Recovery of Interest on Performance and Payment Bond Claims

By Bill Blancato

Recovery of interest on breach of contract claims is governed by G.S. § 24-5. Prejudgment interest is awarded from the date of the breach at the rate specified in the contract and if no rate is specified, at the legal rate of 8 percent. If the contract specifies an interest rate applicable after judgment, then that rate applies, otherwise the contract rate applies before judgment and the judgment rate applies after judgment.

The purpose of awarding prejudgment interest is “threefold: (1) to compensate plaintiffs for loss of the use of their money, (2) to prevent unjust enrichment of the defendant by having money he should not have, and (3) to promote settlement. Brown v. Flowe, 349 N.C. 520, 523, 507 S.E.2d 894, 896 (1998). There is no good faith exception to an award of prejudgment interest. Even if the defendant honestly believed it did not owe the sum ultimately awarded, interest is taxed on the entire amount awarded to the plaintiff. Cleveland Construction, Inc. v. Ellis-Don Construction, Inc., 210 N.C. App. 522, 538-39 709 S.E.2d 512, 525 (2011).

Performance and payment bonds secure obligations under contracts. Thus, prejudgment interest should be awarded on claims brought under performance and payment bonds. But typically, the liability of the surety is limited to the stated dollar amount (penal sum) of the bond. See, e.g Cashman Equipment Corp. v. U.S. Fire Ins. Co., 368 Fed. Appx. 288 (3d Cir. 2010) (where only penal sum was awarded even though damages exceed the penal sum). The question arises whether interest can be added to the principal amount recovered on payment and performance bond claims such that the total recovery exceeds the penal sum.

The North Carolina Supreme Court addressed recovery of interest on a payment bond claim in Interstate Equipment Co. v. Smith, 292 NC 592, 234 S.E.2d 599 (1977). This case concerned a claim to recover the balance owed to an equipment lessor by a subcontractor. Even though the equipment rental agreement was silent as to whether interest could be recovered, the court held that interest was recoverable at the then legal rate of 6 percent in accordance with the statute. The court did not address the question of whether or not interest could exceed the penal sum of the bond nor did the court address whether a surety could be liable for the higher interest allowed under the prompt payment act, G.S. § 22C-1 et seq.

The question of whether interest could exceed a performance bond’s penal sum was presented in Insurance Company of North America v. United States, 951 F.2d 1244 (Fed. Cir. 1991). In INA, the trial court awarded interest accruing after the government had demanded payment from the surety. On appeal to the Federal Circuit, the court first addressed whether prejudgment interest can increase the surety’s liability beyond the face amount of the bond. Citing United States v. United States Fidelity and Guaranty Co., 236 U.S. 512, 530 – 31, 35 S. Ct. 298, 303 – 04, 59 L.Ed. 696 (1915), the court held “if a surety delays payment beyond proper notification of liability, interest accrues on the debt. This interest may cause the surety’s obligation to exceed the penal sum of the bond.” INA, 951 F.2d at 1246. The court further held that the obligation to pay arises when the contractor defaults under the contract, not when the litigation between the contractor and the government ends. “The creditor’s claim against the surety is independent of the claim against the debtor.” Id. at 1247. Thus, interest accrued as of the date of the contractor’s breach, not when the amount owed is liquidated.

There is one case from North Carolina in which interest was added in excess of the penal sum of the bond. In County of Brunswick v. Lexon Insurance Co., 710 F. Supp. 2d 520 (E.D.N.C. 2010), aff’d, 425 Fed. Appx. 190 (4th Cir. 2011) a county sought proceeds of a performance bond from the surety because of non-completion of a subdivision development project. Judge Boyle entered judgment against the surety for the full penal sum. In addition, Judge Boyle added interest at the legal rate from the date the bonded performance came due and post judgment interest at the legal rate until the judgment was satisfied. County of Brunswick, 710 F.Supp. 2d at 526 – 25. The Fourth Circuit affirmed the award of interest citing G.S. § 24 – 5 and Interstate Equipment Company.

Interest is a component of every bond claim as much as the cost of bricks and mortar. North Carolina law is clear that interest is due from the date of breach. On either payment bond claims or performance bond claims, failing to award interest provides a windfall to the surety/debtor and deprives the claimant/creditor compensation for loss of use of their money. Pressing for prejudgment interest at the highest available rate is one way to minimize the loss suffered by a claimant under either a payment or performance bond.

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