# The Law of Performance Bonds, 3rd Ed.

## Contents

- About the Editors xvi
- About the Authors xvii
- Preface xxxi

### Chapter 1

**THE CREATION OF THE RELATIONSHIP**

Gregory L. Daily, Edwin Hubbard, and Darren Grzyb

<table>
<thead>
<tr>
<th>Introduction</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. History and Purposes of Surety Bonds</td>
<td>1</td>
</tr>
<tr>
<td>II. What Is a Bond?</td>
<td>4</td>
</tr>
<tr>
<td>A. Defining Features of a Surety Bond</td>
<td>5</td>
</tr>
<tr>
<td>B. Suretyship v. Insurance</td>
<td>6</td>
</tr>
<tr>
<td>III. Underwriting Considerations</td>
<td>8</td>
</tr>
<tr>
<td>A. Statutory Bonds</td>
<td>11</td>
</tr>
<tr>
<td>B. The American Institute of Architects Bond Forms</td>
<td>11</td>
</tr>
<tr>
<td>C. Subcontractor Bonds</td>
<td>12</td>
</tr>
<tr>
<td>D. Defeasance Bonds</td>
<td>12</td>
</tr>
<tr>
<td>E. Bid Bonds</td>
<td>13</td>
</tr>
<tr>
<td>IV. Execution, Delivery and Acceptance</td>
<td>14</td>
</tr>
<tr>
<td>V. Fraud by the Principal</td>
<td>15</td>
</tr>
<tr>
<td>VI. Fraud by the Obligee</td>
<td>16</td>
</tr>
<tr>
<td>VII. Unauthorized Acts by Agent</td>
<td>16</td>
</tr>
<tr>
<td>VIII. Mistake</td>
<td>17</td>
</tr>
<tr>
<td>IX. Illegality</td>
<td>18</td>
</tr>
<tr>
<td>Conclusion</td>
<td>18</td>
</tr>
</tbody>
</table>

### Chapter 2

**CONDITIONS PRECEDENT TO ASSERTING A PERFORMANCE BOND CLAIM**

Alberta L. Adams, Michael Bramhall, Todd E. Lerner, and Matthew Davis

<table>
<thead>
<tr>
<th>Introduction</th>
<th>19</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Contractor Default</td>
<td>22</td>
</tr>
<tr>
<td>A. Breach vs. Default</td>
<td>22</td>
</tr>
<tr>
<td>B. Determining Materiality</td>
<td>23</td>
</tr>
<tr>
<td>...</td>
<td>...</td>
</tr>
</tbody>
</table>
C. Asserting Contract Defenses 26
D. Conclusion 26

II. Owner Default Provisions 26
A. Owner Default Provision under the A 311 Bond 27
B. Owner Default Provision under the A 312 Bond 27

III. Notice and Declaration of Default under the A 311 Bond 28
A. Notice of Default to the Surety Required 28
B. Declaration of Default Required 30
C. Notice and/or Declaration of Default Not Required 32
D. Conclusion 38

IV. A 312 Bond Conditions 38
A. Notice Requirements under the A 312 Bond 39
B. Declaration of Principal Default 41
C. Declaration of Surety Default 45
D. Requirement for Owner and Surety to Meet 46
E. Obligation to Pay Surety 48
F. Election of Contractor under § 5.1 - § 5.3 50
G. Do the A 312 Conditions Apply to Claims for Strictly Monetary Obligations? 51

V. Situations in Which Conditions Precedent under the Bond May Not Be Enforced 52
A. Lack of Prejudice 52
B. Waiver 54

VI. Discussion Regarding Conditions Precedent under the Miller Act and Little Miller Acts 55

Conclusion 56

Chapter 3
PERFORMANCE OPTIONS AVAILABLE TO THE SURETY 57
Jamie Y. Burgett, Chad H. Melroy, Richard T. Sexton, and Michael J. Timpane

Introduction 57
I. Triggers to the Surety’s Obligation to Perform 58
A. Communication from the Obligee 59
B. Communication from Subcontractors and Suppliers 60
C. Communication from the Principal 61
II. Critical Document for the Surety’s Review 61
A. The Performance Bond 62
B. The Bonded Construction Contract 63
C. Statutes 64

III. The Surety’s Investigation of the Claim and Determination of Its Obligations 64
A. Declaration of Default 66
B. The Surety’s Investigation 67

IV. The Surety’s Performance Options 73
A. Takeover and Complete the Bonded Work 74
B. Tender a New Contractor to Complete the Bonded Work 84
C. Finance the Bonded Principal’s Completion of the Work 87
D. “Buy Out” the Bonded Obligation or Allow the Obligee to Complete the Work 92
E. Deny the Claim 94

Conclusion 95

Chapter 4
THE PERFORMANCE BOND SURETY’S RIGHTS TO CONTRACT FUNDS 97
Christopher J. Brasco, Dennis P. O’Neill, and Kimberly B. Czap

Introduction 97
I. A “Performing Surety” Derives Powerful Rights to Contract Funds from a Number of Sources 97
A. Securing Performing Surety Status 98
B. The Sources of a Performing Surety’s Rights to Contract Funds 99
C. The Various Rights to Which the Performing Surety Is Equitably Subrogated 108
D. Augmenting the Performing Surety’s Rights through a Takeover Agreement 113

II. Defending the Performing Surety’s Rights to Contract Balances Against Various Challengers 115
A. Challenges by the Principal 116
B. Challenges by Principal’s Assigners/Lenders 117
C. Challenges by Principal’s Creditors 122
D. Contests with the Obligee for Contract Funds 123
III. Particular Considerations Governing a Performing Surety’s Recovery of Contract Balances Held by the Federal Government 124
   A. Obtaining Status as Performing Surety and Securing Access to Contract Balances 124
   B. Measuring a Performing Surety’s Rights to Contract Balances on Federal Contracts against Specific Challenges 135
   C. Jurisdictional Issues that Impact the Performing Surety’s Ability to Recover Contract Balances on a Federal Procurement Contract 140

Conclusion 147

Chapter 5
SURETY’S RIGHTS OF RECOVERY AGAINST PRINCIPALS AND INDEMNITORS UNDER THE COMMON LAW AND THE INDEMNITY AGREEMENT 149
Price Jones, Daniel Pentecost, and Patricia Wager

Introduction 149
   I. The Surety’s Common Law Rights 150
      A. Quia Timet 151
      B. Exoneration 155
      C. Reimbursement 158
      D. Contribution 160
   II. The Surety’s Rights Under the Indemnity Agreement 162
      A. The Indemnity Provision 163
      B. Collateral Deposit Provision 167
      C. Right to Compel Indemnitors to Obtain Discharge of the Surety 169
      D. Settlement and Assignment Provisions 170
      E. Prima Facie Evidence Provision 170
      F. Books and Records Provision 173
      G. Reasonableness and Good Faith 175

Conclusion 176
Chapter 6
SURETY’S RIGHTS UNDER THE GENERAL INDEMNITY AGREEMENT TO MINIMIZE LOSS

Jarrod Stone, Patrick Laverty, and Munther Shamieh

Introduction
I. Provisions to Avoid/Minimize the Surety’s Loss
   A. Collateral Security Provisions
   B. Assignment Provisions
   C. Financing Statement and Other UCC Provisions
   E. Takeover, Tender, and Performance Provisions
   F. Surety Financing Provisions
   G. Trust Fund Provisions
   H. Right-to-Settle Provisions
II. Other Provisions of the Indemnity Agreement
   A. Co-Sureties and Reinsurers
   B. Severability and Partial Execution
   C. Separate Suits
   D. Waivers and Non-Waivers
   E. Surety’s Right to Obtain Financial Information from Third Parties
   F. Confession of Judgment
Conclusion

Chapter 7
RIGHT OF THE SURETY TO PURSUE CLAIMS AGAINST THIRD PARTIES

Carter Reid, John Yi, Granger Stuck, and David Stryjewski

Introduction
I. Source of a Surety’s Rights Against Third Parties
   A. Subrogation
   B. Assignment
   C. Exoneration and Indemnification
II. Claims against Subcontractors and Material Designers
III. Claims Against Design Professionals
   A. Potential Causes of Action Against Design Professionals

vii
Chapter 8
THE PERFORMANCE BOND SURETY’S EXPOSURE TO DAMAGES
Elizabeth Roman, Matthew C. Bouchard, and Mark Degenaars

Introduction

I. Foundational Principles

II. Damages Provisions in Standard Bond Forms
   A. AIA A312-2010 Performance Bond
   B. AIA A311-1970 Performance Bond
   C. ConsensusDocs 260 Performance Bond
   D. Standard Form 25
   E. Indemnity Bonds

III. The Surety’s Liability for the Obligee’s Direct Damages
   A. Completion/Correction Premiums
   B. Economic Waste
   C. Lost Revenue as Actual Damages

IV. The Surety’s Liability for Consequential Damages
   A. Direct v. Consequential Damages
   B. Actual Delay Claims
The Law of Performance Bonds, 3rd Ed.

C. Liquidated Damages Claims 349
D. Effect of Bond Language 353

V. The Surety’s Liability for Attorneys’ Fees, Costs, and Interest 354
   A. General Principles 354
   B. Recovery Under the A 312 Performance Bond 357
   C. Recovery Under the A 311 Performance Bond 359
   D. Recovery Under Defeasance Bonds 359
   E. Recovery Under Public Works Bonds 361

VI. The Surety’s Liability for Post-Completion Latent Defect Damages 361
   A. The Principal’s Substantial Completion of Bonded Work, Standing Alone, Is Unlikely to Shield the Surety from Exposure to Post-Completion Damages 361
   B. Tools for Limiting Exposure to Post-Completion Damages 364

VII. Damages Arising from the Principal’s Assumption of Design Responsibility 366

VIII. Damages Recovery by Non-Obligees 368

IX. Applicability of the Penal Sum Recited in the Bond 369
   A. The Takeover Surety 370
   B. Prejudgment Interest and Attorneys’ Fees 373
   C. Escalation Clauses in Bonds 374
   D. Bad Faith Claims 375

Conclusion 375

Chapter 9
EXTRA-CONTRACTUAL LIABILITY OF PERFORMANCE BOND SURETIES 377

Todd W. Blischke, Paul K. Friedrich, Meredith E. Dishaw, Kathryn Truman, and Jim Hamel

Introduction 377
   I. Extra-Contractual Liability of Sureties 377
      A. Recovery from Surety by Obligee for Surety’s Alleged Bad Faith 379
B. Recovery from Surety by Principal or Indemnitor for Surety’s Alleged Bad Faith 386
C. Statutory Causes of Action against Surety for Alleged Unfair Claims Handling Practices 388

II. Surety’s Exposure to Damages, Attorneys’ Fees, or Interest under Extra-Contractual Causes of Action 390
A. Damages 390
B. Attorneys’ Fees 391
C. Interest 393

III. Mitigating the Surety’s Exposure to Extra-Contractual Liability 393
A. Legislative Framework for Regulation of Suretyship 394
B. Practice Tips 396

IV. The Principal’s or Indemnitor’s Liability to Surety Under the General Indemnity Agreement When Extra-Contractual Claims are Alleged 398
A. Jurisdictions Allowing Surety to Seek Indemnity for Fees and Costs Incurred in Defending against a Bad Faith Claim 399
B. Jurisdictions Barring Indemnity for Surety Bad Faith 402

V. Surety’s Liability for Penalties and Punitive Damages Arising from the Principal’s Actions 404

VI. Surety’s Liability for Tort Claims Against Principal 409
A. Jurisdictions Allowing Recovery Against Bond for Tortious Conduct 410
B. Jurisdictions Prohibiting Recovery Against Bond for Tortious Conduct 411
C. Third-Party Claims Against Bond for Tortious Conduct 412

VII. Tax Obligations of the Principal 415
A. Miller Act Bonds 415
B. Little Miller Act Bonds 416
C. Private Performance Bonds 418

Conclusion 418
Chapter 10
COMMON DEFENSES AND AFFIRMATIVE CLAIMS ASSERTED BY PRINCIPALS AND INDEMNITORS 419
Bradford R. Carver, Michele Killebrew, and Michael Cronin

Introduction 419
I. The Surety’s Good Faith 420
   A. Recent Case Law Discussing the Good Faith Requirement 428
II. Defenses Frequently Raised by Indemnitors 436
   A. Breach of Fiduciary Duties to Indemnitors 436
   B. Claims Based Upon Abuse of Rights 438
   C. Disputes Over Execution of the Indemnity Agreement 439
   D. The Indemnitors’ Failure to Read or Understand the Indemnity Agreement 440
   E. The Surety’s Payment Was Not Reasonable 441
   F. Lack of Notice to the Indemnitors 443
   G. Waiver by Surety 445
   H. Surety’s Failure to Write Additional Bonds for Principal 446
   I. The Surety’s Failure to Finance the Principal 447
   J. Wrongful Settlement and Release of the Principal’s Affirmative Claims 448
   K. Obligee’s Breach of Its Duties to the Principal 450
   L. Demand for Excessive Collateral 452
   M. Failure to Pursue Affirmative Claims or to Litigate Claims Asserted by Obligee 457
   N. Attorneys’ Fees Incurred by the Surety 460
   O. Surety Failed to Mitigate Its Damages 470
   P. Burden of Proof Issues 471
III. Affirmative Claims Asserted by Indemnitors 474
Conclusion 485
Chapter 11.
DEFENSES AVAILABLE TO THE SURETY
Eric G. Korphage, Derek A. Popeil, and Diane J. Schumaker

Introduction

I. Project Delivery Systems Matter and May Determine Which Defenses are Available to the Surety
   A. Design-Bid-Build
   B. Design-Build
   C. GAP Finance
   D. Public-Private Partnership—P3

II. The Importance of Professional Conduct and File Documentation

III. The Surety May Rely Upon the Defenses of Its Bond Principal
   A. Defenses That May Excuse the Surety’s Performance
   B. Defenses Which May Reduce the Surety’s Liability
   C. Miscellaneous Defenses

Conclusion

Chapter 12.
LITIGATION ISSUES
Tina Kocke, Jennifer Leuschner, and Christopher A. Scifres

Introduction

I. Federal Court Jurisdiction
   A. Federal Question Jurisdiction
   B. Diversity Jurisdiction
   C. Counterclaims and Cross-Claims
   D. Ancillary Jurisdiction
   E. Abstention

II. Venue and Forum
   A. Forum Non Conveniens
   B. Forum Selection Clauses

III. Removal of State Proceedings to Federal Court
   A. Actions Removable
   B. Actions Removable in Bankruptcy Court
IV. Procedural Issues 556
   A. Stay Pending Arbitration 556
   B. Claims Subject to Stay 558
   C. The Surety’s Obligation to Arbitrate 559
   D. Indispensable Party 560
   E. Intervention 563
V. Issues Relating to Limitations 567
   A. Contractual Limitations 567
   B. Limitation Periods Stated in the Underlying Contract 571
   C. Generally 573
   D. Miller Act Claims 573
   E. Tax Claims 574
   F. Impact of Bankruptcy 574
VI. Use of Motions 575
   A. Motions for Default Judgment 575
   B. Motions for Summary Judgment 578
VII. Declaratory Judgments 580
VIII. Discovery Issues 582
   A. Amendments to Federal Discovery Rules 582
   B. General Scope 582
   C. Earlier Service of Requests for Production 583
   D. Responding and Objecting to Requests for Production 583
   E. Identification of Time Frame for Document Production 584
   F. Withholding Documents Based on Objection 584
   G. Preservation of Electronically Stored Information 584
   H. Joint Defense Privilege 585
   I. Clawback Agreements 587
IX. Jury Trial Issues 589
   A. Claims Not Subject to Jury Demand 590
   B. Waiver of Jury Trial Rights in GIA 591

Conclusion 593

Chapter 13

ARBITRATION PROVISIONS AND THE SURETY 595

Andrew Carter, Douglas J. Wills, and Kelly Perry

Introduction 595
   I. Statutory Framework 596
      A. Early Approach towards Arbitration 596
      B. Federal Arbitration Act 597
The Law of Performance Bonds, 3rd Ed.

C. State Arbitration Statutes 601
D. Consent to Arbitration 603
E. Review of Arbitral Awards 604

II. Requiring the Surety to Arbitrate 609
A. Incorporation-by-Reference Doctrine 611
B. Surety Completes the Bonded Contract 639
C. Statutory Framework Governing Arbitration 647
D. Effects of Preclusion Influencing the Surety’s Decision to Arbitrate 648

III. Consolidation of Arbitration Proceedings 649
A. Procedural vs. Substantive Questions of Arbitrability 650
B. Consolidation under the Federal Arbitration Act 651
C. Consolidation under State Statutes 657

IV. Preclusion 659
A. Res Judicata 660
B. Collateral Estoppel 663
C. Adverse Judgments or Arbitration Decisions Against Principals 665
D. Effect of Default Judgments Against the Principal 669
E. Notice to the Surety and an Opportunity for the Surety to Defend 671

V. Arbitration Procedure 676
A. Arbitration Rules 677
B. Arbitration Venue 679

Conclusion 681

Chapter 14
BANKRUPTCY 683

John W. Morris, Stephanie Geer, and Michelle Stegmann

Introduction 683
I. The History of Bankruptcy Law 684
II. The Purposes of Bankruptcy Law 695
III. Bonded Contract Funds and the Debtor’s Estate 697
A. Creating the Bankruptcy Estate 697
B. The Surety’s Rights to Bonded Contract Funds 699
IV. Effect of Bankruptcy Filings on Performance Bond Surety 710
A. The Automatic Stay 710
V. Relief from the Automatic Stay 720
VI. The Surety’s Setoff Rights with Common Obligee 724
The Law of Performance Bonds, 3rd Ed.

VII. Suppliers/Vendors: Reclamation Rights 726
VIII. Dischargeability of Debts: Preference Actions 728
   A. Elements of a Preferential Transfer 730
   B. Possible Defenses to Preferential Transfer:
      Joint Control Trust Accounts 731
   C. Avoiding Avoidance: Statutory Exceptions
to Preferential Transfers 734
IX. Pre-Packaged Bankruptcies 738
X. Assumption and Rejection of Executory Contracts 741
   A. Standards for Assumption 742
   B. The Surety’s Fight Against Assumption 744
XI. Cash Collateral 748
XII. Section 364: Post-Petition Financing 752
   A. Post-Petition Financing 752
   B. Cross-Collateralization and “Roll Up” Financing 757
   C. Section 364 (e): Safe-Harbor Protection
      for Post-Petition Financiers 758
   D. Negotiating a Section 364 Financial Agreement
      760
   E. Drafting and Implementing a Post-Position Financing
      Agreement and Seeking a Financing Order 762
XIII. Actions to Take Control of the Principal’s Reorganization 764
   A. Motion to Convert a Chapter 11 Reorganization
      to a Chapter 7 Liquidation 765
   B. Motion to Appoint a Trustee or Examiner 770
   C. Involuntary Bankruptcy as a Remedy 775
XIV. Proof of Claim 782
Conclusion 783

Table of Cases 785