BOND, CONTRACTUAL AND STATUTORY PROVISIONS AND THE GENERAL AGREEMENT OF INDEMNITY

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Introduction

The surety industry is a shifting landscape. Viewed daily, changes may not be apparent. However, snapshots taken every few years reveal subtle but appreciable differences.

In the ten years since the ABA TIPS Fidelity and Surety Law Committee published the Third Edition of this Manual, several court decisions have expanded the surety’s responsibilities and incrementally eroded rights that sureties have taken for granted. While the surety can act to protect its rights, a restored landscape will never be the same as the original.

The surety claims professional has several decisions to make upon receipt of a claim. This chapter provides an overview of the provisions contained in the bonds, construction contracts, statutes, and indemnity agreements that should be considered when evaluating the surety’s rights, remedies, defenses, and options upon assertion of a claim by a bond obligee.

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I. Bond Provisions

Suretyship is a “contractual relation resulting from an agreement whereby one person, the surety, engages to be answerable for the debt, default, or miscarriage of another, the principal.”1 Unlike traditional two-party insurance policies that the insurer typically drafts, “[s]uretyship is a form of credit enhancement. . . ”2 and the obligee usually chooses the bond form. In the case of a public project, the bond form is often prescribed by, or manuscripted to meet the requirements of, a statute or applicable administrative regulations.3 As a result, the provisions of a typical surety bond are favorable to the obligee and sureties usually have little or no opportunity to negotiate the terms of a contract surety bond. Either the bond is issued by the surety in the form required by the obligee or the underwriters decline issuance.

Perhaps the most common bond forms in use today are those published by the American Institute of Architects (“AIA”), which promulgates forms of bid bonds, performance bonds, and payment

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2. 4A Philip L. Bruner & Patrick J. O’Connor, BRUNER & O’CONNOR ON CONSTRUCTION LAW § 12.9 (2009); 11 NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION § 146.05 (Michael Keeley, Christopher Ward, Armen Shahinian, & Jeffrey E. Thomas eds., 2014); Pearlman v. Reliance Ins. Co., 371 U.S. 132, 140 n.19 (1962) (“suretyship is not insurance”); cf. Greystone Constr., Inc. v. Nat’l Fire & Marine Ins. Co., 661 F.3d 1272, 1288 (10th Cir. 2011) (“An insurance policy is issued based on an evaluation of risks and losses that is actuarially linked to premiums; that is, losses are expected. In contrast, a surety bond is underwritten based on what amounts to a credit evaluation of the particular contractor and its capabilities to perform its contracts, with the expectation that no losses will occur. Unlike insurance, the performance bond offers no indemnity for the contractor; it protects only the owner.”).

bonds. These forms are crafted by an association of architects, who, some might suggest, are primarily concerned with their own interests and those of the owners who retain their services. Moreover, obligees sometimes modify AIA forms to expand the surety’s liability further and/or restrict the surety’s recourse to traditional common law defenses. As one author noted:

An obligee promulgated bond form is often a product of that obligee’s most recent bad experience. If the last surety on a default did not move fast enough, the time for performance is shortened. If some loss was not covered, the next bond is changed to include that element of damage.5

Obligees may seek to alter a bond form to enlarge the surety’s liability or restrict its ability to mitigate its losses. For instance, obligees may alter bond forms by, among other things: requiring the surety to perform the bonded contract upon assertion of a claim and thereafter litigate the propriety of the termination; enlarging the obligations of the surety beyond the commitment to arrange and/or pay the net additional cost for performance of the balance of the bonded contract work; varying the burden of proof applicable to its claim; precluding the surety from utilizing its defaulted principal in the performance of the contract; or shortening the time frame within which the surety may assert any defenses.

4. The ConsensusDocs® bond forms, created by a “coalition of associations representing diverse interests in the design and construction industry that collaboratively develops and promotes standard form construction contract documents that advance the construction process,” are also utilized on a number of projects. See ConsensusDocs, https://www.consensusdocs.org/FooterSection_About/FooterSection_Coalition (last visited March 31, 2015). The Engineers Joint Contract Document Committee (“EJCDC”), a joint venture of the American Council of Engineering Companies, the National Society of Professional Engineers, and the American Society of Civil Engineers, has also promulgated a performance bond.

In addition to changes to bond forms wrought by obligees, sureties are faced with requests by third parties for not only traditional dual obligee status, but for expansive dual obligee riders that potentially increase the surety’s exposure under the bonds. A traditional dual obligee rider grants rights to a third party, ordinarily a lender, conditioned upon the satisfaction of the obligee’s obligation to make timely payment to the principal in accordance with the terms of the contract. However, some lenders seek additional protections from the surety that alter the surety’s rights and defenses.

For example, lenders may seek the right to receive independent notice and an opportunity to cure a default on the part of the obligee. Such a cure period, if unreasonably long, could effectively eviscerate any contractual right the principal may have to cease performance in the face of the obligee’s non-payment, because—in derogation of that contractual right—the surety would have continuing exposure to claims by the dual obligee, and the principal would have a corresponding indemnity obligation with respect to such claim. Moreover, by the time a principal has declared an obligee default for non-payment, there often has already been a substantial gap in payment. Requiring the principal to continue to perform without compensation during an additional cure period could lead to the principal’s financial inability to continue contract performance. Additionally, the surety would presumably have no control over whether the principal provided timely notice to the lender and yet might lose valuable defenses as to the lender under a bond form requiring such notice. Lenders may also seek to utilize the dual obligee rider to enlarge the surety’s liability, calling for such damages as attorney’s fees or consequential damages not initially contemplated in the bond and not traditionally the surety’s responsibility under a bond form requiring only that the surety either pay for or perform the work necessary to complete the bonded contract.

It has always been axiomatic that upon receipt of a claim, the surety claims professional should not assume the content of the applicable bond, contract or, for that matter, the indemnity agreement. Rather, the surety claims professional should review each of those documents

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6. Sureties also encounter requests by other non-parties to the bonded contract, such as condominium associations, seeking dual obligee status under the bonds. The extension of protection and rights to such third parties, who have no contractual obligations to the principal, is fraught with danger for the surety.
carefully at the inception of the claim, together with any applicable statutes or regulations, in light of the disparity of rights and obligations often embodied therein and the potential impact upon the surety of uncommon or obscure provisions. Adherence to this principle has become even more critical in recent years.  

The terms of the bond, like those of any other contract, establish the extent of the surety’s liability. In most jurisdictions, the “liability of a surety should not be extended by implication beyond the terms of the contract, i.e., the performance bond” and “a surety on a bond does not undertake to do more than that expressed in the bond, and has the right to stand upon the strict terms of the obligation as to his liability thereon.”

As one court has declared:

[T]he obligation of a surety is measured by the contract of surety. The surety’s obligation cannot be extended by implication or enlarged by construction beyond the terms of the suretyship agreement, in a way to include any subject or person other than expressly or necessarily implied from the suretyship contract. In other words, a surety in Florida is bound to the extent and in the manner indicated in the undertaking,

7. The surety rarely has in its possession a fully executed copy of the bond prior to the assertion of a claim against that bond. As a result, it is important to obtain from the obligee or claimant a copy of such bond to ensure that there were no changes made to the bond after the surety authorized its representative to execute it. Likewise, because the surety usually is not involved in the delivery of the bond to the obligee, it is important to obtain a copy of the bond held by the obligee to ensure that the bond was in fact delivered and thereby became effective. See 74 AM. JUR. 2D Suretyship § 16 (2014); Rachman Bag Co. v. Liberty Mut. Ins. Co., 46 F.3d 230, 238 (2d Cir. 1995); In re Muratone Co., Inc., 198 B.R. 871, 876 (E.D. Pa. 1996); but see Allied Bldg. Prod. Corp. v. J. Strober & Sons, LLC, 97 A.3d 1169, 1178 (N.J. Super. Ct. App. Div. 2014).

and no further. The Courts of Florida will not presume that the contracting parties intended to include in their agreement a provision other than, or different from, those indicated by the language used.9

This doctrine of contract interpretation is substantially different from that applicable to insurance policies when, as a rule, ambiguities are construed against the insurer. This disparity in the rules of contract interpretation is grounded in the fact that a surety bond, unlike an insurance policy, does not bear any of the elements of a contract of adhesion; notably, the surety seldom drafts the bond and the surety owes no fiduciary duty to either the principal or the obligee.10 The enforcement of the strict terms and limits of the surety’s undertaking can often have very real practical effects. Thus, it is important to disabuse an obligee, or a reviewing court, of the notion that a surety bond is akin to an insurance policy for purposes of construing the surety’s obligations and defenses.

For instance, the bond may include notice or limitations provisions that, if not complied with, operate as a complete defense to any suit or claim or suit. Generally, a reasonable contractual limitation is enforceable unless expressly prohibited by statute or contrary to public policy, even when the claimant had no knowledge of this bond provision.11 However, in some jurisdictions, specific statutes preclude parties from contractually limiting actions to a shorter time period than that established by the legislature.12

A. Bid Bond

A bid bond typically provides that if the principal is the successful bidder, but does not enter into the contract and provide performance and payment bonds, the principal and the surety are bound to pay a stated


12. See, e.g., ALA. CODE § 6-2-15 (2014); FLA. STAT. § 95.03 (2014); see also Sheehan v. Morris Irrigation, 410 N.W.2d 569, 571 (S.D. 1987).
Bond Provisions and General Indemnity Agreement

sum to the obligee. The most common form of bid bond for private contracts imposes liability upon the principal and surety in the amount of the difference between the principal’s bid and the bid of the next highest bidder, not to exceed the penal sum of the bid bond.\(^{13}\) In some jurisdictions, though, the penal sum of the bid bond is deemed liquidated damages, which are recoverable regardless of the actual damages incurred.\(^{14}\)

In the private context, when a liquidated damages provision is not reasonably related to actual damages, it would be unenforceable as a penalty.\(^{15}\) However, with respect to public construction, bid bonds are usually required and designed in accordance with a statute, and when the penal sum of the bid bond is established as a liquidated damages provision by statute, it typically will be enforced as such regardless of the actual damages incurred by virtue of the principal’s failure to execute the contract in accordance with its bid.\(^{16}\)

While the traditional surety defenses to a claim against a performance bond are seldom implicated by a claim against a bid bond, such a claim is nonetheless subject to any defenses the principal might have for relief from its obligation to enter into the contract. The most commonly litigated defense to a bid bond claim arises from the principal’s error in its bid.\(^{17}\) While contract law disfavors rescission for

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17. See generally 70 A.L.R. 2d 1370 (1960); 2 A.L.R. 4TH 991 (1980). Delay on the part of the obligee in awarding the contract may also serve as a defense to a bid bond claim when the obligee fails to notify the successful bidder of the award within the prescribed period. See, e.g., Jay Twp.
unilateral mistakes, courts have allowed bidders to rescind their bids where it would be inequitable to require the principal to perform the contract at the bid amount; where rescission is appropriate, the surety as secondary obligor is relieved of liability under its bid bond.

The four factors that the surety may explore with the principal to determine whether the principal’s mistake presents a viable defense are: (1) whether the mistake relates to a basic assumption on which the contract is made and is a mistake of fact rather than one of judgment; (2) whether enforcement of the bid would be inequitable; (3) whether the parties can be returned to the status quo, which often turns on whether the mistake was promptly discovered and communicated to the obligee; and (4) whether the mistake occurred regardless of the exercise of ordinary care. 18

The issuance of the bid bond does not generally impose an obligation upon the surety to issue performance or payment bonds. However, at least one state, pursuant to statute, requires that a bid bond be accompanied by, or serve as, a consent of surety to issue the final performance and payment bonds. 19 In those circumstances, the bid bond and consent of surety serve as a guarantee to the obligee that the principal’s surety will furnish bonds in the amount required by the contract if the bid is accepted and the successful bidder executes the contract. 20

**B. Performance Bond**

A performance bond is conditioned upon the principal’s full and faithful performance of the bonded contract. These bonds commonly contain provisions regarding such matters as: the conditions precedent to the surety’s obligation; the time period for institution of suit against the surety; the relevant venue for any such suit; the timing for notice to be provided to the surety; the surety’s performance options; the types and measure of damages for which the surety may be liable; and the surety’s maximum liability—the penal sum—for damages under the bond.

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Certain bonds set forth in detail the conduct required of—or the options available to—the surety in the event of a termination for default. For example, the most recent performance bond form published by the American Institute of Architects (the AIA A312 Performance Bond),\(^{21}\) expressly sets forth the conditions which the obligee must satisfy in the event of a default by the principal.\(^{22}\) The AIA A312-2010 Performance Bond then describes the surety’s options in the event the obligee satisfies those conditions. That bond form provides in relevant part:

3. If there is no Owner Default under the Construction Contract, the Surety’s obligation under this Bond shall arise after

1. 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 Section 3.1 shall be held within ten (10) business days of the Surety’s receipt of 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;

2. the Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety, and

3. 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.

4. Failure on the part of the Owner to comply with the notice requirement in Section 3.1 shall not constitute a failure to comply with a condition precedent to the Surety’s obligations, or release the Surety

\(^{21}\) AIA Document A312, Performance Bond (2010 Ed.).

\(^{22}\) See AIA A312 Performance Bond (2010 Ed.), Vol. II, Form 1.4
from its obligations, except to the extent the Surety demonstrates actual prejudice.\textsuperscript{23}

5. When the Owner has satisfied the conditions of Section 3, the Surety shall promptly and at the Surety’s expense take one of the following actions:

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

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

5.3 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, . . . and pay to the Owner the amount of damages as described in Section 7 in excess of the Balance of the Contract Price incurred by the Owner as a result of the Contractor Default; or

\textsuperscript{23} Under the 1984 edition of the American Institute of Architects A312 Performance Bond, see AIA A312 Performance Bond (1984 Ed.), Vol. II, Form I.3, which remains in common use, the obligee’s failure to comply with the notice and meeting requirements set forth in Paragraph 3 often proves fatal to the obligee’s claim under the bond. See, e.g., Bank of Brewton, Inc. v. Int’l Fid. Ins. Co., 827 So. 2d 747 (Ala. 2002); 120 Greenwich Dev. Assocs., LLC v. Reliance Ins. Co., No. 01 Civ. 8219, 2004 WL 1277998 (S.D.N.Y. 2004). The AIA A312-2010 Performance Bond provides that that obligee’s failure to comply with the requirements set forth under Section 3.1 (providing notice) does not constitute a failure to comply with a condition precedent to the surety’s obligation or release the surety from its obligations. However, the surety’s obligations may be reduced to the extent the surety can demonstrate that it was actually prejudiced by the obligee’s failure to comply with the requirements set forth under Section 3.1. The obligee’s obligation to provide notice to the surety that it has declared a default and terminated the bonded contract and its agreement to pay the balance of the contract price to the surety or its designated completion contractor remain conditions precedent under the AIA A312-2010 Performance Bond.
5.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances:

.1 After investigation, determine the amount for which it may be liable to the Owner and, as soon as practicable after the amount is determined, make payment to the Owner; or
.2 Deny liability in whole or in part and notify the Owner, citing reasons for denial.

Courts have fairly consistently held that the provisions set forth in paragraph 3 of the AIA A312 Performance Bond are conditions precedent to the surety’s liability and that the obligee’s failure to comply with those provisions, or failure to permit the surety to exercise its performance options, discharges the surety from liability.24 Perhaps for that reason, some obligees have sought to modify the AIA A312 Performance Bond form to eliminate or diminish the performance options available to the surety.

In addition to the AIA A312 Performance Bond, common bond forms that a surety claims professional may encounter, include:

1. AIA A311 Performance Bond;25
2. ConsensusDocs Form 260 Performance Bond26,
3. EJCDC Form C-610 Performance Bond.27
4. Standard Form 25 (rev. 8/2014) prescribed by GSA-FAR (48 C.F.R) 53.338(b).28

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27. See Vol. II, Form 1.6.
The surety claims professional will carefully review the bond to determine the obligations of the obligee and whether those obligations have been met, as well as the scope of the surety’s performance obligations and whether the breadth of its performance options has been reduced. Careful scrutiny of the bond is recommended to determine whether there has been any modification to what may otherwise appear to be a common bond form. Moreover, performance bonds invariably incorporate by reference the underlying bonded contract between the principal and the obligee. Therefore, the surety will also thoroughly review the pertinent contractual provisions before considering its options and the risks associated with each of those options. Some contractual provisions will be reviewed later in this chapter, while others will be addressed in detail in Chapter 2.

C. Payment Bond

The payment bond provides that the surety shall make payment to subcontractors, laborers, and/or suppliers who the principal did not pay. The provisions of the payment bond usually establish who may assert a claim, the time for submission of a claim, the earliest point at which suit may be instituted, the limitations period beyond which suit may not be instituted, venue for any litigation, and the penal sum. Often the language of the payment bond is based upon, or even incorporates, relevant statutory provisions, which will be addressed later in this chapter.

Examples of payment bond forms commonly encountered by surety claims professionals include:

1. AIA A312 Payment Bond (2010 Ed.);
2. AIA A312 Payment Bond (1984 Ed.);
3. AIA A311 Payment Bond;
4. ConsensusDocs Form 261 Payment Bond;
5. EJCDC Form C-615 Payment Bond.

29. See 11 NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION § 140.01 (Michael Keeley, Christopher Ward, Armen Shahinian & Jeffrey E. Thomas eds., 2014)
30. See Vol. II, Form 1.7.
32. See Vol. II, Form 1.9.
33. See Vol. II, Form 1.10.
6. Standard Form 25A (rev. 8/2014) prescribed by GSA-FAR (48 C.F.R) 53.338(c).\(^{35}\)

In responding to payment bond claims, the surety has the right to assert all of the defenses of its principal, as well as its own separate surety defenses,\(^{36}\) when applicable. Simply because a subcontractor or supplier is owed money by the principal, or may even have a judgment against the principal, does not establish liability under the payment bond. The claimant must also have complied with the notice and limitation provisions of the bond and prove that its work or materials were utilized on the bonded project or specially manufactured for the project.\(^{37}\) The subcontract and/or purchase order must be examined carefully, to confirm that the claimant has fulfilled its contractual obligations, including any warranty obligations. In addition, when the claimant has performed work on multiple projects for the principal, the account between the parties should be reviewed to ensure that payments made by the principal on bonded projects were properly credited against the bonded obligations.

Finally, the definition of “claimant” contained in the bond may also serve as a defense to a claim. The definition of claimant set forth in the payment bond or in the statute requiring that bond will not cover every vendor to whom the principal may owe money. In addition, courts have consistently rejected attempts by obligees to assert claims against the payment bond.\(^{38}\)

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\(^{35}\) See Vol. II, Form 1.12.


\(^{37}\) Under some bond forms and statutes, the claimant must prove actual incorporation of the materials into the project or consumption in furtherance of construction. See, e.g., N.J. Stat. Ann. § 2A:44-143 (2014); Poly Flex, Inc. v. Cape May County Util., 832 F. Supp. 889 (D.N.J. 1993); Miss. Woodworking Co. v. Maher, 273 S.W.2d 753, 756 (Mo. Ct. App. 1954); but see Cont’l Cas. Co. v. Allsop Lumber Co., 336 F.2d 445, 455 (8th Cir. 1964) (“It is now settled that any local lien rule requiring proof of actual incorporation into the project is not applicable to a suit on a Miller [Act] bond”).


**D. Combination Performance and Payment Bond**

Customarily, sureties issue separate performance and payment bonds with each bond subject to a separate penal sum. Occasionally, the performance bond and payment bond are issued on a single instrument, subject to a single penal sum. Courts have generally found the primary purpose of a combined performance and payment bond to be for the protection of the performance bond obligee, with the secondary purpose being the protection of laborers and suppliers entitled to assert claims by virtue of the payment guarantee set forth in the bond. Thus, when a surety receives claims from both the obligee and its principal’s subcontractors, the obligee’s claims are generally entitled to preference. In such a scenario, the surety’s exposure for claims by its principal’s subcontractors and suppliers would be reduced to the extent of payment to the obligee and they would not share pro rata with the obligee in the penal sum of the bond.

**E. Subcontractor Default Insurance**

Over the last several years, large general contractors have increasingly utilized subcontractor default insurance in lieu of requiring the more traditionally accepted performance and payment bonds from its subcontractors. Subcontractor default insurance is a two-party agreement that shifts the burden of defaulting subcontractors to an insurance company. The typical subcontractor default insurance policy provides...

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40. See Restatement (First) of Security, § 167, cmt. a (1941).


that the insurer will compensate the general contractor for losses resulting from the subcontractor’s default.

Rather than issuing individual policies on a subcontractor-by-subcontractor basis, the typical subcontractor default insurance policy covers all subcontractors on a given project or, on an annualized basis, all subcontractors across all of a given general contractor’s projects. The subcontractors covered by a subcontractor default insurance policy do not undergo the same level of scrutiny that a subcontractor seeking surety bonds would undergo in the underwriting process, e.g., background checks into the subcontractor’s qualifications and financial wherewithal.

There are key distinctions between how claims submitted under surety bonds and claims under subcontractor default insurance policies are handled. With respect to surety bonds, the surety is responsible for the resolution of claims relating to subcontractor defaults, including the payment of subcontractors and suppliers, and completion of the bonded subcontract. Subcontractor default insurance makes the general contractor responsible for resolving subcontractor default issues, although the costs of completing the work may be covered.43

Subcontractor default insurance is not intended to replace traditional surety bonds and general contractors may require certain subcontractors to procure surety bonds even though the risk of their default is also covered by a subcontractor default insurance policy. Because the policies are two-party contracts akin to typical insurance policies, they are generally interpreted in accordance with construction principles applicable to traditional insurance contracts.

II. Contractual Provisions

The bond often expressly incorporates by reference the contract it guarantees and, even if not expressly incorporated, the surety’s

43. Subcontractor default insurance policies are generally subject to high deductibles, and require that the general contractor initially advance the funds needed to resolve the subcontractor’s default. Assuming the alleged default is a covered claim, the subcontractor default insurance carrier reimburses the general contractor for the funds advanced in resolving the subcontractor default. The product is marketed to large general contractors, because smaller operations may not have the cash flow to advance large sums of money with the risk that the funds may not be reimbursed.
The obligation is typically to perform the bonded contract upon the principal’s default. Therefore, the surety claims professional will carefully consider the provisions set forth in the bonded contract between the principal and the obligee when analyzing a claim.

The surety must be alert to onerous or problematic contractual provisions set forth in the bonded contract. For instance, when the bonded contract provides that the principal is responsible for any contamination on the site, the surety may elect not to undertake completion to avoid undertaking that obligation. The surety may choose to proceed in this manner because, in some jurisdictions and under some bond forms, in the absence of an agreement between the surety and the bond obligee to the contrary, once the surety elects to respond to an obligee’s demand by undertaking performance rather than making payment, the surety is deemed to have thereby abandoned the protection of the penal sum limit of its liability. Thus, potential catastrophic exposures must be identified and all risks assessed before a decision is made which may expand the surety’s otherwise limited liability.

The surety claims professional is, at times, confronted by “design-build” contracts, which may significantly expand the responsibilities of the principal and, by extension, the completing surety. The primary distinction between design-build projects and traditional projects is that in a design-build project, the design professional is no longer the obligee’s representative, but rather partners with, or acts as a subcontractor to, the bonded principal. In some instances, the bonded principal undertakes to perform the design work itself. This distinction can substantially impact the surety’s liability. For instance, in traditional construction contracts, the obligee is responsible for design errors. When such errors cause damage to the principal, it is entitled to recover for such damages. Under a design-build contract, the bonded principal bears responsibility for such errors and, by virtue of its bond, the surety typically guarantees performance of such contractual obligation. As a practical matter, the extension of the surety’s liability beyond the


traditional “nuts and bolts” construction creates a need to identify and address potentially complex design issues at an early stage in the claims process.

Even under a traditional construction contract, the surety often encounters problematic contractual provisions that may require it to adjust the manner in which it responds to a performance bond claim. For example, the surety must be cognizant of the dispute resolution provisions of the underlying contract, which may have short deadlines for submission of claims, dictate a mandatory arbitration or mediation proceeding, waive a right to a jury trial, impose onerous cure provisions, or preclude damage for delay claims.

To the extent any underwriting review of the bonded contract occurred, it may have been limited to a determination as to whether the principal possessed the expertise to perform the general scope of work set forth therein. The underwriter is often not equipped or called upon to review all legal and technical aspects of the bonded contract thoroughly. In addition, the principal may have merely entered into the contract with unfavorable terms, just as the obligee presented it. Indeed, public obligees usually present their contracts for bidding in the proverbial “take it or leave it” manner. The surety should approach every bonded contract with a wary eye for such terms, including not only those in the body of the contract, but also those contained in the often-voluminous general and supplemental conditions, addenda, and the plans and specifications incorporated by reference into the bonded contract.

The general conditions contain important provisions, including the conditions under which either party may declare the other in breach and terminate their right or obligation of performance, as well as provisions governing notice, dispute resolution, payment, site protection and safety equipment, insurance coverage, changes to the work, time of performance and many other provisions that substantially impact the surety’s exposure and analysis upon its principal’s default. The specifications set forth how the contractor will complete the work from a technical standpoint. Not only are such contractual provisions important from the standpoint of assessing the surety’s potential liability and options, but also any relet to a completion contractor must incorporate the applicable provisions of the underlying contract, unless the surety and the obligee negotiate and agree to the contrary.

Simply because the bond incorporates the underlying bonded contract by reference does not necessarily mean that the surety is bound by all of the contract terms. The bond may contain language qualifying
or otherwise limiting the surety’s liability. To the extent there is a conflict between the bond and the bonded contract, the surety’s liability “must be measured by the condition[s] stated in the bond and ... such condition[s] cannot be construed to go further than its terms and give rights to others not mentioned either expressly or by intendment.”

A. Termination

The bonded contract customarily contains provisions for termination of the contract. When the termination is for convenience, the obligee cannot call upon the surety to complete the bonded contract and/or to assume responsibility for any damages incurred by the owner/obligee because no default has occurred triggering any obligation on the part of the surety. However, a termination for convenience may signal a problematic project, which may mean that the principal may be experiencing financial difficulties and/or payment bond claims have been or may be asserted with respect to the project. As a result, the financial resolution of a termination for convenience may interest the surety, and the surety may seek to protect itself by utilizing the “consent of surety” requirement, if one is included in the bonded contract. In any event, many obligees seek the surety’s consent before releasing retainage under the bonded contract.

Of course, the surety is more concerned with a declaration of default or a termination for cause of the bonded contract. The bonded contract often imposes certain obligations upon the obligee and/or its representatives in order to properly declare a default or terminate the contract. Those requirements should be reviewed, because the failure of the obligee to comply with those requirements or conditions may constitute a breach of the contract by the obligee and may also provide defenses to the performance bond claim against the surety.

Bases for a termination for cause often include:

1. the principal’s commission of a substantial violation of the bonded contract and, after notice from the obligee or its representative, failure to cure the violation within the time period set forth in the contract;
2. failure to supply adequate materials and/or properly skilled workers;
3. failure to promptly pay the principal’s subcontractors, suppliers and/or its workers;
4. persistent failure to comply with applicable laws, regulations, directives, etc., of a public agency or authority with jurisdiction over the project;
5. failure to complete the project in a timely fashion; and
6. adjudication of the principal to be a bankrupt or a general assignment by the principal for the benefit of its creditors or appointment of a receiver due to the principal’s insolvency.

When the obligee terminates the principal for cause, the obligee normally has the contractual right to take possession of all materials and equipment on the site and may proceed to finish the remaining work and to withhold any further funds from the principal. Generally, the principal will be liable under the bonded contract to the obligee for any excess costs to complete the project over and above the monies remaining in the contract. These termination provisions, and the remedies of the obligee upon termination, provide the framework for the claim against the surety. They may also provide a completing surety with important rights against competing claims by third parties to unpaid contract funds and/or to the materials and equipment on site, because the completing surety stands in the shoes of the obligee following the principal’s default under the bonded contract.


B. Disputes

The general conditions section of the bonded contract often provides for the method to resolve disputes, which vary widely by contract. The bonded contract may provide for an initial means to resolve disputes, such as a decision by the architect, meeting of representatives of the two parties, or a formal decision by a contracting officer or a designated public official with respect to public projects. When one of these initial procedures does not resolve the dispute, the dispute clause may then provide for resolution by mediation, arbitration, or litigation. When mediation or arbitration is set forth, the contract frequently designates a certain association or organization, such as the American Arbitration Association, as the binding decision maker. When litigation is designated, the general conditions often set forth requirements such as venue and whether or not a party may request a jury. Regardless of which mode of dispute resolution is designated, the bonded contract often contains the notice, conditions precedent, and time parameters in connection with the commencement of a dispute resolution proceeding. Failure to adhere to these provisions may result in a waiver or forfeiture of rights.51

Some courts have indicated that the result of an arbitration proceeding or litigation as to which the surety has notice may be binding upon the surety regardless of whether the surety participates, at least as to the scope of the principal’s liability under the contract.52 In addition, some courts have held that when a bond provides for dispute resolution in court and a contract provides for arbitration, the surety may be compelled to arbitrate.53 Nonetheless, the better-reasoned approach binds

51. For an overview of the terms and conditions contained in common contract forms, see infra Ch. 2; see also Brian Golbach & J. Rourke, The New Contracts are Here: A Review of the New Consensus Docs and AIA Documents (unpublished paper submitted at the 19th Annual Northeast Surety & Fidelity Claims Conference, Sept. 18-19, 2008).


53. See U.S. Fid. & Guar. Co. v. West Point Constr. Co., Inc., 837 F.2d 1507, 1508 (11th Cir.1988) (holding the surety was compelled to arbitrate when the performance bond incorporates by reference a subcontract containing an arbitration clause); Cianbro Corp. v. Empresa Nacional De Ingenieria y Technologia, S.A., 697 F. Supp. 15 (D. Me. 1988) (holding that the
the surety to the results of the arbitration of the contract dispute, but allows the surety to reserve its right to litigate any separate bond defenses.54

C. Payment

Virtually all bonded contracts contain provisions governing the means, method, and timing of requests for payment. Usually, the contract will provide for periodic payments based on the progress of the principal. Typically, the payments are to be made on a monthly basis with the principal being required to submit monthly requisitions or requests for payment. Following a default termination of the principal, a review of these requisitions will provide the surety with information regarding the contract balance and the degree of project completion as represented by the principal and approved by the obligee and architect.

The surety should carefully review the obligee’s compliance with the bonded contract’s payment provisions, because overpayment to the principal by the obligee may provide a partial or complete defense for the surety.55 Indeed, under Section 3.3 of the AIA A312-2010 Performance

contractual arbitration provision is incorporated by reference into the surety’s bond); see also Exch. Mut. Ins. Co. v. Haskell Co., 742 F.2d 274, 276 (6th Cir. 1984); but see, e.g., AgGrow Oils, LLC v. Nat’l Union Fire Ins. Co., 242 F. 3d 777, 782 (8th Cir. 2001) and Travelers Indem. Co. v. Hayes Contractors, Inc., 389 N.W. 2d 257 (Minn. Ct. App. 1986). Similarly, when the bonded contract provides for dispute resolution through arbitration, the surety may choose to avail itself of that provision.


55. See generally, BRUNER & O’CONNOR ON CONSTRUCTION LAW, § 8:60: Overpayment: Defense for Surety (West 2014); RESTATEMENT (THIRD) SURETYSHIP & GUAR., §§ 37, 41-42; Christopher Ward, Brett Divers, Matthew Horowitz, & Kevin Lybeck, 11 NEW APPLEMAN ON INSURANCE LAW, LIBRARY EDITION § 139.07 (Michael Keeley, Christopher Ward, Armen Shahinian, & Jeffrey E. Thomas eds., 2014); Julia Blackwell Gelinas & Genise W. Teich, Ch. 11, Defenses Available to the Surety, in THE LAW OF PERFORMANCE BONDS (Lawrence R. Moellmann, Matthew M. Horowitz, & Kevin L. Lybeck, eds., Am. Bar Ass’n, 2d ed. 2009);
Bond, it is a condition precedent to any obligation on the part of the surety that the obligee shall have agreed to pay to the surety the balance of the contract price. Moreover, in calculating such balance of the contract price, the obligee is only entitled to credit against the contract price for payments properly made, and not all payments made. This provision implements the common law rule that the surety is discharged from its obligation to the extent of the obligee’s improper or premature release of the collateral it holds to secure the principal’s performance. In the context of a construction contract, the bonded contract balance and retainage comprise that collateral.

Additionally, most bonded contracts provide for a review procedure with respect to the principal’s requests for payment. The surety may have defenses and/or affirmative claims if it is determined that work for which the principal has been paid was not performed properly. However, the majority of contracts, including those published by the American Institute of Architects, purport to exculpate the architect-engineer from any responsibility for determining the quality or propriety of the work performed by the principal. Nevertheless, the surety may still have recourse with respect to the actions of the architect or engineer when the architect or engineer assumed responsibility for coordination, supervision, and/or inspection, or the bonded contract is silent as to the architect’s or engineer’s liability.


56. Section 14.1 of the A312-2010 Performance Bond defines “Balance of the Contract Price” as:

The total amount payable by the Owner to the Contractor under the Construction Contract after all proper adjustments have been made, including allowance to the Contractor of any amounts received or to be received by the Owner in settlement of insurance or other claims for damages to which the Contractor is entitled, reduced by all valid and proper payments made to or on behalf of the Contractor under the Construction Contract.


58. See infra Ch. 3; see also Gelinas & Teich, supra note 55.

59. See generally, James Ferrucci and Scott Baron, The Surety’s Claims Against Third Parties in SALVAGE BY THE SURETY (George J. Bachrach ed., Am. Bar Ass’n 1998); H. Marks, The Surety’s Rights Relating to...
Finally, many payment provisions require that the principal utilize, or certify that it has utilized, the bonded contract funds paid by the obligee to pay subcontractors and/or suppliers. These provisions are often consistent with trust fund acts\(^\text{60}\) enacted in some states. Falsified certifications and/or violations of a trust fund act may result in personal liability of the principal’s responsible officer or officers and even criminal prosecution.\(^\text{61}\)

**D. Protection of Persons and Property**

Most bonded contracts provide that, after issuance of the notice to proceed through the date of final acceptance, the principal shall be responsible for the worksite and all materials, equipment, and other property located at that worksite, as well as for the safety of all employees and other persons involved or affected by the worksite. These provisions may concern the surety when the obligee terminates the principal for default, because the project site, as of that time, may be unsafe or vulnerable to weather conditions or vandalism. During its investigation, the surety may either attempt to secure the site, based upon an express and full reservation of rights, or it may require the obligee to secure the site as part of its obligation to minimize or mitigate damages.\(^\text{62}\)

**E. Insurance**

Most bonded contracts require the principal to obtain various kinds of insurance, including comprehensive general liability coverage and

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workers compensation insurance. The surety should consider the insurance requirements of the bonded contract in two respects. First, any completion contractor, whether tendered by or retained by the surety to complete the bonded project, must comply with these provisions unless the obligee agrees to reduce or waive these requirements. Secondly, the surety may benefit from pursuing a claim or claims against one of these carriers. For example, a comprehensive general liability policy may cover damage to property caused by defective workmanship (as opposed to the cost to correct the defective workmanship itself). Again, the surety should consider this area during its investigation of the pre-default work on the project, beyond the immediate events leading up to the default and termination.

F. Changes in the Work

Most bonded contracts provide a mechanism to change the scope of work the principal performs, commonly referred to as “change orders.” Often, the principal must submit its request for issuance of a change order within a short time after the principal learns that there is a basis for a change order or the right to a change order may be deemed waived. The obligee’s architect or consultant usually reviews change order requests. Some contracts also provide a procedure for appeal from the denial of a change order request.

The traditional common law rule is that a surety is discharged when the contracting parties alter the bonded contract—and thereby alter the surety’s undertaking—without its consent. However, in most jurisdictions, courts do not apply the rule of strictissimi juris rigidly in


65. See, RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY, § 41 (1996); M. Egan, Ch. 12, Discharge of the Performance Bond Surety, in THE LAW OF SURETYSHIP, 1, 6 (Edward Gallagher ed., 2d ed. 2000); Gelinas & Teich, supra note 55, at 575 & 595; see, e.g., United States v. Freel, 186 U.S. 309 (1902).
the case of a compensated surety on a construction contract. Thus, courts have required, variously, that in order to discharge a compensated surety from its bond obligations, a contract alteration: (a) must increase the surety's risk; (b) must be “material” or “substantial”; or (c) must be prejudicial to the surety. Additionally, when the contract or bond contains language specifically making allowance for alterations to the work, the surety may be deemed to have consented to the changes, and the courts will look to the “materiality” of the change to determine if the surety is discharged from its obligations under the bond. With respect to contracts or bonds containing provisions allowing for alterations to the work, courts have held that only changes not fairly within the contemplation of the parties at the time the contract was made, constituting a material departure from the original undertaking, will release a non-consenting surety from its obligations under its bonds. If the bond has no such provision, a significant change in the scope of the work may prove to be either a complete release of the surety’s obligations under the bond or a partial release to the extent of the prejudice suffered by the surety.

Finally, changes in the scope of the work following execution of the bonded contract are important to the surety when investigating whether or not to complete or tender a completing contractor. Identifying such changes is likewise important in order to confirm that the contract price has been appropriately adjusted to meet those changes.

G. Multiple Prime Contracts

Some projects are undertaken with multiple prime contracts in which the obligee enters into different contracts with different construction trades, such as general construction, plumbing, heating, venting and air conditioning, structural steel, and electrical. Indeed, some jurisdictions mandate multiple prime contracts by statute. Generally speaking, the surety for one prime contractor is not subject to exposure to claims from other prime contractors, notwithstanding the fact that the default of the principal may have damaged other prime contractors. The reason for this is that the only beneficiary of the performance bond is the named obligee; co-prime contractors are not subcontractors or suppliers coming within the scope of coverage of the payment bond.

Nonetheless, the surety should be mindful of the provisions in the general conditions of bonded contracts on multi-prime contract projects that govern scheduling, coordination of the work, interference, and delays. Sometimes on multi-prime projects, the obligee retains the obligation to coordinate all prime contractors in the performance of their work. In other projects, that responsibility is delegated in part to the prime contractor for general construction. Many such contracts contain “no damage for delay” clauses that, subject to certain limits, shield the obligee from claims of damage from any prime contractor caused by the delays and interference of other prime contractors. Some of these

70. See, e.g., N.Y. STATE FINANCE LAW § 135 (McKinney 2014) (“Wick’s Law”).


72. See e.g., Premier-New York, Inc. v. Travelers Prop. Cas. Corp., 867 N.Y.S.2d 20 (N.Y. Sup. Ct. 2008); Landis & Gyr Powers, Inc. v. Berley Indus., Inc., 750 N.Y.S. 2d 82, 84 (N.Y. App. Div., 2d Dept. 2002); Roy A. Elam Masonry, Inc. v. Fru-Con Constr. Corp., 922 S.W.2d 783 (Mo. Ct. App. 1996); State Highway Admin. v. Greiner Eng’g Scis., Inc., 577 A. 2d 363, 369-72 (Md. App. 1990). The exceptions to enforcement of such a clause occur when the claimed delays were either: (a) caused by bad faith or willful, malicious or grossly negligent conduct; (b) of a type not contemplated by the parties when they entered into the contract; (c) so unreasonable as to constitute an intentional abandonment of contract; or (d) result from breach of a fundamental obligation of contract. See
clauses, however, provide that a co-prime contractor has the right to assert a claim of damages directly against another co-prime contractor, with each such prime contractor acknowledging the right of co-primes to assert direct claims against them as a third-party beneficiary of their respect contracts.

The potential exposure for delay damages in these circumstances can be substantial. Therefore, in considering a performance bond claim by an obligee under such a contract, the surety must be mindful not to undertake performance without an agreement with the obligee that protects the surety against exposure to such claims by co-prime contractors. The surety will want to avoid being deemed responsible to perform all of the obligations of the principal without limiting its exposure to claimants other than the obligee.

H. Subcontracts

The nature of the provisions incorporated into a subcontract and/or purchase order will often depend upon which party drafted the document. If the subcontractor is sophisticated and/or is a specialty subcontractor or supplier, its form subcontract and/or purchase orders will often treat the transaction as separate and distinct from the relationship between the general contractor and the owner. The supplier/subcontractor is often entitled to payment when it provides materials and/or performs the subcontract work.

In contrast, the larger or more sophisticated general contractors with greater leverage may require that their forms be utilized. These forms often incorporate the general and special conditions of the general contractor’s contract with the owner as well as technical specifications that relate to the work to be performed or materials to be provided by the subcontractor/supplier. Often these forms provide that, with respect to change orders, the general contractor will be responsible only for payments indicated on written change orders and only for the quantities and/or amounts approved by the owner.

Other subcontract provisions may address the timing of payments, amounts of retainage withheld, and a variety of other issues. Familiarity

with these provisions is important for several reasons. When the principal is a subcontractor or supplier, the performance bond typically incorporates the subcontract and/or purchase order by reference and sets forth the scope of the principal’s obligations and those of any completion contractor. When the principal is the general contractor, its subcontracts may address important issues concerning: (1) consent to assignment of the subcontract to the surety by its principal; (2) agreement of the subcontractor or supplier to adhere to the terms and conditions of the subcontract/purchase order in connection with completion efforts by the surety or its tendered completion contractor; and (3) the subcontractor’s or supplier’s right to payment.

III. Co-Surety Agreements

Sureties sometimes encounter claims activity on bonds issued pursuant to co-surety agreements that designate a “lead” surety charged with certain responsibility for investigating and resolving the claims in accordance with the terms of such co-surety agreement. Co-surety relationships usually arise in one of two ways. First, when the principal is a joint venture and the joint venture is made up of distinct companies with separate ownership, represented by different agents/brokers, each of the venture partners may be bonded with respect to their overall construction program by a different surety. In those instances, the surety for each of the joint venture partners may enter into an agreement whereby they apportion the risk between themselves on the joint venture account. Then, as between the two sureties, there may be an allocation of liability under the bond, usually in proportion to the percentage or amount of participation of each partner within the joint venture. However, when performance and payment bonds are written on behalf of the joint venture, the sureties executing those bonds typically are jointly and severally liable to the obligee and claimants, without regard for the apportionment between them. As a result, the participating sureties should establish and document each joint venture partner’s joint and several indemnity responsibilities to each of the sureties through separate indemnity agreements.73

73. See, Kevin Lybeck, Catherine Squillace, Armen Shahinian & Andrew Kent, Coordinating Investigations Between or Among Co-Sureties (unpublished paper submitted at the ABA/TIPS Fidelity & Surety Law Committee program on Jan. 23, 2009, at the 2009 annual mid-winter meeting); Edward Reilly & Jeffrey Franks, Modern Co-Suretyship
The other situation giving rise to co-surety arrangements with increasing frequency is the case of a principal with a large work program that, through its broker/agent, approaches multiple sureties to “share” its account from an underwriting perspective. Through the execution of a co-surety agreement, the sureties will agree on their respective co-surety participation and designate a “lead” surety for purposes of underwriting and claims management. As with the joint venture scenario, the sureties in this arrangement typically are jointly and severally liable to the obligee on bonds executed for the shared account. Because each surety is jointly and severally liable to the obligee, if one surety is unable or unwilling to pay claims, the other surety or sureties must step up, satisfy those claims, and seek reimbursement from the non-contributing co-surety pursuant to their agreement. If that surety is insolvent then the remaining sureties may be required to guarantee its obligations to an obligee.74

It is important for the surety receiving the initial claim notice against a co-surety bond to ascertain the nature and terms of any co-surety agreement governing that bond. As a threshold matter, the sureties must determine which of them is the “lead” with respect to the investigation and resolution of claims. Then, the lead surety must be aware of the extent of its duties and obligations to its co-sureties, including any limitations on its authority, any notice requirements, and any consent required from the co-sureties. The lead surety must be careful to fulfill its bond obligations, but not overstep its bounds. Traditionally, co-surety agreements have been less formal than most of the documents involved in the performance of the bonded contract and issuance of the bond. However, as co-surety arrangements are becoming more prevalent, sureties are recognizing the need to formalize, and more specifically spell out, the relationship among, and the respective responsibilities of, the co-sureties.75

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74. See Lybeck, Squillace, Shahinian, & Kent, supra note 73, at 32.
75. Id., note 71.
IV. Reinsurance Agreements

Reinsurers follow the fortunes of their insured. The “follow the fortunes” doctrine, which is both a legal rule and a custom developed from the economic and practical interests of both sides of the reinsurance relationship, requires the reinsurer to reimburse payments made by its reinsured, “as long as they are not fraudulent, collusive, or made in bad faith.”

While this doctrine insulates the surety from the sort of second-guessing that might otherwise inhibit its ability to make claims decisions that are necessary to respond to a performance bond claim efficiently and effectively, the surety, nonetheless, must be aware of, and comply with, any reporting obligations or claims handling guidelines that may be part of its reinsurance agreements. For instance, a reinsurance agreement or treaty may require timely notice to the reinsurer of certain claims and subsequent periodic reports. Likewise, the surety may be required to obtain the reinsurer’s prior consent to the settlement of certain large claims or to the surety’s entering into a financing agreement with the principal. Similarly, the reinsurance agreement may prescribe certain means or methods of handling claims or maintaining claims files or financial records. The surety must be mindful of these and any other conditions of its reinsurance agreements, so that a failure to comply with such conditions does not compromise the reinsurance coverage.


V. SBA Guaranteed Bonds

The U.S. Small Business Administration (SBA) established its Surety Bond Guarantee Program to assist small or emerging construction companies in obtaining bonds required on, among other things, federal, state, local, and commercial construction projects. The SBA guarantee provides contractors, who might not otherwise meet minimum underwriting standards, the opportunity to obtain bonding.79 Under the Program, the SBA guarantees bid, performance, and payment bonds issued by surety companies to small and emerging contractors and reimburses the surety a percentage of loss if the contractor defaults.80 The terms and conditions of the SBA’s guarantees and commitments may vary from surety to surety based on the SBA’s experience with the particular surety.81

When presented with a claim under an SBA bond, the surety claims professional should be careful to adhere to the SBA guidelines in order to ensure that the SBA will honor its guarantee.82 Additional requirements are imposed upon a surety when a loss is incurred in avoiding or attempting to avoid a loss.83 Thus, when faced with a request by an SBA bond principal for financing, surety claims professionals should ensure compliance with all applicable requirements.

VI. Statutory Provisions

The federal government regulates surety bonds by statute and virtually every state has enacted legislation pertaining to contract surety bonds for public construction projects. When a bond or contract provision conflicts with a statutory provision, the statutory provision usually controls,84 so it

is important to review the applicable statute in conjunction with a review of the bond. In addition, various regulations, ordinances, orders, and directives may be applicable to the work. Even when the bonded contract does not expressly incorporate these items by reference, the courts usually deem them incorporated and rely upon them when applicable.

The Miller Act\textsuperscript{85} governs federal government construction projects and provides, in part:

\section{§ 3131. Bonds of contractors of public buildings or works}

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\textbf{(b) Types of bonds required.} Before any contract of more than $100,000 is awarded for the construction, alteration, or repair of any public building or public work of the Federal Government, a person must furnish to the Government the following bonds, which become binding when the contract is awarded:

\textbf{Performance bond.} A performance bond with a surety satisfactory to the officer awarding the contract, and in an amount the officer considers adequate, for the protection of the Government.

\textbf{Payment bond.} A payment bond with a surety satisfactory to the officer for the protection of all persons supplying labor and material in carrying out the work provided for in the contract for the use of each person. The amount of the payment bond shall equal the total amount payable by the terms of the contract unless the officer awarding the contract determines, in a writing supported by specific findings, that a payment bond in that amount is impractical, in which case the contracting officer shall set the amount of the payment bond. The amount of the payment bond shall not be less than the amount of the performance bond.

The federal government has promulgated form performance and payment bonds for use on federal projects, commonly referred to as Miller Act

\footnote{1046 (Kan. 1990); Cruz-Mendez v. ISU/Ins. Servs. of San Francisco, 722 A. 2d 515 (N.J. 1999).}

bonds. For a detailed discussion of the performing surety and the federal government, see infra Chapter 8.

Most states have followed the federal government’s lead and adopted so-called “Little Miller Acts.” Like the Miller Act, these statutes require the successful bidder on a public project to provide performance and payment bonds and set forth specific requirements as to the timing and venue of suits on the bonds.

The Miller Act and its state counterparts impose obligations upon a surety and, at the same time, provide potential defenses to, or limitations upon the scope of, the surety’s liability. For example, if the subcontractor or supplier has not instituted suit within the time prescribed by the Miller Act or a comparable state statute, the surety typically has no liability to the payment bond claimant.

The investigating surety should avoid actions that may lead a claimant to believe that the surety will pay and should constantly reserve its rights and defenses to avoid any argument that it has waived these important limitations provisions. Timely receipt of notice of claim and acknowledgment of the receipt of such claim will not estop the surety from thereafter invoking a limitation defense in the absence of some affirmative act that reasonably leads the claimant to assume that it will not be required to meet the applicable limitations period.

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86. See, e.g., Standard Form 25 (rev. 8/2014) prescribed by GSA-FAR (48 C.F.R) 53.338(b) (performance bond); Standard Form 25A (rev. 8/2014) prescribed by GSA-FAR (48 C.F.R) 53.338(c) (payment bond).
87. See, e.g., ALA. CODE §§ 39-1-1 and 39-2-8 (West 2012); ARIZ. REV. STAT. ANN. § 34-222 (West 2011); COLO. REV. STAT. § 24-105-202 (West 2008); IDAHO CODE ANN. § 54-1926 (LexisNexis 2008); IND. CODE § 36-1-12-14 (West 2006); KAN. STAT. ANN. § 60-1111 (2008); MICH. COMP. LAWS ANN. § 129.201 (West 2005); MISS. CODE ANN. § 31-5-51 (West 2004); NEV. REV. STAT. § 339.025 (2011); N.J. STAT. ANN. § 2A:44-143 (West 2014); N.M. STAT. ANN. § 13-4-18 (2003); TEX. GOV’T CODE ANN. § 2253.021 (West 2014).
88. See, e.g., ARK. CODE ANN. § 22-9-403 (2008); IND. CODE ANN. § 36-1-12-14 (g) (West 2006); KAN. STAT. ANN. § 60-1111(b) (2008); N.Y. STATE FIN. LAW § 137 (McKinney 2014).
89. See, Courtney Turnage Walker, Eric H. Loeffler, and Bradford R. Carver, Ch. 6, Suit Limitations in THE LAW OF PAYMENT BONDS (Kevin L. Lybeck, Wayne D. Lambert, and John E. Sebastian eds., Am. Bar Ass’n, 2d ed. 2011).
Beyond those statutes specifically relating to surety bonds, other statutes may be of importance to the surety. For instance, many states have enacted trust fund acts, requiring that the principal receiving bonded contract funds in connection with a public project utilize those funds to pay its subcontractors and suppliers. Some of the statutory provisions impose liability (for fraud) upon the officers of the principal for violation of the statute, which liability may not be dischargeable in bankruptcy. These provisions, while not relevant to interpretation of the bond or the surety’s obligations, can be effective in securing the cooperation of the principal and/or its officers and in augmenting the potential sources of salvage. Additionally, third parties who receive trust funds with knowledge of their source are required to hold such funds in trust and may themselves be liable for diversion of such funds and provide a source of salvage for the surety.

In addition, in instances when the surety may look to assert its subrogation and assignment rights to the affirmative claims of its principal against public owners, the surety must be cognizant of statutes and regulations establishing notice requirements for claims. Such notice requirements should be strictly observed in order to mitigate damages or otherwise protect the surety’s salvage rights.

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VII. Indemnity Agreement Provisions

Surety bonds issued by compensated sureties are meant to function as credit accommodations in which the surety anticipates no loss. Before issuing its bond, the surety will have conducted an underwriting analysis to satisfy itself as to the principal’s capacity to perform the bonded contract, its character and commitment to the fulfillment of its obligations, and its capital adequacy/financial ability to perform the bonded contract and, if necessary, fulfill its common law duties to indemnify and exonerate the surety against any loss sustained or threatened as a result of the issuance of the bond. The compensated surety will not rely solely upon its common law rights of indemnity and exoneration, however. A condition uniformly imposed by the surety is that its principal, and usually the individuals who control it in the case of a closely held corporation, execute an indemnity agreement to augment the surety’s common law rights.

One court, in discussing the essential nature of suretyship, described the indemnity agreement as the “heart of” the relationship among the parties, stating that:

A surety, its principal and its indemnitors are engaged in a commercial business relationship which establishes, by contract, specific benefits and burdens to the parties. By issuing its bond, the surety takes the risk that the principal will fulfill its obligations. If the principal does not do so, the surety is required to step in and bear the cost of satisfactorily completing the project and/or paying the principal’s subcontractors and suppliers. In order to protect it from potentially substantial losses, the surety invariably requires the principal and indemnitors to enter into an indemnity agreement.

At the heart of the surety/principal relationship is the intention of the parties—clearly established in the indemnity agreement—that the surety will be repaid for all claims paid or expenses incurred as a result of issuing bonds on behalf of the principal. When the principals and their indemnitors seek to avoid their contractual obligations, the surety must not only discharge its responsibility under its bonds, but also take the necessary steps to enforce its indemnification rights as to the losses and expenses incurred.94

This indemnification relationship is central to the difference between surety bonds and insurance policies. Whereas an insured purchasing a policy of insurance expects to be indemnified in the event a covered loss occurs, the surety never indemnifies its principal. Rather, the principal has the common law obligation to both indemnify the surety against loss and to exonerate the surety against loss by paying and satisfying all obligations guaranteed by the surety before the surety shall have to perform such obligations itself. The indemnity agreement that the surety will invariably require as a condition to the issuance of bonds on behalf of the principal supplements these common law obligations.

An important way the indemnity agreement expands the rights of the surety beyond the common law is by giving the surety the right to pursue individual indemnitors who are the owners of the principal and their spouses. When the corporate principal is insolvent or bankrupt, the surety’s indemnity rights against the individual owners and his/her spouse can be extremely important both in order to secure the cooperation of the principal’s officers as well as in providing a potential source of reimbursement for losses and expenses. The importance of a spouse’s execution of the indemnity agreement cannot be overemphasized, because savvy principals and indemnitors often place ownership of assets acquired over the years in the name of their spouses or, in the alternative, own assets jointly with their spouses.

Some indemnitors have claimed that demands for spousal signatures on the indemnity agreement violate the provisions of the Equal Credit


Opportunity Act ("ECOA"). ECOA is aimed at banning credit discrimination against individuals based upon factors such as marital status or gender. Congress passed ECOA to end the practice of requiring a male spouse to co-sign a loan by a married female applicant, even if the married female applicant’s own financial status was alone sufficient to justify the credit. Although the legislative history of ECOA reflects that Congress passed it to eliminate this practice as to women, Congress wrote it in gender-neutral terms. The defense, however, is inapplicable inasmuch as the indemnity agreement and surety bond transactions do not fall within the ambit of ECOA.

The surety’s indemnity agreement is an important tool for the surety claims professional both in securing the cooperation of the principal and in taking preemptive measures to ensure that the principal and its indemnitors will save the surety harmless from losses and expenses. The specific terms of the indemnity agreement will vary from surety to surety, but most seek to accomplish similar results. The common objectives of such agreements are: to provide the surety with a contractual right of recovery against the principal and other named indemnitors of all losses, costs, and expenses, including attorney’s fees, incurred as a result of issuing the bonds; to facilitate the handling of bond claims by providing the surety with the discretion to settle and pay such claims; to require the deposit of collateral to secure the surety against losses once bond claims are asserted; to ease the burdens of proof in actions to recover losses and expenses; to provide a security interest in the principal’s equipment, machinery, and receivables; to confirm the surety’s right to decline to execute any further bonds on behalf of the principal; to provide the surety with access to the principal’s and

98. See Capitol Indem. Corp. v. Aulakh, 313 F.3d 200, 203–04 (4th Cir. 2002) (holding that the ECOA does not apply to the indemnity agreement and underlying surety bonds because no right to defer payment existed); Ulico Cas. Co. v. Superior Mgmt. Servs., Inc., 89 F. App’x 278, 279 (D.C. Cir. 2004) (holding that indemnity agreement and underlying surety bonds are not “credit transactions” under the ECOA because there was no right to defer payment).
indemnitors’ books and records, including electronic documents; and to grant the surety the right to settle the principal’s own affirmative claims against the obligee. By virtue of the broad grant to the surety of the right to pay or otherwise settle its bond obligations, the indemnity agreement facilitates the surety’s ability to avoid unnecessary and costly litigation while protecting its rights of indemnity against the principal and the named indemnitors.99

A. The Indemnity Clause

Most indemnity agreements expressly require indemnification for all losses sustained by the surety in good faith as a result of its issuance of the bond on behalf of the principal whether or not the principal turns out to have been actually liable for the claim paid by the surety.100 In short, the indemnity agreement gives the surety the right to be wrong in its assessment of its liability under its bond and in its decision to settle claims, if it acts in good faith. One court acknowledged the impact of such indemnity clauses as follows:

Equity generally implies a right to indemnification in favor of a surety only when the surety pays off a debt for which his principal is liable. However, resort to implied indemnity principles is improper when an express indemnification contract exists. There can be no question but that a surety is entitled to stand upon the letter of his contract...  

* * *

The indemnity agreement does not limit [the principal’s] liability for indemnification to losses incurred based upon [an enforceable] judgment. The broad terms of the clause provide indemnification for any loss by [the surety] by reason of having executed the performance bond. [citations omitted]101


Thus, the indemnity agreement usually requires the named indemnitors to indemnify the surety for all losses incurred by it by virtue of its having issued its bond regardless of the surety’s actual liability under the bond. An example of a common indemnity provision is as follows:

The Contractor and Indemnitors shall exonerate, indemnify, and keep indemnified the Surety from and against any and all liability for losses and/or expenses of whatsoever kind or nature (including, but not limited to, interest, court costs and counsel fees) and from and against any and all such losses and/or expenses which the surety may sustain and incur: (1) by reason of having executed or procured the execution of the bonds, (2) by reason of the failure of the Contractor or Indemnitors to perform or comply with the covenants and conditions of this agreement or (3) in enforcing any of the covenants and conditions of this agreement.

Payment by reason of the aforesaid causes shall be made to the Surety by the Contractor and Indemnitors as soon as liability exists or is asserted against the Surety, whether or not the Surety shall have made any payment therefor. Such payment shall be equal to the amount of the reserve set by the Surety. In the event of any payment by the Surety, the Contractor and Indemnitors further agree that in any accounting between the Surety and the Contractor, or between the Surety and the Indemnitors, or either or both of them, the Surety shall be entitled to charge for any and all disbursements made by it in good faith in and about the matters herein contemplated by this Agreement under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed; and that the vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety.

Courts have repeatedly upheld such contractual indemnity provisions subject only to the condition that the payment by the surety is not the product of its fraud or bad faith. 102 The rationale underlying these

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decisions is that the expense, delay, and risk of loss to the surety are a sufficient safeguard against an unwarranted payment by the surety.

B. The Right-to-Settle Provision

The right-to-settle clause augments the surety’s ability to discharge the principal’s obligations before suit without endangering its indemnification rights. A typical right-to-settle clause may provide as follows:

The surety shall have the right to adjust, settle or compromise any claim, demand, suit or judgment upon the bonds, unless the principal and the indemnitors shall request the surety to litigate such claim or demand, or to defend such suit, or to appeal from such judgment, and shall deposit with the surety, at the time of such request, cash or collateral satisfactory to the surety in kind or amount, to be used in paying any judgment or judgments rendered or that may be rendered, with interest, costs, expenses and attorneys’ fees, including those of the surety.

Such provisions, which permit the surety to compromise and settle claims—and which are often coupled with clauses providing that vouchers and other evidence of payment of claims shall be prima facie evidence of the propriety thereof—have been routinely upheld. Courts have recognized that these provisions afford the surety broad discretion in determining which claims should be compromised and settled, and have held that the surety’s decision will be binding on the principal and the indemnitors as long as the surety acts in good faith. 103 At least one court


has suggested that imposing more strict duties upon sureties would make them reluctant to pay valid claims:

Sureties enjoy such discretion to settle claims because of the important function they serve in the construction industry, and because the economic incentives motivating them are sufficient safeguard against payment of invalid claims. The many parties to a typical construction contract-owners, general contractors, subcontractors and sub-subcontractors—look to sureties to provide assurance that defaults by and of the myriad other parties involved will not result in a loss to them. Courts have recognized that “as a practical matter the suppliers and small contractors on large construction projects need reasonably prompt payment for their work and materials in order for them to remain solvent and stay in business.”

Thus, the surety should not be intimidated by indemnitors who assert challenges to the surety’s right to satisfy a claim without providing the surety with evidence of a viable defense to such claim. Under the indemnity agreement, the surety will not lose its indemnity rights when it makes a good faith payment to the claimant to mitigate its damages.

C. The Prima Facie Evidence Clause

In conjunction with the surety’s right to compromise and settle claims, courts have consistently upheld clauses which provide that vouchers and other evidence of payment will be prima facie evidence of the propriety of the surety’s payment and the amount of the indemnitors’ liability to the surety. Because the courts have recognized the validity of prima facie evidence clauses, the surety that resolves claims under its right-to-settle clause will often be able to use vouchers and affidavits to obtain

summary judgment enforcing its right under the indemnity agreement to indemnification for the losses and expenses incurred in discharging its bond obligations. Even when a court does not grant summary judgment, the prima facie evidence clause effectively shifts to the indemnitors the burden of showing that the surety did not act in good faith in settling claims and incurring expenses. Because sureties ordinarily make payments only upon a good faith belief that the expenditures are necessary or expedient, it is highly unlikely that indemnitors will be able to carry the burden in the usual case.

D. The Collateral Deposit Provision

The collateral deposit clause requires the principal and indemnitors to provide the surety with a reserve of funds when the surety is faced with claims on its bonds.\textsuperscript{106} Under such a provision, once a surety receives a claim on its bond, the principal and/or indemnitor must deposit with the surety, upon its demand, funds sufficient to secure the surety against the claim. If the surety must pay a claim, then it will do so out of the deposited funds. If the surety does not have to pay the claim, it will return the remaining funds, net of expenses incurred. A collateral security provision may provide as follows:

If for any reason the surety shall be required to or shall deem it necessary to set up a reserve in any amount to cover any (a) judgment, actual or contingent, with interest and costs, in any action instituted against the principal and/or the surety or (b) unadjusted claims or (c) losses, costs, attorneys’ fees and disbursements and/or expenses in connection with said bond or (d) default(s) of the principal or (e) abandonment of the contract or (f) liens filed or (g) dispute with the owner or obligee or (h) for any reason whatever regardless of any proceedings contemplated or taken by the principal or the pendency of any appeal, the undersigned shall immediately upon demand, deposit with the surety funds in the amount of such reserve and any increase thereof, to be held by the surety as collateral with the right to use such fund or any part thereof, at any time, in payment or compromise of any judgment, claim, liability, loss, damages, attorney’s fees and disbursements and/or other expenses.

As a general matter, there is no requirement that the surety be liable to the obligee and/or claimant in order to demand that the principal and indemnitors post collateral. Instead, the only condition necessary under most agreements to invoke the collateral reserve obligation is that there is a “claim” or “demand” upon the surety to perform under the bond. Thus, the surety should not hesitate to make a “routine” demand for collateral upon the assertion of a claim. To enforce the collateral reserve provision in the face of the indemnitors’ failure or refusal to comply, a surety can institute an action for specific performance.107

The surety’s right to demand collateral is often coupled in the indemnity agreement with a provision that entitles the surety to demand that collateral be posted by the indemnitors as a condition to the indemnitors’ request that the surety refrain from paying a claim. In such situations, the surety may require that the indemnitors post collateral sufficient to cover the amount of the claim, estimated interest to the date

of probable resolution, and the estimated expenses, including attorney’s fees, to be incurred by the surety in defense of the claim. In addition to securing the surety against an adverse determination of the bond claim, the surety’s demand for collateral will discourage the principal and indemnitees from raising spurious defenses merely to delay payment, because they must collateralize both the amount of the claim and the surety’s cost of defending against it. As compliance with the demand for collateral is a condition to any objection which the principal may interpose to the surety’s payment of a claim, the use of this provision can greatly assist in the resolution of claims without compromising indemnification rights. The surety should invoke this particularly useful provision when there is reason to anticipate that the principal or its indemnitees may attempt to attack the surety’s good faith settling of a claim.

**E. The Assignment Clause**

Another useful clause of the indemnity agreement is the assignment provision, which operates to assign to the surety various rights and interests in the principal’s equipment and receivables conditioned upon the receipt of claims under the surety’s bonds or defaults under the indemnity agreement. These assignment provisions often include an assignment of all of the funds owed to the principal under both bonded and non-bonded contracts and are effective against the principal whether or not the surety filed the indemnity agreement as a financing statement.

One such assignment clause provides:

The Contractor, the Indemnitees hereby consenting, will assign, transfer and set over, and does hereby assign, transfer and set over to the Surety, as collateral, to secure the obligations in any and all of the paragraphs of this Agreement and any other indebtedness and liabilities of the Contractor to the Surety, whether heretofore or hereafter incurred, the assignment in the case of each contract to become effective as of the date of the Bond covering such contract, but only in the event of (1) any abandonment, forfeiture or breach of any contracts referred to in the Bond or of any breach of any said Bonds; or (2) of any breach of the provisions of any of the paragraphs of this Agreement; or (3) of a default in discharging such other indebtedness or liabilities when due; or (4) of any assignment by the Contractor for the benefit of creditors, or of the appointment, or of any application for the appointment of a receiver or trustee for the Contractor whether insolvent or not; or (5) of any proceeding which deprives the
Contractor of the use of any of the machinery, equipment, plant, tools or material referred to in section (b) of this paragraph; or (6) of the Contractor’s dying, absconding, disappearing, incompetency, being convicted of a felony, or imprisoned if the Contractor be an individual: (a) All the rights of the Contractor in, and growing in any manner out of all contracts referred to in the Bonds, or in, or growing in any manner out of the Bonds; (b) All the rights, title and interest of the Contractor in and to all machinery, equipment, plant, tools and materials which are now or may hereafter be, about or upon the site or sites of any and all of the contractual work referred to in the Bonds or elsewhere, including materials purchased for or chargeable to any and all contracts referred to in the Bonds, materials which may be in process of construction, in storage elsewhere, or in transportation to any and all of said sites; (c) All the rights, title and interest of the Contractor in and to all subcontracts let or to be let in connection with any and all contracts referred to in the Bonds, and in and to all surety bonds supporting such subcontracts; (d) All actions, causes of actions, claims and demands whatsoever which the Contractor may have or acquire against any subcontractor, laborer or materialman, or any person furnishing or agreeing to furnish or supply labor, material, supplies, machinery, tools or other equipment in connection with or on account of any and all contracts referred to in the Bonds; and against any surety or sureties of any subcontractor, laborer or materialman; and (e) Any and all percentages retained and any and all sums that may be due or hereafter become due on account of any and all contracts referred to in the Bonds and all other contracts whether bonded or not in which the Contractor has an interest.

As reflected by the quoted language, a major purpose of the assignment clause is to assign to the surety the proceeds of all contracts on which the principal is working. The assignment is not limited to those projects on which the obligee has declared the principal to be “in default.” Once the principal is in default of any obligation on any bonded project, or in breach of its indemnity agreement obligations, the surety has an enforceable assignment that extends to contract funds on all projects, even on projects on which the principal is not in default and on bonded projects where the surety’s losses will be less than the remaining contract proceeds. Those funds may offset the surety’s losses on projects on which the contract proceeds fail to cover its losses.

Even without its contractual assignment rights, the subrogation rights of the surety entitle the surety to recover the contract balance on bonded
contracts to the extent of the surety’s losses.\textsuperscript{108} Moreover, such rights take precedence over the rights of assignees of the principal and are enforceable without the need for any filings under the Uniform Commercial Code.\textsuperscript{109} Nonetheless, the surety’s assignment rights under the indemnity agreement may be important in providing additional sources of recovery other than the proceeds of the bonded contract and any setoff rights which the obligee may have to which rights the surety is subrogated upon satisfaction of its obligations to such obligee. In order to perfect its assignment rights against claims of third parties properly, including lenders, tax authorities, judgment lien creditors, and trustees in bankruptcy, the surety must file a UCC-1 financing statement in order to provide public notice of its assignment rights. This is one of the first actions a surety should consider upon receipt of claims because sureties do not usually file UCC-1 financing statements as a matter of course during the underwriting process.

\section*{F. The Attorney-in-Fact Clause}

Many indemnity agreements include a provision appointing the surety, or its agent, as attorney-in-fact for the principal and indemnitees. These clauses typically allow the surety to sign documents and to take such other action as may be necessary to enforce the principal and indemnitees’ obligations under the indemnity agreement and to protect the surety’s rights under the bonds.\textsuperscript{110} A typical attorney-in-fact clause provides:

\begin{quote}
The Indemnitees and Principals hereby irrevocably nominate, constitute, appoint and designate the Surety as their attorney-in-fact
\end{quote}


\textsuperscript{109} See, \textit{e.g.}, Transamerica Ins. Co. v. Barnett Bank of Marion Cnty., 540 So. 2d 113 (Fla. 1989); \textit{In re} J.V. Gleason, Inc., 452 F.2d 1219 (8th Cir. 1971); Amwest Sur. Ins. Co. v. United States, 870 F. Supp. 432, 434 (D. Conn. 1994).

with the full right and authority, but not the obligation, to exercise all the rights of the Indemnitors and Principals assigned, transferred and set over to the Surety in this Agreement, with full power and authority to execute on behalf of and sign the name of any Indemnitor and/or Principal to any voucher, financing statement, release, satisfaction, check, bill of sale of any property by this Agreement assigned to the Surety, or other documents or papers deemed necessary and proper by the Surety in order to give full effect not only to the intent and meaning of the within assignments, but also to the full protection intended to be herein given to the Surety under all other provisions of this Agreement. The Indemnitors and Principals hereby ratify and confirm all acts and actions taken and done by the Surety as such attorney-in-fact and agree to protect and hold harmless the Surety for acts herein granted as attorney-in-fact.

The surety can use the attorney-in-fact provision, together with the other clauses in the indemnity agreement, in connection with, among other things, settling claims against bonds, completion of bonded contracts, and even settling the principal’s claims against third parties if deemed reasonable and appropriate by the surety.111

G. The Books and Records Provision

Many indemnity agreements provide the surety with the right to inspect the books and records, including electronically stored materials, of its principal.112 This right often also extends to the indemnitors. An example of a books and record provision is as follows:

Upon Surety’s request, Principal and Indemnitors shall immediately turn over to Surety, or its designee, as often as requested and at a time and place and in a manner determined by Surety, such books, records, accounts, documents, computer software and other electronically-stored information, as and when requested by Surety.

The information contained in the principal’s books and records may be of assistance to the surety in the resolution of both performance and

111. See, e.g., Hutton Constr. Co. v. Cnty. of Rockland, 52 F.3d 1191 (2d Cir. 1995).
payment bond claims. With respect to performance bond claims, a review of the principal’s books and records may assist the surety in deciding whether to complete the bonded project and whether there are defenses to the obligee’s claims. As to payment bond claims, the books and records may inform the surety in connection with, among other things, claims that the principal has not paid prevailing wages to its laborers, as well as establishing whether there are any offsets to claims.

Although sometimes met with resistance, the surety is usually entitled to review its indemnitors’ books and records. The information contained in the indemnitors’ documents may be of assistance in enforcing the surety’s rights to collateral security and indemnity from the indemnitors.113

**H. Other Provisions**

Other important provisions found in the indemnity agreement may assist the surety in enforcing its rights in the event of a default by the principal. Common provisions that may be significant include:

1. requiring the indemnitors to pay all premiums and charges of the surety with respect to bonds which it issues on behalf of the principal;
2. providing that the rights of the surety pursuant to the agreement are in addition to its legal and equitable rights at law;
3. definitional provisions, such as those defining the “loss” to include attorney’s fees and consultant fees and those defining “surety” to include co-sureties, reinsurers, and any sureties issuing bonds on behalf of the principal at the request of the named sureties;
4. providing that the surety need not notify the indemnitors of the release of security, collateral, and/or an indemnitor;
5. confirming that the surety may refuse to provide any bond even when it has already furnished the bid bond for an anticipated contract, and confirming that the surety need not provide notice as to any changes in any bond or contract;

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6. providing that the liability of the indemnitors is joint and several, but that the surety is not obligated to pursue or exhaust its rights and claims against the principal or any other indemnitor before pursuing its claims against any of the named indemnitors;

7. providing the governing law and consent to jurisdiction and/or venue in any disputes by and between the surety and the indemnitors; and

8. providing that the indemnity agreement shall continue to apply to all bonds theretofore or thereafter issued on behalf of the principal without notice to the indemnitors and that the indemnity agreement may only be terminated as to future bonds if such bonds are issued more than thirty days after notice is received by the surety and the surety did not issue bid bonds or consents of surety for such bonds prior to the expiration of that thirty day period.

The indemnity agreement provides substantial rights and protection to the surety. In order that such rights may be vindicated effectively, it is advisable for the surety to address such rights promptly upon the receipt of claims. It is neither necessary nor advisable to await the occurrence of a loss before taking steps to enforce the terms of the indemnity agreement. If enforcement of indemnity rights is delayed substantially, the risk increases significantly that other creditors might succeed in enforcing their own rights against the indemnitors, leaving insufficient assets available to satisfy such indemnitors’ obligations to the surety. Moreover, indemnitors will often realize their imminent liability to the surety and take steps to transfer or otherwise dissipate the assets that might otherwise be available to the surety for execution upon obtaining an indemnity judgment. Thus, it is often advisable to take action promptly to seek specific enforcement of the indemnitors’ obligations under the indemnity agreement or to otherwise preserve indemnity rights upon receipt of claims.

**Conclusion**

This chapter provides a brief overview of some of the common and significant bond, contractual, and statutory provisions governing the relationship among the surety, obligee, and principal, which the surety
will review and consider when determining its course of action upon receipt of claims. The implications of those provisions and strategies to be implemented in mitigating losses and maximizing recovery prospects are more fully discussed in the chapters that follow.