THE PROTECTION OF LABORERS AND MATERIALMEN UNDER CONSTRUCTION BONDS*—Part II

MORTON C. CAMPBELL†

II. OTHER FORMS OF BONDS WHICH CONCEIVABLY MAY PROTECT PERSONS FURNISHING LABOR OR MATERIALS

A. BONDS SECURING A CONTRACTUAL UNDERTAKING OF THE PRINCIPAL TO FURNISH LABOR AND MATERIALS—PROTECTION OF THE OWNER[1]

IF THE contractual undertaking is that the builder shall furnish labor and materials "at his own expense," it is evidently designed for the protection of the owner against claims of the builder and of all other persons and hence its meaning would seem to be: (1) to exclude the builder from claiming from the owner any compensation, other than the contract price, for furnishing the requisite labor and materials, whether the former already owns the materials or later procures labor or materials for cash or on credit; and (2) to save the owner harmless from any claims which unpaid laborers or materialmen might have against the owner or his property. Accordingly, if the owner comes under matured, personal responsibility for the payment of any such claim,[2] or if his property becomes subject to a matured lien to secure such payment (as is frequently the case in private construction), and the owner pays the claim, he is obviously entitled to indemnity from the principal, or from his surety if the latter executed a bond conditioned on performance of the contract.

The like law governs situations (1) where the contract of the builder is to furnish labor and materials, although the words "at his own expense" are omitted,[3] for the furnishing thereof without additional expense to the

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† Professor of Law, Harvard Law School.

[1] While this sub-topic is not strictly within the subject of this article, it has been thought wise to consider it in view of its close connection with the following sub-topic.

[2] For example, by reason of guaranty; or by reason of statutory liability arising from a failure to procure a surety bond protecting such persons.

[3] Callan v. Empire State Surety Co., 20 Cal. App. 483, 491, 129 Pac. 978, 981 (1913) (surety company; contract to furnish all materials and labor; overruling Boas v. Maloney, 138 Cal. 105, 70 Pac. 1004 (1902), a case involving individual sureties and a contract to furnish labor and materials and to complete); Mayes v. Lane, 116 Ky. 566, 572, 76 S.W. 399, 401 (1903) (individual sureties); Stoddard v. Hibbler, 156 Mich. 335, 120 N.W. 787, 24 L.R.A. (N.S.) 1075 (1909) (contract to furnish all labor and materials; bond to save owner harmless

owner is implied;[4] and (2) even where the contract is merely to build and complete, because the furnishing of labor and materials necessary to that end without further expense to the owner is implied.[5] Furthermore, even when a lien has been filed but not paid, the owner has been given judgment against the surety for the amount thereof.[6]

The foregoing discussion concerns the right of an owner who is personally responsible, or whose property is subject to liens, for the payment of claims for labor or materials. If the owner is not under such risk, for example, when it is a public body and the property in public use, then the mere existence of liens on the fund, that is, on the contract price owing from the owner to the contractor, and hence on the latter's property, will not constitute such damage to the owner as to justify recovery by him on the surety bond.[7]

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from breach of contract); Wheeler, Osgood & Co. v. Everett Land Co., 14 Wash. 630, 45 Pac. 316 (1896) (circuity of action); Crowley v. United States F. & G. Co., 29 Wash. 268, 275, 69 Pac. 784, 786 (1902) (contract to furnish labor and materials, and to construct). See Howard v. Fisher, 86 Colo. 493, 510, 283 Pac. 1042, 1049 (1930).

Thus, in J. F. Anderson Lumber Co. v. Miner Township School Dist., 56 S.D. 586, 230 N.W. 23 (1930), the contract between a school district and a builder required the latter to furnish labor and materials, and the bond executed by a surety company was conditioned on performance of the contract, but not on payment of laborers and materialmen as a statute required that it should be; by favor of that statute a materialman recovered judgment against the owner for the amount of his claim; the owner was properly held to be entitled to indemnity from the surety because the builder had failed to furnish the materials without expense to the owner.

[4] J. F. Anderson Lumber Co. v. Miner Township School Dist., *supra* note 3 (per Burch, J.).

[5] Closson v. Billman, 161 Ind. 610, 616, 69 N.E. 449, 451 (1904). In that case the materialman was himself surety on the contractor's bond; in a suit brought by him to foreclose his lien, it was properly held that the owner had a defence on the ground of circuity of action. McRae v. University of the South, 52 S.W. 463, 466 (Tenn. Ch. 1898).

Contra: Gato v. Warrington, 37 Fla. 542, 19 So. 883 (1896) (contract to erect, finish and deliver; individual sureties; strict construction of bond).

[6] Kiewit v. Carter, 25 Neb. 460, 41 N.W. 286 (1889) (contract to "furnish material"); J. F. Anderson Lumber Co. v. Miner Township School Dist., 56 S.D. 586, 230 N.W. 23 (1930); Friend v. Ralston, 35 Wash. 422, 77 Pac. 794 (1904).

The writer submits, however, that these cases go too far, because the owner has not yet suffered damage. He is not out of pocket. Nor is he under a *sole* risk: the builder is liable to and may yet have to pay the person furnishing labor or materials, the consequence being that the owner's property would be freed from the lien; moreover, if the owner collects from the builder or his surety and does not pay such person, the builder may be subjected to double payment. The owner's proper redress is specific performance in equity. The writer recognizes, however, that if the obligation of the surety is not merely to save the owner harmless but to *pay* persons furnishing labor or materials, as the court held in Friend v. Ralston, *supra*, the weight of authority in analogous situations supports an action at law by the owner for the amount of the lien. See 2 Sedgwick, Damages §§ 788–795 (9th ed. 1913); *cf.* 38 Harv. L. Rev. 502 (1925).

[7] Village of Argyle v. Plunkett, 226 N.Y. 306, 124 N.E. 1 (1919) (even though the bond is also conditioned on *payment* of persons furnishing labor or materials).

B. BONDS SECURING A CONTRACTUAL UNDERTAKING OF THE PRINCIPAL TO FURNISH LABOR AND MATERIALS—PROTECTION OF PERSONS FURNISHING LABOR OR MATERIALS[8]

In the preceding sub-topic it was found that protection is usually given to the owner. It remains to be considered whether any right or other protection is to be given to persons furnishing labor or materials. The contract between owner and builder, standing alone, could not reasonably be interpreted as conferring rights on such persons against the builder, because he would be bound anyhow as employer or purchaser. Furthermore, even when considered in the light of the surety bond, which was then given or was about to be given to secure performance of all its provisions, the contract can scarcely be interpreted as vesting rights in persons furnishing labor or materials against the builder with a view to giving them redress against the surety on the bond. The contract and the bond run to the owner, and laborers and materialmen are not mentioned therein specifically or as a class; moreover, they frequently have liens on the property, which ordinarily give full protection, or at least on the fund, that is, the unpaid contract price, and so have partial protection. It seems, therefore, that the contract and bond should be referred exclusively to the protection of the owner, and persons furnishing labor or materials denied any right against the surety.[9]

Furthermore, when the materialman[10] has no claim against the owner

[8] Authorities pertinent to this sub-topic are collected in 27 L.R.A. (N.S.) 573, 591 (1910), Ann. Cas. 1916A 754, 756, 759, 77 A.L.R. 21, 64, 101 (1932).

[9] Sun Indemnity Co. v. American University, 58 App. D. C. 184, 26 F. (2d) 556 (1928); Morgantown Mfg. Co. v. Anderson, 165 N.C. 285, 81 S.E. 418 (1914), Ann. Cas. 1916A 763 (contract to provide all materials and perform all work; surety company; lien on fund); Yawkey-Crowley Lumber Co. v. De Longe, 157 Wis. 390, 147 N.W. 334 (1914) (contract to provide all the materials and perform all the work; surety company; lien on property). *A fortiori*, if the bond is conditioned merely on the builder's doing the work; Crane Co. v. Borwick Trenching Corp., Ltd., 138 Cal. App. 319, 32 P. (2d) 387 (1934).

Contra: Lichtentag v. Feitel, 113 La. 931, 37 So. 880 (1905) (contract to furnish labor and material; individual surety; materialman had claim against the owner and lien on his property).

In Pacific States Electric Co. v. United States F. & G. Co., 109 Cal. App. 691, 293 Pac. 812 (1930), S-2, a surety company bound on the bond of P-2, a sub-contractor, to P, a contractor, conditioned on the performance of the sub-contract, was held liable to M, who furnished materials to P-2, although the contract between P and P-2 merely obligated P-2 to "furnish materials"; the court said (1) that it made no difference that S, surety for the contractor, was liable to M for the same materials (on a bond conditioned that P should pay the claims of all persons furnishing materials to be used in the work), and (2) that if M exacted payment from S the latter would be subrogated to the former's right against S-2. The writer disagrees with the decision that M had a right against S-2, but agrees with the *dictum* that if M had such a right S would have an equity of subrogation therein.

[10] What is said in this sub-topic concerning the materialman is equally applicable to one furnishing labor or (if the coverage of the bond be wide enough) supplies, tools, machinery, board, money, etc.

or his property (as is usually true when the owner is the United States, a state, a municipality or other public body, and the property used for a public purpose), the provision of the contract calling for the furnishing of labor and materials, with or without the words "at the contractor's sole expense," can reasonably be attributed to abundant caution on the part of the owner and regarded as meant to bar the contractor from any claim for additional compensation, whether the materials be already owned by him or the labor and materials are to be procured by him for cash or on credit. In spite of the desirability of ascribing meaning to all words of a contract, the writer believes that it is going too far to look on this language as conferring protection on the unpaid materialman when the undertakings and conditions of contract and bond run only to the owner and materialmen are not mentioned therein generally or specifically.[11] Hence, by the better view, in such cases the materialman has no right against the surety, whether the latter be a friendly[12] or a professional surety,[13] and

[11] See reasoning of Otis, J., in Minneapolis Steel & Mach. Co. v. Federal Sur. Co., 34 F. (2d) 270, 273 (C.C.A. 8th 1929).

A fortiori is this interpretation sound, if the materialmen are given liens on the *fund*, that is, the balance due from the public body to the builder, even though it may turn out to be less than the aggregate of the liens. Hunter v. Boston, 218 Mass. 535, 106 N.E. 145 (1914).

[12] City of Sterling v. Wolf, 163 Ill. 467, 45 N.E. 218 (1896); Greenfield Lumber Co. v. Parker, 159 Ind. 571, 65 N.E. 747 (1902) (contract by builder to provide labor and materials at own cost); Green Bay Lumber Co. v. Independent School Dist., 121 Iowa 663, 97 N.W. 72 (1903) (contract to furnish labor and materials and deliver free from liens); Carr & Baal Co. v. Consolidated Dist., 187 Iowa 930, 174 N.W. 780 (1919); Fellows v. Kreutz, 189 Mo. App. 547, 551, 176 S.W. 1080, 1081 (1915) (*dictum*); Van Clief & Sons, Inc. v. City of New York, 141 Misc. 216, 252 N.Y.S. 402 (1931); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916); Montgomery v. Rief, 15 Utah 495, 50 Pac. 623 (1897) (contract to furnish all material and perform labor); Puget Sound Brick Co. v. School Dist., 12 Wash. 118, 40 Pac. 608 (1895) (contract to furnish materials); also cases cited in note 15, *infra*.

Contra: W. P. Fuller & Co. v. Alturas School Dist., 28 Cal. App. 609, 153 Pac. 743 (1915); Crane Co. v. Borwick Trenching Corp., Ltd., 138 Cal. App. 319, 32 P. (2d) 387 (1934), distinguishes the Fuller case on the ground that here the bond was merely conditioned on performance of the work contracted for and not on performance of the contract generally.

In Illinois it has been held that even though the bond, by reference to the contract, is conditioned on the contractor's "furnishing and *paying for*" materials, since nothing is said about paying *the materialmen*, there is no manifested intention that the provision is for their benefit, and hence they have no rights on the bond. Searles v. City of Flora, 225 Ill. 167, 172, 80 N.E. 98, 100 (1907); People v. Merkle, 269 Ill. App. 449 (1933). One wonders how materials could be paid for without paying the persons who furnish the same.

[13] Minneapolis Steel & Mach. Co. v. Federal Sur. Co., 34 F. (2d) 270 (C.C.A. 8th 1929) (alternative decision); also cases cited in note 15, *infra;* Standard Oil Co. v. National Sur. Co., 234 Ky. 764, 29 S.W. (2d) 29 (1930) (contract to furnish materials and perform labor; contract price to include payment for same; Wilson v. Nelson, 54 Okla. 457, 153 Pac. 1179 (1916).

Contra: Royal Ind. Co. v. Northern Ohio Granite & Stone Co., 100 Ohio St. 373, 126 N.E. 405 (1919), 12 A.L.R. 378 (contract to do all work and furnish all material at own expense; bond conditioned on performance of contract and saving city harmless from all claims); Mack

whether bound for the contractor to the owner, or for a subcontractor to the contractor.[14] Moreover, it has been so held when a statute required the taking of a bond conditioned that the principal would pay persons furnishing labor or materials and the particular bond expressed no such condition;[15] this seems to be a sound interpretation, although it must be conceded that the existence of the statute is a circumstance making in favor of the materialman, especially if the omission would expose the public body or the officer accepting the bond to criminal or civil liability.[16]

Mfg. Co. v. Massachusetts Bonding & Ins. Co., 103 S.C. 55, 71, 87 S.E. 439, 443 (1915) (alternative decision); Standard Oil Co. v. Powell Paving Co., 139 S.C. 411, 138 S.E. 184 (1927) (alternative decision; *ib.* 140 S.C. 39 and 144 S.C. 354, 138 S.E. 544 and 142 S.E. 612).

[14] Dunlap v. Eden, 15 Ind. App. 575, 44 N.E. 560 (1896) (individual sureties).

[15] Babcock v. American Surety Co., 236 Fed. 340 (C.C.A. 8th 1916) ("furnish all materials"); United States, for use of W. B. Young Supply Co. v. Stewart, 288 Fed. 187 (C.C.A. 8th 1923) (surety company); United States, to use of Zambetti, v. American Fence Const. Co., 15 F. (2d) 450 (C.C.A. 2d 1926) (surety company); United States, to use of Stallings, v. Starr, 20 F. (2d) 803 (C.C.A. 4th 1927) (surety company; "construct at their own expense"); Daughtry v. Maryland Cas. Co., 48 F. (2d) 786, 788 (C.C.A. 4th 1931) (*dictum*;) Warner v. Halyburton, 187 N.C. 414, 121 S.E. 756 (1924) ("provide labor and material at their own expense"; individual surety; public officer guilty of misdemeanor by omission); Wilson v. Nelson, 54 Okla. 457, 153 Pac. 1179 (1916) ("furnish all labor and materials"; surety company); Hardison & Co. v. Yeaman, 115 Tenn. 639, 91 S.W. 1111 (1906) (officers criminally and civilly responsible; but bond of surety company provided that surety should not be liable "to anyone except the owner"); Tennessee Supply Co. v. Bina Young & Son, 142 Tenn. 142, 218 S.W. 225 (1919) (officers criminally and civilly responsible; surety company). See Gill v. Paysee, 48 Nev. 12, 29, 226 Pac. 302, 308 (1924) (Ducker, C. J.; "provide all the materials and perform all the work"); and Electric Appliance Co. v. United States F. & G. Co., 110 Wis. 434, 85 N.W. 648 (1901).

Contra: Fogarty v. Davis, 305 Mo. 288, 295, 264 S.W. 879, 881 (1924) (contract "to provide all materials and perform all work"; alternative decision); Nye-Schneider-Fowler Co. v. Roeser, 103 Neb. 614, 618, 173 N.W. 605, 607 (1919) (contract "to erect"; alternative decision, reversed on other grounds in 104 Neb. 389, 177 N.W. 750 (1920)).

[16] In Sailling v. Morrell, 97 Neb. 454, 150 N.W. 195 (1914), however, a statute made it the duty of school trustees to exact a bond conditioned on the principal's paying laborers; they accepted a bond merely conditioned on performance of the contract, which required the principal to "provide all materials and perform all work." In an action brought by a laborer against the trustees, judgment was rendered for the defendants on the grounds (1) that the bond indirectly protected the laborer and hence he suffered no damage, and at any rate (2) that it was not proved that the trustees acted in bad faith.

Of course, if a court accepts the doctrine that a bond given because required by statute impliedly incorporates the provisions of the statute, the materialman will prevail against the surety. Fogarty v. Davis, 305 Mo. 288, 293, 264 S.W. 879, 880 (1924) (alternative decision); Nye-Schneider-Fowler Co. v. Roeser, *supra* note 15 (alternative decision); Gill v. Paysee, 48 Nev. 12, 22, 226 Pac. 302, 306 (1924) (Coleman, J.).

It is clear that, if the statute provides that a bond given thereunder shall have the same legal effect as if the condition protecting laborers and materialmen were written therein, they will be protected accordingly even though the bond contains no provision to that effect. Com-

Furthermore, even if the contract states or stipulates that the principal gives or shall give a bond with sufficient surety conditioned on payment of laborers and materialmen, and the surety bond given is not so expressly conditioned but only on performance of all the provisions of the contract, an action does not lie in favor of the materialman against the surety on any theory that the bond was impliedly conditioned on the payment of their claims;[17] nor, it seems, for damages resulting from the principal's failure to give a bond in the originally stipulated form, for the tender and acceptance of a bond in different form constituted an effective discharge of the stipulation of the contract.[18]

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mercial Bank of Magee v. Evans, 145 Miss. 643, 651, 112 So. 482 (1927); Standard Electric Time Co., Inc. v. Fidelity & Deposit Co., 191 N.C. 653, 656, 132 S.E. 808, 809 (1926) (alternative decision); Southern Sur. Co. v. Chambers, 115 Ohio St. 434, 154 N.E. 786 (1926).

For collections of authorities dealing with the liability of the municipality to laborers and materialmen for failing to take the required bond or a bond in the required form, see notes, L.R.A. 1915F 629, Ann. Cas. 1917B 1089, and 64 A.L.R. 678 (1929); with the liability of the public officer, see notes, 49 L.R.A. (N.S.) 1199 (1914), Ann. Cas. 1917B 1089, 1092, and 64 A.L.R. 678 (1929).

[17] Babcock v. American Sur. Co., 236 Fed. 340, 341 (C.C.A. 8th 1916); and cases cited in note 18, *infra;* United States, to use of Stallings, v. Starr, 20 F. (2d) 803 (C.C.A. 4th 1927).

In Daughtry v. Maryland Casualty Co., 48 F. (2d) 786, 788 (C.C.A. 4th 1931), however, the additional facts were present that the bond was expressed by the contract to be, and actually was, executed concurrently therewith, and the contract was attached to the bond and was so referred to therein; it was held that the bond was impliedly conditioned on payment of materialmen. And see Southwestern Sash & Door Co. v. American Employers' Ins. Co., 37 N.M. 212, 215, 20 P. (2d) 928, 930 (1933).

Of course, if the contract stipulates that the principal shall pay laborers and materialmen, and not merely give bond to pay them, the surety is bound to such persons by virtue of the general condition of the bond. Peake v. United States, 16 App. D.C. 415, 419 (1900).

Moreover, if the same surety executed a "bid" bond, though in much smaller amount, conditioned on the principal's entering into proper contract and furnishing a bond securing performance thereof and payment of all claims for labor and materials, the "bid" bond of the surety has been held to indicate that the final bond was intended to comply therewith though explicit protection of the materialman was omitted therefrom. American Guar. Co. v. Cliff Co., 115 Ohio St. 524, 531, 155 N.E. 127, 129 (1926) (alternative decision).

[18] United States, for use of W. B. Young Supply Co., v. Stewart, 288 Fed. 187, 189 (C.C.A. 8th 1923); Builders Material & Supply Co. v. Evans Const. Co., 204 Mo. App. 76, 86, 221 S.W. 142, 145 (1920) (public construction); Crum v. Jenkins, 145 S.C. 177, 187, 143 S.E. 21, 24 (1928) (alternative decision; private construction); Electric Appliance Co. v. United States F. & G. Co., 110 Wis. 434, 438, 85 N.W. 648, 649 (1901); and see United States, to use of Zambetti, v. American Fence Const. Co., 15 F. (2d) 450 (C.C.A. 2d 1926).

A fortiori, no action will lie in favor of the materialman against the surety in the *federal courts* under favor of 33 Stat. 811, c. 778 (1905); 40 U.S.C.A. § 270 (1928). United States, to use of Zambetti, v. American Fence Const. Co., *supra*.

It is to be observed, however, that in case of mutual mistake in expression, not only the owner, but probably the materialman, may have equitable relief by way of reformation. Faurote v. State, 110 Ind. 463, 466, 11 N.E. 472, 474 (1887), as explained in Hart v. State, 120 Ind. 83, 84, 87, 21 N.E. 654, 655, 24 *id.* 151 (1889).

Moreover, the addition of a condition that the work shall be completed and delivered free from liens of persons furnishing labor or materials, or that the owner be saved harmless from the liens or other claims of such persons, should not affect the interpretation of the agreement to furnish labor and materials, whether such liens could be acquired, as in cases of private ownership, or could not be acquired, as in cases of public ownership and use.[19] While the agreement to furnish labor and materials cannot here be reasonably referred to the indemnification of the owner against claims therefor, still it need not be interpreted as vesting rights in the materialman; it may better be ascribed to a desire on the part of the owner to exclude the contractor from claiming compensation in addition to the contract price. It is also to be observed, as discussed in a later subtopic,[20] that a provision to save the owner harmless from liens may be met, not necessarily by paying the materialman or by procuring a release from him, but by putting the owner in sufficient funds to pay him; moreover, the form of the condition imports an intention to protect and vest rights in the owner rather than in the materialman.

Even more clearly, it makes no difference that the additional stipulation is to the effect that a present or retained percentage of estimates should be payable by the owner to the contractor only if there be no liens on the property and/or receipts of payment or other evidence of that fact be produced.[21]

In the Michigan case of *Alpena, for use of Zess, v. Title Guaranty & Surety Co.*,[22] the contract required the principal to furnish labor and materials at his own expense, and the surety bond was conditioned on his performance of the contract and also on his saving the *city and its officers* harmless from all claims for labor and materials. A materialman was held

[19] Townsend v. Cleveland Fire Proofing Co., 18 Ind. App. 568, 575, 47 N.E. 707, 709 (1897); Staples-Hildebrand Co. v. Metal Concrete Chimney Co., 62 Ind. App. 592, 112 N.E. 832 (1916); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916); Smith v. Bowman, 32 Utah 33, 45, 88 Pac. 687, 691 (1907) (individual sureties).

Contra: La Crosse Lumber Co. v. Schwartz, 163 Mo. App. 659, 147 S.W. 501 (1912) (also omission on part of public officers to comply with statutory duty to take bond conditioned on payment of persons furnishing labor or materials; individual sureties; court reasoned that otherwise condition to save harmless would be meaningless).

Moreover, when the materialman has no claim against the owner or on his property, there is no color for "subrogating" or otherwise equitably entitling the materialman to the right of the owner against the surety for exoneration. Townsend v. Cleveland Fire Proofing Co., *supra*.

[20] *Infra*, sub-topic II-C.

[21] Staples-Hildebrand Co. v. Metal Concrete Chimney Co., 62 Ind. App. 592, 112 N.E. 832 (1916); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916); Montgomery v. Rief, 15 Utah 495, 50 Pac. 623 (1897).

[22] 158 Mich. 678, 123 N.W. 536 (1909).

to have a right against the surety. The writer doubts the soundness of the decision; he submits that the materialman had merely a right against the public officers for their failure to require a bond in proper form, and the latter a right of recourse against the surety. The agreement to furnish materials fell short of importing a right in the materialman, and the condition in the bond saving the officers harmless was intended only for their protection and might have been fulfilled by principal or surety without paying the materialman, for example, by putting the officers in funds for that purpose or by procuring the materialman to release them. Likewise, the writer is forced to disagree with the California case of *Sunset Lumber Co. v. Smith*,[23] a case of private construction, in which the bond was conditioned on performance of a contract requiring the contractor to furnish necessary labor and materials and complete the work free from all liens. He believes that an intention to create a right in the materialman against the surety was not sufficiently manifested, in spite of the provision of a California statute[24] that the filing of a bond so protecting materialmen would restrict the lien on the owner's property to the amount due from him to the contractor.

C. BONDS CONDITIONED, DIRECTLY OR BY REFERENCE TO THE CONTRACT, AGAINST LIENS ON THE PROPERTY OF THE OWNER OR FOR HIS INDEMNIFICATION

If the condition is that the principal shall complete and deliver the work free from liens for labor or materials, the obvious purpose is the protection of the owner and the intention is that he, and he alone, shall have rights. Hence, if the owner pays a person who has furnished labor or materials and thus removes a perfected lien on his property, he may recover his loss so caused in an action on the surety bond. If, however, the time for filing or otherwise perfecting the lien has expired, a payment by the owner cannot be recovered in an action on the bond, for it is voluntary and not the proximate consequence of the principal's default.[25] Moreover, if the lien has not been perfected, so that it is as yet non-existing or inchoate, even though the time for perfecting it has not expired, the payment should not be recoverable in an action on the bond;[26] it should be regarded as volun-

[23] 91 Cal. App. 746, 267 Pac. 738 (1928). [24] Cal. Code of Civ. Proc. § 1183 (1931).

[25] Fuqua v. Tulsa Masonic Bldg. Ass'n, 129 Okla. 106, 263 Pac. 660 (1928), Campbell's Cases on Suretyship 19 (1931).

[26] Bell v. Paul, 35 Neb. 240, 52 N.W. 1110 (1892).

Contra: Fuqua v. Tulsa Masonic Bldg. Ass'n, 129 Okla. 106, 110, 263 Pac. 660, 663 (1928) (*dictum* that it is sufficient if lien is existing or impending).

In Simonson v. Grant, 36 Minn. 439, 31 N.W. 861 (1887), it was not held that a payment made by the owner to the materialman before lien filed could not be recovered from the surety, but only that, there being no such amount then due from the owner to the contractor, the payment was such an unjustifiable variation of the risk of the surety as to discharge him from responsibility for future payments.

tary since the owner was not under risk of imminent loss and the principal might have paid the materialman. Nevertheless, it must be observed that, if the bond is also conditioned on the payment of persons furnishing labor or materials, a payment made by the owner to such person before lien filed, while not caused, is not officious and therefore in equity justifies the subrogation of the owner, as a non-officious payor, to the claim of such person against the surety on the bond,[27] or quasi-contractual recovery at law against him on the ground of benefit conferred by the discharge of his obligation.

On the other hand, when the bond is merely conditioned on completion and delivery of the work free from liens, the person furnishing labor or materials, although not paid therefor, usually cannot recover judgment on the surety bond. This conclusion is clear (1) when a statute gives to such person a lien on the property of the owner[28] (as is frequently the case when the work is of a private nature), for the condition is then obviously referable to the protection of the owner alone;[29] and (2) even when no lien on his property is possible, for example, when it is of public ownership and use,[30] because the language shows that the attention of the parties is directed to protection of the public owner, and the presence of the provision is properly attributable to misapprehension or abundant caution. It is to be expected, however, that circumstances may point so strongly the other way as to make the question of interpretation a close one. Thus,

[27] Yawkey-Crowley Lumber Co. v. Sinaiko, 189 Wis. 298, 303, 206 N.W. 976, 978 (1926).

[28] Fleming v. Greener, 173 Ind. 260, 266, 268, 90 N.E. 72, 73, 76, 140 Am. St. Rep. 254, 258, 21 Ann. Cas. 959, 961, modifying 87 N.E. 719, 721 (1909); Stetson & Post Mill Co. v. McDonald, 5 Wash. 496, 32 Pac. 108 (1893) (although the surety did not execute any bond, he signed contract as such). See Uhrich v. Globe Sur. Co., 191 Mo. App. 111, 166 S.W. 845 (1915).

[29] *A fortiori* is this true, if the bond provides that the surety shall not be liable to anyone except the owner (Herpolsheimer v. Hansell-Elcock Co., 141 Mich. 367, 369, 104 N.W. 671, 672 (1905); Morganton Mfg. Co. v. Anderson, 165 N.C. 285, 81 S.E. 418 (1914), Ann. Cas. 1916A 763), or that the use or benefit of the bond, or right of action thereon, shall not accrue to anyone except the owner (Crum v. Jenkins, 145 S.C. 177, 143 S.E. 21 (1928)).

Bonds Given by Owner to Mortgagee. Likewise, if the owner gives to a mortgagee a bond with surety conditioned on completion of construction free from liens for labor or materials, a laborer or materialman has no rights thereon. Cleveland Window Glass & Door Co. v. National Sur. Co., 118 Ohio St. 414, 161 N.E. 280 (1928) (bond also conditioned on saving mortgagee harmless from such liens; mortgage superior to any lien); National Sur. Co. v. Brown-Graves Co., 7 F. (2d) 91 (C.C.A. 6th 1925) (same).

[30] Green Bay Lumber Co. v. Independent School Dist., 121 Iowa 663, 97 N.W. 72 (1903) (*ib.*, 90 N.W. 504); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916) (even though a statute required the taking of a bond conditioned on payment for labor and materials); Electric Appliance Co. v. United States F. & G. Co., 110 Wis. 434, 85 N.W. 648, 53 L.R.A. 609 (1901) (even though contract called for a bond conditioned on payment for labor or materials, and the condition was omitted).

All the more clearly is this true, if the bond provides that the surety shall not be liable, nor its benefit accrue, to anyone other than the owner. *In re* Fowble, 213 Fed. 676 (D.C. Md. 1914).

in *La Crosse Lumber Co. v. Schwartz*,[31] the bond was also conditioned on the contractor's furnishing materials, and it was the statutory duty of the public officers to insert a condition for the payment of persons furnishing labor or materials; it was held that an individual surety was liable to a materialman[32] on the reasoning that otherwise the condition for delivery free from liens would be meaningless and the officers remiss in performance of duty. Nevertheless, in such a case liability to the materialman would be excluded by a provision in the bond that the surety should not be liable to anyone except the owner, or that the use or benefit of the bond or the right of action thereon should not accrue to any person other than the owner.[33]

Likewise, rights are denied to persons furnishing labor or materials when the bond is directly or by reference conditioned on "saving the owner harmless"[34] or "exonerating" him from, or "reimbursing" him for,[35] the payment of such liens or claims. The reasons for such denial are stronger here than in the situations last considered. A condition to deliver construction free from liens can be met, if liens have arisen, only by paying the lienors or by procuring releases from them (in return for which they may exact payment). On the other hand, a condition to exonerate, or to save harmless (which properly includes exoneration), can be met alternatively by putting the owner in sufficient funds to make payment; and a condition to reimburse necessarily contemplates performance to the owner. *A fortiori*, a person furnishing labor or materials will have no right on the bond when the contract to which it refers merely stipulates that the

[31] 163 Mo. App. 659, 147 S.W. 501 (1912).

[32] *Contra:* McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916) (although bond also contained a condition that owner be saved harmless from such claims). And see Wilson v. Nelson, 54 Okla. 457, 153 Pac. 1179 (1916) ("indemnify and save harmless").

[33] Wallace Equipment Co. v. Graves, 132 Wash. 141, 144, 231 Pac. 458, 460 (1924).

[34] Pine Bluff Lodge v. Sanders, 86 Ark. 291, 298, 111 S.W. 255, 257 (1908); Skinner Bros. Mfg. Co., Inc. v. Shevlin Eng. Co., Inc., 231 App. Div. 656, 659, 248 N.Y.S. 380, 383 (1931); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916); Wilson v. Nelson, 54 Okla. 457, 153 Pac. 1179 (1916); Blyth-Fargo Co. v. Free, 46 Utah 233, 148 Pac. 427 (1915). And see Dunlap v. Eden, 15 Ind. App. 575, 44 N.E. 560 (1896) (sub-contractor's bond conditioned on saving contractor harmless from liens; public construction; see note 86, *infra*).

A fortiori is this result to be reached when the bond provides that the surety shall be liable to, or the use or benefit of the bond or the right of action thereon accrue to, no one save the owner. Yet even then the materialman may recover judgment against the surety, if a statute not only requires the execution of a bond conditioned for the protection of persons furnishing labor or materials but also provides that a bond in which such condition is omitted shall have the same legal effect as if it were included. Union Ind. Co. v. Acme Blow Pipe Works, 150 Miss. 332, 349, 117 So. 251, 253 (1928).

[35] Green Bay Lumber Co. v. Independent School Dist., 121 Iowa 663, 97 N.W. 72 (1903).

retained percentage shall be payable by owner to contractor only if there be no liens on the property and/or a receipt of payment or other evidence thereof be produced.[36]

Indeed, in two cases a materialman has been denied recovery from the surety when the bond was conditioned on the contractor's paying any lien for labor or materials as well as on his freeing the owner's property therefrom: (1) The Minnesota case of *Moore v. Mann*[37] was one of private construction and the owner's property was exposed to such liens. The writer submits that the provision for paying the lien might well have been ascribed to an intention to vest a right to receive payment in the lienor, and the provision for freeing the owner's property from the lien to an intention to place in the latter a right to require such payment.[38] (2) In the Illinois decision of *Spalding Lumber Co. v. Brown*,[39] in which the owner was a public school district, the statute imposed a lien not on the building but on the fund, that is, on the balance due from the owner to the contractor, and hence on property of the latter. If the parties inserted the provision for discharging the owner's property from liens *under misapprehension*, the question of interpretation was like that considered in connection with the Minnesota case; and if out of abundant caution, the provision for payment had to be accounted for, and it rather clearly imported an intention to create rights in the materialman, since he needed the responsibility of the surety, inasmuch as the lien on the fund might (and actually did) turn out to be insufficient. The writer's position, that the surety is bound to the materialman on such a bond, is all the stronger if a statute requires it to be conditioned on payment of claims for labor or materials.

Cases have arisen in which the contract calls for a surety bond conditioned on the payment of persons furnishing labor or materials, but the bond executed is conditioned only against liens on the property of the owner or for his indemnification generally. In such cases, if the bond is not also conditioned on performance of the contract, the requirement of the contract is not sufficiently significant to lead to an interpretation of the bond favoring materialmen;[40] and so, even when the bond is conditioned

[36] Montgomery v. Rief, 15 Utah 495, 50 Pac. 623 (1897). Sub-topic II-F.

[37] 130 Minn. 318, 153 N.W. 609 (1915) (surety company held not liable to materialman).

[38] See Getchell & Martin Lumber Co. v. Peterson & Sampson, 124 Iowa 599, 100 N.W. 550 (1904) ("pay all claims for labor and material, and save owner harmless from any liens therefor"; judgment for materialman against surety company affirmed).

[39] 171 Ill. 487, 49 N.E. 725 (1898) (individual sureties held not liable to materialman). *Accord:* City of Herrin v. Stein, 206 Ill. App. 339 (1917).

[40] Wallace Equipment Co. v. Graves, 132 Wash. 141, 231 Pac. 458 (1924) (also, use of bond confined to owner).

on performance of all the provisions of the contract; nor in the latter case could a materialman recover damages for failure to give the bond required by the contract, since the owner by accepting a different bond discharged the contractual undertaking.[41]

D. BONDS CONDITIONED, DIRECTLY OR BY REFERENCE TO THE CONTRACT, ON PAYING CLAIMS FOR LABOR OR MATERIALS, AND ALSO ON PROTECTING THE OWNER AGAINST LIENS THEREFOR

The question presented by such a bond is whether the presumption or inference arising from the condition to pay claims for labor or materials is rebutted by the presence of the condition protecting the owner against such claims, for example, a condition that the work be completed and delivered free from liens, or that the owner be saved harmless or exonerated therefrom or reimbursed for loss suffered thereby. There are three lines of decision:

(1) Some authorities hold that materialmen[42] have no direct rights on the bond, it being said either that the manifested purpose of the bond is confined to protecting the owner and its intention to placing rights in him,[43] or that if there is an intention to create rights in materialmen legal effect will not be given to it.[44] Even so, if the owner's property is subject to lien, as it usually is in a case of private construction, the materialmen may well be held equitably entitled to the right of the owner against the surety that the latter pay the materialmen,[45] although the rule of *Law-*

[41] See sub-topic II-B, note 18.

[42] The statements made in this sub-topic are equally applicable to persons furnishing labor; and, if the coverage of the bond be wide enough, to supply and other creditors.

[43] Maryland Cas. Co. v. Johnson, 15 F. (2d) 253 (D.C. Mich. 1926) (also stressing no reliance); Moore v. Mann, 130 Minn. 318, 153 N.W. 609 (1915) (surety company); Pankey v. National Sur. Co., 115 Ore. 648, 239 Pac. 808 (1925) and cases there cited; National Bank of Cleburne v. Gulf etc. Ry. Co., 95 Tex. 176, 66 S.W. 203 (1902); Oak Cliff Lumber Co. v. American Ind. Co., 266 S.W. 429 (Tex. Civ. App. 1924); Forsyth v. New York Ind. Co., 159 Wash. 318, 293 Pac. 284 (1930) and cases there cited.

[44] Central Supply Co. v. United States F. & G. Co., 273 Mass. 139, 145, 173 N.E. 697, 699 (1930); Jefferson v. Asch, 53 Minn. 446, 55 N.W. 604, 25 L.R.A. 257, 39 Am. St. Rep. 618 (1893) (bond given "for the use" of materialmen).

[45] It is to be observed that the owner is a real surety for the contractor. The fact that one is a real rather than a personal surety does not prevent the creditor from being equitably entitled to his interest in a security *res* proceeding from the principal (Baltimore & Ohio R.R. Co. v. Trimble, 51 Md. 99, 113 (1878); and see Van Orden v. Durham, 35 Cal. 136 (1868), and Sherrod v. Dixon, 120 N.C. 60, 26 S.E. 770 (1897)). Nor should it prevent the creditor from being entitled to the obligation of a stranger (here the surety) especially when, as here, that obligation is to pay the creditor (Curtis v. Tyler, 9 Paige (N.Y.) 431 (1842), Campbell's Cases on Suretyship 233–234 (1931)). It is true that the materialman, not being a creditor of the owner personally, could not seize this asset by way of equitable execution. Nevertheless, ours is a case of a peculiar asset—peculiar in that performance necessarily comes to the materialman. See also the

rence v. Fox[46] probably cannot be so extended as to give a direct legal right against the surety.

(2) Other authorities, especially the more recent ones, hold that the materialmen have direct rights against the surety on the bond. This is the sound conclusion, for, if the condition for the payment of materialmen were intended to give protection to and place a right in the owner alone, the condition protecting him against liens would be entirely redundant. This conclusion becomes almost irresistible when a statute requires the bond to include a condition for the payment of materialmen, or if it requires that it be thus drawn in order to avoid a lien on the property of the owner. Nor does it make any difference whether the owner's property could[47] or could not be subjected to liens.[48] In the former situation each of the two conditions is thus assigned a distinct use; in the latter the condition against liens should be ascribed to misapprehension or abundant

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treatment of an analogous situation in sub-topic I-D, note 106, in Part I of this article, published in 3 Univ. Chi. L. Rev. 1 (1935). Of course, if the materialman has no claim against the owner or on his property, even the indirect method of reaching the surety fails.

[46] 20 N.Y. 268 (1859).

[47] Wm. Bayley Co. v. Columbia Cas. Co., 50 F. (2d) 899 (C.C.A. 5th 1931); Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 265, 125 So. 55, 57 (1929), 77 A.L.R. 13, 18; Mansfield Lumber Co. v. National Sur. Co., 176 Ark. 1035, 5 S.W. (2d) 294 (1928); Aetna Cas. & Sur. Co. v. Big Rock Stone Co., 180 Ark. 1, 20 S.W. (2d) 180 (1929) (as it turned out, the materialman failed to file lien seasonably; and see Morris v. Nowlin Lumber Co., 100 Ark. 253, 268, 140 S.W. 1, 6 (1911)); Byram Lumber & Supply Co. v. Page, 109 Conn. 256, 146 Atl. 293 (1929); American Sur. Co. v. Smith, 100 Fla. 1012, 130 So. 440 (1930); Johnson Elec. Co., Inc. v. Columbia Cas. Co., 101 Fla. 186, 133 So. 850 (1931); Knight & Jillson Co. v. Castle, 172 Ind. 97, 87 N.E. 976 (1909), 27 L.R.A. (N.S.) 573 (*dictum*); Aetna Cas. & Sur. Co. v. United States Gypsum Co., 239 Ky. 247, 39 S.W. (2d) 234 (1931) (materialman filed lien but it was discharged under the statute by the owner's giving another bond with sureties); Dixon & Wright v. Horne, 180 N.C. 585, 105 S.E. 270 (1920) (bond conditioned that principal "satisfy all claims and demands" and indemnify the owner for loss suffered by failure so to do); Pittsburgh Plate Glass Co. v. Fidelity & Deposit Co., 193 N.C. 769, 138 S.E. 143 (1927), *ib.*, 197 N.C. 10, 147 S.E. 681 (1929); Warren Webster & Co. v. Beaumont Hotel Co., 151 Wis. 1, 138 N.W. 102 (1912) (bond conditioned on principal's paying "all indebtedness"); Concrete Steel Co. v. Illinois Sur. Co., 163 Wis. 41, 157 N.W. 543 (1916) (bond conditioned on principal's satisfying "all claims and demands").

So, when the bond referred to the contract, which required the contractor to pay all persons furnishing labor or materials and made final payment of the contract price conditional on the discharge of all liens on the property and production of receipts therefor. Algonite Stone Mfg. Co. v. Fidelity & Deposit Co., 100 Kan. 28, 163 Pac. 1076 (1917), L.R.A. 1917D 722.

[48] Leslie Lumber & Supply Co. v. Lawrence, 178 Ark. 573, 11 S.W. (2d) 458 (1928); French v. Farmer, 178 Cal. 218, 172 Pac. 1102 (1918) (work being done for railway company on land of United States government); Baker & Co. v. Bryan, 64 Iowa 561, 21 N.W. 83 (1884); Hartford Acc. & Ind. Co. v. W. & J. Knox Co., 150 Md. 40, 48, 132 Atl. 261, 263 (1926) (mechanic's lien on private property not obtainable in Baltimore); H. H. Robertson Co. v. Globe Ind. Co., 268 Pa. 309, 112 Atl. 50 (1920) (statute so required).

caution. Since this is a question of interpretation, it obviously makes no difference whether or not a lien was ultimately perfected. It is to be observed that the form of bond adopted by the American Institute of Architects falls within this class,[49] and when a bond in that form is involved in litigation the further reason may be adduced that courts should impute to the parties the apparent intention of the Institute to extend protection not alone to the owner but to persons furnishing labor or materials.[50] Consequently, by the weight of authority, the materialman is recognized as having a direct right on the bond.[51]

(3) There is authority for an intermediate view that the bond is to be interpreted as conditioned on the payment of such claims for labor and materials as shall become effective liens.[52]

In situations where the materialman has a lien on the property of the owner and also a right on the bond against the surety, the owner is a real surety, and the surety a personal surety, for the contractor to the materialman; and they are in the consensual relation of subsurety and surety, respectively, since such is the effect of the condition in the bond to save the owner harmless from, or reimburse him for, payment of the claim of the materialman; the result is that the owner is entitled to the usual rights of recourse, that is, reimbursement, subrogation and exoneration, against the surety as well as against the contractor.

[49] The condition of this form of bond is as follows: "*Now, Therefore*, the Condition of this Obligation is such that if the Principal shall faithfully perform the Contract on his part, and satisfy all claims and demands, incurred for the same, and shall fully indemnify and save harmless the Owner from all cost and damage which he may suffer by reason of failure so to do, and shall fully reimburse and repay the Owner all outlay and expense which the Owner may incur in making good any such default, and shall pay all persons who have contracts directly with the Principal for labor or materials, then this obligation shall be null and void; otherwise it shall remain in full force and effect." Blake, Law of Architecture and Building 317 (2d ed. 1925).

[50] Bouldin, J., in Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 266, 125 So. 55, 59, 77 A.L.R. 13, 19 (1929); Maltbie, J., in Byram Lumber & Supply Co. v. Page, 109 Conn. 256, 266, 146 Atl. 293, 296 (1929).

[51] Wm. Bayley Co. v. Columbia Cas. Co., 50 F. (2d) 899 (C.C.A. 5th 1931); Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 265, 125 So. 55, 57, 77 A.L.R. 13, 18 (1929); Mansfield Lumber Co. v. National Sur. Co., 176 Ark. 1035, 5 S.W. (2d) 294 (1928); Byram Lumber & Supply Co. v. Page, 109 Conn. 256, 146 Atl. 293 (1929); Johnson Elec. Co., Inc. v. Columbia Cas. Co., 101 Fla. 186, 133 So. 850 (1931); Hartford Acc. & Ind. Co. v. W. & J. Knox Co., 150 Md. 40, 132 Atl. 261 (1926); Pittsburgh Plate Glass Co. v. Fidelity & Deposit Co., 193 N.C. 769, 138 S.E. 143 (1927); Pittsburgh Plate Glass Co. v. Hotel Corp., 197 N.C. 10, 147 S.E. 681, 198 N.C. 166, 150 S.E. 877 (1929).

Contra: Central Supply Co. v. United States F. & G. Co., 273 Mass. 139, 173 N.E. 697 (1930); Forsyth v. New York Ind. Co., 159 Wash. 318, 324, 293 Pac. 284, 286 (1930) (on the ground of absence of privity of contract, and distinguishing bonds for public construction).

[52] Marquette Bldg. Co. v. Wilson, 109 Mich. 223, 67 N.W. 123 (1896) (materialman failed seasonably to perfect lien on private property).

E. BONDS CONDITIONED, DIRECTLY OR BY REFERENCE TO THE CONTRACT, ON PAYMENT OF THE CLAIMS OF PERSONS HAVING LIENS FOR LABOR OR MATERIALS OR STATED TO BE FOR THEIR USE

If the bond is so worded, it is generally not intended that persons furnishing labor or materials without acquiring liens on the property should have rights on the bond, whether there is a statute which permits the filing of liens, as when the promisee is a private owner,[53] or no such statute, as when the property is of public ownership and use.[54]

When the property is of public ownership and use, the condition must be ascribed to misapprehension or abundant caution. Even so, if the bond is conditioned generally, that is, for the payment of all indebtedness of the contractor, or the claims of all persons furnishing labor or materials, but is stated to be for the *benefit of persons having liens* on the property of the owner for labor and materials furnished, it has been held that the inference or presumption (arising from the *condition*) that all persons having claims, or claims for furnishing labor or materials, as the case may be, are intended to have rights on the bond, is not rebutted by the expression of a qualified class of beneficiaries, since no one can meet the qualification.[55] Furthermore, the existence of a statute requiring a bond conditioned on the payment of all claims for labor or materials is an additional circumstance lending support to that interpretation.[56]

If the bond is conditioned on the payment of anyone "who, in the absence of the bond, would have a lien" on the fund, steps for the perfection and preservation of such a lien need not be taken, since by force of statute the execution of the bond excludes an enforceable lien.[57]

Lastly, suppose that the property is of private ownership and that a person furnishing labor or materials has acquired a lien thereon. By the very condition of the bond such a person is to receive payment, but is he intended to have *a right* to payment? For the negative, it may be argued that usually he is fully protected by the lien and hence not in need of a

[53] The writer has not found supporting authority.

[54] Hutchinson v. Krueger, 34 Okla. 23, 124 Pac. 591 (1912), 41 L.R.A. (N.S.) 315, Ann. Cas. 1914C 98.

[55] Snider v. Greer-Wilkinson Lumber Co., 51 Ind. App. 348, 96 N.E. 960 (1912) (public construction; bond conditioned on payment of all indebtedness; but expressed to run to and be for the use and suit of persons acquiring liens; individual sureties).

Contra: Smith v. Bowman, 32 Utah 33, 88 Pac. 687 (1907), 9 L.R.A. (N.S.) 889 (like facts).

[56] Klein v. Beers, 95 Okla. 80, 218 Pac. 1087 (1923) (other facts like those in Snider v. Greer-Wilkinson Lumber Co., *supra* note 55).

[57] Guard Rail Erectors, Inc. v. Standard Sur. & Cas. Co., 86 N.H. 349, 168 Atl. 903 (1933) (involving N.H. Laws 1927, c. 88, §§ 1, 2). And see American Bridge Co. v. United States F. & G. Co., 174 Atl. 57 (N.H. 1934), in which one furnishing material to a sub-contractor was allowed to recover on the bond.

right on the bond; and also that, if the owner had an interest in the protection of laborers and materialmen, he would naturally have included those without liens as well as those with liens. It seems to be the better view, however, that the usual inference or presumption of intention to create rights in the person who is to receive payment is not rebutted; it will be to the advantage of the owner for the lienor to have a right against the surety which he can and probably will enforce in exoneration of the property of the owner.

F. BONDS CONDITIONED ON PERFORMANCE OF CONTRACTS WHICH PROVIDE FOR THE OWNER'S WITHHOLDING OF THE CONTRACT PRICE UNTIL CLAIMS FOR LABOR OR MATERIALS BE PAID OR RECEIPTS BE PRODUCED

(1) If the contract makes payment of the contract price or any part thereof (for example, payable or retained percentages of estimates) conditional, either absolutely or at the election of the owner, on the contractor's paying persons having claims for labor or materials, or otherwise provides in effect that the owner shall or may withhold the price until such persons be paid, the latter do not thereby obtain rights on the surety bond, whether the property, being of private ownership, is subject to liens for such claims,[58] or, being of public ownerwhip and use, is not so subject.[59]

(2) Likewise, if the contract makes such payment conditional, either absolutely or at the election of the owner,[60] on the contractor's producing releases, receipts for payment, or other evidence of satisfaction, of claims

[58] Uhrich v. Globe Sur. Co., 191 Mo. App. 111, 166 S.W. 845 (1915) (right to withhold purchase price until liens satisfied; agreement in contract to pay for all labor and material in same sentence with the agreement to build and regarded by court as importing intention only to protect owner). See Lauer v. Dunn, 115 N.Y. 405, 409, 22 N.E. 270, 271 (1889) (*arguendo;* lien only on fund), and Hurd v. Johnson Park Inv. Co., 13 Misc. 643, 34 N.Y.S. 915 (1895) (*arguendo;* lien only on fund).

Contra: Cooke v. Luscombe, 132 Kan. 147, 294 Pac. 849 (1931).

[59] Hunter v. Boston, 218 Mass. 535, 106 N.E. 145 (1914) (contract provided that city "shall deduct and retain" from monthly estimates sums required to settle claims for labor or materials); McCausland & Co. v. Brown Const. Co., 172 N.C. 708, 90 S.E. 1010 (1916) (bond conditioned on turning building over free from liens and saving city harmless; contract provided that city might retain out of price an amount sufficient for its indemnity); Montgomery v. Rief, 15 Utah 495, 50 Pac. 623 (1897) (retained percentage to be payable only if there be no liens for labor or materials and on the contractor's producing payrolls, receipts or releases that all labor and materials have been fully paid for); Electric Appliance Co. v. United States F. & G. Co., 110 Wis. 434, 85 N.W. 648 (1901), 53 L.R.A. 609 (contract provided that work should be delivered free from liens and that before final payment the contractor should produce receipts for labor and materials).

Contra: Korsmeyer Plumbing & Heating Co. v. McClay, 43 Neb. 649, 650, 62 N.W. 50, 51 (1895); Des Moines Bridge & Iron Works v. Marxen, 87 Neb. 684, 128 N.W. 31 (1910); Northwestern Bridge & Iron Co. v. Maryland Cas. Co., 171 Wis. 526, 177 N.W. 31 (1920) (not only was subcontractor awarded the amount due from city to contractor but also given judgment against the surety company for the balance of his claim).

[60] Baltimore v. Maryland Cas. Co., 146 Md. 508, 126 Atl. 880 (1924).

for labor or materials, persons having such claims have no rights on the surety bond, whether the property be of private ownership,[61] or of public ownership and use.[62]

These are sound interpretations. In cases of private ownership the provision of the contract, whether of the type treated in the first paragraph or in the second, is obviously intended for the security of the owner against such liens.[63] In cases of public ownership and use either type of provision is properly attributable to misapprehension or abundant caution on the part of the owner rather than to an intention to place rights in persons furnishing labor or materials; or else to an intention (especially when withholding of payment is made dependent on the election of the owner) to create in such persons liens on the fund, that is, on the right of the contractor against the owner to receive the contract price—an intention which stops far short of vesting rights in them on the surety bond.[64]

It is to be observed, however, in cases falling under either paragraph (1) or (2) of this sub-topic, that if the bond, directly or by reference to the contract, is also conditioned on the payment of persons having claims for labor or materials, such persons have rights on the surety bond, whether the owner's property may[65] or may not be[66] subjected to lien.

[61] *Contra:* Cooke v. Luscombe, 132 Kan. 147, 294 Pac. 849 (1931) ("furnish all labor and materials necessary . . . . ; balance payable after receipts are furnished showing all labor and material is paid for"; improperly rested on Algonite Stone Mfg. Co. v. Fidelity & Deposit Co., 100 Kan. 28, 163 Pac. 1076 (1917), L.R.A. 1917D, 722).

[62] Staples-Hildebrand Co. v. Metal Concrete Chimney Co., 62 Ind. App. 592, 112 N.E. 832 (1916); Hunt v. King, 97 Iowa 88, 90, 66 N.W. 71, 72 (1896) (statute gave mechanics' liens on building in public ownership and use); Ludowici-Celadon Co. v. Netcott, 186 Iowa 730, 732, 172 N.W. 943 (1919) (accelerated payment of contract price on production of receipts); Carr & Baal Co. v. Consolidated Dist., 187 Iowa 930, 174 N.W. 780 (1919); Baltimore v. Maryland Cas. Co., 146 Md. 508, 126 Atl. 880 (1924).

Contra: Lyman v. City of Lincoln, 38 Neb. 794, 57 N.W. 531 (1894) (individual surety); Des Moines Bridge & Iron Works v. Marxen, 87 Neb. 684, 128 N.W. 31 (1910).

[63] So, in case of public ownership and use, if a statute gives liens on the property. Hunt v. King, 97 Iowa 88, 90, 66 N.W. 71, 72 (1896).

[64] Baltimore v. Maryland Cas. Co., 146 Md. 508, 512, 126 Atl. 880, 881 (1924); Hunter v. Boston, 218 Mass. 535, 106 N.E. 145 (1914) (city "shall deduct, and retain"). In Van Clief & Sons, Inc. v. City of New York, 141 Misc. 216, 252 N.Y.S. 402 (1931), a statute gave liens on the fund, so that the provision of the bond was obviously inserted merely by way of recognition of the liens.

[65] Algonite Stone Mfg. Co. v. Fidelity & Deposit Co., 100 Kan. 28, 163 Pac. 1076 (1917), L.R.A. 1917D 722 ("furnish satisfactory evidence"); Warren Webster & Co. v. Beaumont Hotel Co., 151 Wis. 1, 138 N.W. 102 (1912) ("furnish written vouchers of payment or waiver of lien").

Contra: American Sur. Co. v. Wm. Cameron & Co., 35 S.W. (2d) 217 (Tex. Civ. App. 1931).

[66] Brown v. Markland, 22 Ind. App. 652, 53 N.E. 295 (1899) ("neither shall there be any claim against the contractor for labor or materials"; also certificate required from public officer that there are no liens); National Sur. Co. v. Foster Lumber Co., 42 Ind. App. 671, 85 N.E. 489

III. DIFFICULTIES IN CONFERRING PROTECTION ON PERSONS FURNISHING LABOR OR MATERIALS

Certain serious, though not insurmountable, obstacles oppose the protection of such persons and require special treatment.

A. POSSIBLE OR EVENTUAL CONFLICT OF INTEREST BETWEEN THE OWNER AND PERSONS FURNISHING LABOR OR MATERIALS

Most construction bonds are conditioned, either directly or by reference to the contract, on performance of the work as well as on payment of claims of persons furnishing labor or materials. Indeed, the cases cited in this article usually involve bonds of this dual type. It is obvious that a conflict of interest will arise if the claims of the public or private owner and of persons furnishing labor or materials exceed in the aggregate the limit of liability of the surety bond.

(1) This possible conflict of interest has a bearing on the interpretation of the bond. If it is to be interpreted as giving to the owner a superior right and to the materialman an inferior right, the arguments favoring an intention to vest rights in the materialman would be as strong here as if the condition for performance of the work were omitted, since the owner could not be prejudiced. An interpretation tending to vest rights in the materialman of equal rank with those of the owner, however, might eventually place the materialman in competition with the owner to the latter's prejudice, and some courts have thought this a sufficient reason for denying to the materialman any right whatever on the bond.[67] Nevertheless, most courts have soundly held that an intention to vest rights in the materialman may be found even here, because the owner may, and usually does, exact a bond in an amount large enough to cover all defaults which may reasonably be anticipated.[68]

(1908); Baker & Co. v. Bryan, 64 Iowa 561, 21 N.W. 83 (1884) ("produce receipts"); Southwestern Portland Cement Co. v. Williams, 32 N.M. 68, 251 Pac. 380, 49 A.L.R. 525 (1926), Campbell's Cases on Suretyship 13 (1931); R. Connor Co. v. Aetna Ind. Co., 136 Wis. 13, 115 N.W. 811 (1908) ("show that the property was free from all liens for work done or material furnished").

[67] Sun Ind. Co. v. American University, 58 App. D. C. 184, 26 F. (2d) 556 (1928); Fosmire v. National Sur. Co., 229 N.Y. 44, 127 N.E. 472 (1920); City of Lancaster v. Frescoln, 192 Pa. 452, 43 Atl. 961 (1899), 203 Pa. 640, 53 Atl. 508 (1902); Greene County v. Southern Sur. Co., 292 Pa. 304, 308, 141 Atl. 27, 29 (1927), approved as to this question in Concrete Products Co. v. United States F. & G. Co., 310 Pa. 158, 165, 165 Atl. 492, 495 (1933); Patterson v. New Eagle Borough, 294 Pa. 401, 405, 144 Atl. 423, 424 (1928); Pittsburgh v. Bucanelly Const. Co., 300 Pa. 27, 150 Atl. 100 (1930). See sub-topic I–C, note 66, in Part I of this article, published in 3 Univ. Chi. L. Rev. 1 (1935).

[68] Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 267, 125 So. 55, 59 (1929), 77 A.L.R. 13, 20 (private construction); Byram Lumber & Supply Co. v. Page, 109 Conn. 256, 266, 146 Atl. 293, 296 (1929) (private construction); Southwestern Portland Cement Co. v. Williams, 32 N.M. 68, 251 Pac. 380 (1926), 49 A.L.R. 525 (public construction), Campbell's Cases on Sure-

(2) The bond being given the wider interpretation, the question arises what disposition shall be made of the proceeds in the comparatively rare event that they are insufficient to satisfy all the claims of owner and materialmen. Clearly the surety is not liable in the aggregate for more than the amount of the bond.[69] It is submitted that he may interplead the various claimants, paying the amount of the bond into court; the fund will then be distributed ratably among the claimants. Occasionally, statutes regulate the disposition of the proceeds of the bond;[70] or the bond itself may specify the disposition.[71] In the absence of such specific disposition, the owner and the persons furnishing labor or materials should be ratably entitled to the proceeds of the bond.[72]

B. EXPRESSED PAYEE OF THE OBLIGATION OF THE BOND A DIFFERENT PERSON FROM PAYEE OF THE CONDITION

Most bonds considered in this article take the form of an agreement binding principal and surety to pay to the *owner*[73] a certain sum of money,

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tyship 13 (1931); Aetna Cas. & Sur. Co. v. Earle-Lansdell Co., 142 Va. 435, 452, 129 S.E. 263, 130, *id.* 235 (1925) (public construction). Many authorities cited throughout this article sustain this conclusion although the objection of conflict of interest is not discussed.

There has also been a tendency to lay stress on the power of supervision which the owner has over the work, but the writer considers this of little importance since it extends only to the quality of the work but not to economy in the purchase or use of labor and materials.

[69] Pankey v. National Sur. Co., 115 Ore. 648, 654, 239 Pac. 808, 810 (1925) (alternative decision).

[70] 33 U.S. Stat. 811, c. 778 (1905), 40 U.S.C.A. § 270 (1928), amending 28 Stat. 278, c. 280 (1894) (establishing a preference in favor of the United States and providing for the intervention of all persons furnishing labor or materials to obtain ratable distribution of the residue). See United States v. Hampton Roads Corp., 72 F. (2d) 943 (C.C.A. 4th 1934) (deciding what constitutes "final settlement" with government); La. Acts of 1922, no. 139 (preference to persons furnishing labor or materials); Miss. Laws 1918, c. 128, § 3 (priority given to owner; materialmen to share residue *pro rata*); Pa. L. 1921, 650, 653 (priority given to Commonwealth; materialmen to intervene and share residue *pro rata*).

[71] In Commonwealth v. National Sur. Co., 253 Pa. 5, 97 Atl. 1034 (1916), the bond provided that every person having a claim for labor or materials might bring suit in the name of the Commonwealth for his own use; that no suit should be a bar to other suits; that the aggregate of the judgments therein should not exceed the penal sum of the bond, and that such judgments should be paid in the order of the institution of suit, except that judgments on suits brought on the same day should be paid ratably.

In Portland Sand & Gravel Co. v. Globe Ind. Co., 301 Pa. 132, 151 Atl. 687 (1930), the bond provided that persons furnishing labor or materials might intervene in any suit brought by the county, subject to the priority of any claim of the county, and that if the county did not sue within six months then any such person might do so.

[72] The cases seem tacitly to assume such distribution, inasmuch as they indicate no different method. The question was left open, however, in Aetna Cas. & Sur. Co. v. Earle-Lansdell Co., 142 Va. 435, 453, 129 S.E. 263, 130, *id.* 235 (1925).

[73] If the bond provides that the principal and surety shall pay to the owner *and* all persons furnishing labor or materials the amount of the bond if the work be not performed and such

subject to a condition that the obligation shall be void if the principal pays all persons having claims for labor or materials. Some cases hold that an agreement to pay such persons is not to be implied.[74] Most cases, however, hold the contrary,[75] and they represent the better view. To interpret such a bond literally, as the former authorities do, makes it an agreement for a penalty[76] which equity would not permit to be enforced. To interpret the condition as importing an *agreement to reimburse* the owner with limitation of liability avoids that objection but falls short of fully effectuating the contemplated protection of the persons furnishing labor or materials. It is best, therefore, to attribute the form of the bond to the persistency of ancient practice and to interpret the condition as importing an *agreement* made with the owner to *make payment to* the persons furnishing labor or materials, and the obligatory words as imposing a limitation on total liability.[77]

C. EXTENT OF SURETY'S RESPONSIBILITY FOR LABOR AND MATERIALS FURNISHED

The surety's undertaking is to pay for labor and materials furnished for the doing of the work described in the bond or the contract to which it refers. Even though the contractor may fail to perform the contract in the manner stated therein, either with or without agreement between himself and the owner, still the job may be substantially the same as that contracted for; in such a case the surety's liability extends to the labor and materials furnished therefor.[78] Nor will recovery be defeated by the mere

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persons be not paid (or with a condition of defeasance on such performance and payment), no difficulty is encountered. National Sur. Co. v. Hall-Miller Decorating Co., 104 Miss. 626, 61 So. 700 (1913), 46 L.R.A. (N.S.) 325.

[74] Standard Gas Power Corp. v. New England Cas. Co., 90 N.J.L. 570, 101 Atl. 281 (1917) (court stressed fact that bond ran to public owner with penal sum payable to it; bond was conditioned on payment for labor and materials, and saving owner harmless from claims therefor); Skillman v. United States F. & G. Co., 101 N.J.L. 511, 130 Atl. 564 (1925) (like facts, except that public owner was to be saved harmless from all suits and costs of every description).

[75] Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 264, 266, 125 So. 55, 56, 58 (1929), 77 A.L.R. 13, 16, 19, and cases cited therein. Many other authorities are cited *passim*, and in 77 A.L.R. 21, 190 (1932).

[76] Professor Arthur L. Corbin, in an able article in 38 Yale L. J. 1, 13 (1928) entitled "Third Parties as Beneficiaries of Contractors' Surety Bonds."

[77] Fidelity & Deposit Co. v. Rainer, 220 Ala. 262, 266, 125 So. 55, 58 (1929), 77 A.L.R. 13, 19 (private construction); Byram Lumber & Supply Co. v. Page, 109 Conn. 256, 261, 146 Atl. 293, 294 (1929) (private construction).

[78] Chaffee v. United States F. & G. Co., 128 Fed. 918 (C.C.A. 8th 1904) (without knowledge of materialman); Otis Elev. Co. v. Long, 238 Mass. 257, 265, 130 N.E. 265, 268 (1921).

It is to be observed that the distinct right of a materialman who does not participate in a modifying arrangement between owner and contractor, is not discharged on any ground of variation of risk, although the owner's right against the surety be discharged for that reason. Sub-topic V-C.

fact that the labor or materials were furnished after the time specified in the contract for completion of the work.[79]

If, however, the job has become a different job, either with or without the consent of the owner, whether by change in its nature or by enlargement,[80] the surety is not responsible for labor or materials thereafter furnished, since they fall outside the coverage of the bond.

IV. RIGHTS OF LABORERS AND MATERIALMEN ON BONDS GIVEN BY PERSONS OTHER THAN THE PRINCIPAL CONTRACTOR

A. BY A SUBCONTRACTOR

In considering whether M-2, the person so furnishing labor or materials, has a right on the bond against S-2, the surety on the bond of P-2, the subcontractor, two typical situations may be considered.

(1) In cases of the first type, P, the principal contractor, and S, his surety, incur responsibility by virtue of bond or statute, or both, to M-2; thus P becomes surety, and S subsurety, for P-2 to M-2. The bond given by the subcontractor imposes liability on S-2 in favor of M-2 on ordinary principles of third-person-beneficiary contracts.[81] It is not fatal that the obligation of P, the principal contractor and new promisee, and of S-2, the new promisor,[82] are conditional, that is, on nonpayment by P-2. Nor is it necessary that M-2 knew of or relied on the bond.[83] Moreover, it is apparent that P is surety for P-2 and also for S-2, because of the terms of the bond which he has taken from them, and hence S is surety not alone for P but also for P-2 and S-2. The result is that P and S will each have appropriate rights of recourse against every person for whom he is sure-

[79] Kansas City Brick Co. v. National Sur. Co., 149 Fed. 507, 511 (C.C. Mo. 1906); National Sur. Co. v. Kansas City Brick Co., 73 Kan. 196, 210, 84 Pac. 1034, 1039 (1906).

[80] Commonwealth v. R. L. Bonham Co., 297 Pa. 514, 147 Atl. 611 (1929) (material raise in grade of road, requiring one fourth more earth to be borrowed). And see Bullard v. Norton, 107 Tex. 571, 580, 182 S.W. 668, 671 (1916) (reasoning); United States, to use of Anniston Pipe etc. Co. v. National Sur. Co., 92 Fed. 549, 552 (C.C.A. 8th 1899) (*dictum*).

[81] American Employers' Ins. Co. v. Lee & Kincaid Coal Co., 226 Ala. 262, 264, 146 So. 408, 409 (1933) (bond running to surety who had taken over the work and sublet it to sub-contractor); Pacific States Elec. Co. v. United States F. & G. Co., 109 Cal. App. 691, 293 Pac. 812 (1930) (private construction, see note 9, *supra*); Griffith v. Stucker, 91 Kan. 47, 136 Pac. 937 (1913) (public construction); General Motors Truck Co. v. Phillips, 191 Minn. 467, 254 N.W. 580 (1934).

Contra: Spokane Merchants Ass'n v. Pacific Sur. Co., 86 Wash. 489, 150 Pac. 1054 (1915) (on the ground of lack of privity).

All the more clearly is S-2 liable to M-2, if the bond he executed runs to the owner and contractor as promisees. Smith v. Fidelity & Deposit Co., 280 S.W. 767 (Tex. Comm. App. 1926) (public construction).

[82] Restatement, Contracts § 134 (1932).

[83] Griffith v. Stucker, 91 Kan. 47, 136 Pac. 937 (1913).

ty.[84] Furthermore, in the alternative, it would seem that, to the extent of any payment made by him to M-2, P will have an equitable defence to payment of the subcontract price, which defence would be available not only against P-2, but any assignee of his, for example, a financing bank. This defence rests on the fact that the subcontract and the bond were executed as parts of one transaction, and breach of the agreement contained in the bond, to pay materialmen, justifies reduction of the amount due under the contract.[85]

Of course, if the condition of the subcontractor's bond is not to pay persons furnishing labor or materials but to save the contractor harmless from liens on the real estate, and no such liens are possible because the real estate is of public ownership and use, then M-2 is not within the terms of the bond and has no rights thereon against S-2.[86]

(2) In the second type of situation, the obligee in the bond of P-2, the subcontractor (whether such obligee be P, the contractor, or S, his surety) is not liable[87] to M-2 for the materials furnished by him to P-2. In such case the first question is one of interpretation of the subcontractor's bond, on which S-2 is surety, that is, whether it was intended that rights should accrue thereon to materialmen, and the second whether the law should give effect to such intention in favor of third-person-beneficiaries. While the writer has found no case in point, he believes that both questions should be answered in the affirmative, even as in the analogous case of a construction bond given by a contractor to an owner who is under no risk, real or personal, in respect to the payment of materialmen.[88]

B. BY AN INDEMNITOR OR A RE-INSURER OF THE SURETY

In *Brown & Haywood Co. v. Ligon*,[89] a case of public construction, the surety, who was bound by bond and statute to persons furnishing labor or materials, took an indemnity bond conditioned on the contractor's paying

[84] Pacific States Elec. Co. v. United States F. & G. Co., 109 Cal. App. 691, 695, 293 Pac. 812, 813 (1930) (*dictum* that S would be subrogated to the right of M-2 against S-2); Davis Co., Inc. v. D'Lo Guaranty Bank, 162 Miss. 829, 138 So. 802 (1932) (P held entitled to indemnification from P-2 and S-2 for the amount paid to M-2).

[85] American Bridge Co. v. United States F. & G. Co., 174 Atl. 57, 58 (N.H. 1934) (Woodbury, J., *arguendo*); Davis Co., Inc. v. D'Lo Guaranty Bank, 162 Miss. 829, 138 So. 802 (1932) (Smith, C. J., and Anderson, J., dissenting), in effect recognizes a statutory denial of this defence.

[86] Dunlap v. Eden, 15 Ind. App. 575, 44 N.E. 560 (1896).

[87] Such non-liability might well result from the fact that the coverage of P's bond is not wide enough.

[88] See sub-topic I-C, in Part I of this article, 3 Univ. Chi. L. Rev. 1 (1935).

[89] 92 Fed. 851 (C.C. Mo. 1899).

the claims of such persons as well as on his saving the surety harmless therefrom. In an action brought by a materialman against the indemnitor judgment was properly given for the plaintiff. The materialman was a creditor-beneficiary within the rule of *Lawrence v. Fox;*[90] the surety had a peculiar asset, peculiar in that performance would necessarily accrue to persons furnishing labor or materials. If the indemnity contract had been merely for the reimbursement or reinsurance[91] of the surety, clearly no rule of contracts or suretyship would have availed the materialman. A bond conditioned merely on "saving harmless" or "exonerating" the surety would probably be no more efficacious, since the indemnitor might perform his obligation without paying the materialman, that is, by putting the surety in funds without imposing any restriction on their use.[92]

V. LEGAL EFFECT OF COLLATERAL MATTERS

The rights of persons furnishing labor or materials may conceivably be affected by various collateral matters, such as improper action or inaction on the part of the owner or contractor, or transactions between them.

A. BONDS PROCURED BY FRAUD OR NON-DISCLOSURE

If the owner procures the surety to execute the bond by fraudulent representation or concealment or through breach of a duty of disclosure owed by him to the surety, the latter has a *prima facie* right to rescind his obligation to the person furnishing labor or materials;[93] so also, if the principal procures the surety to sign the bond by like means. Nevertheless, this power of rescission will be terminated if, with knowledge of the facts, the surety affirms the bond,[94] or if the third person, without knowledge of the fraud or non-disclosure and in reliance on the terms of the bond, furnishes labor or materials or otherwise suffers an irremediable change or difference in position.[95]

[90] 20 N.Y. 268 (1859); Restatement, Contracts §§ 133–147 (1932).

[91] United States, to use of Colonial Brick Corp. v. Federal Sur. Co., 72 F. (2d) 964, 967 (C.C.A. 4th 1934).

[92] Hasbrouck v. Carr, 19 N.M. 586, 594, 145 Pac. 133, 135 (1914) (bond to indemnify, save harmless and place surety company in funds; surety company insolvent and dissolved).

[93] Pittsburgh Plate Glass Co. v. Fidelity & Deposit Co., 193 N.C. 769, 138 S.E. 143 (1927); Pittsburgh Plate Glass Co. v. Hotel Corp., 198 N.C. 166, 150 S.E. 877 (1929) (same case). This is the rule generally applicable to third-person-beneficiary contracts. 1 Williston, Contracts § 394 (1920); 4 Page, Contracts § 2393 (2d ed. 1920).

[94] Pittsburgh Plate Glass Co. v. Hotel Corp., 197 N.C. 10, 147 S.E. 681 (1929).

[95] American Emp. Ins. Co. v. Lee & Kincaid Coal Co., 226 Ala. 262, 265, 146 So. 408, 410 (1933); Miss. F. Ins. Co. v. Evans, 153 Miss. 635, 644, 120 So. 738, 741 (1929) (non-disclosure); Spokane & Idaho Lumber Co. v. Boyd, 28 Wash. 90, 68 Pac. 337 (1902) (non-disclosure of principal's insanity; also fraudulent representation made by public owner to principal).

It is to be observed that while ordinarily rescission for fraud requires a return or tender of return of that which was received, a surety company need not return or tender return of the premium to the principal or owner until the question of rescission for fraudulent procurement of the bond is adjudicated. The reason is that if the decision were unfavorable to it, the surety company might be liable to the materialman and yet be deprived of its premium.[96]

B. STATUTORY INVALIDITY OF THE CONSTRUCTION CONTRACT

In California, a statute[97] provided that a construction contract should be recorded, and that otherwise it should be void and not enforceable at the suit of either party thereto; that, if it was recorded, persons furnishing labor or materials should have a lien on the property only to the extent of the amount due from the owner to the contractor, but, if not recorded, for the full amount of their claims. The Supreme Court of that state properly decided that, in case the contract was not recorded, a private owner, who had taken a surety bond conditioned on his being saved harmless from liens on his property for labor or materials, could maintain an action on the bond against the contractor[98] and his surety[99] for the amount paid to remove a materialman's lien. The evident purpose of the legislature in requiring the contract to be recorded was to give to persons furnishing labor or materials opportunity to discover the true relation between owner and builder, and the provision as to voidness was to induce recording; to hold the bond invalid as to principal or surety would have exceeded the language of the statute and given to its purpose an unneeded sanction. A different question arose under the same statute in *Union Sheet Metal Works v. Dodge*,[100] a case which involved public construction; the bond made the surety responsible to persons furnishing labor or materials, and the contract was not recorded. Assuming that the statute which voided the contract for non-recording applied to public as well as private construction, the court nevertheless held that the voidness of the contract did not exclude the materialman from rights on the surety bond. This is a sound conclusion, for the language of the statute did not concern the bond and the denial of rights to a materialman thereon would not directly induce the recording of the contract, which was between other parties.

Indeed, it seems to be generally held that statutory invalidity of the

[96] Pittsburgh Plate Glass Co. v. Hotel Corp., 198 N.C. 166, 150 S.E. 877 (1929).

[97] Cal. Code Civ. Proc. § 1183 (1872).

[98] Kiessig v. Allspaugh, 91 Cal. 234, 27 Pac. 662 (1891).

[99] Kiessig v. Allspaugh, 99 Cal. 452, 34 Pac. 106 (1893).

[100] 129 Cal. 390, 62 Pac. 41 (1900).

contract between owner and contractor affords no defence to the surety as against persons furnishing labor or materials.[101] Such invalidity may arise from exceeding a debt limit,[102] irregularity in the proceedings of a public body or the fact that it does not own the land on which the improvement is to be made,[103] failure to establish an official street grade,[104] extending the time of performance after the power of public body to do so has ceased,[105] the exclusion of competitive bidding,[106] or (it has been held) even the entire absence of power of the public body to enter into a contract of this class.[107]

The question now arises whether knowledge of or participation in illegality (invalidating the contract) will prevent the person furnishing labor or materials from recovering on the bond. In Kansas a company manufacturing paving brick procured the signatures of certain abutting owners to street-paving petitions specifying the use of its brick, and the ordinances and contracts for the improvement accordingly contained similar specifications. Such stifling of competitive bidding was involved as to constitute a violation of statute and invalidate the contract between city and contractor. Three questions arose as to the rights of materialmen: (1) Were persons furnishing materials without knowledge of the facts constituting illegality to be given recovery on the surety bond? This question was properly answered in the affirmative.[108] (2) Were persons furnishing materials with knowledge of such facts to have recovery on the bond?

[101] 77 A.L.R. 21, 192 (1932).

[102] Tulsa Rig Real Co. v. Hansel, 69 Okla. 151, 170 Pac. 512 (1918).

[103] Bell v. Kirkland, 102 Minn. 213, 113 N.W. 271 (1907), 13 L.R.A. (N.S.) 793, 120 Am. St. Rep. 621.

[104] Hub Hardware Co. v. Aetna Acc. & Liab. Co., 178 Cal. 264, 173 Pac. 81 (1918).

[105] Los Angeles Stone Co. v. National Sur. Co., 178 Cal. 247, 173 Pac. 79 (1918).

[106] Kansas City Brick Co. v. National Sur. Co., 149 Fed. 507 (D.C. Mo. 1906) (on demurrer); Kansas City Brick Co. v. National Sur. Co., 167 Fed. 496 (C.C.A. 8th 1909) (on motion for directed verdict); American Bonding Co. v. Dickey, 74 Kan. 791, 88 Pac. 66 (1906); National Sur. Co. v. Wyandotte Coal & Lime Co., 76 Kan. 914, 92 Pac. 1111 (1907); Kansas City, *ex rel.* Diamond Brick & Tile Co. v. Schroeder, 196 Mo. 281, 302, 93 S.W. 405, 409 (1906).

[107] Miss. F. Ins. Co. v. Evans, 153 Miss. 635, 643, 120 So. 738, 741 (1929). But see Bell v. Kirkland, 102 Minn. 213, 222, 113 N.W. 271, 275 (1907) (*dictum*).

Metz v. Warrick, 217 Mo. App. 504, 269 S.W. 626 (1925) (contract not in writing), is not *contra*, for there the bond was conditioned on completion of work and not on payment of persons furnishing labor or materials, so that the materialman was obliged to contend that his right was a statutory consequence of a bond in that form.

[108] American Bonding Co. v. Dickey, 74 Kan. 791, 88 Pac. 66 (1906); National Sur. Co. v. Wyandotte Coal & Lime Co., 76 Kan. 914, 92 Pac. 1111 (1907) (holding that the materialman was not put on constructive notice of the terms of the contract).

The Supreme Court of Kansas answered this question in the negative,[109] but the decisions of the federal courts allowing recovery seem to represent the better view.[110] (3) Shall a person who induced or participated in the illegal conduct or transaction, or his assignee, obtain recovery on the surety bond? Even here recovery was granted by the United States Circuit Court of Appeals on the ground that the illegal conduct of the plaintiff did not involve such turpitude as to vitiate the bond which was the indirect result of the illegality.[111] It is to be observed, however, that merely to invalidate the contract between contractor and city would at most only affect the wrongdoer by preventing the sale of the brick, whereas to deny him rights on the bond for the unpaid price would be an additional and much more effective deterrent.

C. TRANSACTIONS BETWEEN OWNER AND PRINCIPAL, SUCH AS MODIFICATION OF THE CONTRACT, SURRENDER OF SECURITY, AND PREMATURE PAYMENT

While a new agreement between the owner and the contractor, extending the time for performance of or otherwise modifying the obligations of their contract, may be such as to discharge the surety from responsibility for the completion of the work on the ground of variation of risk, the distinct right of the person who furnished labor or materials is not affected thereby,[112] unless he was a contributive cause of the agreement of extension or modification.[113] All the more is there reason for this conclusion if

[109] National Sur. Co. v. Kansas City Brick Co., 73 Kan. 196, 84 Pac. 1034 (1906); Atkin v. Wyandotte Coal & Lime Co., 73 Kan. 768, 84 Pac. 1040 (1906).

[110] Kansas City Brick Co. v. National Sur. Co., 149 Fed. 507 (D.C. Mo. 1906) (on demurrer); Kansas City Brick Co. v. National Sur. Co., 167 Fed. 496 (C.C.A. 8th 1909) (on motion for directed verdict; reversing 157 Fed. 620 (1907)).

[111] Kansas City Brick Co. v. National Sur. Co., 167 Fed. 496 (C.C.A. 8th 1909) (on motion for directed verdict; reversing 157 Fed. 620 (1907); plaintiff took assignment of contract for purchase and sale of brick between contractor and wrongdoer and furnished the brick with knowledge of the wrong). *Accord:* Kansas City, *ex rel.* Diamond Brick & Tile Co. v. Schroeder, 196 Mo. 281, 302, 93 S.W. 405, 409 (1906) (one of the plaintiffs was the wrongdoer).

[112] United States v. National Sur. Co., 92 Fed. 549, 551 (C.C.A. 8th 1899); Los Angeles Stone Co. v. National Sur. Co., 178 Cal. 247, 173 Pac. 79 (1918) (extension of time); Conn v. The State, 125 Ind. 514, 519, 25 N.E. 443, 444 (1890); Standard Asphalt & Rubber Co. v. Texas Bldg. Co., 99 Kan. 567, 574, 162 Pac. 299, 302 (1917), L.R.A. 1917C 490, 494; Otis Elev. Co. v. Long, 238 Mass. 257, 264, 130 N.E. 265, 268 (1921); Doll v. Crume, 41 Neb. 655, 59 N.W. 806 (1894); West v. Detroit Fid. & Sur. Co., 118 Neb. 544, 548, 225 N.W. 673, 675 (1929) (extension of time; alternative decision); Crudup v. Oklahoma Portland Cement Co., 56 Okla. 786, 793, 156 Pac. 899, 902 (1916). Cal. Code Civ. Proc. § 1203 (1893).

[113] Hartford Acc. & Ind. Co. v. Natchez Inv. Co., Inc., 161 Miss. 198, 219, 222, 132 So. 535, 538, 135 *id.* 497 (1931) (materialman received secured note from owner in lieu of payment by owner to contractor and by latter to materialman, when bond provided that payments by owner to contractor should be in cash).

the bond was conditioned solely on the payment of persons furnishing labor or materials.[114]

It makes no difference whether the bond on which the materialman's[115] right rests was given in obedience to a statute requiring a bond conditioned on the payment of his claim and also vesting in him a right to receive payment or to sue, or the use or benefit thereof;[116] or in obedience to a statute requiring such a bond but not determining its legal effect; or, in the absence of any such statute, at least if the materials were furnished before the variation of risk took place.[117]

The like statement may be made concerning the premature payment of a retained percentage of the contract price by the owner to the principal,[118] or a payment made or work accepted without procuring receipt or other evidence of the satisfaction of claims for labor or materials,[119] or, it is believed, the surrender of a security *res* by the owner to the principal. Nor does it matter that the time for the completion of the work as fixed by the contract between the owner and the principal had expired when the labor or materials were furnished.[120]

Likewise, while failure of the owner to pay to the principal an agreed

[114] Steffes v. Lemke, 40 Minn. 27, 41 N.W. 302 (1889).

[115] The same statement may be made as to persons furnishing labor, supplies, equipment, money, or the like, if they are within the coverage of the bond.

[116] Dewey v. The State, *ex rel.* McCollum, 91 Ind. 173, 184 (1883).

[117] Doll v. Crume, 41 Neb. 655, 59 N.W. 806 (1894).

[118] United States F. & G. Co. v. Omaha Bldg. & Const. Co., 116 Fed. 145 (C.C.A. 8th 1902); Chaffee v. United States F. & G. Co., 128 Fed. 918 (C.C.A. 8th 1904); Maryland Cas. Co. v. Portland Const. Co., 71 F. (2d) 658, 661 (C.C.A. 2d 1934); Dewey v. The State, *ex rel.* McCollum, 91 Ind. 173, 183 (1883); Getchell & Martin Lumber Co. v. Peterson & Sampson, 124 Iowa 599, 100 N.W. 550 (1904) (private construction; alternative decision); Standard Asphalt & Rubber Co. v. Texas Bldg. Co., 99 Kan. 567, 162 Pac. 299 (1917), L.R.A. 1917C 490; School Dist. of Kansas City v. Livers, 147 Mo. 580, 49 S.W. 507 (1899) (no statute requiring bond to be conditioned on payment of materialmen; materials already furnished); Doll v. Crume, 41 Neb. 655, 59 N.W. 806 (1894) (bond not required by statute); Kaufmann v. Cooper, 46 Neb. 644, 65 N.W. 796 (1896) (bond not required by statute); King v. Murphy, 49 Neb. 670, 68 N.W. 1029 (1896) (bond not required by statute); Des Moines Bridge & Iron Works v. Marxen, 87 Neb. 684, 128 N.W. 31 (1910); Southwestern Sash & Door Co. v. American Emp. Ins. Co., 37 N.M. 212, 20 Pac. (2d) 928 (1933); Webb v. Freng, 181 Wis. 39, 44, 194 N.W. 155, 157 (1923) (statute provided that no change in the contract should release the sureties). Cal. Code Civ. Proc., § 1203 (1931).

Contra: Bullar v. Norton, 107 Tex. 571, 578, 182 S.W. 668, 670 (1916).

[119] Aetna Ind. Co. v. Indianapolis Mortar & Fuel Co., 178 Ind. 70, 74, 98 N.E. 706, 708 (1912) (acceptance of work); Des Moines Bridge & Iron Works v. Marxen, 87 Neb. 684, 128 N.W. 31 (1910) (payment).

[120] Los Angeles Stone Co. v. National Sur. Co., 178 Cal. 247, 173 Pac. 79 (1918); Hub Hardware Co. v. Aetna Acc. & Ind. Co., 178 Cal. 264, 268, 173 Pac. 81, 82 (1918).

instalment of the contract price, if unjustified,[121] may lead to the discharge of the surety from his obligation to the owner, because withholding from the principal the means of pursuing the work varied the surety's risk, still the right of the materialman against the surety should not be defeated thereby.[122]

The reason for these conclusions is that the bond is of a dual nature in that it contains several undertakings running to the owner, one for his own protection and the others for the benefit of persons furnishing labor or materials, and hence creating several rights, the result being that the owner's acts have no more legal effect on the rights of such other persons than if separate bonds had been executed.[123]

It would seem, however, that if the character of the work is so changed that it becomes a different work, whether by arrangement with the owner or not, the surety is relieved from payment for labor and materials thereafter furnished, because the work is now outside of the coverage of the bond, as is more fully discussed in sub-topic III-C.

A ruling somewhat analogous to the doctrine of this sub-topic is presented by *Standard Accident Insurance Co. v. Simpson.*[124] In that case the plaintiff, who had furnished materials to a subcontractor for use "in and about the construction" of a highway, recovered judgment against the surety of the contractor, notwithstanding that the consent of the county to the subletting of the work had not been procured as the principal contract required.

[121] Otherwise, of course, if the failure to pay were justified, for example, because of the filing of liens for labor or materials already furnished, or the imminence of such filing. Yawkey-Crowley Lumber Co. v. Sinaiko, 189 Wis. 298, 206 N.W. 976 (1926).

[122] Glades County v. Detroit Fid. & Sur. Co., 57 F. (2d) 449, 451 (C.C.A. 5th 1932).

[123] School Dist. of Kansas City v. Livers, 147 Mo. 580, 49 S.W. 507 (1899) (citing 137 N.Y. 488); Lyman v. City of Lincoln, 38 Neb. 794, 57 N.W. 531 (1894); Doll v. Crume, 41 Neb. 655, 59 N.W. 806 (1894).

[124] 64 F. (2d) 583, 589 (C.C.A. 4th 1933).