Performance and Payment Bonds on State Construction Projects
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The economic downturn that began with the subprime mortgage crisis in 2007 and has continued through the present has not spared the construction industry. With the private construction market struggling, many contractors refocused their business toward public projects. The increased importance of public projects to contractors continues today. For these reasons, this article provides a brief review of a fundamental public construction law in Kentucky, its "Little Miller Act."

Unlike the private sector, the government has the luxury of being able to enact legislation to help achieve its goals for construction projects. Congress exercised this authority and passed the Miller Act in 1935. This legislation requires prime contractors on Federal projects to provide performance and payment bonds guarantying the contractor's work and the payment of its subcontractors, respectively.

Kentucky, along with many other states, followed suit and enacted its own version of the Miller Act (known as "Little Miller Acts"). This set of laws contain the same or similar provisions as their federal counterparts requiring performance and payment bonds on state projects. Specifically, for all construction contracts in excess of $40,000, Kentucky's Little Miller Act requires the contractor to furnish to the Commonwealth: (1) a performance bond in the amount of 100% of the contract price *as it may be increased*; and (2) a payment bond for the protection of all persons supplying labor and materials to the contractor and its subcontractors in the amount of 100% of the *original contract price*. These bonds must be executed by a surety company authorized by the Commonwealth.

Subcontractors should be aware of one particularly dangerous pitfall related to these bonds, as illustrated by the following case. The Kentucky courts have held that contractors must strictly comply with the terms of payment bonds or face forfeiture of their rights to collect on them. In the case of an insolvent general contractor that has not paid its subs, losing the protections of the payment bond can result in catastrophic (but completely avoidable) losses. In the case *Five Star Lodging, Inc. v. George Const., LLC*, 344 S.W.3d 119 (Ky. App. 2010), the Court of Appeals upheld the dismissal of the payment bond company for failure to file suit timely under the terms of the bond.

In that case, the general contractor owed its subcontractor approximately $2,553,492. As the contractor was apparently insolvent, the subcontractor's only avenue for recovery of the $2.5 Million claim was against the payment bond. However, the subcontractor failed to comply with terms of the bond requiring suit to be filed within two years from *the earlier of* completion of the project or occupancy. Consequently, the subcontractor forfeited the $2.5 Million that it otherwise would have been able to recover!

A complete analysis of Kentucky's Little Miller Act (which would include how it operates in conjunction with the public lien statutes) is beyond the scope of this article, but the careful contractor should beware of the need to comply with the terms of such bonds strictly.