

Off the Beaten Path: The Federal Circuit Departs From Precedent in *Lumbermens*

By Mike F. Pipkin

On August 23, 2011, the Washington, D.C. metropolitan area was surprised and shocked by an earthquake with a magnitude of 5.8, leading to the evacuation and temporary closing of multiple public and private buildings, and leaving area residents feeling unsettled, at the least. Twenty days earlier, the U.S. Federal Circuit Court of Appeals' opinion in *Lumbermens Mutual Casualty Company v. United States* left Miller Act sureties similarly unsettled and queasy with its "simple" holding that, "once a surety makes overpayments on its bond obligation, it has no right to affirmatively recover against the United States," among other things.

This article will look at *Lumbermens* and its reasoning, including a review of the typical vehicles for surety claims against the federal government, the history of Supreme Court, Federal Circuit, and Claims Court cases that established the route from which *Lumbermens* diverted, and the impact of the opinion on Miller Act sureties.

I. The Tucker Act

A surety typically asserts its claims against entities of the U. S. Government in the United States Court of Federal Claims (the "Claims Court") under two jurisdictional statutes: the Tucker Act² and the Contract Disputes Act.³ For certain non-tort monetary damage claims based on any express or implied contract with the U.S. Government or based on a constitutional, statutory, or regulatory provision granting a right to monetary relief, the Tucker Act provides a limited waiver of sovereign immunity and establishes subject matter jurisdiction in the Claims Court, as well as United States District Courts.⁴

The Tucker Act provides authority for the Claims Court and U.S. District Courts to preside over claims for money arising under the U.S. Constitution, statutes, regulations, or express or implied contracts with the federal government, but only where substantive rights already exist that give rise to such claims.⁵ Moreover, the Tucker Act does not convey general

jurisdiction to grant equitable or non-monetary relief.⁶

Over the past decade and a half, the Tucker Act has served as an invaluable vehicle for sureties striving to recover contract funds from the federal government. For instance, in *Insurance Co. of the West v. United States*,⁷ the Federal Circuit reinforced the surety's ability to pursue contract balances because of the waiver of sovereign immunity provided by the Tucker Act to performance bond sureties that execute takeover agreements with the U.S. Government.⁸

II. The Contract Disputes Act

On the other hand, while the Tucker Act grants jurisdiction where a separate substantive right of action exists, the Contract Disputes Act ("CDA")⁹ supplies an avenue for the Claims Court to hear certain claims against the federal government.¹⁰ The CDA grants subject matter jurisdiction upon the Claims Court for specified claims,¹¹ establishes jurisdictional prerequisites in order to sue the federal government in the Claims Court,¹² and creates substantive causes of action available to a surety in the event of the existence of a takeover agreement between the surety and the federal government.¹³ Similar to the Tucker Act, the CDA conveys subject matter jurisdiction in the Claims Court for appeals from a contracting officer's on a claim. Indeed, a surety's failure to submit its claim arising out of the surety's

performance of the takeover agreement to the project's contracting officer divests the Claims Court of jurisdiction to adjudicate the claim on appeal.¹⁴

Historically, the CDA has not proven to be as successful a vehicle for a surety's claim against the federal government. First, the surety is required to pursue its claim initially with the project's contracting officer, before appealing an adverse decision to the Claims Court. Next, the CDA applies only to claims from "contractors" under "government contracts."¹⁵ Thus, for a surety to qualify as a "contractor," the surety must be a party to an express or implied contract for the procurement of services or construction, alteration, repair, or maintenance of real property.¹⁶ In the surety context, the most likely "government contract" would be a takeover agreement arising out of a principal's default.¹⁷

Following the execution of a takeover agreement, the surety is considered a "contractor" for CDA purposes and can thereafter assert claims arising out of its own performance,¹⁸ arising out of representations made and actions taken by the federal government to induce the surety to execute a takeover agreement,¹⁹ for alleged breaches of the bonded contract and/or the Miller Act bonds,²⁰ or the contracting agency's alleged abuse of discretion with respect to payments on and termination of the bonded contract after notice of default.²¹

III. The Trail Leading Up to *Lumbermens*

a. *Fireman's Fund Ins. Co. v. United States* (“*Fireman's Fund*”)

The contract made the subject of *Fireman's Fund* required the federal government to withhold retainage if the bonded principal failed to make satisfactory progress during the subject pay period.²³ Despite ongoing problems maintaining the project schedule, the federal government acquiesced when requested to release the withheld retainage, in an effort to solve the principal's “cash flow problems.”²⁴ Several months later, the principal folded his tent and abandoned the project. Within days of the principal's abandonment, *Fireman's Fund* notified the government not to make further payments to the principal absent the surety's consent.²⁵ Ultimately, *Fireman's Fund* elected not to take over the project. After the government reprocured and completed the project, it sought to recover the excess reprourement costs from *Fireman's Fund*.²⁶

While the surety's effort to defend against excess reprourement costs assessed by the federal government ultimately failed (due to the lack of notice before the retainage was released), *Fireman's Fund* did succeed in establishing Tucker Act jurisdiction for its claims for impairment of suretyship/*pro tanto* discharge in the Claims Court. Indeed, the Federal Circuit summarized:

[I]t is well-settled in many jurisdictions that if the obligee departed from or altered the contractual provisions relating to payments and/or the security of retained funds, a surety is discharged from its obligations . . . to the extent it can show injury, loss, or prejudice.²⁷

It is notable that the surety succeeded in its claim despite the fact that it did provide notice to the federal government to withhold payments to the principal absent the surety's consent.

b. *National Surety v. United States* (“*National Surety*”)

National Surety also concerned a surety's claim against the federal government arising out of a premature release of retainage. However, unlike the surety in *Fireman's Fund*, *National Surety* entered into a takeover agreement with the federal government, after which the surety engaged a completion contractor, completed the project, and was paid the remaining contract balance by the federal government.

Following completion of the project, *National Surety* initiated a claim against the federal government for impairment of suretyship arising out of the early retainage payment. Following a series of hearings before the Claims Court and Federal Circuit,²⁹ the Federal Circuit concluded that *National Surety* was entitled to recover the released retainage from the government because the “retainage provision in a bonded construction contract serves to protect the surety as well as the government. . . .”³⁰ The court further stated:

The ten percent retainage provision was in the contract between [the principal] and the government when *National Surety* set the price for and executed its surety bonds. The retainage requirement served as security for performance of the bonded contract, and this requirement contributed to the surety's assessment of the risk involved. The surety was entitled to rely on the government's obligation to retain this percentage in accordance with the terms of the bonded contract, and on its right of subrogation to this security. *National Surety's* right was fixed upon execution of the surety bonds, and was not dissolved or altered when the government failed to implement the retainage required by the contract. * * * The government, with knowledge that [the principal] had not met the contractual condition predicate to release of the retainage,

did not defeat *National Surety's* subrogation right.³¹

The *National Surety* court identified and applied an exception to the notice requirement required for stakeholder claims,³² based on the principle that the federal government owes the surety a duty “to administer the contract . . . in a way that does not materially increase the risk that was assumed by the surety when the contract was bonded.”³³

c. *Department of the Army v. Blue Fox, Inc.* (“*Blue Fox*”)

Blue Fox, a subcontractor with no contractual privity with the federal government, filed suit against the Department of the Army, seeking to recover sums owed to *Blue Fox* by the prime contractor on a construction contract with the Army. *Blue Fox* had notified the Army of unpaid balances; however, the Army ignored the notices and issued a payment to the prime contractor and, after the prime contractor defaulted, to the completion contractor.³⁵ *Blue Fox* sought an “equitable lien” against any contract funds remaining in government hands or any other funds to the prime contractor, arguing that the Administrative Procedure Act (“APA”) waived the government's sovereign immunity for equitable claims. The Ninth Circuit reversed the trial court's ruling against *Blue Fox*, citing numerous surety equity equitable subrogation cases to support its position.

However, the Supreme Court reversed, holding that there was no jurisdiction under the APA for *Blue Fox's* claim because the “equitable lien” theory was rather a claim for money damages that fell outside the APA's sovereign immunity waiver.³⁶ The Supreme Court noted multiple cases holding that a contractor without contractual privity with the federal government does not have standing to sue the federal government in contract or for an equitable lien on contract funds held by the government.³⁷

d. Insurance Company of the West v. United States (“ICW”)

The ripple effects³⁹ caused by the Supreme Court’s opinion in *Blue Fox* lasted beyond the two months before the Federal Circuit issued its decision in *ICW*. In *ICW*, the Federal Circuit reaffirmed the surety’s right to maintain equitable subrogation claims against the government in response to assertions of sovereign immunity when a performance bond surety executes a takeover agreement with the federal government. Such takeover agreements establish privity of contract with the federal government, thus falling within the Tucker Act’s waiver of sovereign immunity for claims that fit within the scope of the takeover agreement.

In *ICW*, the surety complained of a payment made by the federal government to a bonded contractor after the surety had notified the government that its principal was financially unable to complete the contract and project, that the surety would complete the work pursuant to its performance bond obligations, and directing the government to make future contract balance payments to the surety. Even after issuing a contract modification directing future payments be made payable to the bonded contractor but sent to ICW, the federal government ignored both the notices and its own change order and continued to pay the contractor. Then, after ICW sued for damages it suffered, the federal government moved to dismiss, citing *Blue Fox* and arguing that it had not waived its right of sovereign immunity as to ICW’s subrogation claims.

The Claims Court denied the motion to dismiss. However, before the case was tried and with the parties’ consent, the Claims Court submitted the issue to the Federal Circuit via an interlocutory appeal. The Federal Circuit affirmed the ruling of the Claims Court, holding:

We conclude that the Tucker Act must be read to waive sovereign immunity for assignees as well as those

holding the original claim, except as barred by a statutory provision such as the Anti-Assignment Act. No act here limits the right of subrogees to bring suit against the government, and thus sovereign immunity presents no barrier to such an action.⁴⁰

After the case was remanded, the federal government filed yet another motion to dismiss, citing two sentences in the Federal Circuit’s opinion:

It is well-established that a surety who discharges a contractor’s obligation to pay subcontractors is subrogated only to the rights of the subcontractor. Such a surety does not step into the shoes of the contractor and has no enforceable rights against the government.⁴¹

The Claims Court denied the second motion to dismiss, agreeing with ICW’s argument that the above dicta runs counter to long-standing precedent with respect to the surety’s subrogation rights as to a defaulting principal:

[T]he dicta in [*ICW*] do not define the scope of the surety’s rights under the doctrine of equitable subrogation. When a surety, after financing or completing the performance of a defaulted subcontractor, discharges the outstanding claims of the subcontractors, it may subrogate to the rights of both the defaulted contractor and the subcontractors. * * * Because the subcontractors have no standing to sue the Government directly, the surety must invoke the contractor’s right to sue in order to sustain its claim against the Government. * * * If a surety were limited to exercising the rights of only the subcontractors under the doctrine of equitable subrogation, the surety never would be able to recover directly from the contracting agency. Such a result would contradict a century of jurisprudence on equitable subrogation.⁴²

IV. Lumbermens Mutual Casualty Company v. United States

Over the next several years, the federal government continued to assert sovereign immunity defenses in response to surety subrogation claims, arguing that *Blue Fox* eliminated Tucker Act jurisdiction.⁴³ Meanwhile, the facts and circumstances that eventually led to the *Lumbermens* decision began to take place.

a. Factual Background

Lumbermens arises out of a construction contract between Landmark Construction Company (“Landmark”) and the United States Navy (the “Navy”) for the repair and renovation of military housing units. In accordance with the Miller Act,⁴⁴ the Navy required Landmark to provide performance and payment bonds, which Lumbermens Mutual Casualty Company (“Lumbermens”) issued.

Approximately ten (10) months into the eighteen-month job, Landmark and the Navy agreed to an additive change order, which increased the contract price to \$11,762,200, but did not extend the contract’s completion date.⁴⁵ Less than five (5) months later, Landmark informed the Navy that it did not have the financial wherewithal to complete the job, thereafter abandoning the project. At the time of the contract’s termination, Landmark had completed only 12% of the contract’s scope. However, the Navy had already paid approximately 40% of the contract balance, allegedly ignoring multiple Federal Acquisition Regulation (“FAR”) provisions that were incorporated into the contract, the intent of which was to prevent such an occurrence.⁴⁶

Following the default, the Navy made demand on the performance bond. Thereafter, Lumbermens retained Atherton Construction as the completion contractor, and Lumbermens, Atherton, and the Navy entered into a takeover agreement. The takeover agreement stated that, “in accordance with [its] obligations under

[the] Performance Bond,” “it [would] contract with [Atherton] for completing the work remaining under the contract.”⁴⁷ Atherton agreed to complete the entire scope of the project, including the additional units that Lumbermens had not bonded. Atherton and Lumbermens entered into a completion contract under they agreed that Lumbermens would be responsible for all contractual liquidated damages assessed between a certain time, with Atherton accepting liability if it did not complete the project in a timely manner.⁴⁸

After beginning its completion work, Atherton discovered safety code violations in work performed by Landmark, leading to a 46-day delay in Atherton’s completion. Despite the Navy’s acknowledgment of the issue while Landmark was still working more than two years earlier, the Navy denied Atherton’s requests for an extension of the contract time.⁴⁹

Atherton completed the project more than seven months after the contract’s completion date. The Navy then assessed over \$1 million in liquidated damages, which Lumbermens reimbursed to Atherton. Thereafter, Lumbermens sued the government in the Claims Court under the Tucker Act, seeking damages under three theories.⁵⁰

b. The Claims Court’s Rulings

i. Equitable Subrogation

First, Lumbermens sought damages under the theory of equitable subrogation, arguing that the Navy improperly increased Lumbermens’ completion costs by making overpayments to Landmark in violation of FAR provisions that were incorporated into the bonded contract that were intended to ensure that progress payments were in line with the percentage of completion.⁵¹ Lumbermens asserted that the FAR provisions were as much for Lumbermens’ protection as surety as they were to Landmark. As a result, the Navy owed Lumbermens a duty to administer

the contract in a manner so as not to increase Lumbermens’ risk.

The government moved to dismiss Lumbermens’ equitable subrogation claim for lack of jurisdiction, asserting that “the United States had not waived sovereign immunity for claims by a surety based on alleged overpayments on a bonded contract made prior to receiving notice from the surety of the contractor’s default.”⁵² In its ruling on the motion to dismiss, the Claims Court acknowledged the Federal Circuit’s holding in *ICW*, but noted the distinction that “[t]he Government’s equitable duty to retain contract funds for the surety is triggered upon notice from the surety that the contractor is in default or that payment should be made to the surety.”⁵³ Accordingly, the Claims Court granted the government’s motion to dismiss Lumbermens’ equitable subrogation claim because it “did not notify the Government that Landmark was approaching default or that the Navy should withhold or divert progress payments” before the Navy made the progress payments.⁵⁴

ii. Takeover Agreement

Lumbermens also asserted that the Navy breached the takeover agreement when it withheld liquidated damages from Atherton. Lumbermens argued that the deduction was excessive because of the delay caused due to the faulty electrical wiring and because there had been no extension of time for the additional scope of work.⁵⁵ The government again moved to dismiss, this time asserting that Lumbermens failed to satisfy the jurisdictional prerequisites of the CDA.⁵⁶

The Claims Court found that the CDA’s jurisdictional requirements were inapplicable to Lumbermens’ claim, distinguishing the takeover agreement from a “government contract” to which the jurisdictional prerequisites of the CDA apply, and awarded Lumbermens damages relating to delays caused by the faulty electrical wiring.⁵⁷

iii. Impairment of Suretyship/Pro Tanto Discharge

Lumbermens’ most successful claim was alternative to its initial one, asserting that it was entitled to a *pro tanto* discharge, citing state contract law in support. Again, the government moved to dismiss Lumbermens’ impairment of suretyship/*pro tanto* discharge for lack of jurisdiction, citing the Tucker Act. Following a trial, the Claims Court determined that it indeed had jurisdiction over the impairment of suretyship claim, without addressing the sovereign immunity issue.⁵⁸

Citing the FAR provisions, the *Lumbermens II* court concluded that, “by making overpayments to Landmark, the government had improperly ‘impaired collateral that Lumbermens relied on to support its bond,’” and awarded Lumbermens over \$1.3 million in damages.⁵⁹

c. The Federal Circuit’s Reasoning

The Federal Circuit’s attention was drawn initially to the government’s contention that it had not waived sovereign immunity for Lumbermens’ claims arising out of the premature progress payments.⁶⁰ In its pleadings in the Claims Court, Lumbermens cited only the Tucker Act as the basis for jurisdiction. The Federal Circuit noted, however, that no privity of contract existed between Lumbermens and the Navy until the takeover agreement was executed.⁶¹ Lumbermens argued that “express or implied contracts” jurisdiction existed under the Tucker Act.

i. Equitable Subrogation

The *Lumbermens* court revisited its opinion in *ICW*, reminding that the Claims Court had jurisdiction because, under the doctrine of equitable subrogation, the surety “step[s] into the shoes of [the] government contractor” and may bring suit under the Tucker Act based on the contractor’s privity with the United States under the construction contract.⁶² However, the *Lumbermens* court found that the federal government’s duty to preserve the contract balance is predicated on no-

tice. “The theory of equitable subrogation is based on the view that the triggering of the surety’s bond obligation gives rise to an implied assignment of rights by operation of law whereby the surety ‘is subrogated to the [principal obligor’s] property rights in the contract balance.”⁶³ The *Lumbermens* court relied upon the fact that the alleged overpayments were made *before* the obligee received notice of the principal’s default, which would then trigger the bond obligation and an implied assignment of contractual rights to the surety.⁶⁴

The *Lumbermens* court alluded to *Lumbermens*’ briefing, wherein it stated that such a position was contrary to the Federal Circuit’s earlier holding in *National Surety*,⁶⁵ where the surety prevailed notwithstanding the fact that it had not provided notice to the federal government.⁶⁶ Instead, the *Lumbermens* court noted that the *National Surety* panel may have “misapprehended” the facts of that particular case when applying the “prevailing rule,” noting that the *National Surety* notice requirement was satisfied where “the government had knowledge of the default . . . and so informed the surety.”⁶⁷ Accordingly, the Court affirmed the ruling that *Lumbermens* could not recover the alleged overpayments under the theory of equitable subrogation.⁶⁸

ii. Impairment of Suretyship/Pro Tanto Discharge

Next addressing *Lumbermens*’ assertion that it could bring its claim based on the theory of impairment of suretyship/*pro tanto* discharge, the Federal Circuit found that the federal government had not waived sovereign immunity. In doing so, following a reasonable discussion of the distinction between claims and defenses, the Court saw fit to breathe more life into *Blue Fox*.

The Court began with an analysis of the history of the theory of *pro tanto* discharge, noting that it began as a state law *defense* “that a surety could assert to avoid enforcement of its bond obligation on the

grounds that the obligee (the beneficiary of the bond) had taken improper actions which prejudiced the surety by increasing its financial risk.”⁶⁹ *Lumbermens* claimed that the federal government had prejudiced it by improperly making progress payments that did not reflect the status of completion, in violation of FAR regulations incorporated into the construction contract. “That is, by wasting the contract funds in contravention of the contract’s terms, the obligee may impair the surety’s future right to equitable subrogation and increase its risk of loss, thereby discharging it from its bond obligation *pro tanto*.”⁷⁰

While the Court acknowledged *pro tanto* discharge as a valid defense to a government claim on a performance bond, it noted that *Lumbermens* was using the defense as an affirmative cause of action for impairment of suretyship, “stem[ming] not from an equitable assignment of rights (like equitable subrogation), but rather [based] on an implied-in-law contract theory—i.e., a recovery in the nature of quantum meruit or quantum valebant.”⁷¹ The Court acknowledged the soundness of the theory under state law, but concluded that the United States has not waived sovereign immunity as to such claims.

To support its position, the Court turned to the Supreme Court’s opinion in *Blue Fox*, emphasizing that “the Court . . . made clear that state law equitable theories could not be asserted as monetary claims against the government by subcontractors and suppliers.”⁷² The *Lumbermens* court then recalled *Blue Fox*’s evincing of *Pearlman v. Reliance Insurance Co.*,⁷³ *Henningsen v. United States Fidelity & Guaranty Co.*,⁷⁴ and *Prairie State Bank v. United States*.⁷⁵ (despite the fact that *Blue Fox* did not involve a surety), recalling that none of those Supreme Court cases involved a question of sovereign immunity. “They do not in any way disturb the established rule that, unless waived by Congress, sovereign immunity bars subcontractors and other creditors from en-

forcing liens on Government property or funds to recoup their losses.”⁷⁶ The *Lumbermens* court then compared the attempt by *Blue Fox* to enforce its “equitable lien” to *Lumbermens*’ impairment of suretyship/*pro tanto* discharge claim and found it to be a similar, non-contractual cause of action based on state law or, at most, an implied-in-law contract theory.⁷⁷

Lumbermens argued, to no avail, that the Federal Court’s opinion in *National Surety* “does not support its theory that the government has waived its sovereign immunity as to impairment of suretyship / *pro tanto* discharge claims.”⁷⁸ The Court dismissed the argument out of hand, characterizing the *National Surety* opinion as “decided on the theory of equitable subrogation,”⁷⁹ thus having no bearing on the present issue of whether the government had waived sovereign immunity with respect to claims for impairment of suretyship/*pro tanto* discharge.⁸⁰

Because the Tucker Act’s waiver of sovereign immunity “extends only to contracts either express or implied in fact, and not to claims on contracts implied in law,”⁸¹ *Lumbermens*’ impairment of suretyship/*pro tanto* discharge claim failed for lack of subject matter jurisdiction.⁸²

iii. The CDA and the Takeover Agreement

Finally, the Court turned to the Government’s contention that the Claims Court lacked jurisdiction over *Lumbermens*’ claim arising from the Government’s breach of the takeover agreement, asserting that *Lumbermens* failed to satisfy the jurisdictional prerequisites of the CDA. The CDA requires that “[a]ll claims by a contractor against the government relating to a contract shall be in writing and shall be submitted to the contracting officer for a decision,”⁸³ certifying that the claim is made in good faith if the amount sought exceeds \$100,000.⁸⁴ While, *Lumbermens* did not submit a certified claim to the contracting offer as required by the CDA, the Claims Court had found that the CDA did not apply to the takeover agreement, as *Lumbermens* had signed

it “as a surety fulfilling its performance bond obligation, not as a contractor completing a construction project.”⁸⁵ However, the Federal Circuit disagreed.

First, the Court found that the takeover agreement was “clearly a contract for ‘the procurement of construction, alteration, repair or maintenance of real property.’”⁸⁶ Second, the Court found that the Claims Court erred in concluding that Lumbermens was not a “contractor” as the CDA defines that term. Because the takeover agreement was a tripartite agreement between the government, Lumbermens, and the completing contractor, the Court concluded that the government was looking to Lumbermens for completion of the project, not Atherton.

Indeed, the Court again referred to *Fireman’s Fund*, where the surety, following execution of a takeover agreement, actually followed CDA procedures and initiated a claim with the project’s contracting officer, to support its position that the surety becomes a “contractor” for purposes of the CDA.⁸⁷ Because Lumbermens failed to submit a certified claim to the contracting officer as required by § 605(a) and (c)(1) of the CDA, the Court found that the Claims Court lacked jurisdiction.

Accordingly, because the Court found that the Claims Court lacked jurisdiction over all of Lumbermens’ claims, the Federal Circuit reversed and remanded the Claims Court’s decision, with instructions to dismiss the complaint.

V. “Take Homes” From *Lumbermens*

At the heart of the Court’s faulty analysis appears to a fundamental misunderstanding of the application of equitable subrogation to the facts at hand. The Court inserted a notice requirement in order for Lumbermens to be subrogated to the rights of its contractor. Of course, multiple Supreme Court and other cases do not write in a notice prerequisite for a surety

to pursue its equitable subrogation rights; indeed, *National Surety* rejects such a notion explicitly. Of course, a surety should, and usually does, notify the obligee of its subrogation rights when circumstances dictate. On the other hand, *Lumbermens* now stands alone for the proposition that such notice is a prerequisite to the surety’s equitable subrogation rights.

Moreover, the Court limited Lumbermens’ ability to pursue claims to those which Landmark could have asserted, which, of course, excludes the very actions that were the subject of Lumbermens’ overpayment claim, again failing to follow binding precedent.⁸⁸

Essentially, the Federal Circuit’s opinion in *Lumbermens* limits a Miller Act surety’s options when the federal government terminates a bonded contractor and initiates a performance bond claim, especially in a situation where the surety is otherwise unaware of financial issues with its principal that might suggest that it should send notice to the federal government, directing it to obtain the surety’s consent prior to releasing contract funds going forward. If a surety can only assert *pro tanto* discharge or impairment of suretyship as a defense, rather than as an affirmative claim, they will risk Lumbermens’ fate by taking over and completing the project. Instead, they will be compelled to refuse to take over the work, forcing the federal government to complete on its own and file suit for excess procurement and completion costs, in order for the surety to preserve its defense. The *Lumbermens* ruling creates an unnecessary barrier to prompt resolution of performance bond claims on federal projects.

Finally, Lumbermens appears to concede its arguments with respect to its claim under the CDA, noting in its Petition for Rehearing En Banc that it excludes the Court’s separate findings as to whether the administrative prerequisites of the CDA apply to Lumbermens’ other claims.⁸⁹ Thus, a Miller Act surety must

pursue its claims with the contracting officer prior to appealing any adverse ruling to the Claims Court, in order to preserve its CDA rights.

VI. Conclusion

At least with respect to its holding on Lumbermens’ impairment of suretyship/*pro tanto* discharge claim, the Federal Circuit’s opinion in *Lumbermens* represents an alarming departure from what was believed to be established precedent for sureties and practitioners in the government contract arena. Indeed, while the *Lumbermens* case did not involve the release of retention that formed the basis of the claim in *National Surety*, the underlying facts in both cases are substantially similar, and the claims asserted are virtually identical. Nevertheless, setting aside over two decades of well-settled judicial authority,⁹⁰ *Lumbermens* creates a direct conflict in the law of the Federal Circuit and appears to create a new “bridge to nowhere” for sureties that seek to file suit against the federal government when the contracting entity departs from the requirements of the bonded contract to the surety’s detriment.

Mike F. Pipkin is a partner with international law firm Sedgwick LLP.

End Notes

- ¹ 654 F.3d 1305 (Fed. Cir. 2011).
- ² 28 U.S.C. § 1491 (2011).
- ³ 41 U.S.C. § 601 *et seq.* (2008). For a thorough discussion of jurisdictional issues arising from a surety's disputes with the federal government, see George J. Bachrach and Cynthia E. Rodgers-Waire, *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 223-239 (Lawrence R. Moelmann, Matthew M. Horowitz, and Kevin L. Lybeck eds., 2d ed. 2009).
- ⁴ 28 U.S.C. § 1491(a)(1) (2011); *see also* 28 U.S.C. § 1346(a)(2) (2011).
- ⁵ Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 224 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009); Donald G. Gavin, Shannon J. Briglia, and Mark S. Marino, *Public Works Projects*, in *BOND DEFAULT MANUAL* 306-09 (Duncan Clore, Richard E. Towle, and Michael J. Sugar, eds., 3d ed. 2005).
- ⁶ *Id.*
- ⁷ 243 F.3d 1367 (Fed. Cir. 2001).
- ⁸ Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 225 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009). *See also* Nat'l Am. Ins. Co. v. United States, 498 F.3d 1301 (Fed. Cir. 2007) (affirming a payment bond surety's right to pursue the recovery of contract funds from the federal government because of the waiver of sovereign immunity).
- ⁹ 41 U.S.C. § 601 *et seq.* (2008).
- ¹⁰ Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 230 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009).
- ¹¹ 41 U.S.C. § 609(a) (2008).
- ¹² 41 U.S.C. §§ 605(a) and 605(c)(1) (2008). *See also* Steven L. Reed, *Hot Issues in Pursuing Claims Against the Federal Government: The Dispute Resolution Process* (2010) (unpublished paper submitted at the ABA MidWinter Meeting of the Fidelity & Surety Law Committee on January 28, 2010).
- ¹³ 41 U.S.C. § 605(a) (2008). *See also* Gavin, et al., *Public Works Projects*, in *BOND DEFAULT MANUAL* 299-306 (Clore, et al., eds., 3d ed. 2005).
- ¹⁴ *Reliance Ins. Co. v. United States*, 931 F.2d 863, 866 (Fed. Cir. 1991).
- ¹⁵ *Id.*
- ¹⁶ 41 U.S.C. § 602 (2008).
- ¹⁷ *See, e.g.*, *Reliance Ins. Co. v. United States*, 27 Fed. Cl. 815 (1993); *Employer Ins. of Wausau v. United States*, 23 Cl. Ct. 579 (1991). Note that the Claims Court has held that the surety's Miller Act bonds alone do not satisfy the "government contracts" requirement under the CDA. *Westech Corp. v. United States*, 20 Cl. Ct. 745, 749 (1990); *see also* *Admiralty Constr., Inc. v. Dalton*, 156 F.3d 1217, 1221-22 (Fed. Cir. 1998). *See also* Louis A. Modugno & Michael J. Hurley, *Clean Up on Aisle 40 U.S.C. § 3131 et seq.: Completion of Federal Projects* (2010) (unpublished paper submitted at the ABA MidWinter Meeting of the Fidelity & Surety Law Committee on January 28-29, 2010).
- ¹⁸ *Reliance Ins. Co. v. United States*, 27 Fed. Cl. 815, 821-24 (1993).
- ¹⁹ *Travelers Indem. Co. v. United States*, 16 Cl. Ct. 142, 152-54 (1988).
- ²⁰ *Id.*
- ²¹ *Employers Ins. of Wausau v. United States*, 23 Cl. Ct. 579 (1991). *See also* Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 232-33 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009), for a thorough discussion of these and other impediments to a surety's claims under the CDA.
- ²² 909 F.2d 495 (Fed. Cir. 1990).
- ²³ *Id.* at 496.
- ²⁴ *Id.*
- ²⁵ *Id.* at 496, 499.
- ²⁶ *Id.* at 497.
- ²⁷ *Id.* at 498 (noting that a surety may file suit under the "pro tanto discharge rule" whenever the government "departed from the terms of the bonded contract").
- ²⁸ 118 F.3d 1542 (Fed. Cir. 1997).
- ²⁹ *See* Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 247, n338 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009).
- ³⁰ *National Surety*, 118 F.3d at 1545.
- ³¹ *Id.* (citations omitted).
- ³² *See* Footnote 68.
- ³³ *National Surety*, 118 F.3d at 1546.
- ³⁴ 525 U.S. 255 (1999).
- ³⁵ There were no Miller Act bonds, as the Army had removed the bonding requirement from the prime contract by re-characterizing it as a "services contract". *Id.* at 257-58.
- ³⁶ *Id.* at 263.
- ³⁷ *Id.* at 264.
- ³⁸ 243 F.3d 1367 (Fed. Cir. 2001).
- ³⁹ *See* Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 260-261 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009); Edward G. Gallagher, *Entitlement to Contract Proceeds*, in *THE LAW OF PAYMENT BONDS* 527-528 (Kevin L. Lybeck, Wayne D. Lambert, and John E. Sebastian, eds., 2d ed. 2011).
- ⁴⁰ *Id.* at 1378.
- ⁴¹ *Id.* at 1371 (citing *United States v. Munsey Trust Co.*, 332 U.S. 234, 240-41 (1947)). *See also* Gallagher, *Entitlement to Contract Proceeds*, in *THE LAW OF PAYMENT BONDS* 528-29 (Lybeck, et al., eds., 2d ed. 2011).

End Notes *continued*

- ⁴² Ins. Co. of the West v. United States, 55 Fed. Cl. 529, 538 (2003) (citations omitted).
- ⁴³ See Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 263-64 (Lawrence R. Moelmann, et al. eds., 2d ed. 2009).
- ⁴⁴ 40 U.S.C. § 3131(b) (2006) (formerly 40 U.S.C. § 270a).
- ⁴⁵ *Lumbermens*, 654 F.3d at 1308. Lumbermens did not provide additional surety credit for the additional units.
- ⁴⁶ *Id.*
- ⁴⁷ *Id.* at 1308-09.
- ⁴⁸ *Id.* at 1309.
- ⁴⁹ *Id.*
- ⁵⁰ *Id.*
- ⁵¹ *Id.*
- ⁵² *Id.* at 1309-1310.
- ⁵³ *Id.*, citing *ICW*, 243 F.3d at 1375, and *Lumbermens Mut. Cas. Co. v. United States*, 67 Fed. Cl. 253, 255 (2005) ("*Lumbermens I*").
- ⁵⁴ *Id.* at 1310.
- ⁵⁵ *Id.*
- ⁵⁶ *Id.* at 1310-11.
- ⁵⁷ *Id.* at 1311.
- ⁵⁸ *Id.* at 1310, citing *Lumbermens Mut. Cas. Co. v. United States*, 90 Fed. Cl. 558, 560 (2009) ("*Lumbermens II*").
- ⁵⁹ *Lumbermens*, 654 F.3d at 1310.
- ⁶⁰ *Id.* at 1311.
- ⁶¹ *Id.*, fn 2.
- ⁶² *Id.* at 1312, citing *Nat'l Am. Ins. Co. v. United States*, 298 F.3d 1301, 1304 (Fed. Cir. 2007) (reaffirming that a surety may "invoke the doctrine of equitable subrogation to step into the shoes of the contractor for the purpose of satisfying the jurisdictional requirements of the Tucker Act").
- ⁶³ *Id.* at 1312, citing *Balboa Ins. Co. v. United States*, 775 F.2d 1158, 1161 (Fed. Cir. 1985).
- ⁶⁴ *Id.* at 1312-13.
- ⁶⁵ 118 F.3d 1542 (Fed. Cir. 1997).
- ⁶⁶ For a thorough discussion of *National Surety*, see Bachrach, et al., *The Performance Bond Surety's Rights to the Contract Funds*, in *THE LAW OF PERFORMANCE BONDS* 246-48 (Moelmann, et al., eds., 2d ed. 2009).
- ⁶⁷ *Lumbermens*, 654 F.3d at 1313, citing *National Surety*, 118 F.3d at 1547.
- ⁶⁸ The most common type of equitable subrogation claim is referred to as a "stakeholder" claim, which occurs when the federal government has not yet provided the final payment to the contractor and is notified by the surety that it has received one or payment bond claims. Upon such notice, the government becomes a "stakeholder" of the contract proceeds and thereafter owes an equitable duty to the surety to protect the contract proceeds. See, e.g., *Balboa Insurance Co. v. United States*, 775 F.2d 1158, 1162 (Fed. Cir. 1985). See also Gregory Weinstein and Kimberly B. Czap, *The Holy Grail for Sureties: The Right to Contract Balances* (2010) (unpublished paper submitted at the ABA MidWinter Meeting of the Fidelity & Surety Law Committee on January 28-29, 2010).
- ⁶⁹ *Lumbermens*, 654 F.3d at 1313.
- ⁷⁰ *Id.* at 1314, citing *United States v. Cont'l Cas. Co.*, 512 F.2d 475, 478 (5th Cir. 1975) and *Fort Worth Indep. Sch. Dist. v. Aetna Cas. & Sur. Co.*, 48 F.2d 1, 4 (5th Cir. 1931).
- ⁷¹ *Lumbermens*, 654 F.3d at 1314.
- ⁷² *Id.* at 1315.
- ⁷³ 371 U.S. 132 (1962).
- ⁷⁴ 208 U.S. 404 (1908).
- ⁷⁵ 164 U.S. 227 (1896).
- ⁷⁶ *Blue Fox*, 525 U.S. at 265.
- ⁷⁷ *Lumbermens*, 654 F.3d at 1316.
- ⁷⁸ *Id.* at 1317.
- ⁷⁹ *Id.*
- ⁸⁰ In its Petition for Rehearing En Banc, Lumbermens asserts that "[t]he Panel's refusal to acknowledge the obvious factual and legal parallels between [*Lumbermens*] and *National Surety* is both illogical and indefensible," referring to multiple uses of discharge and impairment terms throughout the *National Surety* opinion, as well as references and citations to the Restatement of Suretyship's provisions on discharge. See 2011 WL 5057041 (C.A.Fed. Sept. 19, 2011). Lumbermens limited its *en banc* request to its impairment of suretyship/*pro tanto* discharge claim. *Hercules Inc. v. United States*, 516 U.S. 417, 423 (1996).
- ⁸¹ The Court specifically noted the amicus brief filed by the Surety & Fidelity Association of America, wherein it contended that finding no waiver of sovereign immunity "would leave sureties without a remedy when the government impairs the surety's collateral." *Lumbermens*, 654 F.3d at 1317. The Court dismissed the argument, opining in dicta that "the surety has the right to withhold payment on the bond, to the extent the surety has been prejudiced, based on the defense of impairment of suretyship/*pro tanto* discharge. **We simply hold that, once a surety makes overpayments on its bond obligation, it has no right to affirmatively recover against the United States.**" *Id.* (emphasis added).
- ⁸² 41 U.S.C. § 605(a).
- ⁸³ *Id.* § 605(c)(1).
- ⁸⁴ *Lumbermens*, 654 F.3d at 1318, citing *Lumbermens II*, 90 Fed. Cl. at 560-61.
- ⁸⁵ *Lumbermens*, 654 F.3d at 1318, citing 41 U.S.C. § 602(a)(3).
- ⁸⁶ *Lumbermens*, 654 F.3d at 1319.
- ⁸⁷ See Brief of Amicus Curiae of the Surety & Fidelity Association of America in Support of the Petition for Rehearing En Banc of *Lumbermens Mutual Casualty Company*, 2011 WL 4735228 (C.A.Fed. Sept. 27, 2011).
- ⁸⁸ 2011 WL 5057041, fn 1 (C.A.Fed. Sept. 19, 2011).
- ⁸⁹ See, e.g., *Nova Casualty Co. v. United States*, 72 Fed. Cl. 755, 760 (2004) (applying *National Surety* in an impairment of suretyship claim against the government); *American Insurance Co. v. United States*, 62 Fed. Cl. 151, 156 (2004) (applying *National Surety* in response to a motion to dismiss when the government materially veers from the bonded contract).
- ⁹⁰