

# **TOP TEN THINGS TO KNOW ABOUT SURETY LAW IN SOUTH CAROLINA**

**2013 SC Bar Convention Construction Law Seminar**

**PRESENTED BY: EMILY R. GIFFORD, ESQ.**

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**TOP TEN THINGS TO KNOW ABOUT SURETY LAW IN SOUTH CAROLINA**  
**2013 SC Bar Convention Construction Law Seminar**  
**By: Emily R. Gifford<sup>1</sup>**

**1. What Is a Surety Bond**

- a. What is a surety?
  - i. A “surety” is one who becomes responsible for the debt, default, or miscarriage of another
- b. A tripartite agreement among the surety, the principal, and the obligee
- c. In construction context, the parties are typically:
  - i. Surety
  - ii. Contractor a/k/a the principal
  - iii. Project owner a/k/a the obligee
- d. Owners can request a bond from the contractor to ensure the contractor’s performance on the project
  - i. If the contractor defaults, the owner can look to the surety to assume the obligations of the principal
  - ii. Surety has several options to satisfy its obligations to owner
- e. A bond is a simple contract
  - i. Terms are given their plain meaning and the surety’s express obligations in the bond cannot be extended by implication<sup>2</sup>
  - ii. The bond makes the surety and principal responsible to the obligee, and the bond is designed to protect obligee -- not the principal<sup>3</sup>
- f. Purpose of a surety bond is to protect the obligee against the principal’s potential default<sup>4</sup>
- g. Insurance v. suretyship
  - i. Sureties are regulated by South Carolina Insurance Code<sup>5</sup>

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<sup>1</sup> This outline is taken largely from the South Carolina Suretyship Chapter of the SC Bar Construction Law Deskbook, which was co-written by James E. Weatherholtz.

<sup>2</sup> See *S.C. Pub. Serv. Comm’n v. Colonial Constr. Co.*, 274 S.C. 581, 584, 266 S.E.2d 76, 77 (1980); see also *Emp’rs Ins. of Wausau v. Constr. Mgmt. Eng’rs of Fla., Inc.*, 297 S.C. 354, 357, 377 S.E.2d 119, 121 (Ct. App. 1989); *SOCAR, Inc. v. St. Paul Fire & Marine Ins. Co.*, 288 S.C. 287, 289, 341 S.E.2d 822, 823 (Ct. App. 1986).

<sup>3</sup> *Masterclean v. Star Ins. Co.*, 347 S.C. 405, 409, 556 S.E.2d 371, 374 (2001).

<sup>4</sup> *Id.*

- ii. South Carolina Supreme Court has stated that “the surety’s presence in a regulatory [insurance] scheme does not render common law duties of an insurer applicable to a surety”<sup>6</sup>
- iii. Courts can analogize sureties with insurance companies for purposes of contract construction, but not for purposes of expanding common law duties in tort<sup>7</sup>
- iv. Public policy interests that guide the regulation of insurance are not present with sureties
- v. United States Supreme Court case - *Pearlman v. Reliance Insurance Co* - noted in dicta that the “usual view, grounded in commercial practice, [is] that suretyship is not insurance”<sup>8</sup>

## **2. Payment and Performance Bonds**

### **a. Performance Bonds**

- i. Purpose is to guarantee, for the benefit of the owner, the principal’s financial responsibility and ability to perform the contract in question
- ii. Typically written in the amount of the contract and are always required on federal projects under the Miller Act<sup>9</sup>
- iii. Under South Carolina’s adoption of various Little Miller Act statutes, performance bonds may be required, depending on the size, scope, and type of project
- iv. On private projects, contractors provide performance bonds at the owner’s discretion

### **b. Payment Bonds**

- i. Purpose is to guarantee payment to unpaid material suppliers, laborers, and certain subcontractors who supply labor and material for use in the project
- ii. Surety’s liability is triggered by the principal’s default, which means a failure to pay a “claimant”
- iii. Typically written in an amount equal to the performance bond

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<sup>5</sup> See S.C. Code Ann. § 38-1-20 (13), (22), (25), & (37) (Supp. 2000).

<sup>6</sup> *Masterclean*, 347 S.C. at 410, 556 S.E.2d at 374.

<sup>7</sup> *Id.* at 411, 556 S.E.2d at 375.

<sup>8</sup> *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 140 n.19 (1962).

<sup>9</sup> 40 U.S.C. §§ 3131–3134 (formerly 40 U.S.C. §§ 270a–270d).

- iv. Surety's actual exposure is usually much less because labor and material payments should have been made consistently over the course of a project
- c. Penal Amount
  - i. Amount is typically specified on the face of the bond itself, and the penal amount defines the aggregate liability of the surety for any and all claims under that particular bond<sup>10</sup>
  - ii. Sum certain and once it is exhausted, the surety's liability on that bond is extinguished
  - iii. South Carolina case law has long held that the liability of a surety is limited to the penal amount stated on the bond<sup>11</sup>

### 3. Indemnity Agreement

- a. Before a surety issues a bond, it typically will conduct an underwriting analysis
- b. Sureties frequently ask the principal and other named indemnitors (including the principal's members or shareholders, indemnitor's spouse, etc.) to sign an indemnity agreement
  - i. The principal agrees to indemnify the surety, to assist in the handling of claims, and to provide security interests in the principals' equipment, machinery and receivables
  - ii. Indemnity agreement also typically provides the surety the right to pay or otherwise settle claims on the bond
- c. Terms will vary from surety to surety and should be examined for specific rights and remedies
- d. Frequently include provisions for recovery of the surety's attorney's fees, costs, and expenses related to the surety's investigation, review, and resolution of claims under the bond
- e. South Carolina law recognizes two types of indemnity: contractual indemnity and equitable indemnity<sup>12</sup>

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<sup>10</sup> See *Brown v. Nat'l Sur. Corp. of N.Y.*, 207 S.C. 462, 36 S.E.2d 588 (1946); *Ellis v. Sanders*, 34 S.C. 236, 13 S.E. 417 (1891); *Mitchell v. Laurens*, 7 Rich. 109, 1854 WL 2782 (1854); *N. River Ins. Co. v. Claar*, 299 S.C. 8, 382 S.E.2d 8 (Ct. App. 1989).

<sup>11</sup> See *Brown v. Nat'l Sur. Corp. of N.Y.*, 207 S.C. 462, 36 S.E.2d 588 (1946); *Ellis v. Sanders*, 34 S.C. 236, 13 S.E. 417 (1891); *Mitchell v. Laurens*, 7 Rich. 109, 1854 WL 2782 (1854); *N. River Ins. Co. v. Claar*, 299 S.C. 8, 382 S.E.2d 8 (Ct. App. 1989).

- i. Contractual indemnity involves a transfer of risk for consideration, and the contract itself establishes the relationship between the parties
  - ii. In the context of a surety, the contractual indemnification is established by virtue of the general agreement of indemnity between the surety and the indemnitors
  - iii. A surety can be held directly liable for the debt of its principal, but an indemnitor is only liable to the surety after the surety has expended monies in connection with a bond it issued on behalf of the surety
- f. Common terms in indemnity agreements:
  - i. Indemnitors agree to indemnify and exonerate the surety
  - ii. Indemnitors will agree to pay funds when claims are made against the principal or surety
  - iii. Indemnitors are liable to the surety for all payments made by the surety in good faith, including payments that were made negligently
  - iv. Indemnitors are jointly and severally liable
  - v. Surety can recover from the indemnitor any attorney's fees, costs, and expenses related to the surety's investigation, review, and resolution of claims under the bond
- g. Indemnity agreement is a contract and is enforceable in the absence of fraud or bad faith
  - i. Surety should be able to seek repayment for its costs, even if payments were made negligently<sup>13</sup>
  - ii. A majority of courts have found that gross negligence or bad judgment is insufficient to amount to bad faith
- h. Under South Carolina law, if the principal has been adjudged liable, the principal is estopped from denying liability in an indemnification action
  - i. *Aetna Casualty & Surety Company v. Golightly*: Court held that a builder who was a party to a proceeding in which his liability was established was

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<sup>12</sup> *Rock Hill Tel. Co. v. Globe Commc'ns, Inc.*, 363 S.C. 385, 389, 611 S.E.2d 235, 237 (2005).

<sup>13</sup> *Fid. & Deposit Co. v. Bristol Steel & Iron Works, Inc.*, 722 F.2d 1160 (4th Cir. 1984).

collaterally estopped from denying his liability in an indemnification action brought by the surety<sup>14</sup>

#### **4. Surety's Options on Default**

- a. Surety's liability typically arises under a performance bond when the principal is in default, either by self-declaration or where the owner has notified the surety of a material breach and declared the principal in default under the terms of the principal's contract
- b. After default and proper demand has been made by the owner, the surety has the right to choose its response
- c. Most bond forms list specific options that the surety may select as its course of action
- d. Some owners incorrectly assume that if the contractor defaults, they need only notify the surety, who will then take over and complete the project
  - i. The surety is usually not technically required to complete the project
  - ii. The performance bond only guarantees that the penal sum will be made available to pay the cost to complete the portion of the contract that exceeds the amount of the remaining contract funds held by the owner
- e. Possible options that a surety has upon principal's default:
  - i. Surety can provide financial assistance to the defaulting principal to help the principal remedy the default on its own
  - ii. Surety can allow the owner to remove the defaulting contractor and surety can then hire a new contractor to complete the project pursuant to a "takeover agreement"
  - iii. Surety can obtain bids for a completing contractor, submit the bids to the owner, and tender the necessary funds to the owner for the lowest completing contractor's bid
  - iv. Surety can tell the obligee to complete the project and request payment from the surety

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<sup>14</sup> 289 S.C. 408, 338 S.E.2d 153 (1985).

- v. Surety can perform a good faith investigation to determine whether the default of its principal was proper and justified; the surety can decline to assume any role in the completion of the projects if determines default not proper
- f. Always review the specific language on private bonds, which may restrict or eliminate some of the aforementioned options

## 5. Surety's Liability

- a. Under South Carolina law, a surety's liability is governed by the strict terms of its bond<sup>15</sup>
  - i. Surety's obligation is "contractual in nature [and as such, it] 'cannot extend beyond the terms of the bond and the intent of the parties thereto'"<sup>16</sup>
  - ii. When a bond refers to or incorporates by reference another document or instrument, it is generally held that "the other instrument . . . 'becomes a part of the bond, and the two should be read together and construed as a whole'"<sup>17</sup>
  - iii. As with other written contracts, a bond is be construed according to the fair import of its language, and if the bond language is plain and unambiguous, it should be interpreted as any other contract to determine the intention of the parties<sup>18</sup>
- b. South Carolina courts have adopted the rule that when the "liability of a surety is dependent on the outcome of litigation in which his principal is or may be involved, a judgment against the principal is binding and conclusive on the surety, and the surety may not interpose defenses which should or might have been set up in the action . . ."<sup>19</sup>
  - i. Rule applies even when "the surety had no notice of the suit or opportunity to defend"<sup>20</sup>
- c. Generally, the surety will only be responsible for compensating the obligee for those costs and expenses that result from the principal's default and are within the scope of the bond obligation bonded by the surety company<sup>21</sup>

<sup>15</sup> See *S.C. Pub. Serv. Comm'n*, 274 S.C. at 584, 266 S.E.2d at 77; *Emp'rs Ins.*, 297 S.C. at 357, 377 S.E.2d at 121.

<sup>16</sup> *SOCAR, Inc.*, 288 S.C. at 289, 341 S.E.2d at 823 (quoting *S.C. Pub. Serv. Comm'n v. Colonial Constr. Co.*, 274 S.C. 581, 584, 266 S.E.2d 76, 77 (1980)).

<sup>17</sup> *Id.* (citing 11 C.J.S. *Bonds* § 43 at 423 (1938)).

<sup>18</sup> *Id.* at 289–90; 11 C.J.S. *Bonds* § 38 at 417 (1938); 12 Am. Jur. 2d *Bonds* § 25 at 493 (1964).

<sup>19</sup> *Ward v. Fed. Ins. Co.*, 233 S.C. 561, 564, 106 S.E.2d 169, 171 (1958) (quoting 72 C.J.S. *Principal and Surety* § 261, p.706).

<sup>20</sup> *Id.*; *Int'l Fid. Ins. Co. v. China Constr. Am. (SC) Inc.*, 375 S.C. 175, 650 S.E.2d 677 (Ct. App. 2007).

## 6. Surety's Defenses

- a. A surety may assert all legal and equitable defenses to which the principal is entitled<sup>22</sup>
- b. Material Change
  - i. Some contracts provide that a surety agrees to increase the bond penal sum to accommodate change orders, and the contract may provide that such an increase can occur without notice to the surety
  - ii. Because payment and performance bonds typically incorporate by reference the terms of the underlying contract, this may be seen as implied consent by the surety to such changes
  - iii. However, some changes may be considered material, and the determination of whether a change is material is a factually intensive question
  - iv. *Employers Insurance of Wasau v. Construction Management Engineers of Florida Inc.* – the surety was granted summary judgment and discharged on the bond because the subcontract value was significantly increased without the surety's consent<sup>23</sup>
    1. Under the original subcontract, the subcontractor was responsible for approximately \$2.3 million of construction. The subcontract change exposed the subcontractor to \$6.2 million of construction. The trial court held and the Court of Appeals affirmed that this change in risk discharged the surety as a matter of law<sup>24</sup>

## 7. Statute of Limitations

- a. Many bonding companies include two year limitation periods within their bonds
  - i. Some construction contracts will also include one or two year limitation periods
- b. S.C. Code Ann. § 15-3-140 provides that any provision in a contract that purports to shorten the prescribed time period for similar causes of action is ineffective

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<sup>21</sup> *Interstate Equip. Co. v. Smith*, 292 N.C. 592, 596, 234 S.E.2d 599, 601 (1977); *Ingram v. Bank of Warsaw*, 195 N.C. 357, 357, 142 S.E. 231, 233 (1928).

<sup>22</sup> Bruner & O'Connor on Construction Law, § 12:43 (2009).

<sup>23</sup> 297 S.C. 354, 377 S.E.2<sup>nd</sup> 119 (Ct. App. 1989).

<sup>24</sup> *Id.* at 358, 377 S.E.2<sup>nd</sup> at 122.

- i. Under South Carolina case law, a provision in a contractor’s bond that limited the time for filing claims was therefore ineffective, unless the shortened limitation is prescribed by South Carolina law.<sup>25</sup>
- c. Miller Act
  - i. Under the Federal Miller Act, a claimant must file against the surety no earlier than 90 days and no later than one year after the date on which it last supplied labor or material to the public project
    - 1. Claimants who have a direct contractual relationship with a subcontractor, but who do not have a direct contractual relationship with the general contractor (express or implied), must give notice of their claim to the general contractor in a manner that can be verified by a third party within 90 days of the last provision of labor or material
    - 2. Failure to meet either of these deadlines is grounds for dismissal of the claim<sup>26</sup>
- d. SC Little Miller Acts
  - i. SC has several different, but related statutory schemes that apply to public projects
  - ii. Statutes include: Subcontractor and Suppliers Payment Protection Act, S.C. Code Ann. §§ 29-6-10 to -290.; the South Carolina Consolidated Procurement Code, S.C. Code Ann. §§ 11-35-10 to -5270; and statutes governing contracts with the Department of Transportation, S.C. Code Ann. §§ 57-5-10 to -1700
- e. South Carolina Consolidated Procurement Code
  - i. Under the South Carolina Consolidated Procurement Code, a person making a payment bond claim shall make claims “within ninety days from the date on which the person did or performed the last of the labor or furnished or supplied the last of the material . . . upon which the claim is made . . . ”<sup>27</sup>
- f. Sealed Instruments

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<sup>25</sup> *Barringer v. Fid. & Deposit Co.*, 161 S.C. 4, 159 S.E. 373 (1931); see also *City of Sumter v. U.S. Fid. & Guar. Co.*, 116 S.C. 29, 106 S.E. 778 (1921); *State Agric. & Mech. Soc’y v. Taylor*, 104 S.C. 167, 88 S.E. 372 (1916).

<sup>26</sup> Bryson, Burns, Proud & Roberts, North Carolina Construction Law Deskbook, Ch. XIV, p. 911 (4<sup>th</sup> ed. 2006).

<sup>27</sup> S.C. Code Ann. § 11-35-3030(2)(c) (1976).

- i. S.C. Code Ann. § 15-3-520 (1976) applies a twenty year statute of limitations to “an action upon a bond” and a “sealed instrument”
- ii. Payment and performance bond forms sometimes include a place upon which a corporate seal may be stamped
- iii. Power of Attorney forms that accompany payment and performance bonds also typically have places upon which a corporate seal may be imprinted
- iv. If a payment or performance bond is sealed, one can argue that the twenty year statute of limitations contained within S.C. Code Ann. § 15-3-520 applies

## **8. Attorneys Fees**

- a. Right to Recover from Principal
  - i. No specific South Carolina case law on point, but as a general rule, the surety is entitled to recover from the principal those attorney’s fees incurred on the principal’s behalf<sup>28</sup>
  - ii. The indemnity agreement executed by the principal and indemnitors will often have a provision providing for the recovery of attorney’s fees incurred by the surety
- b. Recovery from Surety
  - i. South Carolina courts have allowed claimants to recover attorney’s fees when a performance bond expressly includes a provision allowing for such recovery

## **9. Bad Faith**

- a. South Carolina courts have recognized that an indemnitor may assert, as a defense, a breach of good faith and fair dealing against the surety when the surety paid a claim against a bond - *American Fire & Casualty Co. v. Johnson*<sup>29</sup>
- b. Neither the *American Fire* Court nor any other South Carolina case discusses what factors will be considered when evaluating an indemnitor’s defense of breach of good faith and fair dealing against a surety
  - i. Possible factors to consider when determining whether a surety made a reasonable, good faith settlement under the terms of the bond and the indemnity agreement may include

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<sup>28</sup> *Md. Cas. Co. v. Teer*, 197 S.E. 558 (N.C. 1938).

<sup>29</sup> *Am. Fire & Cas. Co. v. Johnson*, 332 S.C. 307, 312, 504 S.E.2d 356, 359 (Ct. App. 1998).

1. Obligations of the surety as provided by the terms and coverage of the bond
  2. Whether the principal has made more than generalized demands that the surety deny the claim
  3. The cooperation, or lack thereof, by the principal, in dealing with the surety
  4. The thoroughness of the investigation performed by the surety<sup>30</sup>
- c. South Carolina Supreme Court held that “a principal cannot sue a surety in tort for a bad faith refusal to pay a first party claim”<sup>31</sup>
- i. *Masterclean, Inc. v. Star Insurance Co.*
    1. Court reasoned that “the nature of the principal-surety relationship itself would mandate finding a bad faith cause of action by a principal against its surety does not sound in tort”<sup>32</sup>
    2. Although the Court in *Masterclean* does recognize that a principal may use “bad faith as a shield in contract against a surety seeking indemnification,” a principal “may not use bad faith as a sword to extract damages from a surety in tort”<sup>33</sup>
- d. No South Carolina statutory or common law recognizes a bad faith claim as to sureties when brought by an obligee
- i. Other jurisdictions are split on the issue of whether a performance bond obligee can bring a tort action for bad faith against a surety
  - ii. States that do not recognize a bad faith cause of action against sureties by the obligee generally do so because the courts distinguish between insurance and suretyship or believe that policy reasons do not support it<sup>34</sup>

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<sup>30</sup> *Atl. Contracting & Material Co. v. Ulico Cas. Co.*, 844 A.2d 460 (Md. Ct. App. 2004).

<sup>31</sup> 347 S.C. 405, 414, 556 S.E.2d 371, 376 (2001).

<sup>32</sup> *Id.* at 413, 556 S.E.2d at 376.

<sup>33</sup> *Id.* at 414, 556 S.E.2d at 376–77.

<sup>34</sup> *See, e.g., Cates Constr., Inc. v. Talbot Partners*, 86 Cal. Rptr. 2d 855 (Cal. 1999); *Resolution Trust Corp. v. Fid. & Deposit Co.*, 885 F. Supp. 228 (D. Kan. 1995); *Republic Ins. Co. v. Bd. of Cnty. Comm'rs*, 511 A.2d 1136 (Md. Ct. Spec. App. 1986); *Great Am. Ins. Co. v. N. Austin Mun. Util. Dist. No. 1*, 908 S.W.2d 415 (Tex. 1995).

## 10. Miscellaneous Bonds

- a. Several other types of bonds are used in construction – they are typically statutory creations, and the requirements of those bonds are largely dictated by or included in the statute itself.
- b. Residential Home Builders
  - i. Residential builders licensed under the laws of South Carolina may be required by the South Carolina Residential Home Builders Commission to obtain a surety bond in the amount of \$15,000<sup>35</sup>
  - ii. Purpose includes ensuring with South Carolina rules and regulations regarding health and safety requirements and construction standards and protecting “the home-buying public from . . . financially irresponsible builders”<sup>36</sup>
  - iii. South Carolina courts have indicated that members of the public, and more specifically, homeowners, who are injured by homebuilders licensed by the Commission can maintain a claim directly against the surety providing the license bond<sup>37</sup>
  - iv. South Carolina courts have held that the bonds will cover claims that relate to the actual construction of the homes, and the courts have declined to extend coverage further - *Kennedy v. Henderson*<sup>38</sup>
    1. *Watson v. Harmon* - the Court found that the surety was obligated for any failure by its principal to comply with the Commission’s rules and regulations<sup>39</sup>
    2. As a condition of licensure, *Watson* Court reasoned a homebuilder is statutorily required to not be guilty of gross negligence, incompetence or misconduct in the building of homes and where a complaint alleges that a homebuilder is guilty of such conduct, the bond may be liable and individual homeowners can bring a direct right of action against the surety

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<sup>35</sup> S.C. Code Ann. § 40-59-220 (1976). The prior statutory cite was S.C. Code Ann. § 40-59-70 (1976).

<sup>36</sup> *Watson v. Harmon*, 280 S.C. 214, 218, 312 S.E.2d 8, 11 (Ct. App. 1984) (quoting *Henderson v. Evans*, 268 S.C. 127, 136, 232 S.E.2d 331, 336 (1977) (Gregory, J., dissenting)).

<sup>37</sup> *Id.*

<sup>38</sup> 289 S.C. 393, 394, 346 S.E.2d 526, 527 (1986).

<sup>39</sup> 280 S.C. 214, 312 S.E.2d 8 (Ct. App. 1984).

- v. The Courts in have not provide a specific definition of “construction standard,” both courts have implied that violations relating to “construction standards” should relate to the actual construction of a building
- c. When interpreting these license bonds, South Carolina courts have applied standard rules of statutory construction
  - i. Although a bond is ordinarily purely a contract that is to be strictly construed and not extended beyond the scope of its express terms, a statutory bond is to be read, construed, and enforced in connection with, and according to, the purpose and meaning of the legislative enactment
- d. Bid bond
  - i. Very specific and limited form of a performance bond
  - ii. Guarantees that if the principal is the successful bidder for a project, the principal will provide performance and payment bonds and enter into a contract with the obligee
  - iii. Penal sum of the bid bond is typically five to ten percent of the bid

# Payments

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## **A. Introduction**

The South Carolina legislature has enacted several statutory provisions related to payment on construction projects in the State. These statutes set up a statutorily required timetable for payments on construction projects in South Carolina and establish that performance in accordance with a contract entitles a subcontractor to payment without the condition precedent of the contractor being paid by the owner. Additionally, they outlaw pay-if-paid provisions in construction contracts and make it a criminal act in South Carolina to misappropriate funds paid to a contractor or subcontractor for that contractor's or subcontractor's laborers, subcontractors, and suppliers. They also set up a process for the recovery of attorney's fees and interest for unpaid amounts due the contractor.

The statutes applicable to construction payments are designed to prevent wrongdoing in the construction payment process, particularly by those who have received monies from an owner, owner's financial institution, or a contractor due others. This chapter addresses the four (4) major statutory provisions in South Carolina that apply to payments on construction projects.

## **B. Payments to Contractors, Subcontractors, and Suppliers**

In 1990, the legislature enacted "Payments to Contractors, Subcontractors, and Suppliers."<sup>1</sup>

### **1. Pay-if-paid provisions unenforceable.**

S.C. Code Ann. § 29-6-20 (2011) provides, "[p]erformance by a contractor or subcontractor in accordance with the provisions of his contract entitles him to payment from the party with whom he contracts." This is, perhaps, the most significant portion of the statute because it appears to outlaw "pay if paid" provisions in South Carolina. The effect of this provision is made clear with a simple example. Dr. Whelchel, an owner, hires Pruitt as his contractor to build Whelchel a dental office. Pruitt, in turn, hires Cash to put the roof on the dental office. Cash performs his work satisfactorily and is, therefore, entitled to payment from Pruitt regardless of whether Whelchel has paid Pruitt for that work or not (i.e. performance by Cash in accordance with the provisions of his contract entitles him to payment from Pruitt, the party with whom he contracted).

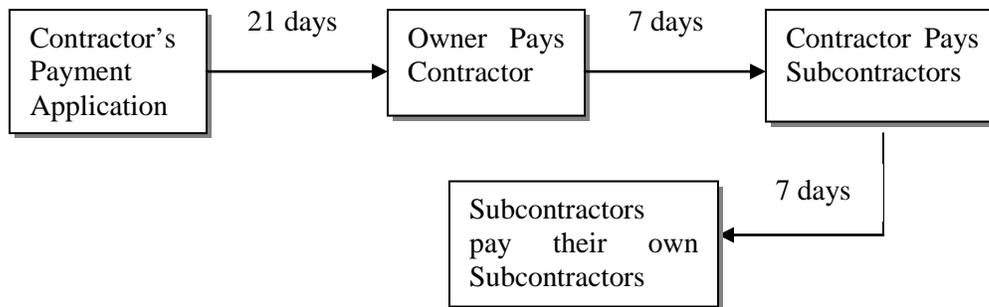
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<sup>1</sup> See S.C. Code Ann. § 29-6-10 (2011), *et. seq.*

## 2. Statutory Timetables for Payments

At S.C. Code Ann. § 29-6-30 (2011), the legislature has set forth a timetable for payments to which all construction projects in South Carolina must adhere.<sup>2</sup> “When a contractor or a subcontractor has performed in accordance with the provisions of his contract, the owner shall pay the contractor within twenty-one (21) days of receipt by the owner of any pay request based upon work completed or service provided under the contract.”<sup>3</sup> The owner must make the payment “by mailing via first class mail or delivering the undisputed amount of any pay request.”<sup>4</sup> Once the contractor is paid by the owner, the contractor is required to pay his subcontractors within seven (7) days of receiving payment by the owner.<sup>5</sup> Those subcontractors then have seven (7) more days to pay their subcontractors.<sup>6</sup> Like with the owner, these payments must be made by “mailing via first class mail or delivering the full amount received for that subcontractor’s work and materials based on work completed or service provided under the subcontract.”<sup>7</sup>

The following flow chart summarizes the statutory payment timeline requirements:



The owner appears to be allowed twenty-one (21) days from the date of submission of the contractor’s payment application. This allows time for verifying that the work in place is acceptable and obtaining draws from any construction lender on the project. Once the contractor’s payment application is received, it will need to be processed by the owner to ensure that it is accurate, particularly with regard to the percentage of work complete. On projects where an architect has been retained to administer the contract, the architect will need to review the contractor’s work and certify

<sup>2</sup> The legislature defines, “Owner” as follows: “‘Owner’ means a person who has an interest in the real property improved and for whom an improvement is made and who ordered the improvement to be made. ‘Owner’ includes any state, local, or municipal government agencies, instrumentalities, or entities.” S.C. Code Ann. 29-6-10(4) (2011) (emphasis added). The import of this definition is to make it clear that the chapter applies to both public and private projects in South Carolina. *See Sloan Constr. Co. v. Southco Grassing, Inc.*, 377 S.C. 108, 659 S.E.2d 158 (2008), *Turner Constr. Co. v. Spartanburg*, 2008-MO-16, 2008 S.C. Unpub. LEXIS 16 (Mar. 24, 2008).

<sup>3</sup> S.C. Code Ann. § 29-6-30 (2011).

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

the payment application. Additionally, if a construction lender is in place, that lender will often have its own project inspector who will independently verify the percentage of work complete and report back to the bank. Of course, all of this takes some time, and it may be the reason the legislature has allowed twenty-one (21) days, as opposed to a shorter period of time, for payment from the owner to the subcontractors to be made. Once payment is made by the Owner, the contractor and his subcontractors are only given seven (7) days to make payment to their subcontractors. At this point, the contractor and subcontractors should have already verified the amount of work their subcontractors have done, as that work was likely included in the contractor's payment application made to the owner.

While S.C. Code Ann. § 29-6-30's statutory payment timetable provides an outline for the required timing of payments on construction projects in South Carolina, it does not lessen the impact of S.C. Code Ann. § 29-6-20's requirement that "[p]erformance by a contractor or subcontractor in accordance with the provisions of his contract entitles him to payment from the party with whom he contracts."<sup>8</sup> In other words, the timing requirements of S.C. Code Ann. § 29-6-30 only apply when a payment from the owner is actually made. However, regardless of whether payment is made by the Owner, S.C. Code Ann. § 29-6-30 requires a contractor to pay its subcontractors for work properly performed. In 2000, the legislature enacted the Subcontractors' and Suppliers' Payment Protection Act, which removes all doubt as to whether pay-if-paid provisions are enforceable in South Carolina. The Subcontractors' and Suppliers' Payment Protection Act is discussed more below.

Finally, S.C. Code Ann. § 29-6-40 (2011) provides, "[n]othing in this chapter requires that payments due a contractor from an owner be paid any more frequently than as set forth in the construction documents, nor shall anything in this chapter affect the terms of any agreement between the owner and any lender."<sup>9</sup> This provision, like much of the chapter, has not received any judicial treatment or interpretation. However, it appears to take into account that, on most projects, payment applications are submitted monthly. This provision appears to guard against a contractor citing the statute for the proposition that he could submit those payment applications more frequently than the monthly provisions of the contract and expect payment within twenty-one (21) days. However, this is not clear.

While the chapter does allow the parties to contract around S.C. Code Ann. § 29-6-30's timing requirements, it is not something that can be done surreptitiously.<sup>10</sup> The statute provides, "[n]othing in this chapter shall prohibit owners, contractors, and subcontractors, *on private construction projects only*, from agreeing by contract to . . . payment periods different from those stipulated in this section, and in this event, these contractual provisions shall control."<sup>11</sup> However, in order for the waiver to be effective, the section must be "specifically waived, by section number, in conspicuous **bold-faced**

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<sup>8</sup> S.C. Code Ann. § 29-6-20 (2011).

<sup>9</sup> S.C. Code Ann. § 29-6-40 (2011).

<sup>10</sup> S.C. Code Ann. § 29-6-50 (2011).

<sup>11</sup> *Id.*

or underlined type.”<sup>12</sup> If the statutory provisions are not strictly followed, the waiver would thus be ineffective.

The latter part of S.C. Code Ann. § 29-6-40 (2011) is aimed at lenders and appears to be an attempt by the legislature to make it clear that lenders are not being forced to approve draw requests, or take any other action, sooner than their loan documents with their lenders (often the owner) require, despite the payment timing provisions which govern the owner, contractor, and subcontractor relationships.<sup>13</sup>

### **3. Justifications for withholding payment**

As inferred from the above-cited statutes, the contractor or subcontractor must perform his or her work in accordance with the terms of the contract in order to be entitled to payment. S.C. Code Ann. § 29-6-40 makes this clear when it states:

Nothing in this chapter prevents the owner, the contractor, or a subcontractor from withholding application and certification for payment because of the following: unsatisfactory job progress, defective construction not remedied, disputed work, third party claims filed or reasonable evidence that claim will be filed, failure of contractor or subcontractor to make timely payments for labor, equipment, and materials, damage to owner, contractor, or another subcontractor, reasonable evidence that contract or subcontract cannot be completed for the unpaid balance of the contract or subcontract sum, or a reasonable amount for retainage.<sup>14</sup>

Though this provision is rather self-explanatory, it certainly sets forth bases upon which an owner, contractor, or subcontractor can validly withhold payment.

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<sup>12</sup> *Id.* (emphasis added).

<sup>13</sup> See S.C. Code Ann. § 29-6-40 (2011).

<sup>14</sup> S.C. Code Ann. § 29-6-40 (2011).

#### 4. Interest on late payments

When an owner, contractor, or subcontractors fails to comply with the statutory timetable for payments and the parties have not waived those requirements, “the owner, contractor, or subcontractor shall pay his contractor or subcontractor interest, beginning on the due date, at the rate of one percent a month or a pro rata fraction thereof on the unpaid balance as may be due.”<sup>15</sup> “However, no interest is due unless the person being charged interest has been notified of the provisions of this section at the time request for payment is made.”<sup>16</sup> “[O]wners, contractors, and subcontractors, on private construction projects only, [may] agree[] by contract to rates of interest . . . different from those stipulated in [S.C. Code § 29-6-50 (2011)], and in this event, these contractual provisions shall control, provided the requirements of [S.C. Code Ann. § 29-6-50 (2011)] are specifically waived, by section number, in conspicuous **bold-faced** or underlined type.”<sup>17</sup> However, “[i]n case of a willful breach of the contract provisions as to time of payment, the interest rate specified in this section shall apply.”<sup>18</sup>

#### 5. Exemptions from application of S.C. Code Ann. §§ 29-6-10 through 29-6-50 (2011)

S.C. Code Ann. §§ 29-6-10 through 29-6-50 does not apply to any of the following:

- (1) residential homebuilders;
- (2) improvements to real property intended for residential purposes which consist of sixteen or fewer residential units; or
- (3) private persons or entities owning improvements to real property when the specific improvements are not financed by a nonowner.<sup>19</sup>

The import of S.C. Code Ann. § 29-6-60 (2011) is that the provisions of S.C. Code Ann. §§ 29-6-10 (2011) through 29-6-50 (2011) apply largely only to governmental and commercial construction projects and larger-scale residential projects involving seventeen (17) or more units. Subsection (3) also exempts “private persons or entities owning improvements to the real property,” but only when the specific improvements are not financed by a nonowner (e.g. a bank).<sup>20</sup> This provision gives financial institutions and other financiers of construction projects an argument that the provisions of S.C. Code Ann. §§ 29-6-10 (2011) through 29-6-50 (2011) are intended to protect them, in addition to owners, contractors, and subcontractors.

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<sup>15</sup> S.C. Code Ann. § 29-6-50 (2011).

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* (emphasis added).

<sup>18</sup> *Id.*

<sup>19</sup> S.C. Code Ann. § 29-6-60 (2011).

<sup>20</sup> S.C. Code Ann. § 29-6-60 (3) (2011).

## C. **Payments to Contractors, Subcontractors, and Suppliers.**

In 2000—ten (10) years after the enactment of the statutory provisions related to “Payments to Contractors, Subcontractors, and Suppliers”—the legislature enacted the “Subcontractors’ and Suppliers’ Payment Protection Act” (“SSPPA”).<sup>21</sup>

### 1. **Pay-if-paid provisions definitively outlawed in South Carolina**

As the SSPPA’s title implies, it is intended to protect subcontractors and suppliers by ensuring they are paid when they have performed according to the terms of their contracts. S.C. Code Ann. § 29-6-230 (2011) states:

Notwithstanding any other provision of law, performance by a construction subcontractor in accordance with the provisions of its contract entitles the subcontractor to payment from the party with whom it contracts. *The payment by the owner to the contractor or the payment by the contractor to another subcontractor or supplier is not, in either case, a condition precedent for payment to the construction subcontractor.* **Any agreement to the contrary is not enforceable.**<sup>22</sup>

The import of S.C. Code Ann. § 29-6-230 (2011) is clear: If a subcontractor performs in accordance with the terms of his contract with the contractor, he is entitled to payment from the party with whom he has contracted, usually the contractor. Payment by the owner to the contractor, or payment by the contractor to another subcontractor or supplier is not, in either case, a condition precedent for payment to the subcontractor. In other words, payment to the subcontractor by the contractor is not conditioned upon payment to the contractor from the owner. Importantly, the parties cannot contract around this. The effect is clear—pay-if-paid provisions are illegal in South Carolina.

### 2. **Bond provisions of the SSPPA**

S.C. Code Ann. §§ 29-6-250 (2011) and 29-6-270 (2011) of the SSPPA relate to bonding requirements of governmental bodies and are beyond the scope of this Payments chapter. However, S.C. Code Ann. § 29-6-290 (2011) provides, “[a] provision in a contract for the improvement of real property in the State must not operate to derogate the rights of a construction contractor, subcontractor, supplier, or other proper claimant against a payment bond or other form of payment security or protection established by law.”<sup>23</sup> This provision makes it clear that parties may not contract to lessen the rights of a proper claimant, including contractors, subcontractors, and suppliers, against a payment bond or other form of payment security or other protection established by law.

### 3. **Ambiguity of exemptions from SSPPA**

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<sup>21</sup> See S.C. Code Ann. § 29-6-210, *et. seq.* (2011).

<sup>22</sup> *Id.* (emphasis added).

<sup>23</sup> S.C. Code Ann. § 29-6-250 (2011).

In 1990, the legislature enacted S.C. Code Ann. § 29-6-60, which made certain exemptions to the chapter. The specific nature of these exemptions is discussed above in the “Payments to Contractors, Subcontractors, and Suppliers” section. When the legislature enacted the SSPPA in 2000, it was as a part of the same chapter as the “Payments to Contractors, Subcontractors, and Suppliers” Act, which includes the exemptions provision of S.C. Code Ann. § 29-6-60. As such, a strict reading of the statute indicates that the exemptions of S.C. Code Ann. § 29-6-60 apply to the SSPPA. The legislature did not resolve the issue one way or the other, and did not modify S.C. Code Ann. § 29-6-60 in 2000. The issue of whether the exemptions of S.C. Code Ann. 29-6-60 apply to the SSPPA has not been judicially resolved.

#### **D. Liens of Laborers and Others on Contract Price**

##### **1. Entitlement to payment from monies received**

S.C. Code Ann. § 29-7-10 (2011) requires that contractors and subcontractors pay their laborers, subcontractors, and materialmen for their lawful services and material furnished out of money received from the owner for the work of those laborers, subcontractors, and materialmen. The section also provides that such laborers, subcontractors, and materialmen, “shall have a first lien on the money received by such contractor for the erection, alteration, or repair of such building in proportion to the amount of their respective claims.”<sup>24</sup> As such, in essence, the law is a *de facto* trust fund statute. The statute is clear that it does not “make the owner of the building responsible in any way” and “contractor[s] or subcontractor[s] [are not prevented] from borrowing money on any such contract.”<sup>25</sup>

S.C. Code Ann. § 29-7-10 “and the penalty provisions immediately following in § 29-7-20 clearly contemplate the case where a general contractor is paid by an owner for renovations or repairs, then withholds payment from a subcontractor.”<sup>26</sup> Furthermore, the statute “requires building contractors to pay subcontractors out of the money received for the work the subcontractors are employed to perform. More importantly, the section grants subcontractors a statutory lien on the money received by the contractor. Even more importantly, the section provides that the lien shall be “a first lien.””<sup>27</sup> However, “the statutory lien created by [S.C. Code Ann. § 29-7-10] does not come into existence until the contractor has received the money.”<sup>28</sup>

##### **2. Criminal penalties associated with failure to pay laborers, subcontractors, or materialmen out of monies received from the owner**

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<sup>24</sup> S.C. Code Ann. § 29-7-10 (2011).

<sup>25</sup> *Id.*

<sup>26</sup> *Adams v. B&D, Inc.*, 297 S.C. 416, 421, 377 S.E.2d 315, 318 (1989).

<sup>27</sup> *Poinsett Constr. Co. v. Fischer*, 301 S.C. 343, 345, 391 S.E.2d 875, 876 (1990).

<sup>28</sup> *Bellsouth Tele. v. Dekalb Concrete Prods.*, 1995 U.S. Dist. LEXIS 11443, \*7 (D.S.C. July 28, 1995).

“S.C. Code Ann. § 29-7-20 requires contractors to pay laborers, subcontractors and materialmen out of building loan funds, and gives such laborers a lien on the funds received by the contractor.”<sup>29</sup>

The legislature set up criminal penalties for a contractor’s or subcontractor’s failure to pay their laborers, subcontractors, or materialmen from monies received for their payment from the owner. S.C. Code Ann. § 29-7-20 (1) (2011) provides that, “[a] contractor or subcontractor who, for other purposes than paying the money loaned upon such contract, transfers, invests or expends and fails to pay to a laborer, subcontractor, or materialmen out of the money received [from the owner or owner’s lender] is guilty of a misdemeanor . . . .”<sup>30</sup> The penalties, upon conviction, provide for a fine of not less than five hundred dollars nor more than one thousand dollars and imprisonment of not less than three months nor more than six months if the work or material is worth more than one hundred dollars.<sup>31</sup> If the work or material is worth less than one hundred dollars, then the fine must not be more than five hundred dollars and imprisonment shall not be longer than 30 days.<sup>32</sup> It should be noted, however, that there is no criminal penalty associated with “commingling” construction funds in a common account of the contractor.<sup>33</sup>

Furthermore, if a person willfully and intentionally certifies to any owner or lending institution, by affidavit or otherwise, that laborers, subcontractors, or materialmen on a project have been paid in full when they have not been is guilty of a misdemeanor.<sup>34</sup> One exception is that if all lien rights have been waived in writing by the laborers, subcontractors, or materialmen.<sup>35</sup> The penalties for violation of this section include a fine of not more than five thousand dollars or imprisonment of not more than sixty days, or both.<sup>36</sup>

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<sup>29</sup> *State v. Rothell*, 301 S.C. 168, 169 n. 1, 391 S.E.2d 228, 229 n.1 (1990).

<sup>30</sup> S.C. Code Ann. § 29-7-20 (1) (2011).

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

<sup>33</sup> *See Rothell, supra*, 301 S.C. at 170, 391 S.E.2d at 229.

<sup>34</sup> S.C. Code Ann. § 29-7-20 (2) (2011), *The Lite House, Inc. v. The North River Ins. Co.*, 322 S.C. 26, 30 n.7, 471 S.E.2d 166, 169 n. 7 (1996).

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

### **3. Waiving the right to file lien.**

“Any agreement to waive the right to file or claim a lien for labor and materials is against public policy and is unenforceable unless payment substantially equal to the amount waived is actually made.”<sup>37</sup>

### **4. Payments cannot be withheld in silence**

Though the chapter provides certain instances when payments to contractors and subcontractors can be withheld, they cannot be withheld in silence.<sup>38</sup>

Unless the parties agree otherwise, a contractor or subcontractor can set off, against the money owed to a laborer, subcontractor, or materialman, any debt claimed to be owed to the contractor by the laborer, subcontractor, or materialman, based upon a good faith claim that those services and materials for which payment is claimed by the laborer, subcontractor, or materialman is defective.<sup>39</sup>

Importantly, however, “[i]n order to make such a set-off, a declaration and accounting thereof must be included in any certificate submitted with an application for payment [to the owner, architect, and/or lending institution] and a copy thereof or a separate notarized original of the declaration must be sent by certified mail to the affected laborer, subcontractor, or materialman at the time the certificate is submitted.”<sup>40</sup>

## **E. Standard Form Contract Documents and the Potential for Criminal Prosecution under South Carolina Law**

Applications for payment from a contractor to an owner take many forms. On a self-financed residential construction project, the application may be little more than a handwritten invoice, or a simple verbal request for payment from the contractor to the owner. As the project gets larger, more parties are likely to be involved, such as a financial institution providing a construction loan or an architect reviewing or certifying payments. Along with these additional parties often come more formalized, written applications for payment, which often take the form of a standard form application for payment. The most widely recognized and used of these standard forms is the AIA G702 Pay Application, which was last updated in 1992.

An integral part of the G702 Pay Application is the Contractor’s representation to the owner as follows:

The undersigned Contractor certifies that, to the best of the Contractor’s knowledge, information and belief, the Work covered by this Application for Payment has been completed in accordance with the Contract

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<sup>37</sup> S.C. Code Ann. § 29-7-20 (2) (2011).

<sup>38</sup> See S.C. Code Ann. § 29-7-20 (3) (2011).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

Documents, that all amounts have been paid by the Contractor for Work for which previous Certificates for Payment were issued and payments received from the Owner, and that current payment shown herein is now due.

Importantly, the contractor certifies this statement under oath, and the contractor's signature is notarized.

The ConsensusDOCS have two (2) pay application forms known as the ConsensusDOCS 291 – Application for Payment (Where the Basis of Payment is a Guaranteed Maximum Price) and ConsensusDOCS 292 – Application for Payment (Where the Contract Price is a Lump Sum). As their names imply, each ConsensusDOCS application for payment is designed for different project payment methods. However, the “Certificate of the Contractor” in each of these documents is identical and reads as follows:

I hereby certify that the Work performed and the materials stored on site, as shown above, represent the actual value of the *Contractor's* performance on this Project under the terms of the Agreement (and all authorized changes thereto) between the undersigned and the *Owner*. I also certify that payments, less applicable retention, have been made through the period covered by previous payments received from the *Owner*, to (1) all Subcontractors and (2) for all materials and labor used in the performance of this Agreement. I further certify that I have complied with Federal, State and local tax laws, including Social Security laws, Unemployment Compensation laws, and Worker's Compensation laws insofar as applicable to the performance of this Agreement.

As with the AIA G702, the contractor's certification contained in the ConsensusDOCS application for payment forms is sworn under oath, and the contractor's signature is notarized.

The certifications from the contractor in both the AIA G702 and ConsensusDOCS 291 and 292 are similar. Essentially, the contractor represents to the owner, under oath, that it has taken the money the owner has previously paid to the contractor for work done on the project and paid for that work. A familiar example would be a contractor who submits a pay application showing its drywall subcontractor had completed \$10,000.00 in work for the period covered by the pay application. Once the contractor receives payment for that subcontractor's work covered by that pay application, he must pay his drywall subcontractor the \$10,000.00. S.C. Code Ann. § 29-6-30 (2011) requires payment to the subcontractor within seven (7) days. In the next pay application, the certification by the contractor represents to the owner, under oath, that the drywall contractor has been paid the \$10,000.00 the contractor applied to from the owner in the previous application for payment. The problem comes if the contractor has not paid the drywall subcontractor, but certifies he has done so nonetheless.

S.C. Code Ann. § 16-9-30 makes it “unlawful for a person to wilfully and knowingly swear falsely in taking any oath required by law that is administered by a person directed or permitted by law to administer such oath [e.g. a notary].”<sup>41</sup> The crime is a felony in South Carolina.<sup>42</sup> As such, a contractor who falsely certifies under oath before a notary that he has paid his subcontractors when, in fact he has not, and does so wilfully and knowingly may subject himself to prosecution pursuant to S.C. Code Ann. § 16-9-30. There is no reported case in South Carolina where a contractor has been so prosecuted, but that may be because of the criminal penalties associated with S.C. Code Ann. § 29-7-10, et. seq., under which there are reported cases of contractors being prosecuted.

#### **F. Recovery of attorneys fees and interest on claims for improvement of real estate.**

In 1987, the South Carolina legislature gave those contractors, subcontractors, and suppliers whose mechanic’s lien rights had expired hope of recovering the attorney’s fees associated with collecting debts from those with whom they have contracted, even if they failed to timely file their mechanic’s liens.<sup>43</sup> S.C. Code Ann. § 27-1-15 provides:

Whenever a contractor, laborer, design professional, or materials supplier has expended labor, services, or materials under contract for the improvement of real property, and where due and just demand has been made by certified or registered mail for payment for the labor, services, or materials under the terms of any regulation, undertaking, or statute, it is the duty of the person upon whom the claim is made to make a reasonable and fair investigation of the merits of the claim and to pay it, or whatever portion of it is determined as valid, within forty-five days from the date of mailing the demand. If the person fails to make a fair investigation or otherwise unreasonably refuses to pay the claim or proper portion, he is liable for reasonable attorney’s fees and interest at the judgment rate from the date of the demand.<sup>44</sup>

The statute allows a contractor, laborer, design professional, or materials supplier who has provided labor, services, or materials for the improvement of real estate, and has not been paid, the ability to recover attorney’s fees and associated with his attempt to collect the debt as well as interest on that debt.<sup>45</sup> Of course, there are procedural requirements. First, the labor, services, or materials must be provided “under contract;” and second, a “due and just demand” must be “made by certified or registered mail for payment for the labor, services, or materials under the terms of any regulation, undertaking, or statute.”<sup>46</sup>

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<sup>41</sup> S.C. Code Ann. § 16-9-30 (2011).

<sup>42</sup> *Id.*

<sup>43</sup> *See* S.C. Code Ann. § 27-1-15 (2011).

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

Once the contractor, laborer, design professional, or materials suppliers has complied with these requirements, “it is the duty of the person upon whom the claim is made to make a reasonable and fair investigation of the merits of the claim and to pay it, or whatever portion of it is determined as valid, within forty-five days from the date of mailing the demand.”<sup>47</sup> Thereafter, “[i]f the person fails to make a fair investigation or otherwise unreasonably refuses to pay the claim or proper portion, he is liable for reasonable attorney’s fees and interest at the judgment rate from the date of the demand.”<sup>48</sup>

**1. Initial burden to prove unreasonableness of investigation is upon the claimant.**

In order to prevail on the claim for attorney’s fees and interest, it is requisite upon the contractor, laborer, design professional, or materials supplier to make out a prima facie case that the party with whom it has contracted did not make a fair and reasonable investigation of the claim.<sup>49</sup>

**2. Conducting a reasonable investigation is the key to avoid liability.**

In *Carolina Steel Corp. v. Palmetto Bridge Constr.*, 444 F.Supp.2d 577, 587 (D.S.C. 2006), the court refused to award attorneys’ fee and interest pursuant to S.C. Code Ann. § 27-1-15 (2011) reasoning that “[d]efendants made a reasonable and fair investigation into the merits of Plaintiff’s claims and paid the portions of those claims that they determined were valid. The fact that the court later found against Defendants in certain particulars does not imply that Defendants’ investigation and resulting decisions were unreasonable or unfair. The lesson from *Carolina Steel Corp.* appears to be that the key to liability under the statute is not whether the claim is paid, but whether a reasonable investigation takes place. Even if some of the results of that investigation are ultimately determined by a fact-finder to be erroneous, that does not necessarily mean the investigation of those claims by the defendant was unreasonable.

**3. Attorney’s fees award for defending counterclaim are recoverable.**

In *Hardaway Concrete Co. v. Hall Constr. Corp.*, 374 S.C. 216, 647 S.E.2d 488 (Ct. App. 2007), the Court of Appeals held that where the defense of a counterclaim raised in a case brought by a claimant making at S.C. Code Ann. § 27-1-15 (2011) was intertwined with the claimant’s causes of action and, therefore, attorneys’ fees associated with defending the counterclaim were recoverable.

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<sup>47</sup> Id.

<sup>48</sup> Id.

<sup>49</sup> *Moore Elec. Supply, Inc. v. Ward*, 316 S.C. 367, 450 S.E.2d 96 (Ct. App. 1994).

# 2013 Bar Convention - Procurement

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Boyd B. (Nick) Nicholson, Jr.  
Haynsworth Sinkler Boyd, P.A.  
One North Main, 2<sup>nd</sup> Floor (29601)  
P.O. Box 2048  
Greenville, SC 29602  
Telephone: (864) 240-3247  
Facsimile: (864) 240-3300  
E-mail: [nnicholson@hsblawfirm.com](mailto:nnicholson@hsblawfirm.com)

## Which Procurement Policy Applies

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State governmental bodies – includes state agency, department, commission, university, or technical school: Must comply with the State Procurement Code. S.C. Code Ann. § 11-35-40(2).

Large school districts – those with budgets over \$75,000,000: Must either follow the State Procurement Code or enact provisions “substantially similar” to it. S.C. Code Ann. § 11-35-70.

Local governments – counties, municipalities, special purpose districts, and smaller school districts: Must adopt Procedures embodying sound principles of appropriately competitive procurement. S.C. Code Ann. § 11-35-50.

# Foundations

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The acquisition of a facility or capital improvement by a foundation or eleemosynary organization on behalf of or for the use of any state agency or institution of higher learning which involves the use of public funds in the acquisition, financing, construction, or current or subsequent leasing of the facility or capital improvement is subject to the provisions of this code in the same manner as a governmental body.

S.C. Code Ann. § 11-35-40(4) (“Koger Amendment”)

# Foundations

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The Koger Amendment proscribes a four-part test:

- (1) Is the organization a foundation or eleemosynary organization;
- (2) Does it acquire a facility or capital improvement (hereinafter a “Project”);
- (3) Is the Project performed on behalf of or for the use of any state agency or institution of higher learning; and
- (4) Does it involve the use of public funds in the acquisition, financing, construction or current or subsequent leasing of the Project.



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# **CHANGES TO THE STATE PROCUREMENT CODE**

**(INCLUDING A SHORT PRIMER ON THE DIFFERENCES BETWEEN  
METHOD OF PROJECT DELIVERY AND SOURCE SELECTION)**

Haynsworth  
Sinkler Boyd, P.A.

ATTORNEYS AND COUNSELORS AT LAW

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- WHY SHOULD LOCAL GOVERNMENT CARE?
  - D.W. Flowe & Sons, Inc. v. Christopher Constr. Co.,  
326 S.C. 17, 482 S.E.2d 558 (1997)

# Significant Changes to the South Carolina Consolidated Procurement Code Project Delivery Methods

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S. 282, 2007-08 Gen. Assem., 117th Sess., 2008 S.C. Acts 174, § 1 (S.C. 2008)

- “One of the primary goals of the revision project was to encourage the competitive use of new forms of project delivery in public construction procurement.” Id. § 1(1).
- General Assembly adopted Article 5 (Procurement of Infrastructure Facilities and Services) of the ABA Model Code and further provided that the “relevant official comments to the model code, and the construction given to the model code, should be examined as persuasive authority for interpreting and construing the new code provisions created by this Act.” Id. § 1(2).

Act 174 authorized several different **project delivery methods** for procurements relating to infrastructure facilities.” See id. § 2, *codified at* S.C. Code Ann. § 11-35-3005(1)

- (a) design-bid-build;
- (b) construction management at-risk;
- (c) operations and maintenance;
- (d) design-build;
- (e) design-build-operate-maintain; and
- (f) design-build-finance-operate-maintain



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[1]“‘Design-bid-build’ means a project delivery method in which the governmental body sequentially awards separate contracts, the first for architectural and engineering services to design an infrastructure facility and the second for construction of the infrastructure facility according to the design.” S.C. Code Ann. § 11-35-2910(6).

[2]““Construction manager at-risk’ means a business that has been awarded a separate contract with the governmental body to provide both construction management services and construction using the construction management at-risk project delivery method. A contract with a construction manager at-risk may be executed before completion of design.” S.C. Code Ann. § 11-35-2910(5).



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[3]“‘Operations and maintenance’ means a project delivery method in which the governmental body enters into a single contract for the routine operation, routine repair, and routine maintenance of an infrastructure facility.” S.C. Code Ann. §11-35-2910(13).



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[4]“‘Design-build’ means a project delivery method in which the governmental body enters into a single contract for design and construction of an infrastructure facility.” S.C. Code Ann. § 11-35-2910(7).

[5]“‘Design-build-operate-maintain’ means a project delivery method in which the governmental body enters into a single contract for design, construction, maintenance, and operation of an infrastructure facility over a contractually defined period. All or a portion of the money required to pay for the services provided by the contractor during the contract period are either appropriated by the State before the award of the contract or secured by the State through fare, toll, or user charges.” S.C. Code Ann. § 11-35-2910(9).



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[6]““Design-build-finance-operate-maintain’ means a project delivery method in which the governmental body enters into a single contract for design, construction, finance, maintenance, and operation of an infrastructure facility over a contractually defined period. Money appropriated by the State is not used to pay for a part of the services provided by the contractor during the contract period.” S.C. Code Ann. § 11-35-2910(8).



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Design-bid-build delivery system must be procured through **competitive sealed bidding**. See id. § 11-35-3015(2). See also id. § 11-35-1520 (sealed bidding provision).



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Construction management at-risk services must be procured either using **competitive sealed bidding or competitive sealed proposals**. Id. § 11-35-3015(3). See also id. § 11-35-1530 (sealed proposals provision).



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Design-build, design-build-operate-maintain, and design-build-finance-operate-maintain must be procured pursuant to a **competitive sealed proposal** process as outlined in §§ 11-35-1530 and 11-35-3024 of the South Carolina Code. See id. § 11-35-3015(5).

# Dispute Resolution – Protests

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**State Projects – Procedures before the State Engineer and Procurement review Panel as set forth in the Procurement Code are the Exclusive Venue. S.C. Code Ann. §§ 11-35-4210 -- 4420.**

# Dispute Resolution – Protests

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## \* Protests concerning the Solicitation

- Have **FIFTEEN DAYS** from the issuance of the solicitation document to protest
- Who has Standing to File a Protest: A **prospective** bidder, offeror, contractor, or subcontractor who is aggrieved in connection with the solicitation of a contract.

# Dispute Resolution – Protests

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## \* Protests concerning the Solicitation

- Have **TEN DAYS** from the date notification of award or of intent to Award.
- Who has Standing to File a Protest: An actual bidder, offeror, contractor, or subcontractor who is aggrieved in connection with the intended award or award of a contract.

# Dispute Resolution – Protests

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\* What about Taxpayer standing?

Sloan v. DOT, 365 S.C. 299; 618 S.E.2d 876 (2005).

Sloan v. Greenville County, 361 S.C. 568, 606 S.E.2d 464 (2004).

Sloan v. Greenville County, 356 S.C. 531, 590 S.E.2d 338 (Ct. App. 2003).

Sloan v. Sch. Dist., 342 S.C. 515, 537 S.E.2d 299 (Ct. App. 2000).

# Dispute Resolution – Contract and Breach of Contract Controversies

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**State Projects – Procedures before the State Engineer and Procurement review Panel as set forth in the Procurement Code are the Exclusive Venue. S.C. Code Ann. §§ 11-35-4230 -- 4420.**

- \* Applies to “controversies between a governmental body and a contractor or subcontractor”,
- \* “[I]ncluding **but not limited** to those based upon breach of contract, mistake, misrepresentation, or other cause for contract modification or recession.

# Dispute Resolution – Contract and Breach of Contract Controversies

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\* Unisys Corp. v. Budget & Control Bd., 346 S.C. 158, 551 S.E.2d 263, 270 (2001)

“Further, because a statute [section 11-35-4230] waiving the State's immunity must be strictly construed, the State can be sued only in the manner and upon the terms and conditions prescribed by the statute. The term "exclusive means" must therefore be strictly construed to limit suits on contracts with the State to the forum provided in § 11 35 4230. Application of the strict construction rule, contrary to Unisys's assertion, results in upholding the exclusivity provision of § 11 35 4230.” (citations omitted).

# Dispute Resolution – Contract and Breach of Contract Controversies

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\* Applies to non-contract actions also. Xerox Corporation v. South Carolina State University, et al., C.A. No. 06-CP-40-5478 (March 28, 2007 (Cooper, Jr.)). Motion to dismiss complaint granted on all causes of action:

- 1) Breach of contract,
- 2) Quantum meruit,
- 3) Promissory estoppel,
- 4) Statutory damages under S.C. Code Ann § 11-35-4310(3)(b);
- 5) Breach of contract accompanied by fraudulent acts; and
- 6) Constructive fraud.

# Dispute Resolution – Contract and Breach of Contract Controversies

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- \* Viability of arbitration clause is doubtful.

Accela, Inc. v. South Carolina Department of Labor, Licensing and Regulation, C.A. No. 3:11-cv-3326-CMC, slip op., 2011 WL 6817870 (D.S.C. Dec. 28, 2011)

South Carolina Department of Labor, Licensing & Regulation v. Accela, Inc., Case No. 2011 224 (Chief Procure. Officer for Constr., Jan. 20, 2012).

# Freedom of Information Act and Procurement Selection Committees

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Quality Towing v. City of Myrtle Beach, 345 S.C. 156, 547 S.E.2d 862 (2001).

- The City was required to bid the contract using requests for proposals ("RFP"). According to the RFP, the City would use six weighted criteria to evaluate each proposal: price, equipment, facilities, reputation, ability to perform, and insurance.
- The City Manager formed a review committee to evaluate the proposals. The Committee consisted of City employees with experience in towing companies and/or procurement. No City Council members.
- The Committee was instructed to evaluate each of the proposals and to advise and aid the City Manager in his determination of which proposal best met the City's requirements.

# Freedom of Information Act and Procurement Selection Committees

- Quality Towing v. City of Myrtle Beach, 345 S.C. 156, 547 S.E.2d 862 (2001).
- Was the RFP “review committee” subject to the Freedom of Information Act?
- Trial Court said “No,” but the Supreme Court said “Yes.”
- FOIA defines “public body” as “any state board, commission, agency, and authority, and public or governmental body or political subdivision of the State, including counties, municipalities, townships, school districts, and special purpose districts . . . including committees, subcommittees, **advisory committees, and the like of any such body by whatever name known.**”
- “We hold the plain language of section 30-4-20(a) clearly includes an ‘advisory committee’ such as the one set up in the instant case.”

# The Subcontractors' and Suppliers' Payment Protection Act

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- Passed in 2000.
- Invalidates “pay-when-paid” clauses in subcontracts.  
§ 29-6-230.
- Requires governmental entities to ensure that a payment bond has been obtained to protect subcontractors.

# The Subcontractors' and Suppliers' Payment Protection Act

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When a governmental body is a party to a contract to improve real property, and the contract is for a sum in excess of fifty thousand dollars, the owner of the property *shall require* the contractor to provide a labor and material payment bond in the full amount of the contract. ...

For the purposes of any contract covered by the provisions of this section, *it is the duty of the entity contracting for the improvement to take reasonable steps to assure that the appropriate payment bond is issued and is in proper form.*

S.C. Code Ann. § 29-6-250 (emphasis added).

- (1) "Contractor" means a person who contracts with an owner to improve real property *or* perform construction services for an owner. (emphasis added).
- (3) "Improvement" means all or any part of any building, structure, erection, alteration, demolition, excavation, clearing, grading, filling, or landscaping, including trees and shrubbery, driveways, and roadways on real property.
- (4) "Owner" means a person who has an interest in the real property improved and for whom an improvement is made and who ordered the improvement to be made. "Owner" includes any state, local, or municipal government agencies, instrumentalities, or entities.
- (6) "Subcontractor" means any person who has contracted to furnish labor or materials to, or has performed labor or supplied materials for, a contractor or another subcontractor in connection with a contract to improve real property.

S.C. Code Ann. § 29-6-10

*Sloan v. Greenville County*  
**356 S.C. 531, 590 S.E.2d 338 (S.C. App. 2003)**

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- The court considered a county ordinance that provided, “[w]hen a construction contract is awarded in excess of twenty-five thousand dollars (\$25,000.00)” a “performance bond” and a “payment bond” “shall be delivered to the county and shall become binding on the parties upon the execution of the contract.”
- The county argued that the bond amount was required to cover only included direct construction costs and did not need to include engineering and program management costs
- The court stated that **the requirement that a bond be obtained was “remedial in nature” and the ordinance’s “provisions should be construed liberally to carry out its purposes** ... [and] should be read to afford the greatest protection to the citizens of Greenville County.” It then ruled that the bond amount must include costs for engineering costs, program management costs, and direct construction costs.



*Sloan v. Southco*  
**FACTS**

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1. Southco does not pay Sloan.
2. Prior to completion of work, June 21, 2001, Southco's Bonding Company becomes insolvent, Notice of Liquidation (known to SCDOT).
3. July 28, 2001 SCDOT advises Southco of Amwest's liquidation "please provide within 7 days of your receipt of this letter evidence of replacement bonds to cover this requirement. (Standard spec 103.05)
4. Southco does not obtain replacement bonds.



*Sloan v. Southco*  
**FACTS (continued)**

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5. January 15, 2002, Sloan files Verified Proof of Claim 27-1-15 demand.
6. March 6, 2003, Southco files Affidavit incorrectly representing that “all claims have been paid.”
7. SCDOT pays retainage to Southco.
8. Sloan sues.

*Sloan Construction Co., Inc. v. Southco Grassing, Inc. et al.,*  
*377 S.C. 108, 659 S.E.2d 158 (2008)*

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[W]e... find that the very title of the SPPA [Subcontractors Payment Protection Act] clearly indicates the General Assembly intended to provide stronger payment protection specifically for subcontractors and suppliers on governmental projects.

The statutory terms which tend to distinguish the SPPA from the Little Miller Act likewise demonstrate the SPPA's enactment for the **particular benefit** of subcontractors and suppliers.

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[T]he SPPA takes the Little Miller Acts' bond requirement one step further by establishing **both a duty** on the part of the governmental body to require payment bonding, **as well as a standard of care for overseeing the issuance of a proper payment bond.** S.C. Code Ann. § 29-6-250 (providing that "it is the duty of the entity contracting for the improvement to take reasonable steps to assure that the appropriate payment bond is issued and is in proper form").

In placing an affirmative duty on the government that is absent from the Little Miller Acts, we find that the legislature must have intended for those to whom the government owed the duty to be able to vindicate their rights under a statute enacted for their special benefit.

In our view, the enactment of the SPPA in 2000 illustrates the legislature's intent to, in essence, pick up where the Little Miller Acts left off by outlining a more extensive payment protection scheme dedicated specifically to subcontractors and suppliers. **Accordingly, we hold that the duty created under the SPPA gives rise to a private right of action against a government entity for failure to ensure that a contractor is properly bonded.**

Recognizing that "the underlying goals of the Procurement Code serve important public interests concerning this particular contractual relationship," this Court has held that contracts formed pursuant to the Procurement Code are deemed to incorporate the applicable statutory provisions and such provisions shall prevail over conflicting contractual provisions. *Unisys Corp. v. S.C. Budget & Control Bd.*, 346 S.C. 158, 171, 551 S.E.2d 263, 271 (2001) . Although not located in the Procurement Code, the SPPA is generally applicable to public procurement. **Therefore, we find that an incorporation of the SPPA's bonding requirements into public works contracts is consistent with this Court's reasoning in Unisys Corp.**

Finally, we find that under established contract law in South Carolina, subcontractors have enforceable rights as third-party beneficiaries to construction contracts incorporating the SPPA. . . . Because the legislature intended to protect contractors by creating bonding requirements, and because the subcontractors are the only ones with a financial stake in enforcing the bond requirements, **subcontractors are direct third-party beneficiaries to the contract between a government entity and a general contractor to which the SPPA is applicable. For this reason, the government may be liable to a subcontractor for breach of contract for failing to comply with the SPPA bonding requirements.**

Accordingly, we hold that a government agency's failure to secure and maintain statutory bonding as required by the SPPA gives rise to a third-party beneficiary breach of contract action by a subcontractor.

## Extent of Governmental Liability

We clarify our holding today by emphasizing that **the government's liability** for failure to ensure compliance with statutory bond requirements **is not open-ended**. The purpose of the SPPA is similar to that underlying the subcontractor's lien outlined in the mechanics' lien statute, see S.C. Code Ann. § 29-5-20, which is to protect a party who provides labor or materials for the improvement of property but does not have a contractual relationship with the property owner.

The subcontractor's lien, however, is not intended to create a windfall to the subcontractor. The mechanics' lien statute provides that when a subcontractor seeks to enforce a mechanics' lien against the owner of the improved property due to the general contractor's nonpayment, the owner's liability is limited to the remaining unpaid balance on the contract with the general contractor at the time the owner receives notice from the subcontractor of the general contractor's nonpayment. S.C. Code Ann. § 29-5-40; Lowndes Hill Realty Co. v. Greenville Concrete Co., 229 S.C. 619, 630, 93 S.E.2d 855, 860 (1956).

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Given the similar purposes behind the SPPA bond requirements for public projects and the subcontractors' mechanics' lien on private work, we hold that **in a tort or contract action arising under the SPPA**, the government entity's **liability is limited to the remaining unpaid balance on the contract with the general contractor when the subcontractor notifies the government of the general contractor's nonpayment.**

This limitation, however, does not preclude the additional recovery of attorneys' fees under any applicable statute.

# RECAP

Public bodies have a duty to make sure:

- (1) An Appropriate Payment Bond is in Place
- (2) An Appropriate Payment Bond Stays in Place (?)

Subcontractors may sue public bodies for breach of contract, or under a negligence theory, for breaching these duties.

Liability is limited to:

- (1) contract balance when **“when the subcontractor notifies the government of the general contractor's nonpayment.”**
- (2) attorneys' fees

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Shirley's Iron Works, Inc. and Tindall Corporation v. City of Union, 379 S.C. 584, 726 S.E.2d 208 (Ct. App. 2010) (filed May 20, 2010).

In this case the City of Union failed to require the general contractor who was awarded the project to obtain a payment bond. The general contractor did not pay the Plaintiff subcontractors, and they sued the City, alleging among other things causes of action in negligence for violating § 29-6-250, and a breach of contract action as a third-party beneficiary based upon the violation of § 29-6-250.



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The City argued that the subcontractors' negligence claims sounded in tort and were, therefore, barred under the doctrine of sovereign immunity and the South Carolina Tort Claims Act.

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The City cited fn. 5 to Sloan v. Southco which states that “a claim for failure to enforce the bonding requirements of the SPPA is not properly brought pursuant to the [SCTCA] because the [SCTCA] does not act as a waiver of sovereign immunity when a governmental entity fails to enforce a statute.” (quoting Sloan v. Southco, 377 S.C. at 118 n. 5, 659 S.E.2d at 164 n. 5 (citing S.C. Code Ann. § 15-78-60(4))).

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The subcontractors argued that § 29-6-250 “creates an affirmative duty on the government, and the SCTCA does not protect the government from liability for breach of that duty. In support of this, they cite to a latter portion of fn. 5 [from Sloan v. Southco] which states, ‘therefore the [SCTCA] is not relevant to the government’s liability for failure to comply with a duty under the SPPA.’” Id. at \*11-12 (quoting Sloan v. Southco, 377 S.C. at 118 n. 5, 659 S.E.2d at 164 n.5).

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Sloan v. Southco Opinion “was merely clarifying that while there exists a private right of action under the SPPA, it would be improper to insert that right by bringing a claim pursuant to the SCTCA for failure to enforce the statute because such claims are clearly barred under the SCTCA. Rather, the claim should be brought under the SPPA as a tort claim in negligence for breach of the duty created by § 29-6-250.

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The City also argued that the subcontractors' claims were barred because the City had paid out the remaining contract balance after it was notified by the subcontractors of their not being paid. Id. at \*18. The Court of Appeals disagreed noting that the same facts were evident in Sloan v. Southco. As the Court of Appeals noted, in “that case, it was undisputed that the government entity disbursed the remaining funds to the general contractor when the subcontractor notified the government of non-payment.” (Citing Sloan v. Southco, 371 S.C. at 111, 659 S.E.2d at 160).



# South Carolina Illegal Immigration Reform Act.

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## A. Introduction

Section 3 of the South Carolina Illegal Immigration Reform Act (2008 S.C. Acts 280) -- entitled "Unauthorized Aliens and Public Employment."



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Public employers may not enter into contracts with contractors unless:

1. The contractor agrees to verify all new employees through the federal work authorization program, and requires the same from its subcontractors and sub-subcontractors, or
2. The contractor agrees to employ only qualifying workers.

S.C. Code Ann. § 8-14-20(B).



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The immigration law defines “Public employer” as “every department, agency, or instrumentality of the State or a political subdivision of the State.” S.C. Code Ann. § 8-14-10(A)(5).

The immigration law defines “federal work authorization program” as “the E-Verify Program maintained and operated by the United States Department of Homeland Security and the Social Security Administration, or any successor program.” S.C. Code Ann. § 8-14-10(A)(4).



Defines “Qualifying Workers” as those workers who:

1. Possess or are eligible to obtain a valid South Carolina driver's license or identification card issued by the South Carolina Department of Motor Vehicles; or
2. Possess a valid driver's license or identification card from another state where the license requirements are at least as strict as those in South Carolina. The South Carolina Department of Motor Vehicles must publish on its website a list of states where the license requirements are at least as strict as those in South Carolina.

S.C. Code Ann. § 8-14-20(B)(2).



A public employer complies with these requirements, and thus satisfies the immigration law, if it obtains a written statement from the contractor certifying:

1. That the contractor will comply with the requirements of the immigration law; and
2. That the contractor agrees to provide to the public employer any documentation required to establish that (a) the immigration law does or does not apply, or (b) the contractor and its subcontractors are in compliance with the immigration law.

S.C. Code Ann. § 8-14-40.



Public employer need not audit or independently verify a contractor's compliance with the immigration law.

S.C. Code Ann. § 8-14-40.

Law provides a safe harbor provision:

Even if a public employer or contractor employs an individual not authorized for employment in the United States, they will not be sanctioned or subject to action if they in **good faith** comply with the requirements of the immigration law.

S.C. Code Ann. § 8-14-50.



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A person who knowingly makes or files any false, fictitious, or fraudulent document, statement, or report pursuant to the immigration law is guilty of a felony punishable by fine and/or up to five years in prison.

South Carolina Code Ann. § 8-14-60.



By signing its bid, offer, or proposal, Contractor certifies that it will comply with the applicable requirements of Title 8, Chapter 14 of the South Carolina Code of Laws and agrees to provide to the Owner upon request any documentation required to establish either: (a) that Title 8, Chapter 14 is inapplicable both to Contractor and its subcontractors or sub-subcontractors; or (b) that Contractor and its subcontractors or sub-subcontractors are in compliance with Title 8, Chapter 14.

Pursuant to Section 8-14-60, "A person who knowingly makes or files any false, fictitious, or fraudulent document, statement, or report pursuant to this chapter is guilty of a felony, and, upon conviction, must be fined within the discretion of the court or imprisoned for not more than five years, or both."

Contractor agrees to include in any contracts with its subcontractors language requiring its subcontractors to (a) comply with the applicable requirements of Title 8, Chapter 14, and (b) include in their contracts with the sub-subcontractors language requiring the sub-subcontractors to comply with the applicable requirements of Title 8, Chapter 14.