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Navigating Payment Disputes on Public Construction Projects

By Patrick S. McCarney - RBE Attorney

For subcontractors that make improvements to real property, navigating the strict requirements of Indiana's mechanic's lien statute is probably all too familiar. However, when the government owns the construction project, mechanic's liens are not available under Indiana law because, as a matter of public policy, the State of Indiana does not want public property to become encumbered by such liens.[1] Instead, the State has provided other statutory procedures for securing delinquent payments.

The Miller Act And Indiana's Little Miller Acts

In 1935, the Miller Act was signed into federal law. Under the Miller Act, contracts providing for the construction, alteration, or repair of federal public buildings or federal public works projects require that general contractors furnish payment bonds with a surety to protect the rights of subcontractors, laborers, and materialmen.[2] Since the codification of the Miller Act, all 50 states have adopted similar provisions related to state and local government projects, which are commonly known as "Little Miller Acts."

Indiana's Little Miller Acts are spread across four different statutory schemes[3], but this article will focus only on the following three: state projects with the Indiana Department of Administration ("IDOA")[4]; projects with all other state agencies (except the Indiana Department of Transportation)[5]; and local government projects.[6] These statutory schemes are all remedial in nature, and they are designed to protect the rights of subcontractors, laborers, materialmen, and others who furnish services on public works projects (collectively, and for the purposes of this article, "Subcontractors").[7]

The code provisions are generally very similar, although there are also some notable differences. All contracts for public works projects are required to include provisions that mandate payment to Subcontractors in one way or another.[8] The state or local government entity also has an obligation to withhold money from contract payments to the general contractor to remedy Subcontractors' nonpayment claims.[9] All three statutory schemes also require the general contractor to execute a payment bond for the benefit of Subcontractors in the event of nonpayment. Yet, the requirements under each scheme are different. IDOA projects require a payment bond equal to the contract price when the project's estimated cost is greater than $200,000.00.[10] Similarly, a payment bond is required for

local public works contracts estimated to exceed $200,000.00.[11] However, the local government entity can, at its election, require payment bonds for smaller contracts.[12] Conversely, state agency projects generally require a payment bond in an amount equal to the contract price, unless the contract is with a state educational institution and less than $500,000.00.[13]

Notably, a Subcontractor's rights to pursue the payment bond or pursue withheld contract payments are considered alternate (but not mutually exclusive) remedies.[14] However, each remedy is treated slightly differently under the respective code provisions, and a Subcontractor needs to ensure that it follows all proper procedures depending on whether it is pursuing one or both remedies.

Initiating A Nonpayment Claim – Whom Do You Notify?

Regardless of whether it is a state or local project, both alternate remedies require the Subcontractor to notify the proper government owner of the project. Because the remedies are alternate, the Subcontractor must also identify whether it seeks compensation from unpaid general contract payments, seeks compensation from the payment bond, or both.[15]

The statutory sections related to state projects specifically require notice to the Public Works Division ("DAPW") of the IDOA.[16] For state agency projects, notice must be given to the appropriate "public body," which refers to a board, commission, trustee, officer, or an agent acting on behalf of the state or a commission created by law.[17] For local projects, the Subcontractor must provide notice to the "board" of the local government entity, which is defined as "the board or officer of a political subdivision or an agency having the power to award contracts for public work."[18] While the code provisions related to local government projects generally apply to public works contracts with all political subdivisions and their agencies, the code also contains numerous exceptions in which the sections become inapplicable.[19]

While all these statutory schemes require proper notification to the appropriate body, compliance can sometimes be confusing when it comes to local government entities because of facial similarities between local entities that are legally separate political subdivisions. For example, school corporations and public libraries are considered separate government entities from any city, town, or county in which they are located. Accordingly, sending notice to the city, town, or county rather than the school or library would not be compliant. Therefore, it is critically important to know which "board" needs to receive notice.

Once the proper government entity to notify has been determined, the specific steps to follow can vary depending on the remedy sought and the type of project involved. Because the type of notice required is generally the same for both remedies, it is important to expressly identify which remedy is being sought so that the government entity can fulfill any responsibilities it has under the applicable statutory scheme.

Remedy One: Withholding Contract Payments

First, it is important to note that a government entity has no authority or obligation to withhold contract payment from a general contractor on behalf of a Subcontractor unless and until the proper notice procedures are followed.[20] A government entity, for example, is not obligated to anticipate a Subcontractor's nonpayment claims.[21] Regardless of the type of public project, the Subcontractor must file statements of the amount due with the proper entity (with copies sent to the general contractor) within 60 days after the subcontractor's last work on the project.[22] Claims made on IDOA projects also are subject to the express requirement that the claim "shall give as much detail explaining the claim as possible."[23] For local projects, the Subcontractor must also obtain a signature on its claim form from an individual from the government entity who is directly responsible for the project and who can, if applicable, verify the quantity of a purchased item or the weight or volume of material supplied in the case of local road, street, or bridge projects.[24]

Because this remedy only requires the public entity to stop making payments to the general contractor, it is conceivable that sometimes the remaining unpaid contract amount will be less than the amount of a Subcontractor's claim. This risk is more significant when multiple Subcontractors make claims at the same time. In these circumstances, the Subcontractor will have to proceed directly against the contractor for any additional amount unless the Subcontractor has also preserved its right to pursue a payment bond executed in connection with the project.

Remedy Two: Pursuing The Payment Bond

If a payment bond was executed on the project, a Subcontractor may proceed directly against the surety.[25] To proceed against the surety, a Subcontractor must still provide the same notice to the appropriate government entity within 60 days after the subcontractor performed their last labor on the project.[26] In the case of IDOA projects, the Subcontractor must notify the surety directly by sending it a copy of the claim and notify DAPW that the surety has been contacted.[27] This provision differs significantly from the process related to state agencies and local governments. For local and state agency projects, the Subcontractor must file duplicate signed statements of the amount due with the government entity (with a copy to the contractor), but it is the government entity's responsibility to notify the surety of the claim.[28]

Perhaps the most significant difference between the two remedies is related to timing. While contract payments are withheld as soon as proper notice is provided, proceeding against the surety involves additional timing components. A Subcontractor must wait, in all cases, at least 30 days before bringing an action against the surety after it provides proper notice.[29] For IDOA claims, the action against the surety must be brought within one year after the general contractor receives final payment.[30] However, for state agency and local projects, the Subcontractor must file an action against the surety no later than 60 days after the completion and acceptance of the public project.[31] These deadlines are particularly important for non-payment claims that arise shortly before the project's final acceptance. In such a case, a Subcontractor may not have a full 60 days to provide notice because it must also comply with both the 30-day waiting period and the requirement to file an action against the surety within 60 days after final acceptance of the public work.

No Matter What, Do Not Deviate From The Code

As a general matter, strict statutory compliance with Little Miller Act procedures is required. The United States Court of Appeals for the Seventh Circuit, while applying Indiana law, noted that "nothing in the statute's plain language or Indiana case law suggests that a subcontractor may deviate from the requisite statutory notice provisions. It is easy to discern why Indiana courts require strict compliance with the statute's notice provisions."[32] In this Seventh Circuit case, a subcontractor on a local project had sent its nonpayment notice directly to the surety, which the court held was legally invalid because the statute requires notice to be sent to the appropriate government board to forward to the surety.[33] The court also noted that the government entity was not properly on notice to withhold general contract payments because the notice at issue only referenced recovery under the "Payment and Performance Bonds."[34] Similarly, the Indiana Court of Appeals has noted that when a contractor fails to comply with the statutory requirements, the government entity is under no obligation to withhold payments to the general contractor.[35]

Conclusion

The Little Miller Acts protect Subcontractors on public projects and help to ensure they are fully compensated. However, like mechanic's liens, Subcontractors must strictly comply with the applicable Little Miller Act to preserve their rights. The failure to comply with any of Indiana's Little Miller Acts does not preclude a Subcontractor from pursuing the general contractor directly for a breach of contract action. However, in cases where the lack of payment is due to a contractor's questionable financial condition, this remedy may not lead to full compensation. Accordingly, when a payment issue arises on a state or local public works project, ensuring proper compliance with these statutes is the best way to preserve all remedies and collect what is owed.

[1] *See Evansville v. Verplank Concrete & Supply, Inc.*, 400 N.E.2d 812, 815-16 (Ind. Ct. App. 1980).
[2] 40 U.S.C. § 3131.
[3] The fourth scheme is related to state highway projects and Indiana Department of Transportation projects under Indiana Code chapter 8-23-9 *et seq*. This article will not discuss the requirements for these projects, which have some significant dif ferences from the other statutory schemes. But to the extent readers may contract for that kind of work, it is important to know there is a separate set of rules to follow.
[4] Ind. Code § 4-13.6-7 *et seq*.
[5] I.C. §§ 5-16-5 *et seq.* and 5-16-5.5 *et seq.* (the latter statutory regime has a narrow focus on retainage amounts to be placed in escrow on certain projects and will not be discussed in detail in this article).
[6] I.C. § 36-1-12 *et seq.*
[7] *Alberici Constructors, Inc. v. Ohio Farmers Ins. Co.*, 866 N.E.2d 740, 743 (Ind. 2007).
[8] I.C. § 4-13.6-7-2; I.C. § 5-16-5-2; I.C. § 36-1-12-13.
[9] *Id.*
[10] I.C. § 4-13.6-7-6.
[11] I.C. § 36-1-12-13.1.
[12] *Id.*
[13] I.C. § 5-16-5-2
[14] *See Kamphuis Pipeline Co. v. Lake George Reg'l Sewer Dist.*, 273 F.3d 732, 736 (7th Cir. 2001) (interpreting Indiana law); *see also Am. States Ins. Co. v. Floyd I. Staub, Inc.*, 370 N.E.2d 989, 994 (Ind. Ct. App. 1977).
[15] *See Kamphuis*, 273 F.3d at 736 (interpreting Indiana law).
[16] I.C. § 4-13.6-7-10.
[17] I.C. § 5-16-5-0.5.
[18] I.C. § 36-1-12-1.2.
[19] I.C. § 36-1-12-1.
[20] *Merrillville Conservancy Dist. v. Atlas Excavating*, 764 N.E.2d 718, 722 (Ind. Ct. App. 2002).
[21] *Id.* at 723.
[22] I.C. § 4-13.6-7-10; I.C. § 5-16-5-1; I.C. § 5-16-5-2; I.C. § 36-1-12-12(b).
[23] I.C. § 4-13.6-7-10.
[24] I.C. § 36-1-12-12(f).
[25] I.C. § 4-13.6-7-10; I.C. § 5-16-5-2; I.C. § 36-1-12-13.1.
[26] *Id.*
[27] I.C. § 4-13.6-7-10.
[28] I.C. § 5-16-5-2; I.C. § 36-1-12-13.1.
[29] I.C. § 4-13.6-7-10; I.C. § 5-16-5-2; I.C. § 36-1-12-13.1.
[30] I.C. § 4-13.6-7-11.
[31] I.C. § 5-16-5-2; I.C. § 36-1-12-13.1.
[32] *Kamphuis*, 273 F.3d at 736 (emphasis supplied).
[33] *Id.*
[34] *Id.*
[35] *See Merrillville, 764 N.E.2d at 722-23.*

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Patrick represents and advises clients in diverse substantive areas, including business entity selection and formation, contract drafting and disputes, municipal law, construction law, insurance defense, and general business litigation.

While attending the Indiana University Robert H. McKinney School of Law, Patrick served as an Articles Editor for the Indiana Law Review and his Note on crowdfunding rules was selected for publication. Patrick also assisted first-year law students with legal writing by serving as a Dean's Tutorial Society Fellow. Patrick was named to the Order of Barristers in the Moot Court Program and was also a Semi-Finalist in the 2017 Honorable Robert H. Staton Moot Court Competition. In addition, Patrick completed a legal externship with Cummins Inc. where he gained experience in cross-border transactions and intellectual property, including trademarks and trade secrets. Concurrently with his final two years of law school, Patrick completed his M.B.A. from Purdue University's Krannert School of Management.