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Interpreting the Public Construction Bond Act: Is a Surety Still a Sure Thing?

Pursuing payment on behalf of a subcontractor on a state or municipal construction project can be complicated. The doctrine of sovereign immunity bars suit against the government in most circumstances. Robert Porter, *Contract Claims Against the Federal Government: Sovereign MUNITY and Contractual Remedies*, Briefing Paper No. 22, Harvard Law School Federal Budget Policy Seminar (2006). State protections against liability operate to prohibit the filing of liens on public property. *F. D. Rich Co. v. United States for the Use of Indus. Lumber Co.*, 417 U.S. 116, 122 (1974) (citing *Illinois Surety Co. v. John Davis Co.*, 244 U.S. 376, 380 (1917)). Thus, while mechanics liens may be filed on private properties by contractors to ensure payment, Illinois law permits only approved liens on money or bonds with respect to work performed on improvements to public property. *Gunther v. O'Brien Bros. Const. Co.*, 369 Ill. 362, 367 (1938); *also see* the Illinois Mechanics Lien Act, 770 ILCS 60/0.01 *et. seq.* (2015). The rationale behind such restrictions is that a subcontractor cannot infringe upon the rights of the State—even if that means the subcontractor will ultimately go unpaid for services rendered. *Gunther*, 369 Ill. at 367.

To avoid such an unpleasant outcome, practitioners may advocate strict compliance with our state's Public Construction Bond Act (the Act), which prescribes a remedy for subcontractors working on public projects. 30 ILCS 550/0.01, *et seq.*; *Aluma Systems, Inc. v. Frederick Quinn Corp.*, 206 Ill. App. 3d 828, 853-54 (1st Dist. 1990). This article provides a brief overview of the history behind the Act, as well as a synopsis of a recent Illinois Supreme Court decision, *Lake County Grading Co., LLC v. Village of Antioch.* 2014 IL 115805, which highlights the protections afforded by the Act and the dangers of failing to comply with its procedural requirements.

Federal Precursors to the Illinois Public Construction Bond Act

In 1894, the United States Congress passed the Heard Act, 28 Stat. 278, ch. 280, mandating the provision of a surety bond by all persons entering into public works contracts with the United States. *J.W. Bateson Co. v. United States*, 434 U.S. 586, 598 (1978). That legislation was passed to address concerns voiced by subcontractors and material suppliers, who complained they were unable to collect outstanding debts from general contractors retained to manage federal construction projects. *Bateson*, 434 U.S. at 598. The bond required under the Heard Act contained language encompassing both common surety bonds—performance bonds and payment bonds. *Id.* A performance bond ensures the property owner that the contractor will perform the work as contracted, whereas a payment bond requires the principle contractor to pay all subcontractors and material providers before final payment is made by the owner. *Western Waterproofing Co. v. Springfield Housing Authority*, 669 F. Supp. 901, 903 (C.D. Ill. 1987).

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From its inception, the Heard Act faced harsh criticism from subcontractors and material suppliers. They complained of undue delay and hardship when attempting to collect moneys owed to them on the bonds, citing difficulties stemming from the fact that the performance portion of the bond took priority over the payment obligations as the federal government was given priority in making a claim under the bond where the principle contractor did not complete the work. H.R. Rep. No. 74-1263, at 1-2 (1935). In response to those complaints, the Heard Act was repealed and the Miller Act was enacted in its place. H.R. Rep. No. 74-1263, at 1-2 (1935), 40 U.S.C. §§ 270a–270d. During the New Deal, the federal government initiated massive public construction projects as a counter to deflation and in an attempt to put money in the pockets of construction workers. Herbert R. Northrup & Augustus T. White, *Subsidizing Contractors to Gain Employment: Construction Union "Job Targeting*," 17 BERKELEY J. EMP. & LAB. L. 62, 77 (1996). As opposed to the singular, all-encompassing bond mandated by the Heard Act, the Miller Act required the principle contractor on federal projects to secure separate performance and payment bonds. H.R. Rep. No. 74-1263, at 1-2 (1935). The resulting protection worked so well that states followed suit and instituted their own laws known as "Little Miller Acts." Gregory Paonessa, *The Mechanic's Lien - Are You Protected?*, 48 NEW ENG. L. REV. 579, 603 (2014).

In Illinois, our General Assembly originally passed its own "Little Miller Act"—the Illinois Public Construction Bond Act (the Bond Act)—in 1931. 30 ILCS 550/1 (2015). Illinois Courts have observed that this Act provides an alternate remedy to that afforded by the Mechanics' Liens Act, and that its passing was meant to protect contractors and materialmen for whom no right of mechanic's lien exists against a public body, as well as to regulate claims against public monies. *City of Chicago v. United States Fidelity & Guaranty Co.*, 142 Ill. App. 3d 621, 626 (1st Dist. 1986).

The Illinois Public Construction Bond Act

With respect to contracts pertaining to work performed for the state on public improvement projects exceeding $50,000, the Bond Act provides, in pertinent part:

> Except as otherwise provided by this Act, all officials, boards, commissions, or agents of this State…shall require every contractor for the work to furnish, supply and deliver a bond to the State, or to the political subdivision thereof entering into the contract, as the case may be, with good and sufficient sureties. The surety on the bond shall be a company that is licensed by the Department of Insurance authorizing it to execute surety bonds and the company shall have a financial strength rating of at least A- as rated by A.M. Best Company, Inc., Moody's Investors Service, Standard & Poor's Corporation, or a similar rating agency. The amount of the bond shall be fixed by the officials, boards, commissions, commissioners or agents, and the bond, among other conditions, shall be conditioned for the completion of the contract, for the payment of material used in the work and for all labor performed in the work, whether by subcontractor or otherwise.

30 ILCS 550/1 (2015).

Each such bond provided in compliance with the Bond Act is deemed to contain the following provisions, regardless of whether such terms are included therein:

> The principal and sureties on this bond agree that all the undertakings, covenants, terms, conditions and agreements of the contract or contracts entered into between the principal and the State or any political subdivision thereof will be performed and fulfilled and to pay all persons, firms and corporations having contracts with the principal or with subcontractors, all just claims due them under the provisions of such contracts for labor performed or materials furnished in the performance of the contract on account of which this bond is given, when such claims are not satisfied out of the contract price of the contract on account of which this bond is given, after final settlement between the officer, board, commission or agent of the State or of any political subdivision thereof and the principal has been made.

Id.

Every person furnishing material or performing labor, either as an individual or as a sub-contractor for an entity required to obtain a bond pursuant to Section 550/1, has the right to sue on the bond. 30 ILCS 550/2. To pursue such a claim, the subcontractor or material provider must first file a verified notice of claim on the bond with the officer, board, bureau or department awarding the prime contract on behalf of the municipal entity within 180 days after the date of the claimant's completion of work on the project in order to preserve its right to recovery. *Id.* The claimant must provide a copy of the verified notice to the prime contractor within 10 days of the filing of the notice with the agency awarding the contract. *Id.* Furthermore, the claimant must file its lawsuit in the same judicial district in which the project was located within one year of the last day it performed work on the project. *Id.* That is, assuming the parties did not previously contractually agree to expand the statutory limitations period. *See generally, United States v. Fischer Excavating, Inc.*, No. 4:12-cv-4CV-SLD-JAG, 2014 U.S. Dist. Lexis 129890, *12 (C.D. Ill. Sept. 17, 2014).

Lake County Grading Co. v. Village of Antioch

Lake County Grading Co. v. Village of Antioch arose from two contracts between the Village of Antioch and a developer retained by the Village to make public improvements to two residential subdivisions. *Lake County Grading*, 2014 IL 115805, ¶¶ 3-4. The contracts required that the developer obtain surety bonds, the amounts of which would be based on the total cost of improvements. *Id.* ¶ 4. Instead of obtaining a single bond incorporating the requisite language pertaining to both a performance and payment bond, the developer obtained and provided the Village with four separate surety bonds that only included language necessary to create a performance bond. *Id.* ¶ 6. In other words, the bonds were lacking language to guarantee payment to subcontractors for labor or materials. *Id.* ¶ 7.

Subsequently, the developer retained a grading company to provide labor and materials for the public improvements called for in the contract between the developer and the Village. *Id.* ¶ 8. The grading company completed the work; however, the developer declared bankruptcy prior to providing full payment for the company's services. *Id.* The grading company filed a complaint seeking payment from the Village, alleging it was a third-party beneficiary of the contracts between the Village and the developer pursuant to the requirements set forth in Section 550/1 of the Bond Act and that the Village breached the contracts by not ensuring that the surety bonds obtained by the developer contained language guaranteeing payment to subcontractors. *Id.* ¶ 9. The Village filed a motion for summary judgment, arguing that the bonds provided by the developer were sufficient because they contained performance and payment obligations as a matter law in light of the mandates of Section 550/1. *Id.* ¶ 10. As such, the Village further argued, the plaintiff could only file a cause of action against the bonds themselves and said claim would be barred by Section 2 of the Bond Act because the grading company failed to give notice of its claims within the 180 days after completion of its work. *Id.*

The Supreme Court found in favor of the Village. *Id.* ¶ 38. The Court found that the plain language of the Bond Act requires the political subdivision of the State to have the principle contractor procure one bond as opposed to separate performance and payment bonds as required under the Miller Act. *Id.* ¶¶ 24, 28. Further, regardless of the actual language of the bond procured by the principle contractor in accordance with the Bond Act, the General Assembly has unambiguously decreed all such bonds are deemed to contain both performance and payment provisions as a matter of law. *Id.* ¶ 25. The Court observed that the guarantee of performance and payment provisions as a matter of law is consistent with the General Assembly's purpose of assuring payment to providers of labor and materials to public projects, while also protecting the tax money paid to the principle contractor, by assuring completion of the public project. *Id.* ¶ 26. Since the bonds procured by the developer did contain a payment provision as a matter of law, the bonds were not defective and the grading company could not recover against the Village under a breach of contract theory. *Id.* ¶¶ 32, 38. Instead, a notice of claim on the bond should have been filed within the 180-day time period allotted under the Bond Act. *Id.* ¶ 24.

Impact of *Lake County Grading Co.*

There are several consequences arising from our Supreme Court's ruling in *Lake County Grading Co.* First, both the municipal entity and the principle contractor retained to manage a public construction project need not expend the costs necessary to procure two separate bonds when contracting to perform public construction. Instead, contractors performing work for subdivisions of the State of Illinois need only pay premiums for one bond, which need not necessarily even contain both a payment provision and a performance provision.

Additionally, because principle contractors need only obtain one bond, subcontractors and material suppliers in Illinois may face the same obstacles as subcontractors dealing with Bonds under the Heard Act that led to the repeal of that legislation: delay in obtaining payment in light of priority given to the state and its subdivisions pursuing the performance provision read into the one obtained bond as a matter of law. So, while Illinois courts have found a two-fold purpose behind the General Assembly's enactment of the Bond Act of assuring payment to providers of labor and materials to public projects and protecting the payment of tax monies, the purpose of protecting payment of tax monies where there is a failure of the principal contractor to comply with the prime contract inevitably takes priority over the purpose of protecting subcontractors. *See City of Chicago*, 142 Ill. App. 3d at 626. To assuage such concerns, practitioners may consider advising their clients to negotiate for additional protections—beyond those minimum protections established by the Bond Act—when bidding on government projects. *See, generally, Fischer Excavating, Inc.*, 2014 U.S. Dist. Lexis 129890, *12; *Aluma Systems, Inc.*, 206 Ill. App. 3d at 853-54.

Finally, the Supreme Court's ruling that the state or a subdivision of the state cannot be found liable for a breach of contract by failing to ensure that the principal contractor obtain a bond with both a payment provision and a performance provision may have far-reaching applications. That determination confirms that the only recourse a public improvement subcontractor may avail itself of in the event of insolvency of the principal contractor is to file suit on the bond. In light of the foregoing, subcontractors on public projects should be counseled to take steps to pursue payment for their work prior to the 180-day deadline provided in the Bond Act. Then, in the event of nonpayment, a verified notice of claim on the bond should be filed with the officer, board, bureau or department awarding the prime contract on behalf of the municipal entity within that timeframe so that their right to payment is not waived.

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