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The Surety's Liability for "Bad Faith": Claims for Extra-Contractual Damages by an Obligee Under the Payment Bond

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*John J. Aromando**

Go with me to a notary, seal me there
Your single bond, and (in a merry sport)
If you repay me not on such a day
In such a place, such sum or sums as are
Express'd in the condition, let the forfeit
Be nominated for an equal pound
Of your fair flesh, to be cut off and taken
In what part of your body pleaseth me.[1]

I. INTRODUCTION

The theory of "bad faith" is by now well established in the areas of liability and casualty insurance. Although the relief available takes different forms in different jurisdictions, a common thread is the exposure of the insurance carrier to extra-contractual damages as a result of its conduct in handling a claim.

Depending on the jurisdiction, these extra-contractual damages can include one or more of the following: penal interest and attorneys' fees; consequential damages for breach of contract; and recovery in tort. Even in the most restrictive jurisdiction the exposure is substantial, and in the most expansive it can be catastrophic. The impact of such potential liability is not unlike that of a claim for punitive damages, but without the procedural and substantive safeguards[2] in place for exemplary awards.[3] A bad faith claim raises the stakes considerably.

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1. WILLIAM SHAKESPEARE, THE MERCHANT OF VENICE act I, sc. 3, lines 140-47 (Harvard Univ. Press 1955) (7th ed. 1598).

2. For instance, under Maine law, punitive damages may be awarded only for conduct rising to the level of malice, proved by clear and convincing evidence. Tuttle v. Raymond, 494 A.2d 1353, 1360-64 (Me. 1985).

3. Unless, of course, there is a claim for punitive damages in a jurisdiction that allows recovery in tort for bad faith, to which any such available procedural and substantive safeguards would apply.

The purpose of this Article is to examine the exposure of the construction surety to a claimant under a payment bond for extra-contractual damages as a result of "bad faith." Reported decisions involving bad faith claims against sureties, as opposed to liability and casualty insurers, are fewer in number, and are divided as to the surety's liability.

This Article focuses on the law of Maine concerning bad faith, and its applicability to the payment bond surety. It also discusses reported state and federal decisions from other jurisdictions that specifically address the payment bond surety's liability for bad faith. Finally, it considers the impact of the federal Miller Act[4] on such claims, where applicable.

It is the conclusion of this Article that under Maine law, as well as the law of other jurisdictions where analogous, a surety is not liable to a payment bond claimant for extra-contractual damages for bad faith. There are several reasons for this conclusion.

First, there are critical distinctions between this type of suretyship relationship and the relationship between a liability or casualty carrier and its insured, which undercut the usual basis for such liability. Although some courts are giving less import to historical distinctions between suretyship and insurance in general,[5] the distinction between a first-party versus a third-party relationship remains vital in the area of bad faith. The interaction between a surety and a payment bond claimant is closer to a third-party insurance claim, for which under Maine law no bad faith remedy exists.[6]

To conclude otherwise places the payment bond surety in a no-win predicament in the event of competing demands between the bond claimant and the bond principal concerning payment under the bond, a not uncommon situation. It would leave the surety with the difficult if not impossible task of discharging simultaneous obligations of good faith to parties in an adversarial relationship.[7] It would ignore the fact that, at its core, the relationship between the surety and the bond claimant is adversary in nature.

4. 40 U.S.C. §§ 270a-270f (1988).

5. *See infra* notes 56-92 and accompanying text.

6. Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d 1161, 1163-64 (Me. 1977).

7. It would be impossible to conclude that the surety owed a duty of good faith to the payment bond claimant without finding a similar duty to the bond principal, who actually has a first-party contractual relationship with the surety. That relationship usually includes not only the bond, but also an agreement by the principal to indemnify the surety for losses suffered under the bond, the enforcement of which is a matter of obvious concern to the surety in responding to claims by third-party obligees against the bond. That accounts for the Hobson's choice that such competing good faith obligations would create. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. 906, 911 (E.D. Cal. 1991) ("[P]ermitting the subcontractor to sue the surety for bad faith would also create an unresolvable conflict of interest for the surety.").

Second, efforts to establish the surety's bad faith liability to the payment bond claimant under a third-party beneficiary analysis are unpersuasive. Although the obligee is an intended beneficiary of the payment bond,[8] that intent extends only to obligations explicit in the bond, which by definition do not include liability for extra-contractual damages.[9] Under Maine law, except for contracts governed by the Uniform Commercial Code, a direct contractual relationship equivalent to a first-party insurance relationship is necessary to give rise to the implied covenant on which "bad faith" liability is based.[10]

Third, although the Maine Insurance Code[11] includes suretyship and the surety within its definitions of "insurance"[12] and "insurer,"[13] specific statutory remedies available under the Code for late payment[14] and for unfair claims practices[15] are limited by their explicit language to claims arising out of the relationship between an "insured" and "his own insurer." As with the common law remedy, a direct first-party contractual relationship is a prerequisite to recovery.

Finally, on construction projects where the Miller Act applies, that federal statute should preempt any state law claim against the payment bond surety for extra-contractual damages. Although there is a split of authority on that issue nationally, the better reasoned view eschews an approach that subjects the Miller Act surety to a multiplicity of potential exposures under its payment bond, dependent only on in what state the bonded project happens to be located.

II. The Payment Bond Relationship

The payment bond is an instrument where a surety on behalf of its principal, the general contractor or a subcontractor, guarantees the payment of third parties, the obligees, for labor, materials, or equip-

8. Restatement of the Law of Security § 165 (1941).

9. *See infra* note 102 and accompanying text.

10. "[T]here is no general implied duty of good faith under Maine law that operates beyond the scope of the mandate of the Maine U.C.C. and the contractual relationship between an insurer and its insured on a policy of casualty insurance." Renaissance Yacht Co. v. Stenbeck, 818 F. Supp. 407, 412 (D. Me. 1993) (citing Diversified Foods, Inc. v. First Nat'l Bank of Boston, 605 A.2d 609, 613 (Me. 1992) and First NH Banks Granite State v. Scarborough, 615 A.2d 248, 250-51 (Me. 1992)). *Cf.* Top of the Track Ass'n v. Lewiston Raceways, Inc., No. AND-94-431, 1995 WL 87493, at *3 (Me. Feb. 23, 1995) (Maine law does recognize an implied covenant in any first-party contract where "it is absolutely necessary to introduce the term to effectuate the intention of the parties.") (quoting 11 Williston on Contracts § 1295 (1968)).

11. Me. Rev. Stat. Ann. tit. 24-A §§ 1-6226 (West 1990 & Supp. 1994-1995).

12. Me. Rev. Stat. Ann. tit. 24-A, § 3 (West 1990).

13. Me. Rev. Stat. Ann. tit. 24-A, § 4 (West 1990).

14. Me. Rev. Stat. Ann. tit. 24-A, § 2436 (West 1990).

15. Me. Rev. Stat. Ann. tit. 24-A, § 2436-A (West 1990).

ment furnished by them in connection with a particular construction project. In the event such labor, materials, and equipment are paid for in full as contracted, the obligation of the bond becomes void; otherwise, it remains in force and may be sued on directly by those obligees subject to the conditions stated therein.

On projects of a requisite dollar amount where the federal or state government is the owner, the general contractor is required to furnish a payment bond by statute. The federal statute is known as the Miller Act[16] and analogous state laws are referred to as "Little Miller Acts."[17] The purpose of these statutes is to substitute the payment bond's security for the mechanic's lien remedy normally available to contractors and suppliers under state law,[18] because government property is not subject to liens.[19]

Although not required by law, payment bonds are used on private projects as well. The principal furnishes the payment bond in satisfaction of its contract with the owner or general contractor to perform the work or a certain portion of the work. Again, the bond serves as substitute security to help protect the owner's property under construction or improvement, which on a private project is subject to the mechanic's lien remedy.

In the usual arrangement, the surety agrees to furnish the payment bond in exchange for consideration from the principal, and the principal in turn agrees to indemnify the surety from losses under that bond. There is no first-party contractual relationship between the surety and the payment bond's obligees. Usually, the obligees are not named in the bond specifically, but are described generally as those furnishing labor, materials, or equipment to the bond principal or its subcontractors in connection with the project.

The surety's total liability to claimants under the payment bond is limited to the penal sum stated therein.[20] "The obligation is *strictis-*

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16. 40 U.S.C. § 270a (1988).

17. *See, e.g.*, ME. REV. STAT. ANN. tit. 14, § 871 (West 1980 & Supp. 1994-1995) (Maine's Public Works Surety Bond Law of 1971, also known as Maine's "Little Miller Act").

18. In Maine, the mechanic's lien remedy is codified at ME. REV. STAT. ANN. tit. 10, §§ 3251-3264 (West 1980 & Supp. 1994-1995).

19. *See* F. D. Rich Co. v. United States *ex rel.* Indus. Lumber Co., 417 U.S. 116, 122 (1974); United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. 906, 908-09 (E.D. Cal. 1991); *but see* ME. REV. STAT. ANN. tit. 10, § 3251 (West Supp. 1994-1995) (mechanic's lien remedy in Maine is available against "any public building erected or owned by any city, town, school district or other municipal corporation").

20. *See, e.g.*, United States v. Seaboard Sur. Co., 817 F.2d 956, 963 (2d Cir.) ("It is hornbook law that a surety is liable up to, and only up to, the limit on the bond it issued."), *cert. denied*, 484 U.S. 855 (1987); Amfac Mortgage Corp. v. Arizona Mall of Tempe, Inc., 583 F.2d 426, 435 (9th Cir. 1978) (noting the "general rule that the liability of the surety is limited to the express terms of the surety contract"); Bill Curphy Co. v. Elliott, 207 F.2d 103, 106 (5th Cir. 1953) ("[T]he sole object of stating

simi juris; that is, he has consented to be bound only within the express terms of his contract and his liability must be found within that contract or not at all."[21]

III. BAD FAITH LIABILITY UNDER MAINE LAW

The question of a surety's liability for extra-contractual damages for bad faith has yet to be addressed in Maine. Both the Maine Supreme Judicial Court ("the Law Court") and the United States District Court for the District of Maine, however, have addressed in other contexts the scope of bad faith liability under Maine law. In Maine, there is both a common law and a statutory basis for such liability.

A. *Common Law Liability*

The Law Court has held "that in every insurance contract an insurer owes a duty to act in good faith and deal fairly with its insured . . . ."[22] This duty is an implied covenant, which "arises at the time the parties enter into the insurance contract."[23] "[T]he obligation is imposed by the parties themselves and is woven within the fabric of their contractual relationship."[24]

The Law Court has specifically rejected, on the other hand, the proposition that an insurer bears any such good faith obligation toward a third-party claimant under a liability policy.[25] The Law Court has described the relationship between the insurer and the

the penalty in a bond is to fix the limit of the liability of the signers, and no recovery can be had on such bond against the principal or surety beyond the penalty named in the bond."); Maryland Casualty Co. v. Alford, 111 F.2d 388, 390-91 (10th Cir.) ("Under the great weight of authority, a surety's liability is limited by the penal sum named in the bond . . . ."), *cert. denied*, 311 U.S. 668 (1940); Massachusetts Bonding & Ins. Co. v. United States, 97 F.2d 879, 881 (9th Cir. 1938) ("It is fundamental in the law of suretyship that a bondsman cannot be held for any default of his principal in an amount greater than the penal sum of the bond."); Wayne Rosa Const. v. Hugo Key & Son, Inc., 153 F.R.D. 481, 484 (D. Me. 1994) ("Connecticut Indemnity's liability is fixed at the amount of the penal sum in the surety bond."); Pennsylvania Fire Ins. Co. v. American Airlines, Inc., 180 F. Supp. 239, 241 (E.D.N.Y. 1960) ("It is fundamental and long settled that a surety's obligation is limited to the face amount of the bond."); American Sur. Co. of New York v. Lawrenceville Cement Co., 110 F. 717, 725 (C.C.D. Me. 1901) (holding surety liable for interest on claims only up to penal sum of bond).

21. United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 911-12 (quoting Goggin v. Reliance Ins. Co., 19 Cal. Rptr. 446, 448 (Cal. Ct. App. 1962)).

22. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d 644, 648 (Me. 1993).

23. *Id.* at 647-48, 652. *See also* Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163.

24. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 652 (quoting McCullough v. Golden Rule Ins. Co., 789 P.2d 855, 864 (Wyo. 1990) (Golden, J., dissenting)).

25. Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163-64.

third-party claimant as essentially "*adversary* in nature."[26] The implied " 'duty of good faith and fair dealing' in the handling of insurance claims" is limited in its application to the actual parties to the insurance contract.[27]

Beyond the first-party insurance situation, Maine law recognizes an implied covenant of good faith and fair dealing only where required by the Maine Uniform Commercial Code.[28] Maine does not "recognize the existence of such an implied duty as a matter of general applicability" to all contractual relationships, despite the fact that "[s]uch was, and is, the majority rule, and that rule is supported, if not based upon, the adoption of such a duty by both the Uniform Commercial Code and the Restatement (Second) of Contracts § 205 (1979)."[29]

Damages recoverable for breach of the implied covenant of good faith and fair dealing in Maine, where available, are limited to "the traditional remedies for breach of contract."[30] The Law Court has "expressly refuse[d] to recognize an independent tort of bad faith resulting from an insurer's breach of its duty to act in good faith and deal fairly with an insured."[31] Such "traditional" contract remedies include "full general and consequential damages"[32] and can exceed the value of the contract itself[33] by a potentially wide margin.[34]

26. *Id.* at 1163.

27. *Id. See also* Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 648, 652.

28. Renaissance Yacht Co. v. Stenbeck, 818 F. Supp. 407, 412 (D. Me. 1993); People's Heritage Sav. Bank v. Recoll Management, 814 F. Supp. 159, 169 & n.17 (D. Me. 1993); First NH Banks Granite State v. Scarborough, 615 A.2d 248, 250-51 (Me. 1992); Diversified Foods, Inc. v. First Nat'l Bank of Boston, 605 A.2d 609, 613-14 (Me. 1992).

29. Renaissance Yacht Co., Inc. v. Stenbeck, 818 F. Supp. at 411. The Law Court recently held that Maine law does recognize implied covenants in contracts where "not inconsistent with some express term of the contract" and where "absolutely necessary . . . to effectuate the intention of the parties." Top of the Track Ass'n v. Lewiston Raceways, Inc., No. AND-94-431, 1995 WL 87493, at *3 (Me. Feb. 23, 1995). The court explicitly noted, however, that this holding is *not* tantamount to recognition of a general implied duty of good faith and fair dealing in all contracts under Maine law. As stated by the court: "Partly because of the influence of the Uniform Commercial Code, some courts have begun to talk of 'good faith' rather than 'implied covenants.' To date, we have not adopted this approach." *Id.* at *4 n.2.

30. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 652.

31. *Id.*

32. *Id.*

33. The value of the contract being the limit of liability under an insurance policy, or the penal sum in the event of a bond.

34. In the *Marquis* case, the plaintiffs brought suit against Farm Family for its failure to pay under two policies with total combined limits of liability of $77,000 and obtained a judgment for $680,000, which included consequential damages for lost profits of $610,629. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 646-47, 650-51.

B. *Statutory Liability*

The Maine Insurance Code[35] contains two provisions, sections 2436 and 2436-A, that create a private cause of action against an "insurer" for extra-contractual damages arising out of the insurer's conduct in handling a claim. Both permit the recovery of attorneys' fees and interest at eighteen percent per annum. Because these statutes are penal in nature, they are strictly construed.[36]

1. *Maine Insurance Code Section 2436*

Section 2436 deals with late payment of claims.[37] It provides a thirty-day window for response to "[a] claim for payment of benefits under a policy of insurance against loss delivered or issued for delivery within this State."[38] The statute provides an exception if, during the original thirty days, the insurer notifies the insured in writing that "reasonable additional information is required," in which case

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35. ME. REV. STAT. ANN. tit. 24-A §§ 1-6226 (West 1990 & Supp. 1994-1995).

36. Seabury Hous. Assocs. v. Home Ins. Co., 695 F. Supp. 1244, 1248 & n.6 (D. Me. 1988) (citing Depositors Trust Co. v. Farm Family Life Ins. Co., 445 A.2d 1014 (Me. 1982)); Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 651-52; Burne v. John Hancock Mut. Life Ins. Co., 403 A.2d 775, 777 (Me. 1979).

37.

> Late Payment
>
> 1. A claim for payment of benefits under a policy of insurance against loss delivered or issued for delivery within this State is payable within 30 days after proof of loss is received by the insurer and ascertainment of the loss is made either by written agreement between the insurer and the insured or by filing with the insured of an award by arbitrators as provided for in the policy, and a claim which is neither disputed nor paid within 30 days is overdue, provided that if during the 30 days the insurer, in writing, notifies the insured that reasonable additional information is required, the undisputed claim shall not be overdue until 30 days following receipt by the insurer of the additional required information; except that the time period applicable to a standard fire policy and to that portion of a policy providing a combination of coverages, as described in section 3003, insuring against the peril of fire shall be 60 days, as provided in section 3002.
>
> 2. An insurer may dispute a claim by furnishing to the insured, or his representative, a written statement that the claim is disputed with a statement of the grounds upon which it is disputed.
>
> 3. If an insurer fails to pay an undisputed claim or any undisputed part of the claim when due, the amount of the overdue claim or part of the claim shall bear interest at the rate of 1½% per month after the due date.
>
> 4. A reasonable attorneys fee for advising and representing a claimant on an overdue claim or action for an overdue claim shall be paid by the insurer if overdue benefits are recovered in an action against the insurer or if overdue benefits are paid after receipt of notice of the attorney's representation.
>
> 5. Nothing in this section prohibits or limits any claim or action for a claim which the claimant has against the insurer.

ME. REV. STAT. ANN. tit. 24-A, § 2436 (West 1990).

38. ME. REV. STAT. ANN. tit. 24-A, § 2436(1) (West 1990). Sixty days are allowed for a response to a claim under a fire policy. *Id.*

the thirty-day period to pay or dispute the claim is tolled until receipt by the insurer of the additional required information.[39]

If the insurer fails to pay an undisputed claim or any undisputed part of a claim when due under section 2436, the statute provides for recovery of interest on the overdue amount at 1½% per month plus a reasonable attorneys' fee in the event the claimant prevails.[40]

Section 2436 does not require "good faith" *per se*, and the Law Court has "decline[d] to imply such a condition."[41] The insurer is not liable for interest and attorneys' fees under this statute so long as it "technically complie[s]" with its deadlines.[42]

The explicit language of section 2436 makes it clear that this remedy is available to an "insured" only for late payment of a first-party claim presented to its own insurer. The Statement of Fact for the original version of section 2436, enacted in 1973,[43] provided that "[t]he purpose of the new draft is to limit the bill to claims for first-party coverage."[44] Although the language of the statute was repealed and replaced in 1977,[45] the Law Court has held that those amendments did not change "that basic limitation," and that the current version of section 2436 therefore applies to first-party casualty insurance only, and not, for instance, to a claim by a third-party beneficiary under a life insurance policy.[46]

2. *Maine Insurance Code Section 2436-A*

Section 2436-A deals with unfair claim practices.[47] It sets forth "four separate bases for an award of statutory interest and attorneys

39. *Id.*
40. ME. REV. STAT. ANN. tit. 24-A, § 2436(3)-2436(4) (West 1990).
41. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 651.
42. *Id.*
43. P.L. 1973, ch. 480.
44. Depositors Trust Co. v. Farm Family Life Ins. Co., 445 A.2d at 1018.
45. P.L. 1977, ch. 357.
46. Depositors Trust Co. v. Farm Family Life Ins. Co., 445 A.2d at 1017-18 & n.4. Section 2436 was amended again in 1987, P.L. 1987, ch. 344, however less extensively, and not in a manner that would extend its application beyond first-part casualty insurance claims.
47.

Unfair Claims Practices

1. Civil Actions. Any person injured by any of the following actions taken by his own insurer may bring a civil action and recover damages, together with costs and disbursements, reasonable attorneys fees and interest on damages at the rate of 1½% per month:

A. Knowingly misrepresenting to an insured pertinent facts of the policy provisions relating to coverage at issue;

B. Failing to acknowledge and review claims, which may include payment or denial of a claim, within a reasonable time following receipt of written notice by the insurer of a claim by an insured arising under a policy;

fees."[48] The plaintiff must "allege and prove a specific violation" of one of those four bases in order to recover.[49]

Section 2436-A "reflect[s] a legislative intent that bad faith insurance claims be addressed and remedied within statutory guidelines."[50] "Allowing, in addition [to sections 2436 and 2436-A], an independent tort action in cases such as this 'might well thwart the legislature's intent to craft a comprehensive insurance code, and could subject insurance companies to multiple and inconsistent liability.' "[51]

A cause of action under section 2436-A will lie only by an "insured" against "his own insurer."[52] The statute explicitly excludes health, life, and workers' compensation insurance.[53] It is therefore clear that Section 2436-A applies only to first-party casualty insurance.[54]

IV. Decisions on the Liability of the Surety to the Payment Bond Claimant for Extra-Contractual Damages for Bad Faith

Both the Law Court and the United States District Court for the District of Maine have yet to confront in a reported decision the question of the surety's liability to a payment bond claimant for extra-contractual damages. There have been a number of recent reported cases on this issue in other jurisdictions, however.[55] These authorities are split as to the surety's liability. Although it is difficult to ascertain any clear trend nationwide, decisions finding that the surety may be liable for such extra-contractual damages are clearly more than an aberrant minority.

C. Threatening to appeal from an arbitration award in favor of an insured for the sole purpose of compelling the insured to accept a settlement less than the arbitration award; or

D. Failing to affirm coverage, reserving any appropriate defenses, or deny coverage within a reasonable time after completed proof of loss forms have been received by the insurer.

2. Application. This section does not apply to health or life insurance or workers' compensation claims.

ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1990).

48. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 651-52.

49. *Id.*

50. Seabury Hous. Assocs. v. Home Ins. Co., 695 F. Supp. at 1249.

51. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 652 (quoting Seabury Hous. Assocs. v. Home Ins. Co., 695 F. Supp. at 1249).

52. ME. REV. STAT. ANN. tit. 24-A, § 2436-A(1) (West 1990).

53. ME. REV. STAT. ANN. tit. 24-A, § 2436-A(2) (West 1990).

54. *See* Depositors Trust Co. v. Farm Family Life Ins. Co., 445 A.2d at 1017-18 & n.4; Seabury Hous. Assocs. v. Home Ins. Co., 695 F. Supp. at 1249.

55. *See* Bernard L. Balkin & Keith Witten, *Current Developments in Bad Faith Litigation Involving the Performance and Payment Bond Surety*, 28 TORT & INS. L.J. 611 (1993).

In order to divine the likely determination of this issue under Maine law, it is useful to examine the grounds for these decisions from other jurisdictions, and to compare their rationale to existing Maine law in the area of "bad faith" in general.

A. The Surety as Insurer

Suretyship is not insurance.[56] The contrary conclusion, however, provides the cornerstone for decisions that recognize the exposure of the surety to the payment bond claimant for extra-contractual damages for bad faith.

The erosion of the relevance of the distinctions between suretyship and insurance can be traced in part to the 1984 decision of the Ohio Supreme Court in *Suver v. Personal Service Insurance Co.*[57] *Suver* involved not a payment bond claim, but a claim by an injured third-party motorist against the surety on a financial responsibility bond for "the malicious and willful failure to pay the amount of the bond."[58]

The court in *Suver* began its discussion of the legal issue with the following acknowledgment: "It is true that a financial responsibility bond is not the same as an insurance policy and that a surety is not an insurer *and may therefore act in its own interest.*"[59] From that venerable truism, however, the court, without citation to authority, leapt to the following conclusion: "These differences are not so pronounced as to require the creation of a cause of action in one case and its denial in the other."[60]

The *Suver* court held, therefore, that under the common law of Ohio, the surety on a financial responsibility bond is liable in tort, including punitive damages, if "guilty of actual malice, fraud or oppression," for breach of the "duty to act in good faith in the handling and payment of claims by one who may be injured by the principal."[61]

The *Suver* case has been cited in other jurisdictions to support the same treatment of the construction surety.[62] As formulated by the

56. For a discussion of distinctions between suretyship and insurance in the context of "bad faith," see B. C. Hart, *Bad Faith Litigation Against Sureties*, 24 TORT & INS. L.J. 18 (1988).

57. 462 N.E.2d 415 (Ohio 1984).

58. *Id.* at 416.

59. *Id.* at 417 (citations omitted) (emphasis added).

60. *Id.*

61. *Id.*

62. *See* Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d 1240, 1243 (Ariz. 1989); Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d 622, 627 n.8 (Alaska 1990). Although the holdings of both of these cases are limited to a claim by an obligee under a performance bond, both courts in dictum indicated that they would reach the same result with respect to the claim of an obligee under a payment bond. Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1243

Supreme Court of Arizona in *Dodge v. Fidelity & Deposit Co. of Maryland*, the issue can be reduced to the following "simple" calculus:

> Plaintiffs' position is simple: sureties are insurers; insurers are subject to bad faith tort liability; therefore, sureties are subject to bad faith tort liability. The court of appeals rejected this syllogism as "too simplistic." Although simple, this proposition is supported by our statutes, case law and sound policy reasons.[63]

Dodge made explicit reference to *Suver* as a case where "[s]imilar policy considerations were determinative."[64]

Closer examination does not bear this similarity out, however. Even if one accepts the logic of the *Suver* decision in the area of the financial responsibility bond,[65] its rationale is not so readily transferable to the construction surety.

Although it cited no legal authority for its dismissal of the historical distinctions between liability insurance and suretyship in the area of the financial responsibility bond, the *Suver* court did state three "policy arguments" it found to be "[p]recisely the same . . . in both settings."[66]

First, "[i]n both cases there is a great disparity of financial resources."[67] The obligee of the financial responsibility bond is an injured motorist, an individual comparable in means to a first-party consumer of personal liability or casualty insurance.[68] The obligee

("The same is true with construction performance bonds and other types of surety insurance."); Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 626 ("We conclude that an implied covenant of good faith and fair dealing exists between a surety and its obligee on payment and performance bonds.").

For more recent decisions adhering to the traditional distinctions between suretyship and insurance, however, see United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. 906, 913 (E.D. Cal. 1991), and Blakeslee Arpaia Chapman, Inc. v. United States Fidelity & Guar. Co., No. 520348, 1994 WL 76383, slip op. at *7 (Conn. Super. Ct. Mar. 4, 1994).

63. Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1241 (citation omitted).

64. *Id.* at 1243.

65. Such acceptance is by no means a foregone conclusion. *See infra* notes 71, 75-83 and accompanying text.

66. Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 417.

67. *Id.*

68. The better analogy is between the obligee under the financial responsibility bond and the third-party tort claimant under the automobile liability insurance policy. The distinction between first-party and third-party claimants, although overlooked by the *Suver* majority, is critical to liability for bad faith. *Id.* at 418 (Holmes, J., dissenting); Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d 1161, 1163-64 (Me. 1977). In the case of a personal automobile liability policy, however, it is fair to say that, for both the first-party and the third-party claimant, there is likely to be a "great disparity of financial resources" as compared to the insurance carrier.

on a payment bond, on the other hand, is usually a commercial entity with resources more comparable to that of the surety.[69]

Second, the *Suver* court found that "issuers of financial responsibility bonds are companies clearly affected with a public interest."[70] That public interest is "the protection of the motoring public."[71] There is no comparable "public interest" with respect to a payment bond.

Although required by statute in some instances,[72] the purpose of the payment bond is simply to serve as substitute security for the mechanic's lien.[73] The aggrieved subcontractor or supplier has no bad faith remedy for non-payment of its claim under the mechanic's lien statute.[74] Exposure of the surety to extra-contractual damages is therefore unnecessary to accomplish the goal of giving the payment bond claimant similar substitute security.

Finally, the *Suver* court found a bad faith cause of action in tort against the financial responsibility bond surety is necessary to discourage "the routine denial of payment of claims for as long as possible."[75] To the extent such a premise is accepted, it would apply equally to the payment bond surety. The experience in California,

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69. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 913 ("Here we deal with commercial entities fully prepared to protect their own interests."); F. D. Rich Co. v. United States *ex rel.* Indus. Lumber Co., 417 U.S. 116, 130 (1974) ("Miller Act suits are plain and simple commercial litigation.").

Interestingly, in Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d 1240 (Ariz. 1989), a leading case finding the construction surety liable for bad faith, the plaintiffs, obligees under a performance bond, were residential homeowners rather than a commercial enterprise. *Id.* at 1241. The *Dodge* court found that "[t]he purpose of the construction performance bond required by plaintiffs' contract with [the general contractor] was not for plaintiffs' commercial advantage, but to protect plaintiffs from calamity—[the contractor's] default on the contract." *Id.* at 1242. At least one court has described both the *Dodge* and the *Suver* cases as decisions "adher[ing] to the distinction between commercial and non-commercial entities." United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 913 n.7.

70. Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 417.

71. *Id.* Maine's Financial Responsibility Law requires every operator or owner of a motor vehicle in the State of Maine to maintain a minimum of $20,000/$40,000 of liability coverage for the protection of the motoring public. ME. REV. STAT. ANN. tit. 29-A, §§ 1601-1612 (West Supp. 1994-1995) (formerly ME. REV. STAT. ANN. tit. 29, §§ 780-A to 791). In contrast to the reasoning of the *Suver* court, Maine's statutory requirement has not given rise to a duty of good faith toward its public beneficiaries, third-party tort claimants. *See* Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 647-48, 652; Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163-64.

72. *See supra* notes 16-17 and *infra* notes 103-04 and accompanying text.

73. *See supra* note 19 and accompanying text.

74. *See* ME. REV. STAT. ANN. tit. 10, § 3251 (West Supp. 1994-1995) ("Whoever performs labor or furnishes labor or materials . . . used in erecting, altering, moving or repairing a house, building or appurtenances . . . by virtue of a contract with or by consent of the owner, has a lien thereon and on the land on which it stands . . . *to secure payment thereof, with costs.*") (emphasis added).

75. Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 417.

however, where the Supreme Court in the 1979 decision of *Royal Globe Insurance Co. v. Superior Court*[76] pioneered the extension of the bad faith remedy "to those not in privity of contract with the insurer,"[77] suggests an abundance of caution before such a premise is accepted.

The California Supreme Court overruled *Royal Globe* nine years later in the 1988 case of *Moradi-Shalal v. Fireman's Fund Insurance Cos.*[78] Any concerns about "disparity of financial resources" and "the routine denial of payment of claims for as long as possible"[79] were outweighed by a new set of greater problems created by the remedy itself. The *Moradi-Shalal* court found that its earlier holding in *Royal Globe*, extending a cause of action for bad faith to third-party claimants, had the following adverse effects: (1) it "promot[ed] multiple litigation"; (2) it "tend[ed] to encourage unwarranted settlement demands by claimants, and to coerce inflated settlements by insurers"; and (3) it created a potentially irreconcilable conflict for the insurer, which "must not only protect the interests of its insured, but also must safeguard its own interests from the adverse claims of the third party claimant."[80] These concerns expressed in *Moradi-Shalal* apply with equal if not greater force to payment bond claims.[81]

In summary, of the three "policy arguments" cited by the *Suver* court in support of its analogy between surety and insurer, two are not transferable to the payment bond context and the third is dubious in its premise even in the insurance area where third-party claimants are concerned. Suretyship is not insurance.[82] More to the point, the payment bond obligee is not a first-party insured.[83]

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76. 592 P.2d 329 (Cal. 1979).

77. United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 910.

78. 758 P.2d 58 (Cal. 1988).

79. Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 417.

80. Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d at 66-67.

81. United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 910-11.

82. *See id.* at 913 ("Yet although suretyship is sometimes treated as a form of insurance, courts and commentators recognize that suretyship is different from liability insurance and has a distinct legal history.") (citations omitted); Blakeslee Arpaia Chapman, Inc. v. United States Fidelity & Guar. Co., No. 520348, 1994 WL 76383, at *7 (Conn. Super. Ct. Mar. 4, 1994) ("A payment bond . . . does not fit within the definition of 'insurance,' nor does it constitute a contract or policy of insurance.").

83. A majority of the Ohio Supreme Court in Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 416-17, as well as the Supreme Courts of Arizona and Alaska in Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1242-43, and Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 626-28, all made the leap from a prior decision finding a duty of good faith owed by an insurer *to its own first-party insured* to the same conclusion about a surety and the bond obligee, without any substantive consideration of "whether the [obligee] should be viewed as

B. State Insurance Codes

Some courts have found firmer footing for the analogy of suretyship to insurance in the insurance codes enacted by their state legislatures. These decisions rely on the inclusion of sureties and suretyship within statutory definitions of insurer and insurance.[84] As stated by the California Court of Appeal in *General Insurance Co. of America v. Mammoth Vista Owners Ass'n*:

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a first party or third party claimant." United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 913. The *Moose Lodge* court made this leap in the face of its own prior decision just two years earlier "declin[ing] to recognize a common-law tort duty of good faith and fair dealing running from an insurer to an injured claimant absent a contractual relationship." Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 627 n.7.

As stated on behalf of the two judges dissenting in *Suver*:

> [T]he imposition of the duty of good faith upon the insurer [is] justified because of the relationship between the insurer and the insured. There [is] obviously privity of contract and consideration flowing from both sides. In my view, the contractual relationship between the parties [is] vital in establishing the duty on the insurer to act in good faith. I fail to see any relationship between the parties herein [surety and obligee] which was so vital to [*Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315 (Ohio 1983) (establishing under Ohio law an insurer's "duty to act in good faith in payment of the claims of its insured.")].

Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 418 (Holmes, J., dissenting). *See also* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 912 ("[T]he California courts repeatedly have stressed that the covenant of good faith and fair dealing arises from a contractual relationship and is limited to the parties in that relationship."). The *Ehmcke Sheet Metal* court also distinguished decisions involving life insurance on the basis that "[t]hose cases simply do not discuss whether the beneficiary should be viewed as a first party or third party claimant." *Id.* at 913.

84. *See* Farmer's Union Cent. Exch. Inc. v. Reliance Ins. Co., 626 F. Supp. 583, 590 (D.N.D. 1985); Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1241-42; K-W Indus. v. National Sur. Corp., 754 P.2d 502, 504-05 (Mont. 1988); Szarkowski v. Reliance Ins. Co., 404 N.W.2d 502, 504-05 (N.D. 1987); General Ins. Co. of America v. Mammoth Vista Owners Ass'n, 220 Cal. Rptr. 291, 297-99 (Cal. Ct. App. 1985); *cf.* Blakeslee Arpaia Chapman, Inc. v. United States Fidelity & Guar. Co., No. 520348, 1994 WL 76383, at *7 (Conn. Super. Ct. Mar. 4, 1994) ("A payment bond . . . does not fit within the definition of 'insurance,' nor does it constitute a contract or policy of insurance" under Connecticut's Unfair Insurance Practices Act.").

The California Court of Appeal in *Mammoth Vista* held that "an obligee under a surety bond may bring an action against its surety for engaging in unfair claims settlement practices in violation of [the California] Insurance Code section 790.03, subdivision (h)" because section 790.03(h) "is merely a codification of the tort of breach of the implied covenant of good faith and fair dealing as applied to insurance," which "extends the cause of action to third party claimants." General Ins. Co. of America v. Mammoth Vista Owners Ass'n, 220 Cal. Rptr. at 296-97, 300 (citing Royal Globe Ins. Co. v. Superior Court, 592 P.2d 329 (Cal. 1979)). In light of the California Supreme Court's holding in Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58 (Cal. 1988), overruling *Royal Globe*, the continuing viability of the holding of *Mammoth Vista* is doubtful. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 908 & n.3, 910-13.

> We recognize liability insurance is not identical in every respect with suretyship. But we are not concerned with the differences between suretyship and liability insurance. We are concerned with whether the Legislature included suretyship among the classes of businesses it intended to regulate under the Insurance Code. It clearly did so.[85]

It is within the purview of the legislative process to regulate suretyship and, assuming a rational basis, even to alter the import of the historical differences between suretyship and insurance.

The logic of these decisions breaks down, however, when the courts start mixing pieces of the comprehensive statutory schemes of their state insurance codes with the common law. Rather than judging the surety's exposure as an "insurer" under the express provisions of the code,[86] these cases simply use the statutory definition of surety as "insurer" as a jumping off point to clear the hurdle to common law bad faith liability otherwise imposed by the historical distinctions between suretyship and insurance.

The approach of the Montana Supreme Court in *K-W Industries v. National Surety Corp.*[87] is illustrative. In that case, the court began its discussion of the legal issue by noting that the surety National "concedes in brief [sic] that if this Court refers only to the statutes for determining whether National is an insurer under Montana law, there is little doubt that National surely would be designated as an insurer."[88] From that point of departure, the *K-W Industries* court reached the following destination:

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85. General Ins. Co. of America v. Mammoth Vista Owners Ass'n, 220 Cal. Rptr. at 298 (footnotes omitted). This language from *Mammoth Vista* has been either quoted or cited with approval by the Supreme Courts of Arizona, Montana, and North Dakota in Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1242, K-W Indus. v. National Sur. Corp., 754 P.2d at 504, and Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 504.

86. Some decisions refer to the issue as whether a private cause of action is "implied" by the statute. *See, e.g.*, United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 909 n.3 ("The court in [*Mammoth Vista*] based its holding solely upon an implied private cause of action found in Cal.Ins.Code 790.03 . . . ."); Farmer's Union Cent. Exch. Inc. v. Reliance Ins. Co., 626 F. Supp. at 590 ("Chapter 26.1-04 [of the North Dakota Insurance Code] does not, by its express terms, recognize a duty giving rise to an action for damages to one who is injured by an insurer's unfair claim settlement practices.").

87. 754 P.2d 502 (Mont. 1988).

88. *Id.* at 504 (citing MONT. CODE ANN. § 33-1-201(6) (1993) (which defines an 'insurer' as including every person engaged as an indemnitor, surety, or contractor in the business of entering into contracts of insurance"); MONT. CODE ANN. § 33-1-201(5) (1993) (which "defines 'insurance' as a contract whereby one undertakes to indemnify another or to pay or provide a specified or determinable amount or benefit upon determinable contingencies"); and MONT. CODE ANN. § 33-1-211 (1993) (which "defines 'surety insurance' as including insurance guaranteeing the performance of contracts, other than insurance policies, and guaranteeing and executing bonds, undertakings, and contracts of suretyship.")).

> Once we determine that an insurer issuing a surety bond is transacting the business of insurance in Montana, the remainder of our decision in this cause is predictable. Every insurer in Montana has an implied-in-law duty to act fairly and in good faith in handling a claim under a contract issued by the insurer. . . .
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> . . . .
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> It follows therefore that if a surety, transacting the business of insurance, violates the provisions of § 33-18-201, MCA, the claimant, in addition to his or her contract remedies, may be compensated under tort law.[89]

The Supreme Courts of Arizona and North Dakota have adopted a similar approach.[90]

Such an apples and oranges approach, mixing bits and pieces of the insurance code with the common law, exceeds the proper role of the judiciary. To the extent the legislature has defined suretyship as insurance for purposes of the code, the ramifications of that choice, including any expansion of the surety's traditional common law liability, should be limited to the express provisions of that code.[91] "Allowing, in addition, an independent tort action . . . 'might well thwart the legislature's intent to craft a comprehensive insurance code, and could subject [sureties] to multiple and inconsistent liability.' "[92]

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89. *Id.* at 505 (citing Klaudt v. Flink, 658 P.2d 1065 (Mont. 1983)). It is noteworthy that, under Montana law, "breach of the applicable provisions of [the insurance code], § 33-18-201, MCA, by an insurer is conduct compensable in tort *as to third parties to the insurance contract.*" *Id.* (emphasis added) (citing Klaudt v. Flink, 658 P.2d 1065 (Mont. 1983)). That holding sets Montana apart from jurisdictions that recognize an insurer's duty of good faith only to its first-party insured and not to third-party claimants. The *K-W Industries* court expressly relied on that Montana precedent concerning third-party claims in finding a duty of good faith by the surety to the payment bond obligee. *Id.*

90. *See* Dodge v. Fidelity & Deposit Co. of Maryland, 778 P.2d at 1241-44; Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 504-05.

91. There are reasons for including sureties as "insurers" regulated under the state insurance code other than to expand their potential liability in private civil actions. *See* ME. REV. STAT. ANN. tit. 24-A, §§ 3101-3105 (West 1990 & Supp. 1994-1995) (specifically regulating "surety insurance contracts"). It should be the legislature that decides the scope and effect of its decision to subject sureties to such regulation.

92. Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 652 (quoting Seabury Hous. Assocs. v. Home Ins. Co., 695 F. Supp. at 1249). *See also* Tudor Dev. Group, Inc. v. United States Fidelity & Guar. Co., 692 F. Supp. 461, 465-66 (M.D. Pa. 1988) (no cause of action under Pennsylvania law for breach of the implied duty of good faith and fair dealing against surety where Pennsylvania Insurance Code "provided an adequate deterrence against bad faith conduct . . ."); United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 910-11 (citing Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58 (Cal. 1988) (where there is a "regulatory scheme" already in place, "no additional private remedy [is] required")).

C. Third-Party Beneficiary Analysis

At least two of the courts imposing on the surety a duty of good faith to the payment bond claimant, the Supreme Court of Alaska in *Loyal Order of Moose, Lodge 1392 v. International Fidelity Insurance Co.*,[93] and the Supreme Court of North Dakota in *Szarkowski v. Reliance Insurance Co.*,[94] have attempted to address the lack of privity between the surety and the obligee.[95] Their answer: the obligee's status as a third-party beneficiary of the bond.[96] These courts found the obligee's third-party beneficiary relationship with the surety "substantially identical" to the first-party insurance relationships giving rise to a duty of good faith in the areas of liability and casualty insurance under their prior decisions.[97]

The obligee has long been recognized as an intended beneficiary of the surety's bond.[98] It is without question, however, a third-party and not a first-party relationship.[99]

The conclusion by the *Szarkowski* and *Moose Lodge* courts that this relationship is "substantially identical" to a first-party insurance relationship is in both cases baldly stated, and in fact does great violence to the true nature of suretyship. Judicial opinions giving the issue more careful consideration have reached the opposite conclusion.[100]

The fact remains that there is no contract of any nature between the surety and the payment bond obligee. The foundation from which the covenant of good faith and fair dealing is implied is therefore absent.[101]

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93. 797 P.2d 622 (Alaska 1990).

94. 404 N.W.2d 502 (N.D. 1987).

95. Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 628; Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 505-06.

96. Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 628; Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 505-06.

97. Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 628 ("In our view the relationship of a surety to its obligee—an intended creditor third-party beneficiary—is more analogous to that of an insurer to its insured than to the relationship between an insurer and an incidental third-party beneficiary."); Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 505 ("As an intended claimant [the obligee] stands in a substantially identical relationship with [the surety] as did the insured claimants with the insurers in [our prior decisions].").

98. *See* Restatement of the Law of Security § 165 (1941).

99. *Id.* *See also* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 913.

100. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 913; Blakeslee Arpaia Chapman, Inc. v. United States Fidelity & Guar. Co., No. 520348, 1994 WL 76383, at *7 (Conn. Super. Ct. Mar. 4, 1994); Suver v. Personal Serv. Ins. Co., 462 N.E.2d at 418 (Holmes, J., dissenting).

101. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 912 ("[T]he California courts repeatedly have stressed that the covenant of good faith and fair dealing arises from a contractual relationship and is limited to the parties in that relationship."); Suver v. Personal Serv. Ins. Co., 462 N.E.2d

Finally, by definition, a third-party beneficiary may profit only to the extent there is a "clear and definite" expression of intent to that effect in the contract or the circumstances under which it was executed.[102] Such a party therefore cannot claim the benefit of any implied covenant.

D. *Miller Act Preemption*

Under the Miller Act:[103]

> Before any contract, exceeding $25,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States . . . a payment bond . . . for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person.[104]

"The rights afforded by the Act are limited . . . by the proviso of § 270b(a),"[105] which provides only that the payment bond obligee:

> shall have the right to sue on such payment bond for the amount, or the balance thereof, unpaid [for labor or material furnished by him in the prosecution of the work] at the time of institution of such suit and to prosecute said action to final execution and judgment for the sum or sums justly due him . . . .[106]

The few courts that have explicitly considered whether the Miller Act preempts state law claims for bad faith against the surety have split on this issue.

In *K-W Industries v. National Surety Corp.*,[107] the Ninth Circuit held that the Miller Act does not preempt independent claims "aris-

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at 418 (Holmes, J., dissenting) ("[T]he contractual relationship between the parties [is] vital in establishing the duty on the insurer to act in good faith."). *See also* Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163 (Me. 1977) ("A 'duty of good faith and fair dealing' in the handling of claims runs only to an insurance company's insured," and "it derives from a covenant implicit in the provisions of the insurance contract . . . .") (citations omitted); Marquis v. Farm Family Mut. Ins. Co., 628 A.2d at 648 ("The duty to act in good faith arises at the time the parties enter into the insurance contract . . . .").

It was on this point that the California Supreme Court overruled the seminal decision of Royal Globe Ins. Co. v. Superior Court, 592 P.2d 329 (Cal. 1979) in Moradi-Shalal v. Fireman's Fund Ins. Cos., 758 P.2d 58 (Cal. 1988), based on nine years of adverse consequences from extending the duty of good faith to third-party claimants as analogous to the first-party insurance relationship. *See generally* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 910.

102. F.O. Bailey Co. v. Ledgewood, Inc., 603 A.2d 466, 468 (Me. 1992).

103. 40 U.S.C. §§ 270a-270f (1988).

104. *Id.* § 270a(a)(2).

105. F. D. Rich Co. v. United States *ex rel.* Indus. Lumber Co., 417 U.S. 116, 122 (1974).

106. 40 U.S.C. § 270b(a) (1988).

107. 855 F.2d 640 (9th Cir. 1988).

ing" under state law, such as the tort claim before it for bad faith under the Montana unfair insurance practices law.[108] The *K-W Industries* court noted that the case before it was "in federal court solely on the basis of diversity jurisdiction," and not under "the Miller Act or any other federal statute."[109] The court concluded that "the Congressional purpose of protecting suppliers of goods and services for federal projects is advanced if sureties are deterred by state tort law from bad faith practices in responding to claims on Miller Act payment bonds."[110]

Opposite *K-W Industries* is the subsequent decision of the Western District of Louisiana in *United States ex rel. Pensacola Construction Co. v. St. Paul Fire and Marine Insurance Co.*[111] Citing the United States Supreme Court decision in *F. D. Rich Co. v. United States ex rel. Industrial Lumber Co.*[112] and its progeny, including the Ninth Circuit decision of *United States ex rel. Aurora Painting, Inc. v. Fireman's Fund Insurance Co.*,[113] the *Pensacola* court flatly stated: "The *K-W* court is wrong in its interpretation of the Miller Act—both as to its purpose and as to its pre-emptive sweep."[114] The court noted that the Miller Act was "designed to protect the surety" as well as the payment bond obligees.[115] The *Pensacola* court concluded: "It would be illogical for Congress to give exclusive jurisdiction over the Miller Act to federal courts and then expect them to follow state law in interpreting it.[116]

The balance in this duel is tipped in favor of preemption by a closer examination of the Supreme Court's *F. D. Rich* decision and

108. *Id.* at 643. In United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. 906 (E.D. Cal. 1991), the Eastern District of California felt compelled to follow suit in the face of this holding by the Ninth Circuit. *Id.* at 908-09. The district court's heart clearly was not in the result. *Id.* at 911 ("If additional remedies are required to fulfill federal purposes such remedies should be by act of Congress and not by individual state courts.").

109. K-W Indus. v. National Sur. Corp., 855 F.2d at 643.

110. *Id.*

111. 710 F. Supp. 638 (W.D. La. 1989).

112. 417 U.S. 117 (1974).

113. 832 F.2d 1150 (9th Cir. 1987).

114. United States *ex rel.* Pensacola Constr. Co. v. St. Paul Fire and Marine Ins. Co., 710 F. Supp. at 640.

115. *Id.* at 639 (citing United States Fidelity & Guar. Co. v. Hendry Corp., 391 F.2d 13 (5th Cir.), *cert. denied*, 393 U.S. 978 (1968)).

116. *Id.* at 640. *See also* United States *ex rel.* Gen. Elec. Supply Co. v. Minority Elec. Co., 537 F. Supp. 1018, 1019-21 (S.D. Ga. 1982) (citing *F. D. Rich* and its progeny and rejecting the plaintiff's attempt to assert a state law claim "for attorney's fees and a bad faith penalty of twenty-five percent of the amount owed as provided by Georgia Code Annotated § 103-210" as part of a Miller Act action). The *General Electric* court found it unnecessary to answer whether such a state law claim can be brought under pendent or supplemental jurisdiction, *see* 28 U.S.C. § 1367 (Supp. I 1991), because the plaintiff had failed to plead a separate "state cause of action over which pendent jurisdiction can be exercised." United States *ex rel.* Gen. Elec. Supply Co. v. Minority Elec. Co., 537 F. Supp. at 1021.

by the undesirable proliferation of multi-forum litigation observed in the *K-W Industries* case itself.

In *F. D. Rich*, the Supreme Court stated:

> The Miller Act provides a federal cause of action, and the scope of the remedy as well as the substance of the rights created thereby are matters of federal, not state law. Neither respondent nor the court below offers any evidence of congressional intent to incorporate state law to govern such an important element of Miller Act litigation as liability for attorneys' fees. Many federal contracts involve construction in more than one State, and often, as here, the parties to Miller Act litigation have little or no contact, other than the contract itself, with the State in which the federal project is located. The reasonable expectations of such potential litigants are better served by a rule of uniform national application.[117]

In *K-W Industries*, the Ninth Circuit attempted to distinguish *F. D. Rich*,[118] but in the face of such explicit language from the Supreme Court on the desirability of a uniform remedy for Miller Act payment bond obligees, those efforts are hard to swallow.[119]

The tortured history of litigation in two separate forums in *K-W Industries* provides perhaps the best practical illustration of the flaws in that decision.[120] As the Ninth Circuit pointed out, "K-W's earlier federal court suit against National for payment on the Miller Act bond has long since been settled."[121] The case appeared in federal court again after the plaintiff filed a second action against the surety in state court; the surety then removed the case to federal district court, which dismissed the case for lack of subject matter jurisdiction; the Ninth Circuit, on appeal from that decision, sent the case back to state court on certification of "two threshold questions

117. F. D. Rich Co. v. United States *ex rel.* Indus. Lumber Co., 417 U.S. at 127.

118. K-W Indus. v. National Sur. Corp., 855 F.2d at 643 (distinguishing on ground that a state law bad faith claim does not arise under Miller Act or other federal statute).

119. *F. D. Rich* did recognize the Miller Act surety's exposure for attorneys' fees in a case where the surety "has acted in bad faith, vexatiously, wantonly, or for oppressive reasons." F. D. Rich Co. v. United States *ex rel.* Indus. Lumber Co., 417 U.S. at 129. Such exposure is not pursuant to any state law bad faith remedy but rather is pursuant to a "long recognized" federal common law exception to the "American Rule" that each litigant shall bear his own legal fees. *Id.* This exception to the American Rule applies to any federal court litigant, not just sureties and insurers. Presumably, the conduct giving rise to such a claim would have to occur during the course of the litigation and be quite extreme, something more than, for instance, mere delay or refusal of a payment bond claim.

120. *See* United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 910 ("[I]t appears that [the bad faith] cause of action might create multiple lawsuits, with the subcontractor first suing in the federal court on the bond and then suing in state court for breach of the covenant of good faith. In *K-W Industries v. National Sur. Corp.*, 855 F.2d 640, this is precisely what happened.").

121. K-W Indus. v. National Sur. Corp., 855 F.2d at 643.

of state law to the Montana Supreme Court for decision"; the case then returned to the Ninth Circuit for decision of the preemption issue; after which the Ninth Circuit remanded to the federal district court for determination of the plaintiff's state law cause of action.[122]

In summary, "[i]f additional remedies are required to fulfill federal purposes such remedies should be by act of Congress and not by individual state courts."[123] The sounder view is that the Miller Act preempts state law claims for bad faith against a surety issuing a payment bond pursuant to that federal statute's requirements.

V. The Likely Result for the Payment Bond Surety in Maine

As noted above, the payment bond surety's liability to its obligee for bad faith is an issue of first impression in Maine. Neither the Maine Law Court nor the United States District Court for the District of Maine has yet passed on that specific question in a reported decision.

A review of relevant Maine statutes and case law in the context of decisions from other jurisdictions that have considered the issue, however, yields an irresistible conclusion: no such cause of action exists in Maine, by statute or at common law.

With respect to a statutory claim, the proper point of reference is Maine's Insurance Code, Title 24-A of the Maine Revised Statutes Annotated.

Section 3 defines "insurance" as "a contract whereby one undertakes to pay or indemnify another as to loss from certain specified contingencies or perils, or to pay or grant a specified amount or determinable benefit or annuity in connection with ascertainable risk contingencies, *or to act as surety*."[124] Section 4 defines "insurer" to include "every person engaged as principal and as indemnitor, *surety* or contractor in the business of entering into contracts of insurance."[125]

Chapter 43 of Title 24-A applies specifically to "surety insurance contracts."[126] Under section 3101, "[a]ll contracts of surety insurance delivered or issued for delivery in this State and covering subjects resident, located, or to be performed in this State are also subject to the applicable provisions of chapter 27 (the insurance contract) and to other applicable provisions of this Title."[127] Chap-

122. *Id.* at 641-44.

123. United States *ex rel.* Ehmcke Sheet Metal Works v. Wausau Ins. Cos., 755 F. Supp. at 911.

124. ME. REV. STAT. ANN. tit. 24-A, § 3 (West 1990) (emphasis added).

125. ME. REV. STAT. ANN. tit. 24-A, § 4 (West 1990) (emphasis added).

126. ME. REV. STAT. ANN. tit. 24-A, §§ 3101-3105 (West 1990 & Supp. 1994-1995).

127. ME. REV. STAT. ANN. tit. 24-A, § 3101 (West 1990).

ter 27 includes both the "late payment"[128] and the "unfair claims practices"[129] provisions of the Code, permitting recovery of penal interest and attorneys' fees.[130]

The key to this entire statutory scheme is the word "applicable" in section 3101. There can be no doubt that a surety is an "insurer" subject to the Maine Insurance Code. By their explicit terms, however, not all the provisions of the Code outside chapter 43[131]—including sections 2436 and 2436-A of chapter 27—are "applicable" to sureties and claims against them by their obligees.

To the contrary, the specific language of both section 2436[132] and section 2436-A,[133] discussed above,[134] makes it clear that they apply only to a first-party claim by an "insured" against "his own insurer."[135] Because these provisions are penal in nature, they must be strictly construed.[136] They are therefore not "applicable" to the third-party relationship between the surety and the payment bond obligee, and provide no cause of action against the surety on the obligee's claim against the payment bond.

With respect to a common law claim, the limitations imposed by Maine law are equally clear.[137] "[T]here is no general implied duty of good faith under Maine law that operates beyond the scope of the mandate of the Maine U.C.C. and the contractual relationship between an insurer and its insured on a policy of casualty insurance."[138]

The Law Court has expressly rebuffed efforts to extend that duty to the third-party relationship between a liability carrier and a tort claimant.[139] The Law Court relied on the fact that the essence of the relationship between those two parties is "*adversary* in nature."[140]

That fact sets Maine apart from other jurisdictions that have found the payment bond surety liable for bad faith based on a com-

128. ME. REV. STAT. ANN. tit. 24-A, § 2436 (West 1990).

129. ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1990).

130. *See supra* notes 35-54 and accompanying text.

131. ME. REV. STAT. ANN. tit. 24-A, §§ 3101-3105 (West 1990 & Supp. 1994-1995).

132. *See supra* note 37.

133. *See supra* note 47.

134. *See supra* notes 35-54 and accompanying text.

135. ME. REV. STAT. ANN. tit. 24-A, § 2436-A (West 1990). Although the "his own insurer" language is found only in section 2436-A, the legislative history and the Law Court's construction of section 2436 make clear that it too applies only to first-party insurance claims. *See supra* notes 43-46 and accompanying text.

136. *See supra* note 36 and accompanying text.

137. *See supra* notes 22-33 and accompanying text.

138. Renaissance Yacht Co. v. Stenbeck, 818 F. Supp. at 412. *See supra* notes 22-29 and accompanying text.

139. Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163-64.

140. *Id.* at 1163.

mon law or statutory scheme that recognizes a third-party tort claimant's cause of action for bad faith.[141] The common law and statutes of Maine are plainly to the contrary.

Maine is also unlikely to agree with those jurisdictions that consider the relationship between surety and payment bond claimant "substantially identical" to the first-party insurance relationship.[142] It is a third-party relationship,[143] which in fact more closely resembles the adversarial relationship between the liability insurer and the third-party tort claimant. The approach of those other jurisdictions is inconsistent with the stringent boundaries set in Maine for application of the duty of good faith and fair dealing. Maine law simply does not leave room to recognize a duty of good faith by a surety to a payment bond obligee.

Finally, it is expected that the District of Maine and the First Circuit will recognize that the Miller Act preempts any state law bad faith claim on payment bonds to which that statute applies.[144] Of course, in Maine there does not appear to be any such claim to preempt.

VI. Conclusion

Where did Antonio's duty of good faith lie, to his good friend and principal Bassanio, or also to his obligee Shylock?[145] As surety, should Antonio have been liable for bad faith for contesting the forfeit of his bond, "an equal pound Of [his] fair flesh"?[146]

Although Shakespeare's tale of suretyship in sixteenth century Venice does not provide a totally apt analogy to the modern day payment bond relationship, it is not totally inapt either. The interaction between surety and payment bond obligee, which arises only in the event of a claim, clearly is "*adversary* in nature."[147]

Careful examination of current Maine law in the area of bad faith demonstrates that it has no application to the relationship between the surety and the payment bond claimant. That is the proper re-

141. *See, e.g.*, K-W Indus. v. National Sur. Corp., 754 P.2d at 504-05 (citing Klaudt v. Flink, 658 P.2d 1065 (Mont. 1983)); General Ins. Co. of America v. Mammoth Vista Owners Ass'n, 220 Cal. Rptr. at 296-97, 300 (citing Royal Globe Ins. Co. v. Superior Court, 592 P.2d 329 (Cal. 1979)).

142. *See, e.g.*, Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 505; Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 628.

143. *See* Restatement of the Law of Security § 165 (1941). Even those decisions suggesting the false analogy to a first-party insurance relationship concede that the payment bond obligee is a "*third-party* beneficiary" of the bond. *See* Szarkowski v. Reliance Ins. Co., 404 N.W.2d at 505; Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins. Co., 797 P.2d at 628.

144. *See supra* notes 103-23 and accompanying text.

145. William Shakespeare, The Merchant of Venice (Harvard Univ. Press 1955) (7th ed. 1598).

146. *Id.* at act I, sc. 3, lines 145-46.

147. Linscott v. State Farm Mut. Auto. Ins. Co., 368 A.2d at 1163.

sult. A surety should not be intimidated or coerced into payment of a claim by the fact that its decision to contest the claim, in all likelihood at the urging of its principal, could result in liability to that claimant grossly in excess of the exposure the surety agreed to carry by contract with its principal, the penal sum of its bond. The surety should have its day in court on claims by third parties against the bond without fear of forfeiting a pound of its flesh as well as its penal sum.