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IS THE COMPENSATED SURETY RESPONSIBLE FOR CONSEQUENTIAL DAMAGES UNDER A PERFORMANCE BOND?

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I. Performance Bond

A. Defined - Guarantees performance of the Principal (contractor/subcontractor) to Obligee (owner/general contractor) in the following language:

> "Whereas, Contractor has by written agreement dated ____________________, 19__, entered into a contract with Owner for ____________________ ____________________ in accordance with Drawings and Specifications prepared by ____________________ which contract is by reference made a part hereof, and is hereinafter referred to as the Contract.
>
> NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that, if Contractor shall promptly and faithfully perform said Contract, then this obligation shall be null and void; otherwise it shall remain in full force and effect.
>
> The Surety hereby waives notice of any alteration or extension of time made by the Owner.
>
> Whenever Contractor shall be, and declared by Owner to be in default under the Contract, the Owner having performed Owner's obligations thereunder, the Surety may promptly remedy the default, or shall promptly
>
> 1. Complete the Contract in accordance with its terms and conditions, or
>
> 2. Obtain a bid or bids for completing the Contract in accordance with its terms and conditions, and upon determination by Surety of the lowest responsible bidder, or, if the Owner elects, upon determination by the Owner and the Surety jointly of the lowest respon-

sible bidder, arrange for a contract between such bidder and Owner, and make available as Work progresses (even though there should be a default or a succession of defaults under the contract or contracts of completion arranged under this paragraph) sufficient funds to pay the cost of completion less the balance of the contract price; but not exceeding, including other costs and damages for which the Surety may be liable hereunder, the amount set forth in the first paragraph hereof. The term "balance of the contract price," as used in this paragraph, shall mean the total amount payable by Owner to Contractor under the Contract and any amendments thereto, less the amount properly paid by Owner to Contractor.

B. Distinguished - from payment bond which runs to subcontractors, suppliers and materialmen and guarantees payment for labor or materials incorporated in the job.

II. <u>Consequential Damages</u>

A. Defined - Damages for delay in completion, damages for lost profits due to delay in completion, damages for lost rental income and other types of indirect damages flowing from failure to complete the project.

B. Distinguished from Compensatory damages which are damages caused directly by breach of contract such as the cost to complete (which is usually more than the contracted for cost based upon the passage of time and escalating prices for labor and materials generally associated with passage of time).

III. Weight of Authority - Surety is liable for compensatory and consequential damages flowing from failure of Principal to complete the contract. *Amerson v. Christman*, 261 Cal.App.2d 811 (Cal.App. 3d Dist. 1968); *Burnett and Doty Development Company v. C.S. Phillips*, 86 Cal.App.3d 384 (Cal.App. 1978); *Prudence Company, Inc. v. Fidelity & Deposit Company of Maryland*, 297 U.S. 198 (1935).

A. The above rule is based upon the fact that the bond incorporates by reference the Owner/Principal contract which makes the Surety's liability coextensive with that of its Principal. *Aetna Casualty & Surety Company v. Warren Brothers Company, Division of Ashland Oil, Inc.*, 335 So.2d 785 (Fla. 1978); *National Union Fire Insurance Company of Pittsburgh, Pennsylvania v. Robuck*, 203 So.2d 204 (Fla. 1st DCA 1967).

B. Common law of most states (and statutes in some states) declare that one who breaches a contract is responsible for the direct and consequential damages which were reasonably within the contemplation of the parties to the contract. *T.D.S., Inc. v. Shelby Mutual Insurance Co.*, 760 F.2d 1520 (11th Cir. 1985); *Travelers*

Indemnity Company v. Parkman, 300 So.2d 284 (Fla. 4th DCA 1974); *First National Insurance Agency, Inc. v. Leesburg Transfer & Storage, Inc.*, 139 So.2d 476 (Fla. 2nd DCA 1962).

IV. Minority (Reasoned) View - Surety is not liable for consequential damages flowing from the breach of the construction contract by Principal. *United States Fidelity & Guaranty Company v. Gulf Florida Development Corporation*, 365 So.2d 748 (Fla. 1st DCA 1978).

A. The Surety does not undertake to do more than is expressed in the bond and has the right to stand upon the strict terms of the bond. *United States Fidelity & Guaranty Company v. Gulf Florida Development Corporation*, 365 So.2d 748 (Fla. 1st DCA 1978); *Crabtree v. Aetna Casualty and Surety Company*, 438 So.2d 102 (Fla. 1st DCA 1983).

B. A performance bond is like any other contract and the Surety's liability is not to be extended by implication beyond the terms of its contract. *Gato v. Warrington*, 19 So. 883, 37 Fla. 542 (Fla. 1896); *Standard Accident Insurance Company v. Bear*, 184 So. 97, 134 Fla. 423 (1938).

V. Conflict in Florida (only state where minority view has been upheld) comes down to whether the terms of the bond control or whether incorporated construction contract terms control Surety's liability upon default. *United States Fidelity & Guaranty Company v. Gulf Florida Development Corporation*, 365 So.2d 748 (Fla. 1st DCA 1978); *St. Paul Fire & Marine Insurance Company v. Wooley/Sweeney*, 545 So.2d 958 (Fla. 4th DCA 1989).

A. Under latter - If Surety's liability is co-extensive with that of the principal, the court will look to the construction contract which spells out all things Principal is responsible for including completion by a date certain, providing liability insurance, workmen's comp insurance, etc.

B. Under former Court will look to bond language to determine liability of Surety. That language says upon default the Surety will:

1. remedy default or
2. complete
    a. itself or
    b. obtain a bid for completing

VI. Liquidated Damages

A. Generally, surety is liable for liquidated damages where Principal's contract contains an enforceable liquidated damages provision. *Ranger Construction Company v. Prince William County School Board*, 605 F.2d 1298 (4th Cir. 1979); *Aetna Casualty & Surety Co. v. Butte-Meade Sanitary Water District*, 500 F. Supp. 193 (D.S.D. 1980); *Mason v. City of Albertville*, 158 So.2d 924 (Ala. 1963).

B. Surety may not be liable for liquidated damages where project is abandoned entirely. *Fisher v. Fidelity & Deposit Company of Maryland*, 466 N.E.2d 332 (Ill.App. 1984); *Six Companies of California v. Joint Highway District No. 13 of the State of California*, 311 U.S. 180 (1940).

VII. Conclusion

Unless the surety can convince the court that the bond by its own terms limits damages to those compensatory, the surety will generally be held liable for consequential damages also. What is the reasonable expectation of the surety regarding consequential damages for principal's breach, when the bond is furnished? The courts have not yet fully examined and developed the rationale for permitting, or alternatively excluding, consequential damages from coverage under the performance bond.

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