



The Surety & Fidelity Association of America

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Assigning Federal Construction Contracts to Sureties Enhances Performance

Background on Federal Surety Statute

The Miller Act, 40 U.S.C. §§3131 *et seq.*, requires performance and payment bonds in connection with all federal public works contracts in excess of \$100,000 to assure completion of construction on time and according to the specifications in the contract and payment of laborers, subcontractors and suppliers of material. If a contractor encounters financial problems during the job, its Miller Act surety is often called upon to finance completion of the bonded federal contract either directly by advancing money to the contractor or indirectly by paying the subcontractors and suppliers. Such financing helps to avoid performance problems and to avoid the delay and expense of a default.

Background on Federal Assignment of Claims Acts

The Assignment of Claims Acts, or Anti-assignment Acts, 31 U.S.C. §3727 and 41 U.S.C. §15, generally void any assignment of a government contract or a claim against the government. During World War II, Congress added certain enumerated exceptions to help contractors obtain financing. Unless the contract provides otherwise, a contractor is permitted to assign all payments remaining under the contract to a single assignee. Written notice of the assignment must be given to the government and the contractor's surety, and the assignee must be a "financing institution" or a "bank, trust company, or other financing institution, including any Federal lending agency." In interpreting the amendments, the courts have held that a Miller Act surety is not a "financing institution" eligible to receive a valid assignment so that contractors cannot assign their rights to funds under a federal construction project to their surety.

How Recent Case Law Interpretations Have Impacted Federal Surety Bonds

Until recently, this was not a practical problem because sureties had other ways to enforce their rights to contract funds. Since the Assignment of Claims Acts do not bar transfers allowed by operation of law, including the doctrine of subrogation, sureties that paid to complete bonded contracts still are entitled to receive the contract funds. When the contractor defaulted and the surety took over the work under its performance bond, the government and the surety usually entered into a takeover agreement, which provided that all funds due or to become due under the contract would be paid to the surety. If the contractor continued to perform, but did not pay its bills, thus obligating the surety to pay the subcontractors and suppliers under the payment bond, the case law entitled the surety to receive the contract funds. The surety, as a "contractor" under the agreement could contest any back-charges and dispute any claims.

In several recent cases, however, the courts have held that a surety which enters into a takeover agreement and completes a bonded construction project becomes a “contractor” only as to claims arising after the takeover agreement and is not entitled to prosecute any claims arising prior to its takeover of the work. Yet, the contractor in default often will have unresolved claims (change orders, extra work, differing site conditions, delays) pending at the time of the default. The surety stepping in to complete the job now cannot assert excusable delays to mitigate liquidated damages or make claims for equitable adjustments if the delays or claims arose prior to the surety’s takeover of the work. Only the defaulted contractor can prosecute these claims, and the contractor is usually out of business and has no incentive in any case to spend money on a claim, which will benefit only the surety. The contractor cannot assign the claims to the surety because of the way that the Assignment of Claims Acts has been interpreted to bar assignment to sureties. As the Court of Appeals for the Federal Circuit stated in 2002, if the statutory exemptions in these Acts are to be broadened, “it is for Congress, not the courts, to do so.”

These cases do not question or change the long-standing subrogation rights of the surety to receive payments due under a construction contract when the surety has paid claims under its payment or performance bonds. They hold that the party entitled to receive the payments, the surety, does not have standing to assert the claims essentially making the right unenforceable.

Why a Change in Federal Law is Needed to Permit Assignments to Sureties

The federal Assignment of Claims Acts should be changed to permit claims under federal contracts to be assigned to sureties as the court decisions interpreting it have misunderstood the role of the surety in providing financial assistance to a contractor that the surety has bonded to complete a job. Since the contractor is obligated to indemnify the surety for any claims paid under the surety bond, most contractors are happy to assign the surety any claims as part of the indemnification process under the bond or as an inducement to the surety to write the bond or provide financing during the project for the contractor’s performance. When a contractor experiences financial difficulty on a project, the surety’s assistance benefits the federal government as the project proceeds without interruption and without the need to terminate the contractor. A permitted assignment of claims to the surety in these circumstances also removes any future confusion, dispute and litigation as to who is entitled to receive government payments under the contract.

Without the ability to make an assignment of claims under a construction contract to a surety that has performed the work, the federal agencies may continue to pay the contractor, which provides the opportunity for the contractor to abscond with the money. If the contractor could make a formal assignment to the surety, these problems could be avoided.

This change in the law gives sureties parity with banks, which can be assignees under the Assignment of Claims Acts. Under the existing interpretation of the Acts, the bank that gave the contractor a loan to do the job can be an assignee, while the surety that provided the Miller Act bonds and gave the contractor a loan mid-term in the project to ensure its completion cannot be an assignee. It should be emphasized that the Assignment of Claims Acts permit only a single assignment of all the contract funds due under the contract. If a contractor has made an assignment to a financing institution and the government has been notified, a later assignment to

another party does not oust the first assignee. The ability to force the government to honor an assignment to a surety will benefit the surety only if the contractor has not already made another assignment under the contract.

Just as the relevant portions of the Assignment of Claims Acts were amended in the World War II era to help contractors working on war-related contracts get financing, amending the law to permit assignments of claims to sureties now is needed to respond to today's contracting realities.

In order to permit assignments to sureties financing performance of the contract work, we propose to amend the Assignment of Claims Acts as follows:

1. Amend paragraph (c) of 31 U.S.C. §3727 by inserting "surety on a bond provided in connection with the contract or other" before "financing institution" in the first sentence.
2. Amend paragraph (b) of 41 U.S.C. §15 by inserting "surety on a bond provided in connection with the contract" after "trust company" and before "or other financing institution" in the first sentence.