

2. Bond amount expressed as the financial limit of that obligation;
3. Duration of the bond obligation;
4. Stated trigger of the surety's performance bond liability; and
5. Nature and extent of risk posed by bonded contract.

§ 12:14 Types of performance bond obligations— Generally

The performance bond obligation traditionally is expressed in conditional “defeasance” language,¹ which simply declares that the bond obligation is “null and void” upon performance of the bonded contract in conformance with its terms and conditions. Defeasance language assures that the bond obligation becomes void upon performance without need for express cancellation of the bond, and confirms that the bond obligation is coextensive with the contractor's obligation under the bonded contract.

With respect to the surety's bond obligation upon the contractor's default, bond language is crucial in defining and in differentiating the type of bond by its specific obligation.² Because the purpose and intent of the performance bond generally is to

Project Risk 34 (unpublished paper, January 19, 1999):

In those states which continue to require a single instrument combination bond, most require subcontractors and suppliers to wait until the project is complete in order to perfect their claim so as to ensure the obligee of the full benefit of the penal sum of the bond. This is obviously prejudicial to subcontractors and suppliers, particularly those that perform in the early stages for the project, but must wait until well after substantial completion to perfect and enforce their claims. Other states literally share the penal sum of the performance bond with subcontractors and suppliers and allow them to perfect their claims before completion of the project, thereby diminishing the availability of the penal sum to the obligee. Separate performance and payment bonds represent a better risk transfer mechanism for both obligees and payment bond claimants than single instrument combination bonds.

[Section 12:14]

¹See *Quinn Const., Inc. v. Skanska USA Bldg., Inc.*, 2008 WL 5187391 (E.D. Pa. 2008) (citing treatise and noting that the bond obligation “comes into existence when the bond is signed and then is excused only if certain conditions occur”). See also Miller Act Performance Bond, Standard Form 25 (January 1990), 48 C.F.R. § 53.228(b) (“The above obligation is void if the principal . . .”); AIA Document A312-1984 Performance Bond (1984) (“If the contractor performs the construction contract, the Surety and the Contractor shall have no obligation . . .”).

²See *Lake County Grading Co., LLC v. Village of Antioch*, 2014 IL 115805, 385 Ill. Dec. 683, 19 N.E.3d 615 (Ill. 2014), in which the Supreme Court of Illinois demonstrated confusion in describing a municipal subdivision infrastructure bond as “a completion bond (also known as a performance bond), [which] provides that if the contractor does not complete a project, the surety will pay

protect the named obligee against the contractor's default, the surety's performance obligation customarily is offered in various expressions, such as performance of the contract and payment for labor and materials furnished in furtherance of the contract, protection of the land against the filing of mechanics' liens, indemnification of the obligee against loss caused by the contractor's failure to perform, or completion of the contract unconditionally. Types of bonds commonly lumped together under the heading of "performance bond" include:

1. Traditional performance bond, such as the AIA performance bond;
2. Indemnity bond, such as the Federal Standard Form 25 performance bond;
3. Completion bond; and
4. Manuscript bond.

Each of these bonds has as their objective the protection of the obligee against contractor default.

§ 12:15 Types of performance bond obligations—What “performance” is required—Typical performance bond surety's options upon its principal's default

Under a “performance bond,” the surety's obligation to complete performance of the bonded contract upon the principal's “default”¹ typically, but not always, includes multiple remedial options:

for its completion.” As noted in §§ 12:14 to 12:21, there are fundamental differences between a “performance bond” and a “completion bond,” and as noted in § 12:15, the surety ordinarily has multiple remedial options beyond the option merely to “pay for its completion.” See also *United City of Yorkville v. Ocean Atlantic Service Corporation*, 2013 WL 5433429 (N.D. Ill. 2013) (Holding a city equitably estopped from commencing suit against a surety on a public infrastructure improvement bond, where the city argued was a payment bond requiring the surety to pay for unpaid labor and materials and to remove mechanic's liens, and where the surety argued that the bond was a performance bond that could only be triggered by the city's demand for performance. The court ruled that the bond was a performance bond that guaranteed installation of uncompleted improvements and was not a payment bond guaranteeing payment of labor and materials. The court concluded that the city was barred from seeking performance on the bonds under the doctrine of laches and Illinois four year statute of repose. The city had waited over five years to demand performance, and its late notice to the surety prejudiced the surety's opportunity to remedy construction defects by cost effective repair before the property deteriorated and commodity costs increased.).

[Section 12:15]

¹See §§ 12:37 to 12:42, 18:1 to 18:31. See also *L & A Contracting Co. v. Southern Concrete Services, Inc.*, 17 F.3d 106, 111 (5th Cir. 1994) (“Not every breach of a construction contract constitutes a default sufficient to require the

- (1) The surety's takeover and completion of the bonded contract;²
- (2) The surety's arrangement for the contractor to cure any default and perform and complete the bonded contract;³
- (3) The surety's tender to the obligee of another contractor willing to enter into a completion contract with the obligee, together with payment of the excess cost of completion—the amount by which the completion contract price exceeds the contract funds remaining under the bonded contract;⁴ or
- (4) The surety's "buy back" of the bond through a cash settlement with the obligee.⁵

In lieu of these affirmative options, the surety can also decide to "do nothing" after careful investigation,⁶ which eliminates the surety's control over completion costs, and leaves the obligee to complete the terminated contract and then to pursue the surety for possible recovery of costs of completion in excess of remaining contract funds.

**§ 12:16 Types of performance bond obligations—
Performance bond surety's options upon its
principal's default—American Institute of
Architects' performance bond**

The A312 Performance Bond is one of the clearest, most defini-

surety to step in and remedy it. To constitute a legal default, there must be a (1) material breach or series of breaches (2) of such magnitude that the obligee is justified in terminating the contract.”).

²See § 12:80.

³See § 12:79.

⁴See § 12:81.

⁵See § 12:82. See also AIA Document A312-1984, Performance Bond (1984), and EJCDC Document C-610 (2002), Construction Performance Bond. The Federal Standard Form 25 Miller Act Performance Bond (January 1990) does not expressly list the surety's alternatives, but government contracting officers routinely are willing to consider them. This "buy back" option includes the payment of the penal sum which the surety can do unilaterally. Payment of a lesser sum requires settlement with the obligee.

⁶See § 12:83. See also Piper and Coe, *The Surety's Investigation*, in *Bond Default Manual* 43 (3d ed. 2005). A few owners have explored bond forms that eliminate this option. The Dallas/Fort Worth ("DFW") International Airport Capital Development Program is one large building program that used bond forms that eliminate the "do nothing" option. See Peartree, *Default Insurance, Alternative Surety Approaches and the Pitfalls of Additional Insured Status*, printed in ABA's, *Passing the Buck: Legal Limitations on Transferring Construction Risks*, (Jan. 24, 2002).

tive, and widely used type of traditional common law “performance bonds” in private construction.¹ The form was developed to

[Section 12:16]

¹See *Mid-State Sur. Corp. v. Thrasher Engineering, Inc.*, 575 F. Supp. 2d 731, 741 (S.D. W. Va. 2008) (citing treatise and opining that “the language of the A312 bond, the bond at issue here, is clear and unambiguous”). See also *U.S. Fidelity and Guar. Co. v. Braspetro Oil Services Co.*, 369 F.3d 34, 159 O.G.R. 690 (2d Cir. 2004) (addressing a surety’s liability for damages under the AIA 312 performance bond); *Seaboard Sur. Co. v. Town of Greenfield*, ex rel. Greenfield Middle School Bldg. Committee, 370 F.3d 215, 188 Ed. Law Rep. 50 (1st Cir. 2004) (relieving the surety of liability due to the owner’s failure to provide proper notice as required under paragraph 4.2 of the AIA A312 performance bond).

The older AIA Document A311-1970 Performance Bond (1970) is less detailed in its express terms, but is still frequently used. For cases construing the AIA-A311 bond, see *CC-Aventura, Inc. v. Weitz Co., LLC*, 2007 WL 2986371 (S.D. Fla. 2007) (holding that the declaration of the principal’s default was required under the A311 bond as a condition precedent to the surety’s liability on the performance bond, and that in the absence of a clear and ambiguous declaration by the obligee, the surety was not liable); *Walter Concrete Const. Corp. v. Lederle Laboratories*, 99 N.Y.2d 603, 758 N.Y.S.2d 260, 788 N.E.2d 609 (2003) (“Unlike the AIA-312 bond, another industry standardized bond, in action on an AIA-311 bond is not tied to a declaration of default. The principal’s cessation of work or the Surety’s refusal to perform under the bond. Rather, an action on the AIA-311 need only be commenced within two years from the date on which final payment under the contract is due. Had the parties to the contract desired notice of default as a precursor to liability under the bond, they could have elected to issue the more specific AIA-312, which by its terms requires predefault notification be given to the contractor and Surety by the owner.”) Cases noting differences between the AIA A312 bond and the AIA A311 bond are *120 Greenwich Development Associates, LLC v. Reliance Ins. Co.*, 2004 WL 1277998 (S.D. N.Y. 2004) (the A312 performance bond, unlike the A311 performance bond, required notice of default as a condition precedent to the surety’s liability, and that the obligee’s failure to provide such notice could be fatal to its claim); *Walter Concrete Const. Corp. v. Lederle Laboratories*, 99 N.Y.2d 603, 758 N.Y.S.2d 260, 788 N.E.2d 609, 610 (2003) (“Notwithstanding [the surety’s] contrary claim, the AIA 311 performance bond contains no explicit provision requiring a notice of default as a condition precedent to any legal action on the bond Unlike the AIA 312 bond, another industry standardized bond, an action on the AIA 311 bond is not tied to a declaration of default, the principal cessation of work or the surety’s refusal to perform under the bond.”).

The broad terms of the A311-1970 bond have received wildly different interpretations as to whether notice of default to the surety is a condition precedent to the surety’s liability. Compare *Colorado Structures, Inc. v. Insurance Co. of the West*, 161 Wash. 2d 577, 167 P.3d 1125 (2007) (in a 5-4 en banc decision, a majority of the Supreme Court of Washington ruled that the obligee’s declaration of default and notice to the surety were conditions precedent to the “use of the remedies and damages” described in the bond but not conditions precedent to “liability,” and held that the surety remained liable on its bond even though the obligee had made no declaration of the principal’s default) and *Hunt Const.*

define clearly the scope and extent of the surety's liability, the "trigger" of the surety's obligation to perform, the options available to the surety in satisfying its bond obligations, and the duration of the surety's obligations. Important provisions of the bond form include:

1. Scope of the bond obligation;
2. Trigger to surety liability;
3. Surety's options to satisfy its bond obligations;
4. Limitations on surety liability;
5. Damages recoverable;
6. Unrelated claims and setoffs, and limitation of right of action;
7. Waiver of notice;
8. Duration of the bonded obligation; and
9. Statutory requirements.

The surety's A312 bond obligations are spelled out in paragraphs 1 and 2.² This language makes clear that: (1) the surety and the contractor are jointly and severally liable under the bond for "the performance of a construction contract," (2) the construction contract is "incorporated herein by reference" so as to make clear that the bond obligation is coextensive with that of the bonded contract, and (3) no obligation arises under the bond for performance of the bonded contract so long as "the contractor performs the construction contract." Paragraph 12.2 expressly defines the "construction contract" to include: "The agreement between the Owner and the Contractor identified on the signature page, including all Contract Documents and changes thereto."

The surety's A312 Bond liability is triggered under paragraph

Group, Inc. v. National Wrecking Corp., 542 F. Supp. 2d 87 (D.D.C. 2008), aff'd on other grounds, 587 F.3d 1119 (D.C. Cir. 2009) (specifically rejecting the *Colorado Structures* reasoning, and opining that an owner's failure to provide a declaration of default would convert the "performance surety into a commercial guarantor—an undertaking well beyond the limits of the surety").

See also *Nova Cas. Co. v. Turner Const. Co.*, 335 S.W.3d 698 (Tex. App. Houston 14th Dist. 2011) (construing an AIA A311 performance bond as requiring the obligee, to trigger the surety's performance obligation, only to notify the surety of its principal's default without having to terminate the bonded contract).

²See AIA Document A312-1984, Performance Bond ¶¶ 1 and 2 (1984):

The Contractor and the Surety jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for the performance of the Construction Contract, which is incorporated herein by reference.

If the Contractor performs the Construction Contract, the Surety and the Contractor shall have no obligation under this Bond, except to participate in conferences as provided in Subparagraph 3.1.

See also AIA Document A312-2010, Performance Bond ¶¶ 1 and 2 (2010), which are substantially identical to the A312-1984 Bond.

3.³ The surety's obligation arises only if:

³See AIA Document A312-1984 Performance ¶ 3 (1984):

If there is no Owner Default, the Surety's obligation under this Bond shall arise after the Owner has notified the Contractor and the Surety at its address described in Paragraph 10 below that the Owner is considering declaring a Contractor Default and has requested and attempted to arrange a conference with the Contractor and the Surety to be held not later than fifteen days after receipt of such notice to discuss methods of performing the Construction Contract. If the Owner, the Contractor and the Surety agree, the Contractor shall be allowed a reasonable time to perform the Construction Contract, but such an agreement shall not waive the Owner's right, if any, subsequently to declare a Contractor Default; and

The Owner has declared a Contractor Default and formally terminated the Contractor's right to complete the contract. Such Contractor Default shall not be declared earlier than twenty days after the Contractor and the Surety have received notice as provided in Subparagraph 3.1; and

The Owner has agreed to pay the Balance of the Contract Price to the Surety in accordance with the terms of the Construction Contract or to a contractor selected to perform the Construction Contract in accordance with the terms of the contract with the Owner.

See *Current Builders of Florida, Inc. v. First Sealord Sur., Inc.*, 984 So. 2d 526 (Fla. 4th DCA 2008) (default waived by not terminating the contractor and allowing work to continue for a significant period of time); *Hunt Const. Group, Inc. v. National Wrecking Corp.*, 542 F. Supp. 2d 87 (D.D.C. 2008), *aff'd* on other grounds, 587 F.3d 1119 (D.C. Cir. 2009) (holding that the owner's delayed termination of the contractor did not trigger the surety's performance obligation); *Developers Sur. and Indem. Co. v. Dismal River Club, LLC*, 2008 WL 2223872 (D. Neb. 2008) (Paragraph 3 provisions of the AIA A312 Bond constituted "conditions precedent" to the triggering of the surety's obligations, which the owner had failed to perform); *U.S. ex rel. Platinum Mechanical, LLC v. U.S. Sur. Co.*, 2007 WL 4547849 (S.D. N.Y. 2007) (same); *Solai & Cameron, Inc. v. Plainfield Community Consol. School Dist.* No. 202, 374 Ill. App. 3d 825, 313 Ill. Dec. 217, 871 N.E.2d 944, 221 Ed. Law Rep. 807 (3d Dist. 2007) (same); *Donald M. Durkin Contracting, Inc. v. City of Newark*, 2006 WL 2724882 (D. Del. 2006) (same); *LBL Skysystems (USA), Inc. v. APG-America, Inc.*, 2006 WL 2590497 (E.D. Pa. 2006) ("The language of paragraph 3 of the [A312] performance bond . . . creates conditions precedent to the duty of the surety."); *Enterprise Capital, Inc. v. San-Gra Corp.*, 284 F. Supp. 2d 166 (D. Mass. 2003) (discharging Surety under an AIA-A312 performance because of the obligee's failure to comply with the trigger requirements in paragraph 3 of the bond and the termination requirements under the Bonded contract.). Compare *Mid-State Sur. Corp. v. Thrasher Engineering, Inc.*, 575 F. Supp. 2d 731, 740-747 (S.D. W. Va. 2008) (upholding a surety's liability under an A312 subcontract bond after finding all conditions precedent to the surety's liability to have been satisfied).

See also AIA Document A312-2010, Performance Bond ¶ 3 (2010):

If there is no Owner Default under the Construction Contract, the Surety's obligation under this Bond shall arise after the Owner first provides notice to the Contractor and the Surety that the Owner is considering declaring a Contractor Default. Such notice shall indicate whether the Owner is requesting a conference among the Owner, Contractor and Surety to discuss the Contractor's performance. If the Owner does not request a conference, the Surety may, within five (5) business days after receipt of the Owner's notice, request such a conference. If the Surety timely requests a conference, the Owner shall attend. Unless the Owner agrees otherwise any conference requested under this § 3.1 shall be held within ten (10) business days of the Surety's receipt of

- (1) The owner is not in default;
- (2) The owner has notified both the contractor and the surety that it is considering declaring the contractor in default;
- (3) The owner has requested a conference with the contractor and the surety to discuss the contractor's alleged dereliction in performance;⁴
- (4) Following that conference, the owner has declared the contractor to be in default and has formally terminated the contractor's right to proceed under the bonded contract; and⁵
- (5) The owner has agreed to pay the balance of the contract

the Owner's notice. If the Owner, the Contractor, and the Surety agree, the Contractor shall be allowed a reasonable time to perform the Construction Contract, but such an agreement shall not waive the Owner's right, if any, subsequently to declare a Contractor Default; the Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety; and the Owner has agreed to pay the Balance of the Contract Price in accordance with the terms of the Construction Contract to the Surety or to a contractor selected to perform the Construction Contract.

⁴Under the AIA Document A312-2010, Performance Bond (2010), the owner's request of a conference is no longer a "condition precedent" to triggering the surety's liability. The obligee's declaration of contractor default and formal termination of the contractor's right to proceed remain the crucial conditions precedent to the surety's performance bond liability.

⁵The owner's obligation to declare contractor default and formally terminate the contractor's right to proceed is a condition precedent to the surety's liability under the AIA A312 bond. See *Developers Sur. and Indem. Co. v. Dismal River Club, LLC*, 2008 WL 2223872 (D. Neb. 2008) (the owner failed to comply with the bond's conditions precedent, and failed to trigger the surety's performance bond obligations); *Hunt Const. Group, Inc. v. National Wrecking Corp.*, 542 F. Supp. 2d 87 (D.D.C. 2008), *aff'd* on other grounds, 587 F.3d 1119 (D.C. Cir. 2009) (the owner's untimely termination of the principal failed to trigger the surety's performance obligations, and the surety was relieved of liability); *Seaboard Sur. Co. v. Town of Greenfield, ex rel. Greenfield Middle School Bldg. Committee*, 370 F.3d 215, 188 Ed. Law Rep. 50 (1st Cir. 2004) (surety discharged from performance bond obligations by the owner's failure to give the surety a 15-day cure notice prior to performing the contract itself); *Elm Haven Const. Ltd. Partnership v. Neri Const. LLC*, 376 F.3d 96 (2d Cir. 2004) (surety discharge of its performance bond obligation by the obligee's hiring of a replacement contractor prior to declaring the principal in default and making demand on the surety to complete); *120 Greenwich Development Associates, LLC v. Reliance Ins. Co.*, 2004 WL 1277998 (S.D. N.Y. 2004) (notice of default is a condition precedent to the surety's liability); *Enterprise Capital, Inc. v. San-Gra Corp.*, 284 F. Supp. 2d 166 (D. Mass. 2003) (obligee's bond claim defective because the obligee failed to notify the principal that it was in default, even though it notified the surety that the principal is in default); *153 Hudson Development, LLC v. DiNunno*, 8 A.D.3d 77, 778 N.Y.S.2d 482 (1st Dep't 2004) (Upholding dismissal of claims against the surety, because "plaintiff's failure to comply with the notice provisions of the performance bond issued by [the surety]

price to the surety or to a contractor selected to perform.

The owner must satisfy all of these conditions. To trigger the surety's obligations, the owner must not itself be in default⁶ and must properly follow the contract termination procedure after giving the contractor and surety whatever opportunity to "cure" the deficiencies upon which the owner relies to terminate the bonded contract that are mandated by the contract documents and the applicable law.⁷

precludes it from not maintaining this action for damages against the bond surety. Contrary to plaintiff's contention that these notice provisions are not conditioned precedent to recovery against the surety, this bond mandates that predefault notification be given to the contractor and surety by the owner.").

⁶AIA A312 Bond ¶¶ 12.3 and 12.4 define "default" as follows:

Contractor Default: Failure of the Contractor, which has neither been remedied nor waived, to perform or otherwise to comply with the terms of the Construction Contract.

Owner Default: Failure of the Owner, which has neither been remedied nor waived, to pay the Contractor as required by the Construction Contract or to perform and complete or comply with the other terms thereof.

Failure of an obligee to provide the extra 15-day cure notice under the A312 performance bond prior to hiring its own completion contractor may discharge the surety from liability on the performance bond. See *Tishman Westwide Const. LLC v. ASF Glass, Inc.*, 33 A.D.3d 539, 823 N.Y.S.2d 71 (1st Dep't 2006).

The AIA Document A312-1984, Performance Bond (1984) was updated in 2010 by the American Architect's issuance of AIA Document A312-2010, Performance Bond (2010). The principal differences between the 2010 and 1984 AIA Performance Bond forms are as follows: (1) providing that so long as the obligee provided the contractor and surety with notice that it is "considering declaring a contractor default," the obligee's request for a conference with the surety is not a "condition precedent" to the surety's obligations, but the surety had the right to request such a conference if the owner did not call one; and (2) confirming in Section 8 that the surety's liability for damages in arranging for completion of the bonded contract, with the exception of its own takeover of the work, is limited to the amount of the bond. In the AIA Document A312-2010, Performance Bond, the definitions of "default" are found in §§ 14:3 and 14:4.

See also *Gulf Liquids New River Project, LLC v. Gulsby Engineering, Inc.*, 356 S.W.3d 54 (Tex. App. Houston 1st Dist. 2011) (barring an owner's recovery against a performance bond surety, because the owner was in default itself by having failed to properly pay the bonded contractor).

⁷See *U.S. ex rel. Platinum Mechanical, LLC v. U.S. Sur. Co.*, 2007 WL 4547849 (S.D. N.Y. 2007) (holding that the obligee's failure to satisfy the explicit notice requirement set forth in the A312-1984 bond precluded the obligee's recovery against the surety).

See also *Donald M. Durkin Contracting, Inc. v. City of Newark*, 2006 WL 2724882 (D. Del. 2006) (letter was not a proper 7-day contract termination notice); *New Viasys Holdings, LLC v. Hanover Ins. Co.*, 2007 WL 783179 (E.D. Va. 2007) (notice of default to surety was untimely); *Tishman Westwide Const. LLC v. ASF Glass, Inc.*, 33 A.D.3d 539, 823 N.Y.S.2d 71 (1st Dep't 2006) (surety discharged by obligee's failure to provide 15-day cure notice); *Current Builders of Florida, Inc. v. First Sealord Sur., Inc.*, 984 So. 2d 526 (Fla. 4th DCA 2008)

The A312 Bond affords the surety a wide array of options following the triggering of its liability.⁸ These options allow the

(same); *Hunt Const. Group, Inc. v. National Wrecking Corp.*, 542 F. Supp. 2d 87 (D.D.C. 2008), *aff'd* on other grounds, 587 F.3d 1119 (D.C. Cir. 2009) (same); *Memphis-Shelby County Airport Authority v. Illinois Valley Paving Co.*, 2007 WL 2904539 (W.D. Tenn. 2007) (surety discharged by obligee's failure to provide 10-day cure notice); *CC-Aventura, Inc. v. Weitz Co., LLC*, 2008 WL 2937856 (S.D. Fla. 2008), *aff'd*, 492 Fed. Appx. 54 (11th Cir. 2012) (letter deficient to inform surety of contractor's default and trigger the surety's obligation, where the letter merely advises the contractor of corrective action).

See also *East 49th Street Development II v. Prestige Air & Design, LLC*, 33 Misc. 3d 1205(A), 938 N.Y.S.2d 226 (Sup 2011) (rejecting an obligee's claim under an AIA A312 Performance Bond because the obligee failed to trigger the surety's bond liability by not complying strictly with the bond's preconditions); *Town of Plainfield v. Paden Engineering Co., Inc.*, 943 N.E.2d 904 (Ind. Ct. App. 2011) (rejecting an obligee's claim under an AIA A312 performance bond due to the claimant's failure to comply with the bond's condition precedent of giving the surety timely notice of the principal's default, and opining, in rebuttal to the obligee's assertion that the surety should be obliged to prove actual prejudice from the obligee's noncompliance, that late notice created a rebuttable presumption of prejudice which the obligee had the burden to rebut); *Stonington Water Street Assoc., LLC v. Hodess Bldg. Co., Inc.*, 792 F. Supp. 2d 253 (D. Conn. 2011) (holding that the obligee's failure to terminate the principal's contract, failure to obtain the surety's consent to retaining a completion contractor, and failing to obtain the surety's approval to its use of the remaining contract balance, constituted material breaches of the AIA 312 performance bond which discharged the surety from its bonded obligation).

⁸See the AIA Document A312-1984, Performance Bond, ¶¶ 4 and 5:

When the Owner has satisfied the conditions of Paragraph 3, the Surety shall promptly and at the Surety's expense take one of the following actions:

Arrange for the Contractor, with consent of the Owner, to perform and complete the Construction Contract; or

Undertake to perform and complete The Construction Contract itself, through its agents or through independent contractors; or

Obtain bids or negotiated proposals from qualified contractors acceptable to the Owner for a contract for performance and completion of the Construction Contract, arrange for a contract to be prepared for execution by the Owner and the contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract, and pay to the Owner the amount of damages as described in Paragraph 6 in excess of the Balance of the Contract Price incurred by the Owner resulting from the Contractor's default; or

Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances:

After investigation, determine the amount for which it may be liable to the Owner and, as soon as practicable after the amount is determined, tender payment therefor to the Owner; or

Deny liability in whole or in part and notify the Owner citing reasons therefor.

If the Surety does not proceed as provided in Paragraph 4 with reasonable promptness, the Surety shall be deemed to be in default on this Bond 15 days after receipt of an additional written notice from the Owner to the Surety

surety:

1. To arrange for completion by arranging for the contractor with the consent of the owner to continue to perform the contract, a remedy utilized when the surety's financing of the contractor may be advantageous;
2. Take over and complete the contract itself;
3. Tender to the owner a substitute contractor under contract terms and with new bonds acceptable to the owner and payment to the owner of any excess costs of completion up to the penal sum of the bond;
4. Seek to "buy back" the bond by tendering payment to the owner "the amount for which it may be liable to the owner"; or
5. Deny liability in whole or in part with notification to the owner of the reasons therefore.

If the surety exercises options (1) or (3), the surety's liability is limited to the amount of the bond, and the owner is obliged to utilize the balance of the contract price for mitigation of costs and damages. If the surety exercises option (2), the surety's liability is not limited to the bond amount.⁹ If the surety exercises option (5), the surety's liability typically is limited to the amount of the bond.¹⁰

The surety's liability is limited to the liability of the contractor under the bonded contract.¹¹ The bond extends coverage to: (1)

demanding that the Surety perform its obligations under this Bond, and the Owner shall be entitled to enforce any remedy available to the Owner. If the Surety proceeds as provided in Subparagraph 4.4, and the Owner refuses the payment tendered or the Surety has denied liability, in whole or in part, without further notice the Owner shall be entitled to enforce any remedy available to the Owner.

Under the AIA Document A312-2010, Performance Bond (2010), the same language found in §§ 4 and 5 of the 1984 bond form is found in §§ 5 and 6 of the 2010 bond form.

⁹See § 12:80. See also *Employers Mut. Cas. Co. v. United Fire & Cas. Co.*, 682 N.W.2d 452 (Iowa Ct. App. 2004) ("When a surety takes over performance of a contract, the surety's liability is no longer limited by the amount of the bond.").

¹⁰See § 12:22. See also *Employers Mut. Cas. Co. v. United Fire & Cas. Co.*, 682 N.W.2d 452 (Iowa Ct. App. 2004) ("When the surety refuses to perform the contract after the principal defaults, the surety is liable to the owner for the damages caused by the contractor's default but only up to the penal sum of the bond.").

¹¹See AIA Document A312-1984, Performance Bond ¶ 6 (1984):

After the Owner has terminated the Contractor's right to complete the Construction Contract, and if the Surety elects to act under Subparagraph 4.1, 4.2, or 4.3 above,

postcompletion correction of defective work¹² and (2) delay damages, both of which have been items of controversy under less definitive bonds.¹³

The surety's liability is limited to the liability of the contractor under the bonded contract.

The surety's liability under the A312 Bond includes correction of defective work, completion of the contract, additional legal, design professional, and delay costs resulting from the contractor's default, liquidated or actual damages caused by delayed performance or nonperformance, and any costs resulting from "the actions or failure to act of the surety under paragraph 4."¹⁴ The

then the responsibilities of the Surety to the Owner shall not be greater than those of the Contractor under the Construction Contract, and the responsibilities of the Owner to the Surety shall not be greater than those of the Owner under the Construction Contract. To the limit of the amount of this Bond, but subject to commitment by the Owner of the Balance of the Contract Price to mitigation or costs and damages on the Construction Contract, the Surety is obligated without duplication for:

The responsibilities of the Contractor for correction of defective work and completion of the Construction Contract;

Additional legal, design professional and delay costs resulting from the Contractor's Default, and resulting from the actions or failure to act of the Surety under Paragraph 4; and

Liquidated damages, or if no liquidated damages are specified in the Construction Contract, actual damages caused by delayed performance or nonperformance of the Contractor.

Under the AIA Document A312-2010, Performance Bond (2010), § 7 contains the substance of the terms of § 6 in the 1984 bond form.

¹²See AIA Document A201-2007, General Conditions of Contract for Construction ¶ 12.2 (2007), which covers "correction of work" both prior to and within one year following substantial completion.

¹³See § 12:35. See *International Fidelity Insurance Company v. County of Rockland*, 98 F. Supp. 2d 400 (S.D. N.Y. 2000) (penal sum does not limit surety's exposure for delay damages where the delay caused by the surety's failure to fulfill its obligations in a timely manner); *Mycon Const. Corp. v. Board of Regents of State*, 755 So. 2d 154 (Fla. 4th DCA 2000) ("Because the performance bond contains no provision for damages for delay, the surety cannot be held liable for such damages . . . [The delay] was not related to any breach of duty by the surety. Any delay in payment by the surety is covered by interest."); *St. Paul Fire & Marine Ins. Co. v. City of Green River, Wyo.*, 93 F. Supp. 2d 1170 (D. Wyo. 2000), *aff'd*, 6 Fed. Appx. 828 (10th Cir. 2001) (surety not required to complete project by construction contract's completion date; instead surety to proceed with "reasonable promptness."). See also *Consolidated Elec. & Mechanicals, Inc. v. Biggs General Contracting, Inc.*, 167 F.3d 432 (8th Cir. 1999) (Miller Act payment bond surety liable for delay damages but was not responsible for lost profits); *U.S. Fidelity and Guar. Co. v. West Rock Development Corp.*, 50 F. Supp. 2d 127 (D. Conn. 1999) (contract provision reducing contract sums if work not completed on time limited the amount of delay damages recoverable from surety).

¹⁴The surety's dilatory behavior has, on occasion, exposed it to liability

bond therefore reasserts the primacy of the limitation of the bond amount as a cap on the surety's liability for any breach of the bond, and in exchange, grants to the obligee the right to be protected for specified consequential delay and other damages.¹⁵

The owner is precluded from asserting claims against the bond or setting off against unpaid contract funds any obligations of the contractor unrelated to the bonded contract. Only the owner or its "heirs, executors, administrators or successors" have the right to enforce the bond.¹⁶ Paragraph 7 provides:

The Surety shall not be liable to the Owner or others for obligations of the Contractor that are unrelated to the Construction Contract, and the Balance of the Contract Price shall not be reduced or set off on account of any such unrelated obligations. No right of action shall accrue on this Bond to any person or entity other than the Owner or its heirs, executors, administrators or successors.

The surety expressly waives the owner's obligation to notify

above its penal sum. This result can occur without resorting to tort theories. See *International Fidelity Insurance Company v. County of Rockland*, 98 F. Supp. 2d 400 (S.D. N.Y. 2000) (surety responsible for delay damages above penal limit as those damages were caused by the surety's failure to timely fulfill its bond obligations and were not due to its principal's failures).

¹⁵AIA Document A201-2007, General Conditions of Contract for Construction ¶ 15.1.6 (2007) provides for a waiver of all consequential damages as follows:

15.1.6 Claims for Consequential Damages. The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes:

.1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and

.2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Subparagraph 15.1.6 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

Since the surety's liability is coextensive with that of the contractor under the bonded contract, the mutual waiver by the owner and contractor of the right to claim consequential damages should limit the surety's liability for such damages as well.

¹⁶See AIA Document A312-1984, Performance Bond ¶ 7 (1984):

The Surety shall not be liable to the Owner or others for obligations of the Contractor that are unrelated to the Construction Contract, and the Balance of the Contract Price shall not be reduced or set off on account of any such unrelated obligations. No right of action shall accrue on this Bond to any person or entity other than the Owner or its heirs, executors, administrators or successors.

Under the AIA Document A312-2010, Performance Bond (2010), § 9 contains the same language found in § 7 of the 1984 Performance Bond form.

the surety of contract change orders in the A312 Performance Bond, which provides in paragraph 8 that: “The Surety hereby waives notice of any change, including changes of time, to the Construction Contract or to related subcontracts, purchase orders and other obligations.”

This assumes that the change orders are issued “within the general scope of the contract” so as not to constitute a breach of contract that would cause the owner to be in default.¹⁷

The A312 Performance Bond affords the obligee two years in which to commence suit against the surety, measured from the date of contractor default or the date the contractor ceased work or the date the surety refused or failed to perform its obligations, whichever occurred first.¹⁸

When the A312 Bond is given in compliance with a statutory or other legal requirement, the bond will be construed in conformance with the statutory legal requirement.¹⁹

This, of course, means that the scope of bond coverage as well as the procedural requirements for pursuing the surety may be

¹⁷See AIA Document A201-2007, General Conditions of Contract for Construction ¶ 7.3.1 (2007) (authorizing “changes in the work within the general scope of the contract”); *In re Liquidation of Union Indem. Ins. Co. of New York*, 220 A.D.2d 339, 632 N.Y.S.2d 788 (1st Dep’t 1995) (discharging a surety from its performance bond obligation because two change orders were issued that nearly doubled the original contract price and thus were deemed “material alteration” of the bonded contract to which the surety had not consented); see also *Hancock Electronics Corp. v. Washington Metropolitan Area Transit Authority*, 81 F.3d 451 (4th Cir. 1996); *Airprep Technology, Inc. v. U.S.*, 30 Fed. Cl. 488, 39 Cont. Cas. Fed. (CCH) ¶ 76634 (1994); *C. Norman Peterson Co. v. Container Corp. of America*, 172 Cal. App. 3d 628, 218 Cal. Rptr. 592 (1st Dist. 1985).

¹⁸See AIA Document A312-1984 Performance Bond ¶ 9 (1984):

Any proceeding, legal or equitable, under this Bond may be instituted in any court of competent jurisdiction in the location in which the work or part of the work is located and shall be instituted within two years after Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under this Bond, whichever occurs first. If the provisions of this Paragraph are void or prohibited by law, the minimum period of limitation available to sureties as a defense in the jurisdiction of the suit shall be applicable.

Under the AIA Document A312-2010, Performance Bond (2010), § 11 contains the same language found in § 9 of the 1984 Performance Bond form.

¹⁹See AIA Document A312-1984 Performance Bond ¶ 11 (1984):

When this Bond has been furnished to comply with a statutory other legal requirement in the location where the construction was to be performed, any provision in this Bond conflicting with said statutory or legal requirement shall be deemed deleted herefrom and provisions conforming to such statutory or other legal requirement shall be deemed incorporated herein. The intent is that this Bond shall be construed as a statutory bond and not as a common law bond.

Under the AIA Document A312-2010, Performance Bond (2010), § 13 contains the same language found in § 11 of the 1984 Performance Bond form.

limited to that dictated by statute.²⁰ In many jurisdictions, however, where the scope of the bond obligations or time for commencement of suit set forth in the bond itself is broader than that required by statute, the language of the bond will be enforced as a voluntary grant of protection in excess of that required by statute.²¹

**§ 12:17 Types of performance bond obligations—
ConsensusDOCS performance bond**

A new family of standard form industry documents known as “ConsensusDOCS” was published in 2007 to compete with the standard form documents of the American Institute of Architects and other organizations. The publication of the ConsensusDocs was endorsed and supported by the major industry associations of American owners, contractors, subcontractors, and sureties.¹ In this new document family is ConsensusDOCS 260 Performance Bond and ConsensusDOCS 706 Subcontract Performance Bond have important differences in comparison with the AIA A312 Performance Bond as follows:

1. The “meeting” obligation in AIA A312 ¶ 3.1 is deleted, al-

²⁰See, for example, the important case of *A.C. Legnetto Const., Inc. v. Hartford Fire Ins. Co.*, 92 N.Y.2d 275, 680 N.Y.S.2d 45, 702 N.E.2d 830 (1998), in which a common-law bond is defined as a bond required solely by the contract whereas a statutory bond is that furnished pursuant to statute or other law.

²¹See *Nelson Roofing & Contracting, Inc. v. C. W. Moore Co.*, 310 Minn. 140, 245 N.W.2d 866 (1976); *Reliance Ins. Co. v. Trane Co.*, 212 Va. 394, 184 S.E.2d 817 (1971); but see *Transamerica Ins. Co. v. Housing Authority of City of Victoria*, 669 S.W.2d 818 (Tex. App. Corpus Christi 1984), writ refused n.r.e., (Sept. 19, 1984). See, generally, O’Connor, Jr., *Statutory Bonds or Common-Law Bonds: The Public-Private Dilemma*, 29 *Tort & Ins. L.J.* 77 (1993).

[Section 12:17]

¹The endorsing and sponsoring organizations included Associated Building Contractors (ABC), Associated General Contractors of America (AGC), Associated Specialty Contractors, Inc. (ASC), American Subcontractors Association, Inc. (ASA), Construction Owners Association of American (COAA), Construction Industry Round Table (CIRT), Construction Users Round Table (CURT), Finishing Contractors Association (FCA), Lien Concrete Institute (LCI), Mechanical Contractors Association of America (MCAA), National Association of State Facilities Administrators (NASFA), National Association of Surety Bond Producers (NASBP), National Electrical Contractors of America (NECA), National Insulation Contractors Association (NICA), National Roofing Contractors Association (NRCA), National Subcontractors Alliance (NSA), Painting and Decorating Contractors of America (PDCA), Plumbing-Heating-Cooling Contractors National Association (PHCC), Sheet Metal and Air-Conditioning Contractors National Association (SMACNA), and The Surety & Fidelity Association of America (SFAA). The bond forms were endorsed by all sponsoring parties except LCI, MCAA, and SMACNA.

though a declaration of default by the obligee still is required. The ConsensusDOCS 260 form thus is more like the AIA A311-1970 Bond Form.

2. The surety's liability is limited to "completion of the construction work," as distinguished from the more expansive liability under the AIA A312-1984 Bond for additional legal, design professional costs, delay costs, liquidated damages, and correction of defective work.
3. The duration of surety liability is limited to a two-year period accruing upon default of the contractor or substantial completion of the work, whichever is first, whereas the AIA A312-1984 Bond affords the obligee two years from the first of three accrual points, namely, the date of contractor default, the date the contractor ceased work, or the date the surety refused or failed to perform.
4. The time for commencement of suit is limited to two years after substantial completion of the work, whereas the AIA A312-1984 Bond limitation is "within two years after the contractor ceased working."

§ 12:18 Types of performance bond obligations— "Indemnity bond"

Under an "indemnity bond,"¹ the surety's performance obligation is limited to reimbursing the obligee up to the penal sum of

[Section 12:18]

¹The most common indemnity bond is the Federal Government's Standard Form 25 Performance Bond (January 1009), 48 C.F.R. § 53.228, which provides simply for "payment" up to the penal sum. The bond does not expressly grant to the surety the right to cure a default by takeover and completion, or by tender of another contractor, although such options are frequently considered by contracting officers. The private sector also has employed indemnity bonds. See *Winston Corp. v. Continental Cas. Co.*, 508 F.2d 1298 (6th Cir. 1975). For a case that comes close to construing an AIA-A311 performance bond as more in the nature of an indemnity bond see *Walter Concrete Const. Corp. v. Lederle Laboratories*, 99 N.Y.2d 603, 758 N.Y.S.2d 260, 788 N.E.2d 609 (2003):

Surety bonds—like all contracts—are to be construed in accordance with their terms. Unlike the AIA-312 bond, another industry standardized bond, an action on the AIA-311 bond is not tied to a declaration of default, the principal's cessation of work or the surety's refusal to perform under the bond. Rather, an action on the AIA-311 need only be commenced within two years from the date on which final payment under the contract is due. Had the parties to the contract desired notice of default as a precursor to liability under the bond, they could have elected to issue the more specific AIA-312, which by its terms requires predefault notification be given to the contractor and surety by the owner.

The bond permits [the subcontractor's surety] to complete [the subcontractor's] contract on its own, or through another contractor after a default declaration by [the contractor]. However, the bond also acknowledges that [the subcontractor's

the bond for any cost of completion of the bonded contract in excess of contract funds remaining unpaid at the time of contract termination.² An indemnity bond exposes the surety to increased risk created by its lack of control over the obligee's completion of the contract and incurrence of completion costs.³ Moreover, broad

surety] will pay "other costs and damages for which [the surety] may be liable hereunder" up to the limit of liability for the bond. Thus, the bond clearly anticipates liability for damages caused by [the subcontractor] even if those damages could have been avoided by assumption of [the subcontractor's] obligation under the subcontract.

See also *Nova Cas. Co. v. Turner Const. Co.*, 335 S.W.3d 698 (Tex. App. Houston 14th Dist. 2011) (construing an AIA A311 performance bond as requiring the obligee, to trigger the surety's performance obligation, only to notify the surety of its principal's default without having to terminate the bonded contract).

²See *Quinn Const., Inc. v. Skanska USA Bldg., Inc.*, 2008 WL 5187391 (E.D. Pa. 2008) (construing liability under an indemnity subcontract bond that required the subcontractor and its surety to "indemnify and hold harmless [contractor and owner] from any loss, liability, cost, damage, or expense, including attorney's fees, by reason of the failure of performance as specified"); *John A. Russell Corp. v. Fine Line Drywall, Inc.*, 2008 WL 501273 (D. Vt. 2008) (citing treatise, and opining that "without adequate notice of default, a surety may be prejudiced in its ability to choose the appropriate remedy. The bond in this case did not provide the surety with any remedies excepting payment of cost."). See also *Bossier Medical Properties v. Abbott and Williams Const. Co. of Louisiana, Inc.*, 557 So. 2d 1131, 1134 (La. Ct. App. 2d Cir. 1990) in which the surety's obligation under an indemnity bond was expressed as follows:

Now, therefore, the condition of this obligation is such that, if the Principal shall faithfully perform the work as specified in the contract on his part, and shall fully indemnify and save harmless the obligee, from all costs and damage which the obligee may suffer by reason of a failure to do so and shall fully reimburse and repay the Obligee all outlay and expense which the Obligee may incur in making good any such default, and shall pay all persons who have contracts directly with the principal for labor or materials, then this obligation shall be null and void, otherwise it shall remain in full force and effect.

³Although completion costs must be "reasonable," the compensated surety's burden in proving unreasonableness has been heavy. See *Prudence Co. v. Fidelity & Deposit Co. of Maryland*, 297 U.S. 198, 56 S. Ct. 387, 80 L. Ed. 581 (1936), amended on other grounds, 298 U.S. 642, 56 S. Ct. 935, 80 L. Ed. 1374 (1936) (holding bond indemnification obligation extended to cost of completion, diminution in value for inferior work, interest on the investment there and insurance). Upon the contractor's default, the owner ordinarily is not obliged to award the completion contract on the basis of competitive bidding and is not required to prove that its costs were the lowest possible. See *Schmidt Bros. Const. Co. v. Raymond Y.M.C.A. of Charles City*, 180 Iowa 1306, 163 N.W. 458 (1917) (owner "not required to submit the cost of completing the structure to competitive bidders, nor to complete the same at the lowest possible cost, but had the right to expend such sum for labor and material as was fairly and reasonably necessary to complete the structure in accordance with the contract and the plans and specifications of the architect"); *Continental Realty Corp. v. Andrew J. Crevolin Co.*, 380 F. Supp. 246 (S.D. W. Va. 1974). Compare *Dooley*

indemnity language sometimes found in indemnity bonds may be construed to require the surety to indemnify the obligee for a variety of consequential damages, including delay damages and lost profits.⁴ One advantage for the surety of the indemnity bond is said to be that the surety is not exposed to liability to third-party beneficiaries because the obligation is limited solely to indemnification of the obligee,⁵ unless the indemnification language is deemed broad enough to cover such liability.⁶

**§ 12:19 Types of performance bond obligations—
“Indemnity bond”—Federal Standard Form 25
Performance Bond**

Contrary to the A312 Performance Bond, the Federal Standard Form 25 Performance Bond is a type of statutory indemnity bond that simply provides for “payment” as the only performance option.¹ This bond form has left to the Miller Act,² federal regulations, and courts and boards of contract appeal the task of defin-

and Mack Constructors, Inc. v. Developers Sur. and Indem. Co., 972 So. 2d 893 (Fla. 3d DCA 2007) (holding that the triggering conditions precedent of the surety’s subcontract bond were modified by the terms of the bonded subcontract incorporated by reference in the bond so as to afford the contractor the options either to declare the subcontractor’s surety in default or to take over the work and complete the work itself and charge the surety for the cost of completion).

⁴See *Bossier Medical Properties v. Abbott and Williams Const. Co. of Louisiana, Inc.*, 557 So. 2d 1131, 1135 (La. Ct. App. 2d Cir. 1990) (holding surety liable to compensate the obligee for lost rents caused by construction delays where the bond contained broad indemnity language). See also *Capua v. W. E. O’Neil Const. Co.*, 67 Ill. 2d 255, 10 Ill. Dec. 216, 367 N.E.2d 669, 670–671 (1977); *People v. Westchester Colprovia Corp.*, 1 A.D.2d 724, 147 N.Y.S.2d 185, 187 (3d Dep’t 1955).

⁵See *American Radiator & Standard Sanitary Corp. v. Forbes*, 259 F.2d 147 (9th Cir. 1958); *Transamerica Premier Ins. Co. v. Ober*, 894 F. Supp. 471, 40 Cont. Cas. Fed. (CCH) ¶ 76850 (D. Me. 1995); *Sun Ins. Co. of New York v. Diversified Engineers, Inc.*, 240 F. Supp. 606, 611, 51 Lab. Cas. (CCH) ¶ 31697 (D. Mont. 1965); *Bourrett v. W. M. Bride Const. Co.*, 248 Iowa 1080, 84 N.W.2d 4 (1957).

⁶See *Camelot Excavating Co., Inc. v. St. Paul Fire and Marine Ins. Co.*, 410 Mich. 118, 301 N.W.2d 275 (1981) (overruled on other grounds by *Rory v. Continental Ins. Co.*, 473 Mich. 457, 703 N.W.2d 23 (2005)); see also *U.S. for Use and Benefit of Blount Fabricators, Inc. v. Pitt General Contractors, Inc.*, 769 F. Supp. 1016, 37 Cont. Cas. Fed. (CCH) ¶ 76214 (E.D. Tenn. 1991); *U. S. for Use of Edward Hines Lumber Co. v. Kalady Const. Co.*, 227 F. Supp. 1017 (N.D. Ill. 1964).

[Section 12:19]

¹C.F.R. §§ 53.282(b), 53.301-25. Although Standard Form 25 is in form an indemnity bond, government contracting officers are authorized to consider options allowing the surety to arrange completion. See C.F.R. §§ 49.400 to 49.406.

ing the scope of the surety's obligations.³ Although written as a pure indemnity bond for "payment of the penal sum," the surety's options upon default are whatever the government agrees to accept.⁴

§ 12:20 Types of performance bond obligations— "Completion bond"

Under a "completion bond," the surety's performance obligation is limited to a single option: to take over the work and complete the contract at the sole expense of the surety. The completion bond is a favorite of lenders who finance private construction and frequently seek to shift responsibility for financing completion of

The Standard Form 25 Indemnity Bond reads:

OBLIGATION

We, the Principal and Surety(ies), are firmly bound to the United States of America (hereinafter called the Government) in the above penal sum. For payment of the penal sum, we bind ourselves, our heirs, executors, administrators, and successors, jointly and severally. However, where the Sureties are corporations acting as co-sureties, we, the Sureties, bind ourselves in such sum "jointly and severally" as well as "severally" only for the purpose of allowing a joint action or actions against any or all of us. For all other purposes, each Surety binds itself, jointly and severally with the Principal, for the payment of the sum shown opposite the name of the Surety. If no limit of liability is indicated, the limit of liability is the full amount of the penal sum.

CONDITIONS:

The Principal has entered into the [bonded contract].

THEREFORE:

The above obligation is void if the Principal

(a)(1) Performs and fulfills all the undertakings, covenants, terms, conditions, and agreements of the contract during the original term of the contract and any extensions thereof that are granted by the Government, with or without notice to the Surety(ies), and during the life of any guaranty required under the contract and (2) performs and fulfills all the undertakings, covenants, terms conditions, and agreements of any and all duly authorized modifications of the contract that hereafter are made. Notice of those modifications to the Surety(ies) are waived.

(b) Pays to the Government the full amount of the taxes imposed by the Government, if the said contract is subject to the Miller Act, (40 U.S.C.A. § 270a to 270e), which are collected, deducted, or withheld from wages paid by the Principal in carrying out the construction contract with respect to which this bond is furnished.

²40 U.S.C.A. § 270a. The Miller Act expressly provides that the performance bond indemnity obligation includes payment of the contractor's unpaid withholding and FICA taxes. See 40 U.S.C.A. § 270a(d). See *U.S. v. American Druggists' Ins. Co.*, 627 F. Supp. 315 (D. Md. 1985) (Miller Act performance bond surety liability for taxes).

³See Gavin et al., *Public Works Projects*, in *Bond Default Manual* (3d ed. 2005).

⁴See *Aetna Cas. and Sur. Co. v. U.S.*, 845 F.2d 971, 34 Cont. Cas. Fed. (CCH) P 75476 (Fed. Cir. 1988).

the project to the surety after a contractor breach of the bonded contract has caused a default under the loan agreement.¹ Such an unconditional completion bond is an anathema to sureties and rarely is accepted without significant qualification to require the obligee and its lenders to continue funding completion with funds remaining unpaid under the bonded contract. The completion bond typically names the owner as obligee and its construction lender as a “co-obligee,” thus giving both the owner and construction lender the right to enforce the bond.² The completion bond ordinarily is written by the construction lender, and its execution by the surety and principal is demanded as a condition of the lender’s agreement to provide construction financing to the obligee.

The completion bond proposed by lenders typically imposes no obligation upon the lender, after default of either the owner or the principal, to continue advancing funds under its loan agreement to facilitate the surety’s completion of the contract. Without the construction lender’s obligation to continue advancing funds under its loan agreement, the surety would be obliged to utilize its own funds for completion without recourse to funds under the loan agreement and thus would become an unwilling equity investor subordinated to the rights of the lender in the construction project.³ To remedy this risk, sureties often require both the owner and any lenders named as “dual obligees” to be bound by a

[Section 12:20]

¹The other bond of choice for lenders is a broad indemnity bond. See *Prudence Co. v. Fidelity & Deposit Co. of Maryland*, 297 U.S. 198, 56 S. Ct. 387, 80 L. Ed. 581 (1936), amended on other grounds, 298 U.S. 642, 56 S. Ct. 935, 80 L. Ed. 1374 (1936) (holding lender to be indemnified by the surety bond upon default of the principal for costs of completion diminution in value of uncorrected inferior substitutions and delay, including interest, taxes and insurance).

²See *Trainor Co. v. Aetna Casualty & Surety Co.*, 290 U.S. 47, 52, 54 S. Ct. 1, 78 L. Ed. 162 (1933).

³See Trecker, *Bonding a Project: Issues and Trends in Anticipating the Preventable: Identifying and Managing Project Risk* (unpublished paper, January 21, 1999):

True completion bonds are financial guarantees generally written in favor of lenders which guarantee a completed lien free project, but do not require payment by the lender or any other parties for completion of the improvement. Completion bonds do not require the beneficiary to perform any specific obligations such as payment to the contractor or compliance with contract documents as conditions precedent to surety liability. Completion bonds are generally an excluded or restricted class of business under conventional surety reinsurance treaties, are underwritten with collateral, if at all, and are more expensive than conventional performance bonds.

“continuing flow of money” clause⁴ that obligates them jointly and severally to perform the obligee’s duties under the terms and conditions of the bonded contract and to pay the surety the unpaid balance of contract funds in conformance with the terms of a bonded contract.

By tying the construction lender to the performance of the owner’s obligations under the bonded contract, the construction lender becomes the guarantor of the owner’s performance of its obligations under the bonded contract, including making prompt and timely payment to the principal or, upon the principal’s default and termination, to the surety.⁵ Even a “continuing flow of money” clause, however, will not permit the surety to escape liability to a lender⁶ or unpaid laborers or materialmen⁷ based on misrepresentations made by the owner obligee, as to which the lender or other third-party claimants were innocent.

§ 12:21 Types of performance bond obligations— “Manuscript bond”

Unique among performance bond types is the tailored “manuscript” combined obligations bond that frequently is prepared by large owners intent on shifting to the surety and contractor as

⁴Trecker, *Bonding a Project: Issues and Trends in Anticipating the Preventable: Identifying and Managing Project Risk* (unpublished paper, January 21, 1999), at 24. The continuing flow of money clause is attached to the dual obligee bond by a rider that typically provides as follows:

Provided, HOWEVER, there shall be no liability under this bond to the obligees, or any of them, unless the said obligees, or any of them, shall make payments to the principal (or upon the principal’s default and termination to the surety) strictly in accordance with the terms of said contract as to payments, and shall perform all other obligations to be performed under said contract at the time and in the manner therein set forth; all of the acts of one obligee being binding on the other(s). The obligee and additional obligee(s) understand and by acceptance of this rider acknowledge that this agreement is subject to the precedent condition that the additional obligee(s) shall have no right of action against the principal or surety except such as the original obligee would have and shall be subject to all counterclaims, offsets and defenses however arising which would be available against the original obligee.

⁵See AIA Document A201-2007, General Conditions of Contract for Construction ¶ 13.2 (2007), which allows the Owner to assign the bonded Contract to an “institutional lender” without consent of the Contractor on the condition that “the lender shall assume the Owner’s rights and obligations under the Contract Documents.”

⁶See *New Amsterdam Cas. Co. v. Bettes*, 407 S.W.2d 307 (Tex. Civ. App. Dallas 1966), writ refused n.r.e., (May 24, 1967).

⁷See *Aetna Ins. Co. v. Maryland Cast Stone Co.*, 254 Md. 109, 253 A.2d 872, 6 U.C.C. Rep. Serv. 661 (1969).

much risk as possible.¹ This type of bond written by lawyers employing a “belt and suspenders” approach to bond drafting, combines performance, indemnity, completion, and lien-free property obligations in a single instrument manuscripted to apply to specific risks. Use of such a manuscript bond can be justified where the bonded contract is negotiated and the reallocation of risks to the contractor and surety are taken into consideration in agreeing on the price of the contract and bond. In recent years, manuscript bonds have been proposed by the city of New York,² the city of Philadelphia,³ and the National Association of Attorneys General⁴ for use in connection with competitively bid public contracts. Those manuscript bonds sought to denude sureties of traditional bond defenses and traditional performance options upon default of the principal. After extended negotiations with the surety industry, each of those bond forms were materially changed or withdrawn.

**§ 12:22 Financial limit of performance bond obligation:
“Penal sum”**

The limit of the surety’s financial exposure under a performance bond is the sum stated on the face of the performance bond as the surety’s maximum liability to the obligee for completion of the contract or payment of the obligee’s actual costs of completion.¹ This sum historically has been referred to as the “penal sum” or “bond penalty”—terms which originated in earlier

[Section 12:21]

¹For an interesting example of a manuscript bond that failed to tie the surety to a critical contract milestone schedule, see *People of Porto Rico v. Title Guaranty & Surety Co.*, 227 U.S. 382, 33 S. Ct. 362, 57 L. Ed. 561 (1913). The manuscript bond was conditioned on completion of the entire contract within three years. After the contractor was terminated for failing to meet the first and second year milestones, the surety successfully avoided liability because the contractor was not then in default of its obligation to complete the bonded contract within three years.

²See Trecker, *Bonding a Project: Issues and Trends in Anticipating the Preventable: Identifying and Managing Project Risk* (unpublished paper, January 21, 1999), pp. 21, 22.

³See Trecker, *Bonding a Project: Issues and Trends in Anticipating the Preventable: Identifying and Managing Project Risk* (unpublished paper, January 21, 1999), at 19, 20.

⁴For a brief commentary on the NAAG contract documents, see § 5:7.

[Section 12:22]

¹See *Morse/Diesel, Inc. v. Trinity Industries, Inc.*, 875 F. Supp. 165 (S.D. N.Y. 1994); *Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F. Supp. 91 (D.R.I. 1993); *Board of County Sup’rs of Prince William County v. Sie-Gray*