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CONSTRUCTION LEGAL ALERT

ILLINOIS SUPREME COURT HOLDS THAT ALL ILLINOIS PUBLIC CONSTRUCTION BONDS ARE “DEEMED” TO INCLUDE BOTH A PERFORMANCE AND PAYMENT GUARANTEE

Last month, in *Lake County Grading Company, LLC v. Village of Antioch*, the Illinois Supreme Court handed down a ruling concerning bonds procured under the Illinois Public Construction Bond Act. The following is a summary and analysis of this seminal case.

Factual Background

The case arose out of construction work performed by the developer Neumann Homes, Inc. (Neumann) in two residential subdivisions located in Antioch, Illinois. The Village of Antioch (the Village) entered into infrastructure agreements with Neumann to make certain public improvements in the subdivisions for the general benefit of the Village. Thereafter, Neumann entered into agreements with Lake County Grading (LCG) for certain portions of the public improvement projects. Pursuant to the infrastructure agreements with the Village, and presumably pursuant to the Illinois Public Construction Bond Act (the Illinois Bond Act or the Act), Neumann was required to post bonds for the public improvement portion of the project. The bonds purchased contained the following language:

The Principal Neumann shall perform and complete improvement(s) to development in accordance with either the plan(s)/specification(s)/agreement prepared by Pearson Brown & Associates, Inc. or Manhard Consulting. This bond will terminate upon written acceptance of the improvements by the obligee Village to the principal Neumann and/or surety Fidelity.

It is important to note that the bonds purchased by Neumann pursuant to the express language of the bonds were *performance* bonds, not *payment or completion* bonds. Whereas payment bonds expressly guarantee payment to subcontractors, performance bonds expressly guarantee that the surety will honor the contractor’s performance obligations in the event the contractor fails to complete the promised work. As will be discussed in detail

below, the practical difference between these two types of bonds becomes complicated in the context of Illinois law.

LCG completed the work it contracted to perform with Neumann for the public improvement portion of the project, but was not paid by Neumann. Neumann in fact went bankrupt and defaulted on its various agreements with the Village. LCG consequently served lien claims for its uncompensated work, in addition to filing a complaint which sought to recover payments from the Village. The complaint filed by LCG asserted that the Illinois Bond Act requires every public project to have a payment bond (along with a performance bond) for the benefit of the subcontractors, such as itself. The Village, LCG argued, breached its contract with Neumann by not requiring the latter to obtain bonds that guaranteed payment to its subcontractors pursuant to the Illinois Bond Act, and LCG sued as a third party beneficiary of that contract.

Legal Issues and Court Holding

The case involved the determination of the obligations of a public body, like the Village, pursuant to the Illinois Bond Act. Section 1 of the Illinois Public Construction Bond Act provides as follows:

Except as otherwise provided by this Act, all officials, boards, commissions, or agents of this State, or of any political subdivision thereof, in making contracts for public work of any kind costing over \$50,000 to be performed for the State, or of any political subdivision thereof, shall require every contractor for the work to furnish, supply and deliver a bond to the State, or to the political subdivision thereof entering into the contract, as the case may be, with good and sufficient sureties. . . . The amount of the bond shall be fixed by the officials, boards, commissions, commissioners or agents, and the bond, among other conditions, **shall be conditioned for the completion of the contract, for the payment of material used in the work and for all labor performed in the work, whether by subcontractor or otherwise.**

Each such bond is deemed to contain the following provisions whether such provisions are inserted in such bond or not:

The principal and sureties on this bond agree that all the undertakings, covenants, terms, conditions and agreements of the contract or contracts entered into between the principal and the State or any political subdivision thereof **will be performed and fulfilled and to pay all persons**, firms and corporations having contracts with the principal or with subcontractors, all just claims due them under the provisions of such contracts for labor performed or materials furnished in the performance of the contract on account of which this bond is given, when such claims are not satisfied out of the contract price of the contract on account of which this bond is given, after final settlement between the officer, board, commission or agent of the State or of any political subdivision thereof and the principal has been made. (Emphasis added)

In this case, the parties agreed that the above-quoted language required both performance and payment guarantees to be secured by the contractor from a surety for the public infrastructure projects. The dispute centered on the issue of whether the performance bonds procured by Neumann were “deemed” to include payment obligations pursuant to the Illinois Bond Act, even though the actual bonds procured did not include payment guarantees. The Illinois Supreme Court answered this question in the affirmative.

In so holding, the Illinois Supreme Court looked to the plain language of Section 1 of the Illinois Bond Act and found that “regardless of the actual language contained in a public construction bond . . . the legislature has unambiguously provided that all such bonds are deemed to contain both [performance] and payment provisions as a matter of law.” The Court continued to explain that this interpretation is consistent with the two main purposes of the Illinois Bond Act:

First, the Act “protects subcontractors for whom no right of mechanics’ lien exists against a public body by guaranteeing payment for their labor and materials furnished to the contractor.” In other words, the Illinois Bond Act assures payment to subcontractors who make timely demand on the bond, and who would not have recourse against a public entity; and

Second, the Act “guards the tax money allotted for public works by assuring that the terms, conditions and agreements of the contract will be fulfilled and paid for by the surety if the contractor does not complete the Project,” meaning the surety protects the Village from having to pay more than it originally contracted to pay.

The Illinois Supreme Court ruled that given the policy purposes of the Illinois Bond Act, and the requirement that both performance and payment be ensured, each bond is “deemed” to include a payment obligation pursuant to Section 1 of the Illinois Bond Act.¹

Lessons Learned

Lake County Grading Company, LLC v. Village of Antioch, unfortunately, creates more uncertainty than it attempted to resolve. This is due in part to the somewhat unique nature of the Illinois Public Construction Bond Act in comparison to other bond statutes around the nation. Under the federal bond statute, and most state bond statutes, a contractor on a public works project is expressly required to furnish to the government *both* a performance bond *and* a payment bond. By contrast, the Illinois Public Construction Bond Act only requires the procurement of “a [single] bond” in connection with a public project which, as now interpreted by the Illinois Supreme Court, as “deemed” to include *both* a payment and performance provision, regardless of the actual wording of the bond. This legal anomaly has very real consequences in the practical sphere, the biggest of which is uncertainty. A few questions immediately arise:

- ❖ Is a surety who writes a performance bond expressly disclaiming any payment guarantee still liable to a subcontractor for payment obligations?
- ❖ Can a subcontractor make a claim for payment on a performance bond on a public project in Illinois where the contractor has obtained both a performance bond and payment bond?

These are but two examples of the types of questions and issues that now lie ahead for those stakeholders engaged in public construction projects in the State of Illinois. At the moment it does not appear that any real winners emerged from this decision. Undoubtedly, sureties will increase premiums to protect against these uncertainties and the unintended consequences of being liable for exposures never negotiated, and these costs, while initially fronted by contractors, will be passed along to the public entity requiring such bonds. In fact, the only

¹ It is worth noting that while the Court found that the performance bond was deemed to include the payment guarantees pursuant to the Illinois Bond Act, LCG apparently could no longer make a claim on the bond as such a claim was barred by the 180-day limitations period (which, pursuant to the Illinois Bond Act, requires a claimant to give notice of a claim within 180-days after last working on a project).

certainty from the *Antioch* decision is more uncertainty regarding the proper interpretation and application of the Illinois Public Construction Bond Act, and the concomitant fear that public work projects will invariably cost more and place greater financial burden on scarce public coffers.

Contacts

Clients that have questions regarding the subject matter of this Legal Alert are welcome to contact either Robert Harris (312-662-4601) (rharris@hwhlegal.com) or Daniel Dorfman (312-662-4609) (ddorfman@hwhlegal.com).

Information

A copy of the Illinois Supreme Court's decision in *Lake County Grading Company, LLC v. Village of Antioch* is available [here](#).

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