

Arizona Court of Appeals Refuses to Provide Bad Faith Remedy for Little Miller Act Payment Dispute

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A recent decision out of the Arizona Court of Appeals, Division One, held a subcontractor who fails to timely file suit against surety on a payment bond issued under the Little Miller Act may not subsequently sue the surety for bad faith. *S&S Paving & Const., Inc. v. Berkley Reg'l Ins. Co.*, 2016 WL 2756428, (Ariz. Ct. App. May 12, 2016).

Facts and Procedural History

The City of Prescott hired general contractor Spire Engineering, LLC (“Spire”) to oversee the Demerse Avenue Overlay Project (“the Project”). S&S Paving and Construction Inc. (“S&S”) was hired as a paving subcontractor. Berkley Regional Insurance Company (“Berkley”) issued a payment bond for the Project

pursuant to Ariz. Rev. Stat. (“A.R.S.”) § 34-222(A)(2), which is part of the “Little Miller Act” and requires payment bonds for public projects.

In October 2011, S&S’s attorney sent a demand letter to Berkley, stating S&S was owed \$23,763 for paving work performed at the Project pursuant to its subcontract. Berkley acknowledged the claim and requested additional information. Berkley advised its investigation of the claim “does not toll the running of any statute of limitations or other time period.”

S&S provided Berkley with a proof of claim and other requested information. Berkley acknowledged receipt of the documentation in December 2011 and stated it needed to determine Spire’s position regarding S&S’s claim before it could have any further communication. Berkley reiterated its investigation of the claim “in no way waives or alters any rights, interests or defenses that we may have under our bond or applicable law.” No further communication occurred between the parties until May 2013, when S&S’s attorney sent a second demand letter. Berkley then responded S&S’s claim was untimely.

In November 2013, S&S sued Berkley for breach of contract and bad faith. Berkley moved for summary judgment on both claims. The superior court dismissed both claims, ruling the breach of contract claim was barred by the one year statute of limitations set out in A.R.S. § 34-223(B) and there was no “contractual relationship or special relationship for the [bad faith] claim to survive.” S&S timely appealed.

Arguments on Appeal

S&S argued sureties providing payment bonds under the Little Miller Act owe the same duty of good faith to claimants as insurance companies owe to insureds, including a duty to “undertake an investigation adequate to determine whether a claimant’s claim is tenable or valid,” relying heavily on *Dodge v. Fidelity & Deposit Co. of Maryland*, 161 Ariz. 344 (1989).¹ In *Dodge*, the Supreme Court of Arizona held a homeowner could proceed with a bad faith claim against a contractor’s surety who refuses to pay a valid claim.

Discussion of *Dodge v. Fidelity and the Little Miller Act*

The Little Miller Act requires contractors on public works projects to provide payment

¹ S&S did not challenge the dismissal of its breach of contract claim pursuant to the statute of limitations.

bonds “for the protection of claimants supplying labor or materials to the contractor or his subcontractors.” A.R.S. § 34-222(A)(2). A contractor who is not paid in full for labor or materials “shall have the right to sue on such payment bond.” A.R.S. § 34-223(A). “The purpose behind both of the Miller Acts is to provide security for those who supply materials or labor in the construction of public projects.” *SCA Const. Supply v. Aetna Cas. & Sur. Co.*, 157 Ariz. 64, 66, 754 P.2d 1339, 1341 (1988). No lien rights exist on public projects, so statutory protection is necessary.

The Little Miller Act provides payment bonds must include a statement that “all liabilities on th[e] bond shall be determined in accordance with” the Little Miller Act. It further dictates the procedure claimants are required to follow in order to recover against payment bonds. Under the Little Miller Act, an unpaid claimant’s right is “to sue on such payment bond for the amount . . . unpaid at the time of institution of such suit and to prosecute such action to final judgment. . . .” A.R.S. § 34-223(A). It is silent regarding pre-litigation claims and neither imposes nor contemplates imposing upon sureties and any pre-litigation investigative or processing duties. The Court noted “where a statute expressly provides a particular remedy or remedies, a court must be chary of reading others into it,” citing *Transamerica Mortg. Advisors, Inc. v. Lewis*, 444 U.S. 11, 19 (1988).

The Court of Appeals distinguished *Dodge* because in

that case the contractor did not provide a surety bond pursuant to a statute, whereas this case involved “a carefully crafted statutory scheme that seeks to balance the competing interests inherent in public works projects.” Moreover, in *Dodge*, the Arizona Supreme Court found the surety lacked incentive to address the homeowners’ claim, but in this case the surety had a strong financial incentive to pay valid claims without litigation, as an award of attorneys’ fees to a successful litigant is mandatory under the Little Miller Act.

Holding

The Court of Appeals found S&S had a “complete and valid remedy” under the Little Miller Act, i.e. litigation. Had S&S timely filed suit for breach of contract, it would have been able to proceed with a claim against Berkley.

However, because a payment bond is “sufficient to pay all claims, and is the sole source from which laborers and materialmen are to be paid, it necessarily follows that laborers and materialmen who do not timely avail themselves of this remedy fall into the category of general creditors of the contractor.” *Gen. Acrylics v. U.S. Fid. & Guar. Co.*, 128 Ariz. 50, 55 (App. 1980). Thus, the Court deemed S&S a general creditor and held it may not assert a bad faith claim against Berkley. The Court noted its determination “is consistent with the treatment of private project claimants under

Arizona’s mechanics’ lien statutes.”

Thus, the Court of Appeals declined to incorporate a common law bad faith remedy into the Little Miller statutory scheme, which already includes both the availability of complete relief and specific conditions precedent to recovery. It stated in dicta, “[s]hould the Arizona Legislature deem it appropriate to permit bad faith claims against Act sureties in addition to existing statutory remedies, it is free to enact legislation that effectuates that policy determination.” Thus, the Court affirmed the superior court’s judgment and awarded judgment for Berkley on appeal.

Conclusion

When litigating claims pursuant to statutorily created rights and duties, it is crucial to analyze the legislative intent and public policy behind the statute, as well as the breadth of the statute, to determine if the statute provides a complete and valid remedy. It is important to consider any relevant statutes of limitations which apply. Moreover, Arizona courts consistently decline to read obligations and remedies into statutes where the legislature has not expressly provided them.

ABOUT THE AUTHOR

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