

PAYMENT BONDS

WHAT PUBLIC OFFICIALS AND PUBLIC WORKS CONTRACTORS NEED TO KNOW

by Edward V. Crites and Joseph C. Blanner

Public construction projects in Missouri are subject to certain legal requirements that do not apply to private sector projects.¹ These legal requirements must be considered by public officials and contractors when contemplating a public works project because they can affect cost and their violation can carry civil or criminal liability.² Moreover, contracting officials are presumed to know the requirements of the law.³

This article examines the legal requirements in Missouri for payment bonds for public works projects.

PAYMENT BOND STATUTE

The Missouri Payment Bond Statute (PBS), §107.170, RSMo imposes a duty on:

Public entities ... in making contracts for public works [exceeding \$50,000] ... to require every contractor ... to furnish the public entity, a bond with good and sufficient sureties ... conditioned for the payment of ... materials incorporated, consumed or used in ... such work ... and for all labor performed in such work whether by subcontractor or otherwise.*

HISTORY AND PURPOSE

Missouri's long-established policy protects those who furnish labor or materials in making improvements for the benefit of private persons by

allowing a lien upon the improvements.⁵ These are known as "mechanics' and materialmen's liens."⁶ Public policy considerations, however, prohibit liens on public improvements.⁷ In recognition of the moral duty to protect material suppliers and laborers, and to enable public entities to secure cheaper labor and materials, Missouri courts recognized a public entity's right to require contractors to provide a surety bond for payment of suppliers and laborers.⁸ A public entity's right to require surety bonds was eventually made into a statutory obligation by the enactment of the predecessor to §107.707.⁹

Payment bonds are intended to provide the same protections to those furnishing labor and materials on a public project as mechanic's liens do for private projects.¹⁰ Therefore, the PBS is intended to protect everyone who would have had the protection of a mechanic's lien.¹¹ To achieve that purpose, the PBS is broadly construed by the courts.¹²

PUBLIC ENTITIES

"Public entity" is defined in §107.170.1 (2) as, "any official, board, commission or agency of this state or any county, city, town, township, school, road district, or other political subdivision of this state."¹³

Numerous cases apply the

requirements of §107.170 to various departments of the state,¹⁴ counties,¹⁵ cities and towns,¹⁶ and school districts.¹⁷ The obligation to require a payment bond also has been applied by the courts to municipal utilities,¹⁸ port authorities,¹⁹ public water supply districts,²⁰ and housing authorities.²¹ These entities are presumably "political subdivisions of the state" as the term is used in §107.170.²²

The term "agency of this state" is not defined within §107.170 and has been examined and applied in several Missouri cases. In *Redbird Eng'r Sales, Inc. v. Bi-State Dev. Agency*,²³ a material supplier brought a mechanic's lien action against property owned by Bi-State Development Agency, a nonprofit corporation that operates in the public interest,²⁴ relating to the construction of a public transportation facility. After its mechanic's lien claim was dismissed, the material supplier sought damages against Bi-State for its failure to require the contractor to furnish a payment bond pursuant to §107.170.²⁵

The court held that, "only such property held by a quasi-public corporation for the benefit of the public which can be determined to be reasonably necessary for public use is exempt [from mechanic's liens]."²⁶ Because the public transportation facility was "reasonably necessary for the public use," the court found that the material supplier could not file a



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mechanic's lien against the property. The court then determined that Bi-State was an "agency of the state" as the phrase is used in §107.170 (since the enabling legislation for Bi-State refers to it as a state agency).

Another case examining the phrase "agency of the state" was *Johnson Controls, Inc. v. Citizens Mem. Hosp. Dist.*,²⁷ where a subcontractor who had not been paid for labor and materials sued a public hospital district²⁸ and its directors for failing to require a payment bond.²⁹

In *Johnson Controls*, the court determined that a public hospital district did not need a payment bond. The court concluded that the public hospital district was not an "agency of the state" and, accordingly, the requirements of §107.170 did not apply because the statutes authorizing their creation did not refer to them as such.

In *Collins & Herman, Inc. v. TM2 Construction Co.*,³⁰ the court applied the Payment Bond Statute (PBS) to AmerenUE, a Missouri corporation that supplies electric and gas utility service to large portions of the state.³¹ The plaintiffs, who had furnished labor and materials, brought mechanic's lien claims against Ameren that were dismissed. The plaintiffs then brought claims alleging that Ameren should have required its contractor to furnish a payment bond in accordance with the PBS.

Before determining whether Ameren was required to comply with the PBS, the court stated "that subcontractors and suppliers are entitled to the protection of either mechanic's liens or payment bonds depending on the nature of the property they improve."³²

The court determined that Ameren was an "agency of the state" because Ameren is a "public utility" operated in the public interest and its power substations, on which plaintiffs worked, were "reasonably necessary for public use."³³ Moreover, while Ameren, unlike Bi-State, is an investor-owned utility company, this difference was not considered to be important due to the public policy consideration behind the PBS. Ameren is subject to heavy regulation by the Public Service Commission (PSC) and its authority to provide essential utility services to the residents of the state of Missouri derives solely from its regulation by the PSC.³⁴

The court also distinguished *Johnson Controls* on the basis that public hospital districts are not regulated by the state, whereas Ameren's authority to provide electrical services to Missouri derives solely from the PSC.³⁵

WHAT ARE PUBLIC WORKS?

Courts have found the following qualify as public works: improvements to utility company substations;³⁶

asbestos removal from a port authority warehouse;³⁷ construction of water test wells;³⁸ street repairs resulting from work on a natural gas pipeline;³⁹ construction of a shelter and repair of a garage for public buses;⁴⁰ raising streets over railroad tracks with bridges;⁴¹ sewers, grading, curbing, guttering and macadamizing of streets;⁴² removal and disposal of garbage;⁴³ installing and serving computer network equipment in a public entity;⁴⁴ and demolishing buildings condemned by a governmental body.⁴⁵

In 1995, an amendment to the PBS defined public works as "the erection, construction, alteration, repair or improvement of any building, road, street, public utility, or other public facility owned by the public entity." Before that, no definition was provided.

One court has held that the 1995 definition narrows the PBS's application to projects "owned" by a public entity rather than to "fixed works constructed for public use or benefit paid for wholly or in part out of public funds." However, the court did not apply the narrower definition because the project at issue pre-dated the amendment.⁴⁶ In spite of the narrower definition, courts continue to analyze the meaning of "public works" in the context of the PBS's purpose of providing laborers and material suppliers' protection of either a mechanic's lien or payment bond.⁴⁷ Accordingly, the court will likely reject any interpretation urged upon the court that would deprive laborers or material suppliers the protection of either a mechanic's lien or a payment bond.

Additionally, a recent case found that a permit surety bond required by the Missouri Highway and Transportation Commission with a right-of-way permit for incidental work upon a public right of way was not "public work" since the project was paid for and owned by a private company. Since the work was not a "public work," it did not come within the PBS.⁴⁸

DUTIES OF PUBLIC OFFICIALS

Under the PBS, "public entities" must require every contractor to furnish the bond on projects exceeding \$50,000. "Public Entity" is defined as "any official, board, commission, or agency" of the state or political subdivision. Public officials⁴⁹ must require contractors to obtain a payment bond or face personal liability to those who thereby suffer a loss.⁵⁰

Courts have held board members personally liable when they breach their duty to require a bond.⁵¹ Similarly, individual commissioners of state agencies⁵² or counties⁵³ and utility board members⁵⁴ have been held personally liable for failure to require a bond.

On the other hand, the decision whether to accept a particular bond is discretionary and, in such instances, board members are generally entitled to immunity.⁵⁵ So, where a board obtains a bond from a company that behaves as a normal bonding company, it is protected by official immunity.⁵⁶ However, the board is responsible for verifying the surety's existence.⁵⁷

There are circumstances where the public entity has no liability for failure to obtain the bond but individual officials do. A board that passes an ordinance incorporating the bond requirement into a contract cannot be held liable because it had fulfilled its ministerial duty.⁵⁸ As a legislative body, it has limited power to insure compliance with the ordinance. The mayor, who has general supervisory powers over executive affairs and sees that each officer and employee performs his duty, and the comptroller, who supervises the city's fiscal affairs, are differently situated. Each can be held liable for breaching their ministerial duties in failing to require a payment bond on a construction project.⁵⁹

There must be a contract for the construction project for the duty to arise. A commissioner involved in the request for bids but who did not engage the contractor is not personally liable because there was no enforceable contract for a public work.⁶⁰ Additionally, current public officials are not liable when they were not in their positions when the contract was entered.⁶¹

Indemnity of Public Officials. Under the PBS, the public entity may choose to defend a public official or employee in litigation and may choose to pay any judgment entered if the official or employee fails to require a payment bond, except in instances involving malfeasance in office or willful or wanton neglect of duty.

DAMAGES ALLOWED

Payment bonds cover all labor and materials used and incorporated into a construction project.⁶² In addition, payment bonds have been held to cover the cost of repair of capital equipment (e.g. crane);⁶³ extra costs incurred



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in finishing a job on time due to a subcontractor's negligence;⁶⁴ amounts due under the Prevailing Wage Act⁶⁵ and Prompt Pay Act;⁶⁶ cost of labor and materials;⁶⁷ cash loans to a subcontractor to procure mandated insurance;⁶⁸ and rental equipment.⁶⁹

Although bonds issued will incorporate the PBS's terms, they may grant broader coverage. In such instances, normal rules of construction apply to determine coverage. Accordingly, where the bond covers all of the principal's obligations rather than only payment of materials and labor, it is broad enough to cover payment of attorney's fees owed pursuant to the principal's subcontract.⁷⁰

Interest. The Act does not require that bonds cover interest.⁷¹ As such, public entities have been held to have no liability for interest when sued for failure to obtain a payment bond.⁷²

Loans. Loans to contractors to pay for labor and materials are not covered by payment bonds because the Act protects those supplying labor and materials, not entities that lend money.⁷³ A supplier who advances funds to the principal, however, is entitled to apply payment to funds advanced rather than to materials supplied.⁷⁴

Deductions. Contractors who failed to finish work are entitled to the reasonable value of their work, less damages for non-completion.⁷⁵

Punitive Damages. There is some support for prohibiting an award of

punitive damages against public officials in claims under §107.170 on the basis that the purpose is only to provide the relief available by mechanic's liens.⁷⁶

CONCLUSION

Because the PBS creates liability for public officials and because it contains complex, technical requirements for its enforcement, public officials and contractors and subcontractors working on public projects should possess a knowledge of its requirements. □

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