of a statute such as that in the public works area which required bonds to contain provisions for payment of labor and materials claims, went on to say that "[w]e do not mean to say that even with such a statute in force a bond would here be held liable in a suit by a sub-contractor, unless the bond itself contained such a condition." 146 Md. at 512, 126 A. at 881.

41. The Court of Appeals in *Minnix* probably made at least one mistaken factual assumption. It stated that the notice requirement in the bond was an invention of

conclusion, the court made some sweeping pronouncements to the effect that all provisions in the bond which conflict with the terms of the statute will be reformed to conform to the statute.<sup>42</sup> While it seems clear that compliance with the statutory provisions will suffice where the requirements for perfecting a claim are more stringent than those imposed by the statute, it is uncertain whether the Court of Appeals would follow the implications of the decision to their fullest extent. For example, if a private bond form is used on a public project, the coverage in the bond may be broader than that required by the statute.<sup>43</sup> In such case, a surety would undoubtedly rely on *Minnix* to support an assertion that the statute, rather than the bond, should control the rights of the parties. However, a crucial element of the *Minnix* decision was the court's view that more severe conditions upon claimants' right to recover than those required by the statute were unacceptable in view of the statutory purpose of protecting suppliers. Such an argument would lack the force of this policy consideration, and therefore would be of doubtful validity.

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the Montgomery County Board of Education and that "the question resolves itself into whether the Board may require a more rigid notice requirement in the bond than that provided by the statute." 259 Md. at 313, 269 A.2d at 584. The court should not have attributed to the Board of Education sufficient familiarity with payment bonds to have required any specific form of notice. The bond involved was simply a form intended for use on a private project.

As if to prove that *Minnix* was not an isolated incident, the Maryland National Park and Planning Commission recently let a contract for the construction of the Long Branch Community Center in Montgomery County and accepted a private bond form. The commission is a bi-county agency established by the Maryland General Assembly in 1927 which operates facilities in Montgomery County and Prince George's County. It is clearly an agency whose construction contracts are governed by the bond statute. A subcontractor failed to pay some of its suppliers, and several suits have been brought on the bond. One of the suits was brought in Prince George's County where the contractor has its principal place of business. The statute permits suits in the county either where the contract was performed or where the contractor has its principal place of business. The bond requires that suit be filed in the county where the project is located. As a result of the *Minnix* decision, it seems that the suit in Prince George's County may be proper.

42. The court quoted with approval the following passage from an Iowa case: The bond in this case is a statutory bond, and the liability of the parties to the bond must be measured by the statute and not the wording of the bond \* \* \*. We have said repeatedly that any addition to such bond will be treated as surplusage, and any omission of the provisions of the statute will be read into the bond. 259 Md. at 316, 269 A.2d at 586, quoting *Charles City v. Rasmussen*, 210 Iowa 841, 847, 232 N.W. 137, 139 (1930).

43. The widely used private form covers water, gas, power, light, heat, oil, gasoline and telephone service used in performance of the contract. These items are not covered by the statute.

Regardless of the rule as to the types of items covered, a different rule may be applied with respect to which persons are covered by the statute. If the bond does not promise payment to all of the claimants protected by the statute, then the excluded claimants may be without a remedy, despite the fact they are within the statute. The current practice in Baltimore City is a good example. The City requires performance bonds on all contracts in excess of \$5,000. Apparently, City officials do not realize that the state statute requires a separate payment bond on construction projects. Consequently, the City requires only the single bond dealing predominantly with the performance of the contract. The bond does call for the payment of labor and material "for which the contractor is liable," but nothing is said about claims against subcontractors. Prior to passage of the Little Miller Act, the Court of Appeals held that this type of language did not protect suppliers of subcontractors.<sup>44</sup> Therefore, a supplier of a subcontractor on a Baltimore City project may not be protected, notwithstanding the terms of the statute.<sup>45</sup>

### Notice

A claimant with no express or implied contractual relationship with the contractor must give written notice of his claim to the contractor within ninety days from the date on which the last of the labor was performed or the last materials were furnished or supplied. The notice must state with substantial accuracy the amount claimed and the name of the party to whom the labor or material was supplied. It is to be served by registered or certified mail addressed to the contractor at any place where he maintains an office, conducts his business or has his residence.<sup>46</sup> While these requirements are ostensibly unambiguous, they have been questioned in several cases before the Court of Appeals.

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44. Mayor & City Council of Baltimore *ex rel.* Lehigh Structural Steel Co. v. Maryland Cas. Co., 171 Md. 667, 190 A. 250 (1937).

45. *But see* Joseph F. Hughes & Co. v. Harry S. Mickey, Inc., 211 F. Supp. 298 (D. Md. 1962), where the United States District Court for the District of Maryland said, "[t]he statute fixes both the fact and the amount of this liability without regard to the precise terms in which a particular bond is worded. For this reason Hughes' attempt to show that the Maryland Court of Appeals, in *Women's Hospital for use of Robert S. Green v. Fid. & Guar. Co.*, 177 Md. 615, 11 A.2d 457, 128 A.L.R. 931 (where wording of the bond apparently closely paralleled that in the present case) would not hold the principal liable for the debt of a subcontractor to a materialman is not pertinent." 211 F. Supp. at 300.

46. MD. ANN. CODE art. 21, § 9-112(c) (Supp. 1972).

## Date of Last Item Supplied

A determination of the date on which the last of the labor or materials was supplied may require an evaluation of the plaintiff's intention in supplying the items. Where those items are quite small in comparison to the total claim, it may be argued that they were supplied simply to revive the claimant's rights under the bond. Even if the claimant's motive is not questioned, there must be a relationship between those items and the ones previously provided. The items must be supplied pursuant to a single contract to qualify as part of a claim for purposes of notice; the fact that they were supplied on a single job is not sufficient.<sup>47</sup>

It may be difficult to determine the date on which the last materials were "furnished or supplied." There is a tendency to equate those terms to delivery, especially if no installation work is required.<sup>48</sup> Where installation is required, the date the materials were furnished or supplied may be in doubt. The only Maryland case to face this problem was *R.T. Woodfield, Inc. v. Montgomery County Board of Education ex rel. International Telephone and Telegraph Co.*<sup>49</sup> There the claimant had supplied the equipment ordered to a subcontractor on October 26. However, it was discovered that the architect had specified the wrong model number, and therefore that an additional piece had to be installed on the equipment to ensure proper performance. The claimant subsequently delivered and installed the new piece, which was not initially called for by the terms of the contract, on January 5. Notice was given to the prime contractor on February 16 of the subcontractor's failure to pay for the goods. The issue then arose as to the date of delivery for the equipment under the contract, and whether this notice was within the ninety day limit. The surety argued that the supplier's claim arose on October 26, since the goods conformed

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47. *United States ex rel. Austin & Great Am. Ins. Co. v. Western Elec. Co.*, 337 F.2d 568 (9th Cir. 1964). There the court pointed out that under the provisions of the Miller Act, which are substantially the same as the Maryland bond statute, the goods or services must be a part of the original contract. Under federal decisions construing the Miller Act, the courts have also held that minor corrections or items supplied long after the original installation will not revive the claimant's rights under the bond. *See United States ex rel. McGregor Architectural Iron Co. v. Merritt-Chapman & Scott Corp.*, 185 F. Supp. 381 (M.D. Pa. 1960). *See generally* 78 A.L.R.2d 412, § 3 (1961). Where, however, the work is not minor, and is necessary for the completion of the project, the date for delivery is extended to this later delivery or work. *United States ex rel. General Elec. Co. v. Gunnar I. Johnson & Sons, Inc.*, 310 F.2d 899 (8th Cir. 1962). *See generally* 78 A.L.R.2d 412, § 2 (1961).

48. *See* MD. ANN. CODE art. 95B, § 2-503 (1964). *But cf.* *William F. Wilke, Inc. v. Cummins Diesel Engines, Inc.*, 252 Md. 611, 250 A.2d 886 (1969).

49. 252 Md. 33, 248 A.2d 895 (1969).

to the catalogue description by which the order was placed.<sup>50</sup> The claimant argued that an implied warranty of fitness for a particular purpose had arisen,<sup>51</sup> and, therefore, the contract was not completed until the necessary conversion was made on January 5. The court determined that it need not resolve the conflicting claims as to warranties, deciding instead that a modification of the original contract had occurred. Under the provisions of the Uniform Commercial Code,<sup>52</sup> when the subcontractor informed the supplier that one of the items had to be changed, and the supplier agreed in good faith to make the change, that constituted a modification of the contract, without the need of consideration, and extended the time of notice.

In assessing the reach of the *Woodfield* holding, it is probably important to keep in mind that the "modification of the contract" in that case occurred as a result of a discrepancy noted very shortly after physical delivery and while the construction process was still going on. Had the project been occupied by the owner and used for any length of time, any alterations to the equipment would probably not have extended the time for filing a claim for money owed for the original installation.<sup>53</sup>

#### Further Requirements of Notice

The bond statute requires only that the notice state the amount claimed and the name of the party to whom labor and material were supplied.<sup>54</sup> It is thus similar to the mechanics' lien statute which con-

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50. MD. ANN. CODE art. 95B, § 2-313(1)(b) (1964), provides that "[a]ny description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description."

51. MD. ANN. CODE art. 95B, § 2-315 (1964), which provides that "[w]here the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is . . . an implied warranty that the goods shall be fit for such purpose." The claimant's contention was that the subcontractor had relied on its expertise to supply the needed items and that it had known of the particular purpose. Therefore, it argued, a warranty of fitness for particular purpose arose, to which the goods delivered on October 26 did not conform, and the contract was not completed until the conversion was made on January 5.

52. The court relied upon MD. ANN. CODE art. 95B, § 2-209(1) (1964), which provides that "[a]n agreement modifying a contract within this subtitle needs no consideration to be binding."

53. That repair work under the guarantee will not extend the period of notice is indicated by *Joseph J. Hock, Inc. v. Baltimore Contractors, Inc.*, 252 Md. 61, 69, 249 A.2d 135, 140 (1969), where the court said that final acceptance refers to the date when the contractor's responsibility to the owner is at an end, *except for the liability on the guarantee*. Applying an analogy to this reasoning, it would seem logical that a guarantee should have no effect on the time when notice is required.

54. MD. ANN. CODE art. 21, § 9-112(c) (1972).

tains no detailed requirements as to the content of the analogous notice to be given by a subcontractor or supplier to the owner. The Court of Appeals in construing the mechanics' lien statute has imposed several additional requirements of notice, stating that in addition to the amount claimed and the name of the party to whom goods or services were supplied, the notice must contain a statement of intent by the claimant to claim a lien, the nature of the work or materials furnished, and the time when the work is done or finished.<sup>55</sup> Some uncertainty exists as to whether these additional requirements will be applied to notice under payment bonds.

In *Westinghouse Electric Corp. v. Minnix*,<sup>56</sup> it was asserted that the notice must indicate that the claimant was looking to the contractor for payment. The court rejected this argument, holding that to add such a requirement to those in the statute would be contrary to the liberal construction in favor of claimants to be accorded to such legislation.<sup>57</sup> While no defendant in a bond suit has yet attempted to assert that the other two items required in a mechanics' lien notice, the nature of the work and the time when the work is completed, should be required in a payment bond notice, the reluctance of the Court of Appeals, as manifested in *Minnix*, to impose further requirements not expressly contained in the statute should foreclose resort to such an argument. There are other reasons why mechanics' lien requirements should not be carried over into payment bond law,<sup>58</sup> the general contractor had less need for such information than does the owner of a project subject to a mechanics' lien since the contractor is protected by its ability to choose a responsible subcontractor. In addition, the contractor is amply protected by its ability to withhold payment until given proof that the suppliers have been paid, and to require a payment bond from the subcontractor.

Since the notice is apt to have the practical purpose of being paid as soon as possible, it probably should include: the date on which the last of the labor or materials were furnished; a brief description of labor done or material supplied; and a demand for payment. More-

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55. *Welch v. Humphrey*, 200 Md. 410, 414, 90 A.2d 686, 687 (1952).

56. 259 Md. 305, 269 A.2d 580 (1970).

57. 259 Md. at 311, 269 A.2d at 583. However, the ruling on this point might be slightly weakened by the fact that the opinion went on to hold that the notice involved indicated that the claimant was looking to the contractor for payment.

58. One good reason may be found in the court's recent questioning of its prior holdings imposing these requirements on mechanics' lien notices. See *Himmelfarb v. B&M Iron Works*, 254 Md. 37, 253 A.2d 842 (1969), where the court, while adhering to the rule that inclusion of the date on which the last work was completed was necessary, indicated that it would not have insisted on this requirement in a case of first impression.



over, it should be sent to both the contractor and the surety. Such a procedure should foreclose the defense that the notice was inadequate and will entitle the claimant to interest from the date of notice rather than from the date of suit.<sup>59</sup>

### Time and Manner of Notice

The statute seems to require that notice be given within ninety days and that such notice be given by registered or certified mail. However, in *Montgomery County Board of Education ex rel. Carrier Corp. v. Glassman Construction Co.*,<sup>60</sup> where notice had been sent by certified mail within ninety days, the court ruled that the notice requirement was satisfied even though the letter was not received by the contractor until after the ninety day period had elapsed. In dicta, the court stated that notice sent by ordinary mail would not be sufficient.

However, where a notice sent by regular mail is actually received by the contractor within the ninety day period, the fact that the bond is to be liberally construed may cause the court to hold that such notice is adequate. The direction to use registered or certified mail is contained in a separate sentence in the statute. By separating this direction, the legislature may have intended merely to suggest a manner in which a claimant might be certain that the contractor received the notice, and can protect itself if the contractor refuses to accept the letter.<sup>61</sup> The federal courts have used this reasoning in interpreting the Miller Act, and have held that notice sent by ordinary mail which is otherwise sufficient will satisfy the requirements of the statute if actually received by the contractor.<sup>62</sup> Moreover, this interpretation has been applied to the Maryland statute by the United States District Court for the District of Maryland.<sup>63</sup>

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59. For a discussion of interest see notes 153-55 *infra* and accompanying text.

60. 245 Md. 192, 225 A.2d 448 (1967).

61. There is reason to believe that whether the notice is sent by certified mail or by regular mail, it is essential that the notice be actually received. See *Wheeler v. Unsatisfied Claim & Judgment Fund*, 259 Md. 232, 269 A.2d 593 (1970) (citing the *Glassman* case as authority for requiring actual receipt of a notice sent by ordinary mail to the Unsatisfied Claim and Judgment Fund); *Pressman v. Accident Fund*, 246 Md. 406, 228 A.2d 443 (1967). The advantage of certified mail is that the sender can request a receipt showing the signature of the person who received it as well as the date and place the letter was delivered.

62. *Fleisher Eng'r & Constr. Co. v. United States ex rel. Hallenback*, 311 U.S. 15 (1940).

63. *State Roads Comm'n v. Contee Sand & Gravel Co.*, 308 F. Supp. 650 (D. Md. 1970).

*Filing Suit*

Under the prior bond statute, suit was brought in the name of the State of Maryland, to the use of the claimant. Today, the claimant can probably bring suit in its own name, without including the obligee as a nominal party. When the Little Miller Act was passed, it omitted the clause specifying the name in which suit was to be brought.<sup>64</sup> The only thing which suggests suit should be brought in the name of the obligee is subsection (d) which says that the obligee shall not be liable for the payment of any cost or expenses of the suit.<sup>65</sup>

The importance of filing suit quickly cannot be overemphasized. Even if the bond complies with the requirements of the statute, and the claim is clearly within its coverage, a claimant who delays suit may not be able to recover. The Act contemplates separate suits by claimants. Since the bond is usually in an amount which is only fifty percent of the amount payable under the contract, it is possible for the bond to be exhausted before all claimants are paid, especially if the contractor has used the money from the bonded project to pay creditors from other jobs.

In this regard, the Little Miller Act may be less satisfactory than the prior contractors' bond statute which contemplated a single suit in which other suppliers would intervene.<sup>66</sup> Under the earlier procedure, if the bond was not sufficient to pay all claimants, the available money was divided on a pro rata basis. Under the present act, the proceeds of the bond may be divided pro rata only if the surety files a bill of interpleader and pays the amount of the bond into court.

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64. In *Glens Falls Ins. Co. v. Baltimore County*, 230 Md. 524, 187 A.2d 875 (1963), suit was brought in the claimant's name. At the end of the plaintiff's case, the surety moved for judgment because suit was not brought in the name of the obligee. The motion was denied and permission was granted to amend the plaintiff's name by adding "Baltimore County, Maryland, for the use and benefit of." On appeal, the court approved the amendment, and pointed out that the statute contained nothing which required that suit be brought in the name of the obligee. Without deciding whether the new Act had changed the existing practice, the court held the amendment was proper because it was not such a change as to constitute a new suit or cause of action. Subsequent cases have reached the Court of Appeals without the obligee as the nominal plaintiff and without the defendant asserting that defense. *See, e.g.*, *William Constr. Co. v. Construction Equip., Inc.*, 253 Md. 60, 251 A.2d 864 (1969); *Joseph J. Hock, Inc. v. Baltimore Contractors, Inc.*, 252 Md. 61, 249 A.2d 135 (1969); *Ruberoid Co. v. Glassman Constr. Co.*, 248 Md. 97, 234 A.2d 875 (1967).

65. MD. ANN. CODE art. 21, § 9-112(d) (1972).

66. At least one claim was apparently lost when the procedure was changed by the passage of the new act in 1959. *See Maryland ex rel. American-Marietta Co. v. W.E. Dunn Constr. Co.*, 191 F. Supp. 297 (D. Md. 1961), where a claimant tried to intervene in a case in which a judgment had already been rendered because it mistakenly believed that it was required to do so under the statute.

## Bill of Interpleader

Where the bond proceeds cover all of the pending claims there is no real problem concerning separate actions; however, where the claims exceed the amount of the bond, the surety may wish to file a bill of interpleader and pay the amount of the bond into court.<sup>67</sup> The money would then be distributed pro rata among the claimants. There is authority which indicates that interpleader is not available where the total amount of claims does not exceed the amount of the bond, regardless of whether the situation would otherwise fit traditional interpleader adversity requirements. In *Joseph F. Hughes & Co. v. Harry S. Mickey, Inc.*,<sup>68</sup> the contractor had built a public school in Baltimore County, and in compliance with the bond statute had filed a bond in the amount of \$2,780,375. The contractor ordered chairs and tables for the school from A for \$5,000. A subcontracted the order to B for \$3,287. In turn, B ordered the items from C at a cost of \$4,755. Finally, C placed the order with D for \$3,287. C went into a reorganization in bankruptcy and D filed suit against the contractor in the Baltimore County Circuit Court. When the contractor filed an action of interpleader in the United States District Court for the District of Maryland, D countered with a motion to dismiss.

In granting D's motion to dismiss, the District Court held that adversity among defendants is essential to the concept of interpleader, and that no adversity could exist where the claims did not exceed the amount of the bond. In reaching this conclusion, the court stated:

The interpleader is intended to prevent multiple payments to multiple claimants each of which payments is in the full amount of what actually is but a single liability. Here, however, the statute in question acknowledges the possibility of not merely a single liability; its purpose is to guarantee payments by a subcontractor to his materialmen, regardless of whether or not the subcontractor himself has been paid. Thus, the claim of the subcontractor usually is not adverse to that of the materialmen, and vice versa. Where, as here, there is a contractual chain linking successive potential claimants, there are ways in which a prime contractor can guard against multiple payments. The interpleader is not one of them, at least where the amount of the fund exceeds the total amount claimed.<sup>69</sup>

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67. Md. R.P. BU 70-74, govern interpleader actions in Maryland courts. If an action is brought in federal court, the applicable rule is FED. R. CIV. P. 22; jurisdiction is provided by 28 U.S.C. § 1335 (1970). Interpleader should also be available in private bond cases to the same extent to which it is available in public bond cases.

68. 211 F. Supp. 298 (D. Md. 1962).

69. *Id.* at 301.

The use of an interpleader suit may also raise a question of whether such a suit may be used to permit evasion of the statute's requirements. Claimants might be joined who had not complied with the statutory requirements as to notice or who had not yet filed suit. The question has not yet been decided by a Maryland court; if the issue arises the solution should be to permit joinder only of those claimants who have complied with all conditions for recovery, including filing suit. Under the normal statutory procedure for filing suit a premium is placed upon diligence in pursuing one's remedy, since there is no pro rata distribution when the claims filed exceed the amount of the bond. Joinder of claimants who have not filed suit will permit claimants who have been less diligent to evade the statutory requirements. In any event, a court should not permit joinder of claimants who have not complied with prerequisites to suit, such as giving notice.

#### Persons Entitled to Sue

Any claimant who has furnished labor or materials to the contractor or a subcontractor is clearly entitled to recover on the bond.<sup>70</sup> Federal cases have held that a supplier of a sub-subcontractor (commonly known as a second tier subcontractor) is not entitled to protection.<sup>71</sup> Both the federal and the Maryland acts provide that the bond is for the protection of persons supplying labor and materials to the contractor or his subcontractors, and do not mention sub-subcontractors. However, section 9-112(c) of the Maryland Act, which requires notice from claimants who have not dealt directly with the contractor, refers to "any person having direct contractual relationship with a subcontractor . . . or with any subcontractor of the contractor." Therefore, it appears that a supplier of a sub-subcontractor may be entitled to protection. The issue has not been raised in the Court of Appeals to date.

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70. The language and purpose of the statute seem to compel the conclusion that any one who has dealt *directly* with the contractor or a subcontractor will be entitled to recover on the bond. This is true regardless of the formality with which they are hired, and regardless of whether it was contemplated that they would be hired at the time the bond was filed and the contract signed by the general contractor and the obligee. Problems may arise when a contractor or subcontractor defaults and the person completing the work may be deemed to be a new prime contractor or subcontractor. *But cf.* State Contracting Co. v. Maryland Cas. Co., No. 472 (Ct. C.P., Baltimore, Dec. 12, 1966) in *The Daily Record* (Baltimore), Dec. 21, 1966, at 3, col. 1, where the claimant, who was "informally" hired to complete the work of a subcontractor, admitted that it was not a subcontractor within the definition established by the Little Miller Act. It was denied recovery on the basis that the parties to the original contract had not specifically intended this subsequent party to be covered by the bond.

71. *United States ex rel. Newport News Shipbuilding Corp. v. Blount Bros. Constr. Co.*, 168 F. Supp. 407 (D. Md. 1958).

The issue was arguably presented in *Ruberoid Co. v. Glassman Construction Co.*<sup>72</sup> There an individual had been hired by the general contractor to do the tile work. Before the work commenced, the individual formed a corporation which subsequently performed the work. This was done without the knowledge of the contractor and despite a provision in the subcontract prohibiting an assignment without the contractor's consent. The lower court was of the opinion that since the principal had contracted with the sole proprietorship, and the supplier furnished the materials to the corporation, the supplier did not supply the materials to a subcontractor as required by the bond statute and, therefore, was not a claimant as defined in the bond. The Court of Appeals avoided the issue of whether the corporation was a sub-subcontractor. Instead, it found that the proprietorship had made an equitable assignment of the subcontract. The court said the prohibition in the bond against assignment was intended to insure that the work would be performed by a subcontractor considered competent by the contractor, and that purpose had not been defeated by the assignment. It pointed out that the corporation was wholly owned by the individual who also remained personally liable under an indemnification provision in the subcontract. The court concluded that the corporation was a subcontractor by virtue of the equitable assignment, and that its supplier was entitled to recover on the bond.<sup>73</sup>

The settled construction of the bond statute is that the Act does not protect suppliers of suppliers.<sup>74</sup> Consequently, it may be important for the claimant to know whether his debtor is a subcontractor or a supplier. For instance, if the contractor hires a specialist to supply air conditioning units and that company purchases parts from the claimant, his right to bring suit on the bond may depend on whether the air conditioning specialist was a subcontractor or a supplier. That determination will probably depend upon how much installation work the specialist is required to do at the job site.<sup>75</sup>

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72. 248 Md. 97, 234 A.2d 875 (1967).

73. Even though *Ruberoid* points to the fact that the original subcontractor was still liable on the indemnification provision, it may be that this fact was not essential. If the original subcontractor is a corporation, and it assigns the subcontract to another corporation, if the contractor should permit the second corporation to complete the work, it could be argued that the contractor had waived the provision prohibiting assignment. However, such an argument of waiver may not be effective against the surety unless the surety is notified of the assignment.

74. The same result has been reached in federal cases involving the Miller Act. See *Clifford F. MacEvoy Co. v. United States ex rel. Calvin Tomkins Co.*, 322 U.S. 102 (1944).

75. In *Clifford F. MacEvoy Co. v. United States ex rel. Calvin Tomkins Co.*, 322 U.S. 102 (1944), the Supreme Court gave the following definition for a subcontractor :

## Statute of Limitations

It may be difficult for the claimant to determine how long the statute of limitations has to run. The Act provides that suit must be filed within one year after the final acceptance of the work.<sup>76</sup> Several cases have shown that the court may have to decide if and when final acceptance actually took place.

Some contracts contain a provision requiring a "final certificate" from the architect. Such a requirement should make the date of final acceptance easier to ascertain. However, the Court of Appeals had to determine when final acceptance took place in two cases where architects' final certificates were required.<sup>77</sup> In both cases, the court held that if the contract required a final certificate, then without it there could be no final acceptance. No action by any party can substitute for the architect's final certificate.<sup>78</sup>

The length to which this rule can be carried was illustrated in *United States Fidelity & Guaranty Co. v. Hamilton & Speigel, Inc.*,<sup>79</sup> where the board of education took possession of a school and no work was done by the prime contractor after the acceptance of the classrooms by the board. However, the architect failed to issue the final certificate until after the expiration of more than two years following occupancy of the project. In determining when the period of limitations began to run, the court held the date of the architect's final certificate was determinative, regardless of when the board of education took possession. The court seemed to feel that it mitigated the difficulties such a long delay could cause by stating: "If the bonding

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In a broad, generic sense a subcontractor includes anyone who has a contract to furnish labor or material to a prime contractor. . . . But under the more technical meaning, as established by usage in the building trades, a subcontractor is 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 108-09. See also *Aetna Cas. & Sur. Co. v. United States ex rel. Gibson Steel Co.*, 382 F.2d 615 (5th Cir. 1967).

76. MD. ANN. CODE art. 21, § 9-112(d) (Supp. 1972).

77. *United States Fidelity & Guar. Co. v. Hamilton & Speigel, Inc.*, 241 Md. 133, 215 A.2d 735 (1966); *Baltimore County Dep't of Educ. v. Henry A. Knott, Inc.*, 234 Md. 417, 199 A.2d 369 (1964).

78. The final certificate, when provided for in the contract, is necessary regardless of how many other factors indicating a final acceptance are present. The facts of the *Knott* case [*supra* note 73] indicate that it is immaterial that the owner had no right to hold back any portion of the purchase price, that the owner took possession of the project, that a conditional acceptance had taken place, that the owner or anyone else thought that final acceptance had occurred, or that the architect had made a verbal acceptance of a portion of the work.

79. 241 Md. 133, 215 A.2d 735 (1966).

company was concerned and in doubt as to when limitations began to run it could have removed the uncertainty by obtaining a declaration of its rights and legal status under the construction contract."<sup>80</sup>

The inconvenience caused by this rule is aggravated by the fact that a certificate issued by an architect may not qualify as a final certificate. In *Baltimore County Department of Education v. Henry A. Knott, Inc.*,<sup>81</sup> the Board of Education's engineer had written a letter to the principal of a newly completed school indicating that work had been substantially finished in July, 1961, and had indicated that this date was agreed to by the architect. A certificate of payment was filed with the Board of Education by the architect in December, 1961, which entitled the contractor to full payment for the job. In holding that in no event could final acceptance have taken place before this certificate was issued, which was within one year of the date of suit, the court expressly left open the question of whether even this certificate constituted final acceptance. Thus, further uncertainty may result even where a certificate has been issued.

The problem is even more difficult where the contract does not require an architect's final certificate. Final acceptance, as established by the court, must be unqualified and unconditional. It cannot take place if there is work to be completed. The lack of final acceptance may be shown by the fact that part of the contract price is held back to secure full performance.<sup>82</sup> Final acceptance can take place only when the contractor has no responsibility except on its guarantee.<sup>83</sup> For example, if the contract requires a release of subcontractors' claims, then final acceptance will be delayed until the releases are supplied or waived.

This measurement of limitations in terms of final acceptance is a vestige of the former statutes requiring combination performance and payment bonds. Under those statutes, the claim of the obligee was given priority over the claims of suppliers. In order to give the obligee an opportunity to assess the amount of any loss it might have sustained, the statute of limitations had to be measured from the completion of the contract.<sup>84</sup>

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80. 241 Md. at 136, 215 A.2d at 737. The bonding company could obtain a declaration of its rights under the Uniform Declaratory Judgments Act. MD. ANN. CODE art. 31A, §§ 1-3 (1971).

81. 234 Md. 417, 199 A.2d 369 (1964).

82. 234 Md. at 424, 199 A.2d at 373.

83. *Joseph J. Hock, Inc. v. Baltimore Contractors, Inc.*, 252 Md. 61, 69, 249 A.2d 135, 140 (1969).

84. Granting the obligee's claim priority apparently did not provide sufficient protection in cases where suppliers' claims were paid before the obligee had sufficient

The Miller Act and similar state statutes were passed in order to do away with the conflict between the obligee and the suppliers by providing for a separate payment bond. The federal act, at first, retained the statute of limitations measured from the date of final acceptance. This rule was unsatisfactory because of the difficulty in determining the date of final acceptance, and because the statute of limitations for each claimant is not measured from his last action, but rather from an occurrence over which he had no control, and about which he might have no knowledge. The Miller Act now requires suit to be filed within one year after the date on which the claimant supplied the last of his labor or material.<sup>85</sup> These reasons for changing the statute of limitations in the Miller Act apply with equal logic to the Maryland Act.<sup>86</sup>

### *Suits Against the Oblige*

The statutory requirement for a payment bond has not been interpreted as allowing the claimant to sue the government agency for which the project is built. While the purpose of the Act is to protect claimants, there is no indication of any legislative intent to grant them the right to demand payment directly from the obligee. Claimants have attempted unsuccessfully to recover from the governmental agency on the basis of three different theories: creditor beneficiary, unjust enrichment, and negligence.

In *Hamilton & Spiegel, Inc. v. Board of Education of Montgomery County*,<sup>87</sup> the Board of Education was sued along with the general contractor and the surety. The trial court sustained the Board's demurrer, and the Court of Appeals affirmed. The claimant argued that the Board had entered the bond agreement to satisfy an obliga-

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time to assess its damages and file suit. The Heard Act, passed in 1894, was amended in 1905 to prohibit suit by a supplier until six months after the completion and final settlement of the contract. During that six month period, the only hope of getting a supplier's claim before the court depended upon the government's bringing a suit in which the supplier could intervene. If no such suit were brought by the government, then a supplier could file suit during the next six month period. The former version of the Maryland Act was not amended in this fashion, apparently because the state never experienced the problem of a bond becoming inadequate because of prior payment to suppliers.

85. 40 U.S.C. § 270b(b) (1970).

86. However, there also may be difficulty in determining the date on which the last of the labor or material was supplied. See notes 47-53 *supra* and accompanying text. In addition the working out of the payment to all parties from retained funds may be possible only long after completion of a particular project. Thus, the choice between the federal approach and the present Maryland rule is not easy.

87. 233 Md. 196, 195 A.2d 710 (1963).



tion which the Board believed to be owed the claimant as a supplier, and, therefore, regardless of whether there was an actual obligation owed, the claimant was a creditor beneficiary of the Board's promise to pay under the construction contract. As a creditor beneficiary, the claimant asserted the right to enforce the contract directly against the promisor, the Board of Education.<sup>88</sup> The court said that in order for the claimant to be a creditor beneficiary, rather than an incidental beneficiary, the contract must have been intended for its benefit. The statutory requirement of the payment bond was said to refute such an intention.

In the alternative, the claimant argued that the Board was unjustly enriched because the claimant had not been paid. In rejecting this proposition, the court noted that there was no allegation that the Board had not paid in full, but it passed over the question of whether the Board had been benefited. Rather, it held that, in any case, the benefit was not unjustly received, stating that the Board had done "all it was required to do or reasonably or justly could have been expected to do by exacting the statutory payment bond . . . ."<sup>89</sup> Moreover, the court reasoned that the claimant knew, when the services and materials were being furnished, that the bond could be looked to if the claimant was not paid by the contractor and that it "cannot now justly claim that it expected to receive payment direct from the Board."<sup>90</sup>

The Court of Appeals considered the issue of the obligee's liability when the bond is defective in several suits against the Charles County Board of Education arising out of a contract the Board awarded for an addition to the LaPlata High School. The contractor, Spa Construction Company, furnished a payment bond in the amount of \$113,898, supposedly issued by the Metropolitan Fund, Inc., Annapolis, Maryland. When the Board received the payment bond, it did not ask the State Insurance Department whether Metropolitan was authorized to do business in Maryland. The bond was forwarded to the Supervisor of School Plant Planning for the Maryland State Department of Education and was approved by the Supervisor. Eight months later, the Board discovered that the bonding company was not licensed to do business in this state. After giving Spa an opportunity to supply a proper bond, the prime contract was cancelled. Spa became insolvent, and the suits against the board of education ensued.

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88. For a more extensive discussion of creditor beneficiary theories, see RESTATEMENT OF CONTRACTS § 133(b) (1932).

89. 233 Md. at 201, 195 A.2d at 712.

90. *Id.*

In *Bolick v. Board of Education of Charles County*,<sup>91</sup> the claimant alleged the Board was negligent in accepting the bond, which it described as fraudulently executed and unenforceable. The Court of Appeals held that the bond statute had created no liability for the board beyond its duty to see that a payment bond was furnished. In doing so, the court reiterated its rule<sup>92</sup> that boards of education are immune from tort actions because the legislature has not given them the power to raise money for the purpose of paying damages or judgments.<sup>93</sup> The claimant had also asserted a right to recover on a creditor beneficiary theory. The court relied on *Hamilton* in rejecting this theory.<sup>94</sup>

The last case decided on these facts was *Board of Education of Charles County v. Alcrymat Corp.*<sup>95</sup> At no time before or during the trial of the *Alcrymat* case did the school board assert its governmental immunity as a defense. Despite the fact that the Maryland Rules of Procedure state that the defense of governmental immunity "shall be filed before any other pleadings,"<sup>96</sup> the Court of Appeals reversed the lower court judgment for the supplier, holding that the defense of governmental immunity could not be waived.<sup>97</sup>

91. 256 Md. 180, 260 A.2d 31 (1969).

92. See, e.g., *Weddle v. Board of County School Comm'rs*, 94 Md. 334, 51 A. 289 (1902).

93. The defense of governmental immunity is now no longer available to boards of education to the extent of \$100,000. MD. ANN. CODE art. 77, § 56B (Supp. 1972). Although governmental immunity has been partially abolished as to school boards, it is still available to other governmental bodies in tort suits.

94. The *Bolick* case was cited as authority for a per curiam affirmance of the trial court's judgment for the defendant in *Thomas L. Higdon, Inc. v. Board of Educ. of Charles County*, 256 Md. 595, 261 A.2d 793 (1970), a case which involved the same basic facts.

95. 258 Md. 508, 266 A.2d 349 (1970).

96. The rule states in part:

A motion raising one or more such defenses . . . [including governmental immunity] . . . shall be filed before any other pleading on behalf of the party making the motion is filed. . . .

MD. R.P. 323(c).

97. The court did instruct its Rules Committee to clarify the rule, and, as a token to the claimant, the Board of Education was required to pay the court costs because the case had been tried when it could have been disposed of on the pleadings.

Where an owner or state contracting authority retains some part of the contract price after the project is completed, the right of an unpaid subcontractor to those funds (as against other creditors of the contractor) presents a difficult problem beyond the scope of this article. See generally Teach, *The No Property Rule in Federal Tax Lien Litigation*, 24 MD. L. REV. 310 (1964). In *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962), the surety was held to be entitled to the retainage on the basis of being subrogated to the rights of laborers and materialmen whom it had paid.

## PRIVATE BONDS

There is no statutory or common law rule in Maryland which requires the owner of a private project to insist on a payment bond. However, many owners have found it advisable to include this requirement in their agreement with the contractor, and many such bonds have been written in this state.

It is not safe for a supplier to assume that there is a payment bond. The expense of the bond adds to the cost of the project. The larger the contractor and the smaller the project, the more likely it is that no bond will be required. The best way to find out whether there is a bond is to ask the owner for a copy. The owner usually will give a copy of the bond to a potential supplier in order to encourage him to deal with the contractor and the subcontractors, and to a supplier with an outstanding claim to discourage him from filing a mechanics' lien.<sup>98</sup>

*Form of the Bond*

In the past, the common practice was to use a combination performance and payment bond, sometimes called a contract bond.<sup>99</sup> Paralleling the change in the statutory bond pattern, the tendency in recent years has been to use separate performance and payment bonds on private projects.<sup>100</sup>

The form of the bond to be supplied is usually included in the specifications prepared by the architect. The form most often specified is copyrighted by The American Institute of Architects and is entitled "Labor & Material Payment Bond."<sup>101</sup> This bond form incorporates by reference the contract with the owner, the supporting drawings and the specifications. It assures the owner (the obligee) that payment

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98. It is important to remember that on a private job the protection afforded suppliers by a bond is in addition to their mechanics' lien protection and not in place of it. Because the bond may be exhausted by other claims, or because the claimant may not properly perfect his claim under the bond, he will wish to pursue his mechanics' lien rights as well as his bond rights. For this reason separate notices should be sent. The claimant should remember also that if he has not dealt directly with the owner, he will have to give notice to the owner of his intention to file a mechanics' lien, even though notice may not be required by the bond if he has dealt directly with the contractor.

99. For an example of the form of such a bond see MOD. LEGAL FORMS ch. 17, § 1616 (1965).

100. This change to separate performance and payment bonds for private projects was undoubtedly influenced by occurrences similar to those experienced on public projects involving competition between the obligee and supplier, which led to the replacement of Heard Act type statutes with Miller Act type statutes.

101. See MOD. LEGAL FORMS ch. 17, § 1615 (1965).

will be made to all claimants who supply labor and material used or reasonably required for use in the performance of the contract. A claimant is defined as anyone having a direct contract with the contractor or with a subcontractor for labor, material, or both. Material is broadly defined to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment directly applicable to the contract. A claimant is given the right to sue on the bond if he has not been paid in full within ninety days after the date on which he supplied the last of his labor or material on the project.<sup>102</sup>

Under the terms of this bond, unless the claimant has dealt directly with the contractor he must give written notice to any two of the following: the contractor, the owner, or the surety. The notice must: be given within ninety days after the last of the labor or materials were supplied for which the claim is being made; state with substantial accuracy the amount claimed and the name of the party to whom the materials or labor were furnished and either; be sent by registered or certified mail addressed to any place where the contractor, owner or surety regularly maintain offices for the transaction of business,<sup>103</sup> or be served in any manner in which legal process may be served, except

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102. While present bond forms specifically grant the suppliers the right to sue on the bond, the earlier forms did not. In *Hartford Accident & Indem. Co. v. W.&J. Knox Net & Twine Co.*, 150 Md. 40, 132 A. 261 (1926), the court was called upon to decide whether a supplier had the right to bring suit on a bond conditioned upon the contractor's indemnifying and saving harmless the owner from all claims and demands, and paying all persons having contracts with the principal for labor or materials. In reviewing the standing of the supplier to bring the suit, the court pointed out that the right of a third party beneficiary to bring suit on a contract intended for his benefit had become a well established exception to the rule restricting the right to bring such a suit to those persons who were parties to the contract. Suits by suppliers on contractors' bonds were said to constitute a substantial part of the cases establishing this exception. The court acknowledged that the earlier Maryland cases on the subject involved statutory bonds, but concluded that the same principles applied to private bonds. Holding that this bond was intended for the benefit of the suppliers, the opinion pointed out that the owner was adequately protected by the indemnification provision. It therefore concluded that the provisions for the payment of the suppliers must have been included with the intention that suppliers would be able to bring suit because materialmen did not have the right to file mechanics' liens in Baltimore at that time. Otherwise, this provision would have existed only to protect the owner from the annoyance of knowing that there were unpaid bills for labor or materials furnished him, even if he could not be compelled to pay the bills.

103. The author has been involved in several cases where the claimant sent one of the notices to the surety in care of the insurance agent who procured the bond for the contractor. Care should be taken not to send the surety's notice in this fashion because it may lead to the defense that the notice was not sent to an office maintained by the surety for the transaction of business.

that it need not be served by a public officer. Suit must be filed within one year after the date on which the contractor ceased work on the contract in the county in which the project is situated or in the United States District Court for the district in which the project is located. The amount of the bond is to be reduced by any payments made in good faith under it, including any payment of mechanics' liens whether or not presented under the bond.

It is important for the claimant to remember that there are other forms of contractors' payment bonds still in use today, and they contain provisions which differ from those in the AIA form.<sup>104</sup> These bonds differ as to such matters as the types of items covered, the definition of claimants,<sup>105</sup> the notice requirements and the statute of limi-

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104. For some alternative forms of bonds see 5 AM. JUR. LEGAL FORMS 2d 296-300 (1971).

105. The variety of coverage contained in contractors' bonds is demonstrated by the following list of bond conditions quoted in opinions rendered by the Court of Appeals:

Pay all just debts for labor and materials incurred by such contractor in the construction and improvement of the road contracted for. *See, e.g., State ex rel. Southern Md. Nat'l Bank v. National Sur. Co.*, 126 Md. 290, 94 A. 916 (1915);

Indemnify and save harmless the owner from all losses, costs, expenses, damages or injury to which the owner may be subjected by reason of any wrongdoing or misconduct on the part of the contractor. *See, e.g., Mayor & City Council of Baltimore ex rel. Warren Webster & Co. v. Maryland Cas. Co.*, 146 Md. 508, 126 A. 880 (1924);

Pay all persons who have contracts directly with the contractor for labor or materials. *See, e.g., Hartford Accident & Indem. Co. v. W.&J. Knox Net & Twine Co.*, 150 Md. 40, 132 A. 261 (1926);

Pay all suppliers of labor and materials incorporated in the structure for which the contractor is liable. *See, e.g., Mayor & City Council of Baltimore ex rel. Lehigh Structural Steel Co. v. Maryland Cas. Co.*, 171 Md. 667, 190 A. 250 (1937);

Pay all claims for materials furnished, installed, erected and incorporated in structure for which contractor is liable. *See, e.g., Fidelity & Deposit Co. v. Mattingly Lumber Co.*, 176 Md. 217, 4 A.2d 447 (1939);

Pay all debts for labor and materials incurred through subcontract or in any other manner by or on behalf of the contractor. *See, e.g., Hospital for the Women of Md. ex rel. Robert S. Green, Inc. v. United States Fidelity & Guar. Co.*, 177 Md. 615, 11 A.2d 457 (1940);

Pay any person furnishing labor or material for said work. *See, e.g., Lange v. Board of Educ. of Cecil County*, 183 Md. 255, 37 A.2d 317 (1944);

Pay all persons supplying labor and material in the prosecution of the work provided for in said contract. *See, e.g., Mullan Contracting Co. v. International Business Machines Corp.*, 220 Md. 248, 151 A.2d 906 (1959);

Keep, do and perform each and every, all and singular, the matters and things in said contract set forth and specified to be by the said principal kept done and performance at the time and in the manner in said contract specified. *See, e.g., Kirby & McGuire, Inc. v. Board of Educ. of Cecil County*, 210 Md. 383, 123 A.2d 606 (1956);

Pay all persons who have contracts directly with principal for labor and materials furnished pursuant to provisions of said construction contract and cause

tations. The recent case of *Aetna Insurance Co. v. Maryland Cast Stone Co.*<sup>106</sup> contains an illustration of the fact that the terms of a payment bond must be carefully read. There the bond was conditioned upon payment by the principal of all persons who had contracted with the general contractor to supply labor and materials, and upon discharge of all mechanics liens. Although the bond defined claimant to include all persons who had contracted with the contractor or a subcontractor, the condition of the bond is the controlling element. Therefore, unless the claimant had directly contracted with the general contractor, he would not be able to sue on the bond, although he might obtain payment had a mechanics' lien been filed. It is therefore not safe to proceed without a copy of the bond. It may also be necessary to examine the prime contract and supporting documents to determine whether coverage exists.

### *Interpreting the Bond*

Certain basic principles are said by the courts to be useful in construing the language of a private payment bond. One broad statement often made by the courts is that the liability of a surety upon a bond is dependent upon the covenants contained in the bond; a conventional bond is a simple contract. Therefore the ordinary method of interpreting contracts, that of ascertaining the intent of the parties, is used. Furthermore, the old doctrine that a surety is a favorite of the law, and that a claim against him is *strictissimi juris*, has been greatly eroded by the advent of corporate bonding companies who become sureties for profit. Sureties' liability on payment bonds has been greatly extended, since their business is essentially that of insurers.<sup>107</sup> In addition, the fact that the bond is executed for the benefit of suppliers and laborers is said to warrant a liberal construction of the bond in their favor.

Despite the favorable ring of these principles, the bond will not always be interpreted in the claimant's favor. In *Hospital for the Women of Md. ex rel. Robert S. Green, Inc. v. United States Fidelity &*

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all mechanics' liens to be discharged. *See, e.g., Aetna Ins. Co. v. Maryland Cast Stone Co.*, 254 Md. 109, 253 A.2d 872 (1969);

Make payments to all persons supplying labor and materials to the contractor or any subcontractor in the prosecution of the work provided for in the contract. *See, e.g., Williams Constr. Co. v. Construction Equip., Inc.*, 253 Md. 60, 251 A.2d 864 (1969).

106. 254 Md. 109, 253 A.2d 872 (1969).

107. *Hospital for the Women of Md. ex rel. Robert S. Green, Inc. v. United States Fidelity & Guar. Co.*, 177 Md. 615, 11 A.2d 457 (1940).

*Guaranty Co.*,<sup>108</sup> the court recited these principles and then denied recovery on the basis of a strict reading of the bond. The bond was conditioned upon the principal paying "all just debts for labor and materials incurred through subcontract, or in any other manner, by or on behalf of the principal." The plaintiff had sold to a subcontractor materials used in the project. The court held the claim was not within the coverage of the bond, quoting the following passage from the opinion of the lower court:

The 'by or in [sic] behalf of the principal' is a restrictive term. If the meaning and intent of the bond was to cover all just debts for labor and material incurred through subcontractors or in any other manner, as contended for by the plaintiff, the clause should have stopped there, but it added the definitely restrictive provision limiting the above to those incurred 'by or on behalf of the principal.' These words cannot be rejected as surplusage. They restrict the obligation to debts for labor and materials incurred by and on behalf of the principal. The debts in the present case were contracted by the subcontractor, . . . and not 'by or on behalf of the principal.'<sup>109</sup>

As noted earlier, where there is no statute the bond usually incorporates the construction contract and its supporting documents by reference. In *Lange v. Board of Education of Cecil County*,<sup>110</sup> decided before the adoption of the Little Miller Act extended coverage to projects built for local subdivisions,<sup>111</sup> the court stated that "[w]here the contract incorporates as a part of itself the specifications, and the contract is, by reference incorporated as part of the bond, the contract, the specifications and the bond must all be construed together."<sup>112</sup> The surety argued that the claimant was not entitled to recover because the requirement for payment of suppliers contained in the contract's specifications was limited to those suppliers who performed labor at the job site. While the bond contained no such restriction, the court read the specifications into the bond.<sup>113</sup>

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108. 177 Md. 615, 11 A.2d 457 (1940).

109. 177 Md. at 620, 11 A.2d at 460.

110. 183 Md. 255, 37 A.2d 317 (1944).

111. Before 1959, the bond statute applied only to projects built for the state and its agencies. Bonds given on projects for the counties and their agencies were treated as private jobs.

112. 183 Md. at 261, 37 A.2d at 321.

113. A considerable portion of the opinion was devoted to showing how the testimony in the lower court proved that the supplier had performed labor installing its equipment at the job site.

The very next payment bond case to come before the Court of Appeals<sup>114</sup> presented the question of whether the "Instructions to Bidders" was incorporated into the bond through a contract which incorporated "technical specifications." Although the project was not covered by the state statute, the bond was in the standard Miller Act form protecting suppliers of subcontractors. The "Instructions to Bidders" had required only a bond insuring the payment of persons to whom the contractor was legally indebted. The court held for the supplier on the grounds that incorporation of the specifications was only for the purpose of defining the scope of the work, and that all of the documents read together indicated that the "Instructions to Bidders" was merely a preliminary document and was not part of the contract.

In *Kirby & McGuire, Inc. v. Board of Education of Cecil County*,<sup>115</sup> the court acknowledged that restrictive provisions in the specifications may narrow the scope of coverage otherwise implied by the language of the bond. However, it concluded that the language in the specifications had not narrowed the coverage of the bond supplied in that particular case. It pointed out that the specifications had included the "Advertisement," the "Instructions to Bidders," the "Form of Proposal" and the "Special Conditions." This statement indicates that the manner in which these preliminary documents are referred to in the contract or specifications will determine whether they are to be looked to in interpreting the condition of the bond.

No language in the contract can substitute for conditions left out of a bond. In *Board of Education of Montgomery County v. Victor N. Judson, Inc.*,<sup>116</sup> the bond simply promised to indemnify the owner for any loss sustained by the failure of the contractor to perform the contract. No mechanics' liens could be filed on the project because it was a public school, and the owner could not sustain any loss by reason of the contractor failing to pay suppliers. The court held against the claimant despite a provision in the contract which could have permitted the Board of Education to require a bond conditioned upon the payment of all obligations arising under the contract. This case is particularly interesting because the claimant had dealt directly with the contractor. However, the court said that it was not necessary for the surety to make its undertaking as broad as that of the contractor.<sup>117</sup>

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114. *United States Fidelity & Guar. Co. v. Housing Authority ex rel. Monumental Brick & Supply Co.*, 206 Md. 379, 111 A.2d 658 (1955).

115. 210 Md. 383, 123 A.2d 606 (1956).

116. 211 Md. 188, 126 A.2d 615 (1956).

117. *See also Mayor & City Council of Baltimore ex rel. Warren Webster & Co. v. Maryland Cas. Co.*, 146 Md. 508, 126 A. 880 (1924).



The claimant may be able to recover without producing plans and specifications if other types of evidence are available. In *Penn Plastering Corp. v. O'Boyle*,<sup>118</sup> the surety argued that the prime contract and the plans and specifications were essential elements of proof. The claimant was apparently unable to produce these items, and instead relied on secondary evidence and records kept in the ordinary course of business. The court reviewed the evidence and concluded that the testimony of the claimant's accountant-comptroller and the claimant's business records had sufficient probative value to permit a judgment to be entered against the surety.

#### ISSUES COMMON TO BOTH TYPES OF BONDS

There are many issues which may arise regardless of whether a bond is issued on a public project or a private project. Some of these warrant treatment here since they are important elements in the claimant's recovery.

##### *Application of Payments*

The claimant may have supplied materials or labor to the debtor on more than one project, some of which may not have been bonded. If the claimant has received payments after the dates on which labor or materials were supplied to the bonded job, the court may have to decide how the payments should have been applied as between the non-bonded and the bonded projects.

The general rule is well established as follows:

[W]here a debtor owes a creditor on several accounts, he may apply a payment to the discharge of any particular debt he chooses; but if he does not specify the account on which he wishes to pay, the creditor may apply the payment. If neither makes the application, the law will make it according to the justice of the case, and usually to the payment of the earliest debt.<sup>119</sup>

However, there is one established exception to the creditor's right to appropriate an undesignated payment as he sees fit; where the debtor's payment can be traced to funds received from a bonded project, and the creditor had knowledge of that source when the payment was re-

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118. 254 Md. 16, 253 A.2d 862 (1969).

119. *Carozza v. Brannan*, 186 Md. 123, 126, 46 A.2d 198, 199-200 (1946). *But cf.* *T. Dan Kolker, Inc. v. Shure*, 209 Md. 290, 121 A.2d 223 (1955) (debtor's direction as to application held not controlling on particular facts).

ceived, then the creditor must devote the payment to the satisfaction of the balance due on the bonded project.<sup>120</sup>

It is common practice in the construction industry for a creditor who supplies numerous separate items to a debtor to maintain only one running account record to which invoiced amounts are debited and payments are credited chronologically. In such a situation, it is generally held that when a payment is received, "by operation of law, the appropriation is at once made to the discharge or reduction of the first item or items on the debit side of the account."<sup>121</sup>

The defendants in *Mullan Contracting Co. v. International Business Machine Corp.*,<sup>122</sup> attempted to rely on this running account rule. They alleged that the subcontractor had made payments amounting to \$8,360 to IBM from monies paid by the defendant contractor to the subcontractor, but that only \$2,429.50 had been credited toward the \$4,367 purchase from IBM on the bonded project. The Court of Appeals disputed the defendants' theory that if IBM had maintained a running account then the burden would be on it to show why the payments had not discharged the claim in issue, but found it unnecessary to explore the question. IBM had not attached a running account statement to its declaration. Instead it had attached what the court called a "summary invoice" which merely listed the items sold on that invoice and the payments credited to it. An affidavit made by a representative of the contractor as to IBM's use of running accounts had been stricken, and the defendants had failed to establish by discovery that IBM had kept such a running account. Without a running account having been established, the defendants were not permitted to question the application of the payments received by the claimant. The court therefore affirmed the summary judgment in favor of IBM. Thus it seems that where there is a question with regard to whether payments have been applied properly the claimant should attach to his complaint a summary invoice rather

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120. See *American Fidelity Co. v. State ex rel. Cobb*, 135 Md. 326, 109 A. 99 (1919). This exception is based on the theory that the surety, which is liable for the payment of labor and material claims incurred on a job, has an equitable right to have the funds derived from that job devoted to the payment of those claims. There is also an exception to this exception. *American Fidelity* involved a claim for money loaned to pay for concrete on a bonded job. A payment was received by the lender, who applied it against other loans made to permit the contractor to pay for items on other jobs for which the defendant was also the surety. The court concluded that since the surety was liable on both jobs, it had no right to complain about a payment being applied against one job rather than the other.

121. *German Lutheran Church v. Heise*, 44 Md. 453, 472 (1876).

122. 220 Md. 248, 151 A.2d 906 (1959).

than a statement of account, and thereby shift the burden of proving by discovery that the claimant kept a running account to the defendant.

### *Joint Checks*

In order to induce a supplier to deal with a subcontractor whose credit is questionable, the general contractor may agree to pay the subcontractor with checks payable to the joint order of the subcontractor and the supplier. The subcontractor usually endorses the checks and gives them to the supplier who takes out the amount due it and pays the balance to the subcontractor. This is the type of arrangement which gave rise to *N.S. Stavrou, Inc. v. Beacon Supply Co.*<sup>123</sup> The case was complicated by the fact that the arrangement involved materials supplied to three separate projects. Each of the checks issued by the general contractor contained a designation of one of the jobs. As each check was received by the supplier, it deducted the balance due on the designated project and paid the remainder of the check to the subcontractor, even though the subcontractor might have owed money to the supplier on one of the other projects. Under this procedure, checks totalling \$19,851 were received from the contractor. From these checks, the supplier took \$4,818.46 and turned over to the subcontractor \$15,032.54, so the subcontractor could pay its employees.

The supplier brought suit under the bond claiming that \$14,059.16 was still due. The contractor and the surety defended, arguing that the job designation marked on each check was merely for internal bookkeeping purposes. They argued that the supplier should have applied the checks to the balance due for materials delivered to any or all of the jobs prior to the time the checks were received. In addition, they asserted that any surplus should have been held by the supplier to be applied to the cost of future materials.

The court rejected these arguments. It said that the contractor was aware of the subcontractor's poor financial condition, and that it must have intended each check to be applied only to payment of the designated project so there would be sufficient money available for the subcontractor to meet its payroll. This conclusion was reinforced by the fact that during the period the joint checks were being issued, the contractor made no direct payments to the subcontractor to enable it to pay its employees. *Dickerson Lumber Co. v. Hersin*,<sup>124</sup> a mechanics'

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123. 249 Md. 451, 240 A.2d 278 (1968).

124. 230 Md. 487, 187 A.2d 689 (1963). Although there was no authority cited as to balances due at the time the joint checks were cashed, the court's conclusion that the

lien case, was cited as authority for the rule that the supplier may not hold funds represented by a check of which he is a joint payee for application to the future costs of materials, and may only apply the proceeds to the extent of the debt then due.

Therefore, where the subcontractor is not financially responsible, and the general contractor enters into an agreement with the supplier to assure payment for the materials purchased by the subcontractor, the claimant must exercise caution in dividing the proceeds of the checks made payable to the joint order of the supplier and the subcontractor. Where the general contractor indicates for which project payment is being made, the general contractor can release to the subcontractor amounts over and above that due the supplier on that particular job. However, where the check does not designate the project for which payment is being made, the supplier might have to withhold from the checks all monies due it on jobs on which the payor of the check is the general contractor. If the supplier has any doubts, he should attempt to get a letter from the general contractor specifying the application of the monies.

### *Set-Offs*

The rule in joint check cases is very similar to the treatment of set-offs in that the surety will not be discharged by the failure of the claimant to exercise a right of set-off against the principal. In *Glens Falls Insurance Co. v. Baltimore County, ex rel. Dyer*,<sup>125</sup> the claimant supplied materials to the principal on various highway jobs, most of which had been bonded by Glens Falls. Because the principal was experiencing financial difficulty, a new arrangement was entered into under which the claimant bid on a number of projects for which it hired the principal as a subcontractor or superintendent. As a result of these subsequent transactions, the claimant owed the principal money which could have been set-off against the claim on this job. Instead, the claimant paid the principal so that the principal could meet its payrolls and other pressing needs. In holding for the claimant, the court said that the surety's right to discharge is limited to those instances where the claimant is bound to hold the principal's property in special trust to pay the particular debt for which the surety is liable. If the claimant holds funds arising out of some other transaction, he may pay the principal and still proceed against the surety. The creditor's right to set-off is one he may or may not use, as he chooses.

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application of the proceeds of a joint check depends upon the intention and understanding of the parties is certainly correct.

125. 230 Md. 524, 187 A.2d 875 (1963).

*Retainages*

Most subcontracts provide for progress payments equal to ninety percent of the value of the work completed. Usually, the unpaid portion (the retainage) is payable after the project is completed and final payment is received by the contractor from the owner. In many instances the final payment from the owner is due only after final acceptance. Since final acceptance may not occur until a year or two after the work is completed, it is not surprising that subcontractors sometimes become impatient about being paid the retainages.

In *Fishman Construction Co. v. Hansen*,<sup>126</sup> a public construction bond case, the plumbing and heating subcontractor brought suit for the retainages about six months after the project was completed, but before final acceptance. In opposition to the plaintiff's motion for summary judgment, the defendants asserted that the plaintiff's suit was premature because his retainage was not due until the contractor had been paid the balance due from the owner; they alleged that final acceptance of the new school had not yet taken place, and the contractor had not yet received final payment from the owner. Although the express language of the subcontract seemed to bar recovery, the Court of Appeals affirmed the summary judgment in favor of the plaintiff. It held that the subcontractual provisions for retainages were designed to postpone payments due a subcontractor who is not at fault for only a reasonable time after completion of the project, and not for such an indefinite time as might preclude the subcontractor from bringing suit on a payment bond. The court cited *Eastern Heavy Constructors, Inc. v. Fox*,<sup>127</sup> a mechanics' lien case, for the proposition that the subcontractor is entitled to be paid its retained percentage even though final payment has not been made by the owner unless there is a dispute between the owner and the general contractor which involves the work or materials supplied by the claimant. Since the defendant did not allege that the plaintiff had not satisfactorily completed his work or that the delay in the final acceptance was caused by defects in the work performed by the plaintiff, the court concluded that there was no basis for denying recovery.<sup>128</sup>

The court's reasoning that indefinite delay might preclude the subcontractor's suit seems misplaced in the *Fishman* case. The opinion

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126. 238 Md. 418, 209 A.2d 605 (1965).

127. 231 Md. 15, 188 A.2d 286 (1963).

128. The opinion also pointed out that the defendant had failed to attach a copy of the contract to the affidavit. However, the balance of the opinion indicates that even if the prime contract had been attached, the plaintiff would have been entitled to a summary judgment.

indicated that final acceptance of the project had not yet taken place. Therefore, the statute of limitations in the bond statute could not have started to run. The reasoning would seem to apply better to the AIA form of private bond which measures the statute of limitations from the date on which the contractor last worked on the project, or the Miller Act where the claimant has only one year from the date on which it supplied the last of its labor or materials to file suit.

*Subsequent Conduct Affecting  
Surety's Liability*

Suit under the bond usually is brought upon the debtor's failure to pay the claimant in accordance with the original terms of sale. However, there are other remedies available to the claimant. If they are resorted to, the surety may resist a subsequent suit under the bond on the ground that it was discharged by the claimant's intervening actions. The Court of Appeals had occasion to discuss a number of these other remedies and their effect on the bond claim in *A/C Electric Co. v. Aetna Insurance Co.*<sup>129</sup>

In that case, after the contractor's check for payment to the subcontractor was dishonored, the claimant notified the owner of its intention to file a mechanics' lien and accepted the contractor's confessed judgment note maturing in sixty days for the amount due the claimant. The note was executed in the name of the contractor company and guaranteed by the individual owner of the company. Contrary to the claimant's understanding, the contractor was a sole proprietorship rather than a corporation, so that the purported guarantee was not a separate undertaking representing collateral security.

The court did not discuss the effect of the mechanics' lien, but since it could not prejudice the surety it would not impair the claim on the bond. Although the issue was not in fact present in the case, the court stated that the taking of collateral security would not have affected the bond claim if the claimant could still have enforced the original undertaking. However, since the note in the instant case amounted to the acceptance of an obligation having a different due date from that created by the extension of credit, in essence it was given and accepted in substitution for, and in satisfaction of, the pre-existing and different obligation.

The surety argued that it had been released because the note extended the time for payment. The court answered that an extension granted without the consent of a compensated surety discharges the

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129. 251 Md. 410, 247 A.2d 708 (1968).

surety only to the extent that it is harmed by the extension. The surety's obligation was said to include an agreement for reasonable extensions, regardless of the original terms of sale. Whether an extension of the terms is reasonable is a question of fact. The surety had been notified that the claimant was going to accept the contractor's note, and had failed to object. The court said that a compensated surety is regarded as an insurer, and by its conduct, may be deemed to have waived a condition in its policy or some irregularity on the part of the insured if no addition in coverage results.

### *Suits by Assignees*

In recent years, the Court of Appeals has not been called upon to consider the right of an assignee to bring suit against the surety. The last case involving an assignee's suit was *London & Lancashire Indemnity Co. v. State ex rel. International Harvester Co.*<sup>130</sup> in which the claim had been assigned by a supplier, and the surety did not question the assignee's standing to sue. Unless the prime contract prohibits such an assignment,<sup>131</sup> there is no reason why a supplier's assignee should not have the right to bring suit.

The situation is different where the plaintiff claims an equitable assignment by virtue of a loan to the general contractor used to pay suppliers. Between 1915 and 1925, the Court of Appeals decided a series of cases concerning lenders to highway contractors. In each case the bond was conditioned upon the payment of persons furnishing material or performing labor in and about the construction of the roadway for which the contractor was liable. Each loan had been used by the contractor to pay suppliers of covered labor or materials.

The first case was *State ex rel. Southern Maryland National Bank v. National Surety Co.*<sup>132</sup> The court said that the liability of the surety was limited by the terms of the bond, and a claim based on a loan to pay for covered items was not within those terms. It pointed out that the loan could have been used by the contractor for any purpose, and concluded with the unfortunate suggestion that had the loan agreement restricted the use of the proceeds to the payment of covered items, the result might have been different. Four years later, in *American Fidelity Co. v. State ex rel. Cobb*,<sup>133</sup> the surety, without

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130. 153 Md. 308, 138 A.2d 231 (1927).

131. However, such a prohibition may be ineffective. See MD. ANN. CODE art. 95B, § 2-210(2) (1964).

132. 126 Md. 290, 94 A. 916 (1915), which was also the first Maryland case of any kind dealing with contractors' payment bonds.

133. 135 Md. 326, 109 A. 99 (1919).

questioning the assignee's standing to sue, defended on the ground that the lender had been repaid enough to satisfy this claim, but had applied the money against other loans made to the contractor. The surety argued that the jury should have been instructed that the lender was obligated to apply the payment against this claim. The court rejected this argument and held for the assignee.

In *New Amsterdam Casualty Co. v. State ex rel. Green*<sup>134</sup> the court decided that it was not bound by the language in *Southern Maryland Bank* nor by its subsequent decision in *American Fidelity*. A loan had been made upon the condition that the contractor use it to pay for covered materials. The surety's demurrer questioned the lender-assignee's right to recover where the bond required the contractor "shall, well and truly pay all and every person furnishing material and performing labor in and about the construction of said roadway." The court said it had never been presented with this question before, and dismissed as dictum the language in the *Southern Maryland Bank* opinion which suggested that the lender might prevail if the loan agreement restricted the use of the money to the payment of covered items.

The issue, the court said, was whether it was necessary for the surety or the supplier to be notified of the loan in order for the assignee to recover. The court concluded that it was and said:

By the method of payment suggested the surety would be deprived of all means of ascertaining the status or condition of the contractor in respect to his paying for labor and material as the work progressed, for if he inquired of the materialmen or laborers, he would be told by them that they had been paid and thus he would be lulled into a position of security, only to find, upon the completion of the work, when told by the various parties from whom money had been borrowed to pay for the labor and material furnished upon the job, that they had not been repaid therefor and that he was liable for all the money so borrowed; and this information would come too late for him to take over the work to protect himself against loss resulting from any inability of the contractors to prosecute it successfully.<sup>135</sup>

In summary, it appears that for a contractor's lender to maintain a successful suit on the bond: the loan must be made on condition that it be used to pay for covered items; the proceeds must be used for that purpose; and the supplier of the covered item or the surety must be informed of the loan and the assignment.

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134. 147 Md. 554, 128 A. 641 (1925).

135. 147 Md. at 565, 128 A. at 645.



*Covered Items*

One of the things the claimant may have to determine at the outset is whether the labor or materials to be supplied are covered by the bond. To do this, the language of the bond, the statute and the contract, where applicable, should be reviewed. When there is no clear requirement that the item be incorporated in the project, it probably will be covered if it was reasonably necessary for the contractor to satisfy his undertaking. Because the courts are usually liberal in their interpretation of the bond's coverage, there is also a chance that language appearing to require incorporation may be held to cover other items essential to the work.<sup>136</sup> The Court of Appeals has considered whether the following items were covered by at least one form of bond.<sup>137</sup>

*Engineering, Surveying, and Architectural Services*

*Peerless Insurance Co. v. Prince George's County ex rel. Ben Dyer Associates, Inc.*<sup>138</sup> held that engineering and surveying work performed on the job site are covered by a statutory payment bond. The opinion stated that: the coverage of a statutory bond is to be liberally construed; services need not be specifically mentioned in the statute if they are indispensable to the prosecution and completion of the project; and while decisions in mechanics' lien cases are not controlling, they are to be looked to because the purpose of the bond is to make up for the fact that liens cannot be filed on a public work. The court pointed to one of its earlier decisions, in which it had held that an architect who furnished plans and supervised construction was entitled to a mechanics' lien.<sup>139</sup> This reference to a mechanics' lien case seems to justify the conclusion that services of this type also will be

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136. The list of items which are not incorporated in a building, but which are specifically said to subject a building to a mechanics' lien is contained in MD. ANN. CODE art. 21, § 9-101 (1972), and currently includes: drilling and installation of wells for the purpose of supplying water; the construction or installation of any swimming pools; the sodding, seeding or planting in or about the premises, of any shrubs, trees, plants, flowers or nursery products of any kind or description; and the grading, filling, landscaping, and paving thereon.

137. There are many items which may or may not be covered by particular forms of payment bonds. The Court of Appeals has been presented with only a few of the possible situations. In instances involving situations not yet considered by the Court of Appeals, out of state cases should be referred to, but cannot be relied upon with certainty.

138. 248 Md. 439, 237 A.2d 15 (1968).

139. *Caton Ridge, Inc. v. Bonnett*, 245 Md. 268, 225 A.2d 853 (1967).

covered by the usual private bond, since its purpose is primarily to spare the owner the inconvenience of having mechanics' liens filed on his project.

### Wooden Concrete Forms and Scaffolding

In *Fidelity & Deposit Co. v. Mattingly Lumber Co.*<sup>140</sup> the payment bond covered materials "installed, erected and incorporated in said structure or work." As restrictive as that language seems, it was held to cover wooden concrete forms and scaffolding. The decisive factor was that the lumber had come into physical contact with the work. Although it did not become a permanent part of the work and was not annihilated in the course of its use, its original form and condition was "practically destroyed." The court even refused to reduce the amount of the judgment by the lumber's salvage value after the job was completed.

### Diverted Materials

There are instances where materials delivered to the job site are diverted to another use. In *Ruberoid Co. v. Glassman Construction Co.*,<sup>141</sup> the Court of Appeals, reversing a judgment, entered judgment against the contractor and its surety for the full price of floor tiles delivered to a school job site, despite the fact that the order was for twice the number of tiles required on the particular job and that the unneeded balance had been diverted to other jobs.<sup>142</sup> The statutory language required protection of persons supplying labor and material "in the prosecution of the work." The bond protected suppliers of material or labor "used or reasonably required for use in the performance of the contract." The court stated that the two phrases "are substantially the same in effect."<sup>143</sup> It held that the prima facie case established by delivery to the job site under a purchase order designating the material for the particular job could be defeated only by a showing of bad faith on the part of the supplier, thus interpreting the statute and the bond in terms of what a supplier might reasonably expect to be covered. It concluded that the double order was not so grossly excessive as to have put the supplier on notice, accepting the supplier's argument that for a school job to require twice the amount of flooring

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140. 176 Md. 217, 4 A.2d 447 (1939).

141. 248 Md. 97, 234 A.2d 875 (1967).

142. Some of the tiles were apparently of a color not specified on the particular job, but this aspect was not discussed by the court.

143. 248 Md. at 105, 234 A.2d at 879.

material as that actually used would not be improbable. It buttressed its holding by pointing out that the general contractor is amply protected by its ability to pick a responsible subcontractor, to prevent an assignment by the subcontractor, to withhold payments until given proof that the suppliers have been paid, and to require a payment bond from the subcontractor.

### Hauling

One of the early bond cases decided by the Court of Appeals involved a claim for hauling sand and gravel from a yard in the District of Columbia to the Montgomery County job site.<sup>144</sup> The trucker had contracted directly with the contractor and had supplied both the vehicles and the drivers. The applicable statute required a bond covering "all just debts for labor and material incurred by the bidder in the construction and improvement of the road contracted for." The bond supplied arguably had a narrower coverage extending only to those furnishing material or performing labor "in and about the construction of said roadway." The court, without mentioning the possible discrepancy between the statute and the bond, held that the claims for the hauling "are within the statute and the bond executed in conformity with the statute."<sup>145</sup> The court rejected the argument that the supplier could not recover because he would not have been entitled to a mechanics' lien. It pointed to several federal cases which had allowed similar claims and which had said that statutory bonds are susceptible to more liberal construction than lien statutes. It also quoted at length from a federal decision which distinguished cases denying recovery for long distance hauling by common carriers.<sup>146</sup>

### Specially Fabricated Materials

A private bond protecting suppliers of "material used or reasonably required for use in the performance of the contract," was held to cover materials specially fabricated but not yet delivered in *Aetna Insurance Co. v. Maryland Cast Stone Co.*<sup>147</sup> In that case, the supplier advised the contractor that the materials were ready and requested delivery instructions. Quoting from section 2-503 of the Uniform

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144. *London & Lancashire Indem. Co. v. Maryland*, 153 Md. 308, 138 A. 231 (1927).

145. 153 Md. at 312, 138 A. at 232.

146. *American Sur. Co. v. Lawrenceville Cement Co.*, 110 F. 717 (C.C.D. Me. 1901). In a later case involving a similar claim for hauling the surety did not even question whether the hauling services were covered by the bond. See *Joseph J. Hock, Inc. v. Baltimore Contractors, Inc.*, 252 Md. 61, 249 A.2d 135 (1969).

147. 254 Md. 109, 253 A.2d 872 (1969).

Commercial Code for the definition of tender of delivery, the court held that the claimant's tender of conforming goods was the equivalent of delivery. The court said it did "not reach the question whether material especially fabricated for a building, but never delivered to the site, is 'furnished' within the meaning of a mechanics' lien statute."<sup>148</sup> A similar question might be raised in a statutory bond case because the statute protects persons "supplying" labor and materials. It seems unfortunate that the court accepted the surety's argument that the general test is delivery and based its decision on the theory that the material had been tendered and that tender was the equivalent of delivery. Equity would seem to require the supplier of specially fabricated items be protected at any stage of production, if the debtor notifies the supplier that it will not accept delivery.

### Rental Equipment

The fair rental value of leased equipment is the only item which is now specifically covered by the Little Miller Act. It was added by amendment in 1970,<sup>149</sup> after the Court of Appeals had held the year before that such rental was not within the statute's general coverage.

On two occasions the Court of Appeals had held that equipment rental was not covered by the statute. In *State ex rel. Gwynns Falls Quarry Co.* and *Maryland v. National Surety Co.*,<sup>150</sup> the court said equipment rental did not constitute material and labor. It could have held against the claimant on the ground that he had dealt with a subcontractor, and the bond promised payment of only those items for which the contractor was liable. The plaintiff's position had been weakened by the fact that it had received sufficient payments from the subcontractor to pay the rental on the bonded job, but had applied the payments to rental owed on an earlier project. In addition, the lease had not restricted the use of the equipment to the bonded job, and the subcontractor was offered an opportunity to purchase the equipment with the rental from the bonded job being applied against the purchase price. The court pointed out that a lessor would not be entitled to a mechanics' lien. It concluded that the equipment (a steam shovel) was merely an implement utilized by the lessee in its work and formed a part of its equipment.

Any doubt that *National Surety* was still the law of Maryland after the adoption of the Little Miller Act was removed by *Williams*

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148. 254 Md. at 119, 253 A.2d at 877.

149. Ch. 275 [1970] Md. Laws 658.

150. 148 Md. 221, 128 A. 916 (1925).

*Construction Co. v. Construction Equipment, Inc.*<sup>151</sup> The court acknowledged that rentals could be recovered under the Miller Act, but said its earlier decision rebutted the presumption that the enactment of the Little Miller Act also adopted the interpretation of the statute by the federal courts. It asserted that there was nothing to indicate that the legislature intended to reverse the *National Surety* case, and to permit recovery would destroy the symmetry which had existed for years between rights under the mechanics' lien law and rights under a public works bond. To date, no cases have been decided involving bonds on private projects, but the reference to symmetry between rights under the mechanics' lien law and public works bonds certainly indicates that there may not be coverage under a private bond unless its language shows a clear intention to provide such coverage.

### *Interest*

The claimant should be certain to ask for interest because on a payment bond claim interest is recoverable as a matter of right.<sup>152</sup> To maximize the amount of interest recoverable, the claimant should make formal demand for payment upon the principal and the surety. If such a demand is refused, interest will be allowed from the date of refusal.<sup>153</sup> Otherwise interest is recoverable only from the date suit is filed.<sup>154</sup>

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151. 253 Md. 60, 251 A.2d 864 (1969).

152. In the first payment bond case where the Court of Appeals considered the question of interest [*Fidelity & Deposit Co. v. Mattingly Lumber Co.*, 176 Md. 217, 4 A.2d 447 (1939)] it said that in claims of this character, interest is allowable in the discretion of the jury or the trial court sitting as a jury. Since that rule has never been specifically reversed, it is not surprising that the court has never referred to the *Mattingly* case in its later cases where the question of interest was discussed. The court has since applied interest as a matter of right in several cases. See *Joseph J. Hock, Inc. v. Baltimore Contractors, Inc.*, 252 Md. 61, 249 A.2d 135 (1969); *R.T. Woodfield, Inc. v. Montgomery County ex rel. International Tel. & Tel. Co.*, 252 Md. 33, 248 A.2d 895 (1969); *Peerless Ins. Co. v. Prince George's County ex rel. Ben Dyer Associates, Inc.*, 248 Md. 439, 237 A.2d 15 (1968); *Mullan Contracting Co. v. International Business Machines Corp.*, 220 Md. 248, 151 A.2d 906 (1959).

153. *Mullan Contracting Co. v. International Business Machines Corp.*, 220 Md. 248, 151 A.2d 906 (1959).

154. See, e.g., *Joseph J. Hock, Inc. v. Baltimore Contractors*, 252 Md. 61, 249 A.2d 135 (1969); *Peerless Ins. Co. v. Prince George's County ex rel. Ben Dyer Associates, Inc.*, 248 Md. 439, 237 A.2d 15 (1968). If the claimant dealt directly with the contractor and the contractor is still in business, the claimant should consider including in his suit a count against the owner on the contract asking for interest from the date on which the amount claimed became due. If the claimant is a supplier and the sale was on a normal 30 day account, the balance was probably due long before demand was made on the surety or suit was filed. The same may be true where the claimant is a subcontractor even if the balance due is a retainage to be paid when

*Waiver of Bond Rights*

A potential claimant may waive his right to recover on the payment bond. The Court of Appeals specifically held to this effect in *N.S. Stavrou, Inc. v. Beacon Supply Co.*<sup>155</sup> in connection with a statutory bond. There, although a joint check system had been arranged for, the supplier had only taken the amount due for the particular project at the time the check arrived. The supplier then sought recovery through the bond for the remainder due. The court agreed that the supplier could still recover under the bond; however, the court said that in return for the joint checks agreement the contractor could have gotten the supplier to execute a waiver of its rights under the bond. In order to successfully assert this defense, the court said, the contractor would have to show by a fair preponderance of the evidence an express or implied waiver on the part of the supplier of its statutory rights under the Little Miller Act. Certainly, if this is true as to a statutory bond, it should be equally applicable to a private bond.

*Suits Outside the Bond*

In suits against the contractor, the one year statute of limitations only applies to actions brought on the bond. If the contractor is still in business and the supplier dealt directly with the contractor, suit may be brought on the open account even though the statute of limitations may have run for suit on the bond.<sup>156</sup>

Where the contractor is out of business and limitations have run on the bond, the supplier must try to develop some other theory if he hopes to recover against the surety. An unsuccessful attempt to develop such a theory was made in *Frisco v. Aetna Insurance Co.*<sup>157</sup> The surety had paid all claimants who had made timely claims. The contractor indemnified the surety by assigning its interest in certain equipment and thereafter went out of business. Almost two years after the final acceptance of the project, a supplier brought suit against the surety, whom it claimed was the successor and assignee of the contractor by reason of having taken over all the equipment and assets of the contractor. The plaintiff asserted that the surety assumed the contractor's debts as a matter of law, and, since the contractor was insolvent when

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the contractor is paid by the owner. See *Atlantic States Constr. Co. v. Drummond & Co.*, 251 Md. 77, 246 A.2d 251 (1968).

155. 249 Md. 451, 240 A.2d 278 (1968).

156. On statutory bonds, attempted suits against the owner have failed. See notes 87-97 *supra* and accompanying text.

157. 235 Md. 472, 201 A.2d 781 (1964).

it gave the surety the interest in the equipment, it gave the surety a preference over other creditors which was a voidable preference<sup>158</sup> and in addition was a violation of the Bulk Sales Act.<sup>159</sup> However, the court rejected the plaintiff's arguments on the ground that neither was raised within the procedure set forth by the respective statutes.

#### CONCLUSION

The contractors' payment bond can be an important protection for suppliers of labor or material on a construction project. The effectiveness of this protection depends upon the diligence of the creditor in complying with the terms of the bond, in the case of a private project, and the statute, in the case of a public project.

A substantial body of case law on contractors' payment bonds has developed. These cases indicate that there are many questions which cannot be answered simply by reading the bond or the statute. In order to perfect a claim under the bond, the supplier must be familiar with the history of the bond statutes and the evolution of the private bond forms.

Construction of public facilities and large private projects continues at a rapid rate. If these bonds are to perform their function effectively in Maryland, several statutory changes should be made:

(1) Article 21, section 9-112 should be amended to require a central depository for all payment bonds on public projects. This change would insure that the proper form of bond was being obtained on all projects and would make it easier for the claimant to obtain a copy.

(2) The statute of limitations in article 21, section 9-112 should be changed to be measured from the date on which the claimant supplied the last of the labor or materials for which he is bringing suit. This would enable the claimant to know the date by which suit must be filed. At present, the statute of limitations is measured from the date of the final acceptance of the project, which is often difficult to determine, and which often requires judicial decisions to settle differing interpretations.

(3) The statute should be amended to remove the apparent inconsistency between subsection 9-112 (a)(2) and subsection 9-112 (c) to make it clear whether suppliers of second tier subcontractors are entitled to recover on the bond. There seems to be no policy

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158. MD. ANN. CODE art. 95B, § 6-101 to -111 (1964).

159. MD. ANN. CODE art. 47, § 15 (1971).

reason why a supplier of a second tier subcontractor should not be protected. However, it is not clear what the Maryland General Assembly contemplated in this area when it passed the Little Miller Act, and since the Miller Act does not cover these parties, if Maryland intends to cover these suppliers, it should make this clearer.

(4) Finally, a statute should be enacted exempting private buildings from mechanics' liens where a payment bond with coverage as broad as that provided by a mechanics' lien has been obtained from a licensed surety and has been filed in a designated public department where it will be available to claimants. It does not seem justified that an owner who pays the additional price for the protection of a bond should still be subjected to the threat of the mechanics' lien.