

Pennsylvania Supreme Court Clarifies Bad Faith and Arbitration Exposure for Sureties

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The Pennsylvania Supreme Court's decision in *Eastern Steel Constructors, Inc. v. International Fidelity Insurance Co.*, 2026 WL 457805 (Pa. Feb. 18, 2026), has two immediate consequences for Pennsylvania construction projects: it removes statutory bad faith as a weapon against sureties, but confirms that sureties can still be held directly liable for arbitration awards entered against their principals.

Bad Faith Statute Does Not Apply to Sureties

Pennsylvania's "bad faith" statute, Section 8371 of Title 42 of the Pennsylvania Consolidated Statutes, authorizes remedies such as punitive damages, interest, and attorneys' fees when an "insurer" acts in bad faith in an action "arising under an insurance policy."

In *Eastern Steel*, a subcontractor asserted a bad faith claim against the contractor's surety on a payment bond. The court rejected that claim, holding: (i) a payment bond is not an "insurance policy" within the meaning of § 8371; and (ii) a surety is not an "insurer" under the statute.

The court construed the plain language of the statute and determined that the statutory language clearly and unambiguously targets insurers, and if the General Assembly had intended to include sureties and surety bonds, it would have said so. The court further relied on previous Pennsylvania case law and emphasized long-recognized differences between insurance and suretyship.^[1] Insurance protects the insured against defined risks. Suretyship protects the obligee (here, the subcontractor) from the principal's (here, the contractor's) default, while giving a surety a right of indemnity from the principal.

Surety Can Still Be Bound by Arbitration Award Against the Principal

The court also confirmed that a surety may still be bound by an arbitration award entered against its principal where the bond language and circumstances support that result.

In *Eastern Steel*, the subcontract required arbitration, and the subcontractor obtained a default award against the contractor after the contractor failed to participate in arbitration. The terms of the payment bond made the principal and surety jointly and severally liable "for all sums due" under the construction contract. And the surety had notice of the arbitration and an opportunity to participate, but declined.

Relying on Pennsylvania authority in *Conneaut Lake Agricultural Ass'n v. Pittsburgh Surety Co.*, the court held that an arbitration award is binding on a surety where the surety had a fair opportunity to defend and protect its interests.^[2] The court rejected Fidelity's argument that *Conneaut* was distinguishable because it involved a performance bond rather than a payment bond, finding no meaningful distinction where the underlying obligation was a promise to perform. The court stated that due to the "very nature of surety relationships" and the language of the bond, Fidelity knew that it would be responsible for payment to the subcontractor in the event of the contractor's breach and knew that any claim of breach would be resolved in arbitration.

The decision reinforces a core principle: a surety on a performance or payment bond cannot avoid liability simply by sitting out an arbitration that will determine the principal's indebtedness, particularly where the bond ties the surety's liability directly to the principal's obligations.

Key Takeaways

Subcontractors and Suppliers: You cannot assert a § 8371 bad faith claim against a surety, but you can still pursue contractual claims and enforce arbitration awards where the surety's obligations are co-extensive with the principal's.

Sureties: This narrows exposure primarily to contractual damages and any interest or fee remedies available under the bond, subcontract, or other statutes. While statutory bad faith exposure is curtailed, the decision heightens the need to monitor and, when appropriate, participate in arbitrations involving your principal. Ignoring arbitration proceedings may result in being bound by the resulting award.

All Project Participants: Bonds remain a robust tool for enforcing obligations, but the risk allocation is contractual. Careful drafting of bonds and subcontracts, and coordination with sureties during arbitration, will heavily influence whether a surety can later contest an award.

For Pennsylvania construction projects, *Eastern Steel* draws an important line: bad faith remedies under § 8371 are off the table for claims against sureties, but sureties remain firmly on the hook for arbitration awards against the bond's principal when they have notice and an opportunity to be heard.

[1] The court noted that Pennsylvania courts have followed Supreme Court precedent clarifying the differences between suretyship and insurance, citing *Foster v. Mutual Fire, Marine and Inland Ins. Co.*, 614 A.2d 1086 (Pa. 1992); *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962)

[2] See *Conneaut Lake Agricultural Ass'n v. Pittsburgh Surety Co.*, 74 A. 620 (Pa. 1909).

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