

A BAD CLAIM FOR BAD FAITH

By Jack Burch and Jackson Harris September 15, 2020

Georgia and other states have statutes that expressly authorize bad faith penalties against sureties. The threat of such penalties often weighs heavily. But do not assume, simply because a case is pending in Georgia or another state with a bad faith statute, that bad faith penalties are a real threat.

In *NP 301, LLC v. Liberty Mut. Ins. Co.*, No. 1:20-CV-02298 (N.D. Ga. Aug. 7, 2020), the Georgia obligee on a maintenance bond issued on a North Carolina project sued the co-sureties in Georgia. The construction contract provided it was governed by North Carolina law. The obligee alleged in the Georgia lawsuit that the sureties acted in bad faith for denying the claim. Such a claim exists under Georgia law. See O.C.G.A. § 10-7-30.

The co-sureties filed a motion to dismiss the bad faith claim as a matter of law, asserting that because North Carolina does not recognize bad faith claims against sureties that the Georgia statute did not apply even though the lawsuit was brought in Georgia. See *Cincinnati Ins. Co. v. Centech Bldg. Corp.*, 286 F. Supp. 2d 669, 690-91 (M.D.N.C. 2003).

The obligee argued that its bad faith claim was a tort, and therefore the place where alleged tort occurred – that is in Georgia where the obligee was located – governed which state’s law applies. The sureties countered that since the bad faith claim arose out of an alleged breach of a contractual obligation, i.e. non-payment of the maintenance bond claim, that the laws of the place of contract – that is in North Carolina where the project was located – governed which law applies.

How did the Court resolved this dispute?

The resolution of this dispute required the application of Georgia’s conflict-of-law rules. Those rules hinge on the nature of the claim asserted. If a bad faith claim is a contract claim, as the sureties alleged, the rule of *lex loci contractus* – the law of the place where the contract was made – applies. However, if the claim is a tort claim, the rule of *lex loci delicti* – the law of the place where the tort was committed – applies.

The obligee placed great reliance upon a District Court in Ohio which held that Georgia bad faith surety claims did indeed sound in tort, not contract. *In re: Commercial Money Center, Inc., Equipment Litigation*, 603 F. Supp. 2d 1095 (M.D. Ohio 2003). The sureties responded that the Ohio court flatly got it wrong, and that any contention of surety bad faith sounded in contract, which in this case would then be governed by North Carolina law.

The sureties prevailed. The District Court recognized that a bad faith claim on a liability insurance policy was treated as a contract claim in Georgia, and bad faith against sureties was no different; both are

contract actions. In short, because the relation between the surety and its obligee is contractual, and any breach is a contract claim, that the claim that the surety acted in bad faith when it failed to pay the claim is a contract claim and not a tort.

The obligee argued that the surety relationship, like all contracts, carries with it a duty of good faith. The obligee then went further, though, and argued that coupling the duty of good faith with the existence of the bad faith statute created a special relationship between the surety and the obligee, which supported a tort claim. The court rejected this argument: even though the surety owes a duty of good faith, this duty arises out of a contract, and tort law is simply inapplicable.

The court recognized that it was undisputed that the bond incorporated the construction contract, the contract was to be performed in North Carolina, and it provided it was governed by North Carolina law. The court dismissed plaintiff's bad faith claims as a matter of law. (However, the court declined to transfer the case to North Carolina, rejecting a *forum non conveniens* motion.)

The sureties were represented by Bovis, Kyle, Burch & Medlin, LLC, whose attorneys are licensed in Georgia, North Carolina, and South Carolina.