

## No good deed goes unpunished with performance bonds

Great care must be taken to ensure that all claim requirements of bond are satisfied

**W**ith economic conditions becoming more ominous, the use and management of performance bonds provided by subcontractors may be increasingly important to



### CONSTRUCTIVE ADVICE

Guy A. Randles

prime contractors. A recent Washington Supreme Court case, *Colorado Structures v. Insurance Company of the West*, provides a timely reminder that obtaining a performance bond from a subcontractor is a far cry from actually getting the subcontractor's surety to step up in the event of a subcontractor default. One can count on the fact that sureties will try to insist on compliance with every technical requirement before paying up on their bonds.

The case arose during the construction of a WalMart store by Colorado Structures. Colorado Structures subcontracted with Action Excavating and Paving to perform the sewer work and Insurance Company of the West issued a performance bond.

Action's work on the project languished, and the project schedule was put in jeopardy. However, due to the potentially stiff penalties if the project was delayed further, Colorado Structures opted not to terminate Action because that would have resulted in even greater delays. Rather, Colorado Structures tried to expedite Action's performance by supplementing its crew and equipment. All the while, Colorado Structures kept West informed of Action's performance problems and the steps it was taking to mitigate those problems. However, West refused Colorado Structures' requests that it send representatives to visit the site or to discuss Action's poor performance. Instead, without any notice to Colorado Structures, West stopped writing bonds for Action and obtained a judgment against Action's owners for an amount that included the potential payments to Colorado Structures on Action's bond.

One would have thought that West would appreciate Colorado Structures' cooperative approach, which avoided an immediate termination of Action's contract. After all, Colorado Structures undoubtedly minimized the damages to the surety by working to facilitate Action's performance, all with full knowledge of the surety. However, when Action completely defaulted in its performance at the end of the project and Colorado Structures sought to recover the increased costs incurred due to Action's breaches, West refused to pay on the bond. West argued that

**Do not assume that what is right or fair will happen in the weird world of surety law. Although the Colorado Structures case had a happy ending for the prime contractor, it had to invest in years of litigation and attorney fees to get there.**

Colorado Structures had waived its rights to make a bond claim because it had failed to formally declare Action in default and terminate the subcontract before the sewer work was substantially complete. The surety argued that its knowledge of Action's breaches and Colorado Structures' steps to mitigate damages did not substitute for the default notification it claimed was required under the terms of its bond.

The case turned on an interpretation of the language in AIA Bond Form A3111. West relied on a federal case that had held that for the surety to be liable, a prime contractor had to declare a formal default and terminate the contract before its claim matured. Fortunately for Colorado Structures, the Washington Supreme Court held in a close decision that the federal case failed to properly analyze the bond language. Instead, the Supreme Court held that the bond language at issue did not require a formal default declaration or subcontract termination for the surety to be liable.

The moral of this story is that great care must be taken to ensure that all the claim requirements of a bond are satisfied, or the surety may try to skate. Even if a prime contractor has the best of intentions, keeps the surety informed and actually mitigates its damages, the surety may try to invoke arcane defenses to avoid responsibility. Do not assume that what is right or fair will happen in the weird world of surety law. Although the Colorado Structures case had a happy ending for the prime contractor, it had to invest in years of litigation and attorney fees to get there. Remember, too, that there are many different bond forms. The fact that in Washington the AIA Bond Form A3111 will be interpreted reasonably does not mean that other bond language or litigation in other states will cause the same result.

*Guy A. Randles is the chair of the construction and design practice group at Stoel Rives. Contact him at (503) 294-9288 or [garandles@stoel.com](mailto:garandles@stoel.com).*