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**NAVIGATING THE LABYRINTH: PRACTICAL ISSUES
ARISING WHEN LITIGATING AIA A312 PERFORMANCE
BOND CLAIMS**

PRESENTED BY:

MARIA DEL CARMEN RAMOS
SHUMAKER, LOOP & KENDRICK, LLP
101 East Kennedy Boulevard, Suite 2800
Tampa, Florida 33602
(813) 229-7600

- AND -

NANCY MANNO
ATLANTIC MUTUAL INSURANCE COMPANY, INC.
Madison, New Jersey

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BY MARIA DEL CARMEN RAMOS
SHUMAKER, LOOP & KENDRICK, LLP
TAMPA, FLORIDA

- AND -

NANCY MANNO
ATLANTIC MUTUAL INSURANCE COMPANY, INC.
MADISON, NEW JERSEY¹

INTRODUCTION

The term labyrinth is often used interchangeably with the term maze to refer to an intricate combination of paths or passages in which it is difficult to find one's way or to reach the exit.² In Greek mythology, the labyrinth was "an elaborate structure constructed for King Minos of Crete and designed by the legendary artificer Daedalus to hold the Minotaur, a creature that was half man and half bull and which was eventually killed by the Athenian hero Theseus."³ According to Greek legend, however, Daedalus "made the Labyrinth so cunningly that he himself could barely escape it after he built it."⁴

The Athenian Daedalus, son of Metion and the grandson of Erechtheus, was a famous architect, inventor, and craftsman. Among his inventions and creations were the wooden cow he constructed for the queen Pasiphae, the Labyrinth at Knossos, artificial wings for himself and his son Icarus, and he was even said to have invented images.

His homeland was Athens. For a short time, his apprentice was his sister's son Perdix. When Daedalus feared that the boy would surpass him in talent, he murdered the boy by tossing him from the Acropolis of Athens. He was then tried at the Areopagus and banished from the city.

¹ **Note:** The views expressed in this article are those of the authors and do not necessarily reflect the views of Atlantic Mutual Insurance Company or any of its affiliated insurance companies. This article is for general informational purposes only. None of it constitutes legal advice, nor is it intended to create any attorney-client relationship between you and the authors. You should not act or rely on this information concerning the meaning, interpretation, or effect of particular contractual language or the resolution of any particular demand, claim, or suit without seeking the advice of your own attorney.

² <http://en.wikipedia.org/wiki/Labyrinth>.

³ *Id.*

⁴ *Id.*

He fled to Crete, where he began to work at the court of King Minos and Queen Pasiphae, in the magnificent palace of Knossos. There he constructed a wooden cow for the queen to hide in to satisfy her amorous longings for a white bull sent by Poseidon, and by which she became pregnant with the Minotaur.

When the Minotaur was born, Daedalus built the Labyrinth to contain the monstrous half-man, half-bull. For years Minos demanded a tribute of youths from Athens to feed the creature. Eventually, the hero Theseus came to Crete to attempt to slay the Minotaur. Ariadne, daughter of Minos and Pasiphae, fell in love with Theseus and asked Daedalus to help him. Daedalus gave her a flaxen thread for Theseus to tie to the door of the Labyrinth as he entered, and by which he could find his way out after killing the monster. Theseus succeeded, and escaped Crete with Ariadne. Minos, enraged at the loss of his daughter, shut Daedalus and his son Icarus into the Labyrinth.

To escape, Daedalus built wings for himself and Icarus. They successfully flew from Crete, but Icarus' wings melted when he flew too close to the sun, and he drowned in the sea. Daedalus buried his son and continued to Sicily, where he came to stay at the court of Cocalus.⁵

Like Daedalus, the surety industry has created its own version of a labyrinth: the American Institute of Architects (“AIA”) A312 Performance Bond (“A312 Bond”). In 1984, the AIA, in conjunction with the surety industry, promulgated the standard AIA in an effort to unambiguously set forth the scope and extent of, among other things, a surety’s liability, the conditions precedent to triggering the surety’s performance obligations, the options available to the surety in satisfying its bond obligations, and the duration of the surety’s obligation.⁶

Although one leading commentator has described the A312 Bond as “one of the clearest, most definitive, and widely used type of traditional common law ‘performance bonds’ in private construction,” the A312 Bond nevertheless creates its own intricate combination of provisions through which obligees must navigate their way to obtain recovery under the A312 Bond.⁷

Obligees, however, are not on their own. The surety industry has given obligees their own flaxen thread: paragraph 3 of the A312 Bond. Paragraph 3 details for the obligee the

⁵ <http://www.pantheon.org/articles/d/daedalus.html>

⁶ Among some of the most important provisions of the A312 Bond are “(1) scope of the bond obligation; (2) trigger to surety liability; (3) surety’s options to satisfy its bond obligations; (4) limitations on surety liability; (5) damages recoverable; (6) unrelated claims and setoffs, and limitations of right of action; (7) waiver of notice; (8) duration of the bonded obligation; and (9) statutory requirements.” See PHILIP L. BRUNER AND PATRICK J. O’CONNOR, JR., *Suretyship: Assuring Contract Performance*, in 4 BRUNER & O’CONNOR CONSTRUCTION LAW §12:16 (May 2007)

⁷ *Id.*

specific requirements they must comply with in order to recover under the A312 Bond (provided, of course, the obligee has not materially defaulted under the bonded contract).⁸

While the A312 Bond generally creates a labyrinth the obligee must navigate, sureties also must be vigilant against suffering the fate of Daedalus: being trapped by the obligee in the very labyrinth the surety has created. Fortunately, the surety need not build a set of wings to avoid being ensnared in the labyrinth. Rather, a thorough understanding of its obligations under paragraph 4 of the A312 Bond and its potential exposure to liability under paragraph 6 of the A312 Bond should be all a surety needs to avoid to being trapped in the labyrinth.

THE “FLAXEN THREAD”: PARAGRAPH 3

The surety’s obligations under the A312 Bond are spelled out in paragraphs 1 and 2. Those paragraphs make clear that the surety and the contractor are jointly and severally liable under the A312 Bond for “the performance of a construction contract.” Those paragraphs also specifically incorporate the underlying construction contract, making clear that the bond obligation is coextensive with that of the underlying bonded contract.⁹ Accordingly, no obligation arises under the bond for performance of the bonded contract so long as “the contractor performs the construction contract.”¹⁰

Failure to properly perform the construction contract by itself, however, does not trigger a surety’s liability under the A312 Bond. Indeed, it is well established that a surety’s obligation does not arise until the obligee satisfies the requirements of paragraph of 3 the A312 Bond. That paragraph specifically provides that a surety is not obligated under the Bond until:

- 3.1 The Owner has notified the Contractor and the Surety at its address described in Paragraph 10 below that the Owner is considering declaring a Contractor Default and has requested and attempted to arrange a conference with the Contractor and the Surety to be held no later than fifteen days after receipt of such notice to discuss methods of performing the Construction Contract. If the Owner, the Contractor and the Surety agree, the Contractor shall be allowed a reasonable time to perform the Construction Contract, but such an agreement shall not waive the Owner’s right, if any, subsequently to declare a Contractor Default; and
- 3.2 The Owner has declared a Contractor Default and formally terminated the Contractor’s right to complete the contract. Such Contractor Default shall not be declared earlier than twenty days after the Contractor and the Surety have received notice as provided in Subparagraph 3.1; and

⁸ See *Beard Family P’ship v. Commercial Indem. Ins. Co.*, 116 S.W. 3d 839 (Tex. App. Austin 2003); *Enterprise Capital, Inc. v. San-Gra Corp.*, 282 F. Supp. 2d 166 (D. Mass. 2003).

⁹ See A312 Performance Bond, ¶¶1, 2.

¹⁰ 4 BRUNER & O’CONNOR CONSTRUCTION LAW §12:16 (May 2007).

- 3.3 The Owner has agreed to pay the Balance of the Contract Price to the Surety in accordance with the terms of the Construction Contract or to a contractor selected to perform the Construction Contract in accordance with the terms of the Contract with the Owner.¹¹

Thus, to trigger the surety's obligations, the obligee must satisfy all of the following conditions:

1. Notify the contractor and surety that the owner is considering declaring the contractor in default (§ 3.1);
2. Attempt to arrange a conference with the contractor and surety within fifteen days of the receipt of the notice to discuss methods of performing the construction contract (§ 3.1);
3. Wait at least twenty days after the contractor and the surety have received notice as provided in subparagraph 3.1 (§ 3.2);
4. Declare a contractor default and formally terminate the contractor's right to complete the construction contract (§ 3.2); and
5. Agree to pay the balance of the contract price (§ 3.3).¹²

Moreover, the obligee must not itself be in default of the bonded contract and "must properly follow the contract termination procedure after giving the contractor and the surety whatever opportunity to 'cure' the deficiencies upon which the owner relies to terminate the bonded contract that are mandated by the contract documents and the applicable law."¹³

In *Donald M. Durkin Contracting, Inc. v. City of Newark*, 2006 WL 2724882 (D. Del. Sept. 22, 2006), where the general contractor sued the owner for breach of contract for improper termination of the construction contract and the owner turned around and sued the surety that provided the performance bond, the court found that the owner was not entitled to bond coverage because the owner had failed to comply with the contractually mandated notice-to-cure.

In *Durkin*, the AIA A312 performance bond issued by surety required a notice that the owner was *considering* declaring a contract default from the owner at least twenty days prior to

¹¹ AIA A312 Performance Bond.

¹² PATRICK KINGSLEY AND DAVID BURKHOLDER, *Performance Bond Notice Provisions: 36 Million Reasons to Comply*, FIDELITY AND SURETY LAW COMMITTEE NEWSLETTER (Fall 2007).

¹³ 4 BRUNER & O'CONNOR CONSTRUCTION LAW §12:16 (May 2007).

actually declaring the default.¹⁴ In addition to the performance bond notice requirements, the underlying bonded contract required the owner to provide both the general contractor and its surety with seven days' written notice of the owner's intent to declare a contractor default and terminate the construction contract.¹⁵ Thus, while the owner complied with each of the notice requirements in the bond, the owner failed to comply with its notice obligations under the contract.¹⁶

Ultimately, the court denied coverage and the surety was dismissed as a matter of law.¹⁷ In determining that failure of the owner to abide with its notification requirements discharged the surety's obligations, the court reasoned as follows:

It is clear that the 'considering declaring' provision of the Bond functions to initiate a conflict-resolution process that could potentially obviate a declaration of default. Further the parties proceeded to carry out these steps ostensibly to resolve the conflicts. For these reasons, it is unreasonable to suggest that the November 21 letter was notice under Paragraph 3.1 of the Bond, and at the same time, notice under Section 15.2 of the Construction Contract. The procedural requirements of Paragraph 3.1 are expressly *before* a declaration of default and the requirement of Section 15.2 of the Construction Contract must necessarily *be* a declaration of default or intent to terminate.¹⁸

Moreover, an owner's failure to comply with the conditions precedent set forth above should discharge the surety of any liability to the obligee under the bond.¹⁹ For example, in *Dragon Constr., Inc. v. Parkway Bank & Trust*, 678 N.E.2d 55 (Ill. St. DCA 1997), the Appellate Court of Illinois discharged the surety for this very reason—holding that the obligee's failure to provide adequate notice of the principal's termination and the obligee's hiring of a successor contractor before providing notice to the principal's performance bond surety strips the surety

¹⁴ *Durkin*, 2006 WL 2724882 at n. 3.

¹⁵ *Id.* at *8.

¹⁶ *Id.*

¹⁷ *Id.* at *9.

¹⁸ *Id.*

¹⁹ See, e.g., *USF & G v. Brastrepo Oil Servs. Co.*, 369 F.3d 34, 51 (2d Cir. 2004) ("[B]efore a surety's obligations under a [performance] bond can mature, the obligee must comply with any conditions precedent."); *LBL Skysystems (USA), Inc. v. APG-America, Inc.*, 2006 WL 2590497, at *23 (E.D. Pa. Sept. 6, 2006) ("the language of Paragraph 3 of the Performance Bond, that 'the Surety's obligations under this bond shall arise after. . .' creates conditions precedent to the duty of the surety"); *St. Paul Fire & Marine Ins. Co. v. City of Green River*, 93 F. Supp. 2d 1170 (D. Wyo. 2000) (the requirements set forth in paragraph 3 are conditions precedent); *Bank v. Brewton, Inc. v. Int'l Fid. Ins. Co.*, 827 So. 2d 747 (Ala. 2002) (surety was not liable for a general delay damage claim when obligee failed to comply with subparagraph 3.2 and 3.3); *Dadeland Station Assoc., Ltd. v. St. Paul Fire and Marine Ins. Co.*, 2003 WL 21981974 (S.D. Fla. June 13, 2003) (holding that surety was not required to do anything until all the conditions in paragraph 3 of the performance bond were satisfied and therefore, there could be no claim against the surety for bad faith for delayed performance).

of its right to limit its liability and constitutes a material breach of the contract.²⁰ As the court reasoned,

If [the contractor-principal] were declared to be in default, [the surety] would be entitled to select, or at the very least, participate in selecting the lowest bidding contractor to complete the project in order to mitigate its damages under the performance bond. Surely, [the surety] would not have issued the surety bonds if it did not have the authority to protect itself through the selection of a successor contractor. Furthermore, the seven-day notice requirement [in the termination clause of the bonded contract] is a means to provide the surety with time to get the search for a successor contractor underway. We find that the [obligee's] failure to provide adequate notice of [the principal's] termination and hiring of a successor contractor before [the surety] received the late notice stripped [the surety] of its right to limit its liability and constituted a material breach of contract which rendered the surety bond null and void.²¹

It is important to note here, however, that despite the fact that case law appears to set forth a bright line rule that paragraph 3 is a condition precedent prior to an obligee recovering against a surety that is not always the case. “Even where case law is favorable to the surety, counsel will still be responding to arguments that “shall arise after” does not expressly and unequivocally set forth express conditions precedent to the surety’s obligations; or that substantial compliance by the obligee is sufficient; or that the performance bond terms are not unenforceable since they are more restrictive than statutorily permitted; or that the surety waived the obligee’s obligations under paragraph 3; and/or that paragraph 3 should not be read in conjunction with the surety’s obligations to choose a completion option under paragraph 4, should not be read in conjunction with the surety default provisions of paragraph 5, or should not be read in conjunction with the damage provisions set forth in paragraph 6.”²² As such, sureties need to be prepared to address these arguments.

AVOIDING THE LABYRINTH: “BUILDING WINGS” BY CHOOSING A COURSE OF ACTION UNDER PARAGRAPH 4

The purpose of the notice provisions discussed above permit a surety to weigh its options under the A312 Bond in order to mitigate its liability. Unlike past performance bonds that simply obligated the surety to complete the underlying bonded contract pursuant to the terms therein, the A312 Bond spells out an array of options available to the surety.²³ In particular, Paragraph 4 of the A312 Bond provides:

²⁰ *Dragon Constr.*, 678 N.E.2d at 58.

²¹ *Id.*

²² STEPHEN WEINBERG, *Does it set forth Conditions Precedent?: The AIA A312 Performance Bond*, in 49 No. 3 DRIFTD 57 (Mach 2007).

²³ “AIA Document 311 Performance Bond provides that, upon default of the principal, the performance bond surety has two options: (1) complete the contract itself; or (2) obtain bids for completion from contractors and

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

- 4.1 Arrange for the Contractor, with consent of the Owner, to perform and complete the Construction Contract; or
- 4.2 Undertake to perform and complete the Construction Contract itself, through its agents or through independent contractors; or
- 4.3 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's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issues on the Construction Contract, and pay to the Owner the amount of damages as described in Paragraph 6 in excess of the Balance of the Contract Prince incurred by the Owner resulting from the Contractor's default; or
- 4.4 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, tender payment therefore to the Owner; or
 - .2 Deny liability in whole or in part and notify the Owner citing reasons therefor.²⁴

Thus, in the event the principal has materially breached the underlying bonded contract and remains in default, the A312 Bond provides the surety with a variety of affirmative responses, including: (i) financing the principal's completion of the bonded project; (ii) surety's takeover of the project with its own subcontractors and laborers; (iii) tendering of another contractor with whom the obligee may enter into a completion contract and for which the surety will be responsible for completion costs in excess of the remaining contract balance funds; (iv) "buy

finance the project to completion, if necessary, over and above the remaining contract balance." See EDWARD GALLAGHER, THE LAW OF SURETYSHIP, 91, n.39 (American Bar Association, 2000).

²⁴ AIA A312 Performance Bond.

back” of the bond in a straight cash settlement; or (v) “do nothing.”²⁵ Importantly, absent a default, a performance bond surety *cannot* interfere with its principal’s performance on a bonded contract or the obligee’s declaration of default.²⁶

Once the obligee has triggered the surety’s performance obligations and the surety has completed its investigation, the surety must decide whether to admit or deny liability under its performance bond by considering “the obligee’s stated grounds for default and assess its contract and bond defenses all within the complex construction and engineering problems at the heart of many disputes”²⁷ and within the time parameters afforded by the bond and underlying contract. As one commentator has observed: “Each performance option has its own rights and rewards, advantages and disadvantages, and potential headaches that the surety must consider carefully. Because of the financial risks of the ‘do nothing’ indemnity option, sureties frequently advocate tender or takeover options subject to a full and complete reservation of rights against the obligee’s termination of the bonded contract was wrongful.”²⁸

THE SURETY’S LIABILITY: ISSUES RAISED BY PARAGRAPH 6

To most sureties, however, the surety’s most important consideration is their bottom line exposure. Under a performance bond, an obligee’s measure of damages depends in large part upon the terms of the bond and the underlying contract.²⁹ Bonded contracts may or may not provide for liquidated damages and/or waive consequential damages altogether.³⁰ Examining the terms of the underlying bonded contract (and, in particular, determining whether the bonded contract provides for liquidated damages and/or waives consequential damages) is important because:

[t]he paramount controversies surrounding the scope of performance bond coverage have been issues over recovery for damages *consequential* to the contractor’s improper or untimely completion of the bonded contract, such as:

²⁵ The most common disputes prompting obligees to propose termination of a bonded contract “involve issues of conformance of the work with the plans and specifications, timeliness of performance, and responsibility for delay and ambiguous contractual allocation of the risks of construction.” 4 BRUNER & O’CONNOR CONSTRUCTION LAW §12:77 (May 2007); *Dadeland Station Assoc., Ltd. v. St. Paul Fire and Marine Ins. Co.*, 2003 WL 21981974 (S.D. Fla. 2003) (finding a surety that reasonably refused to perform as not acting in “bad faith.”).

²⁶ 4 BRUNER & O’CONNOR CONSTRUCTION LAW §12:35 (May 2007).

²⁷ *Id.* at §12:77.

²⁸ *Id.*

²⁹ *Chatham Partners, Inc. v. Fid. and Deposit Co. of Maryland*, 6 Fed. Appx. 81 (2d Cir. 2001).

³⁰ See AIA Document A201-1997, General Conditions of Contract, ¶4.3.10; see also *Nat’l Fire Ins. Co. of Hartford v. Fortune Constr. Co.*, 320 F.3d 1260 (11th Cir. 2003) (surety was liable for liquidated damages under the performance bond, where the bond incorporated by reference the construction contract that contained a liquidated damages provision); *Cates Constr. Co. v. Talbot Partners*, 980 P.2d 407, 414-15 (delay damages were recoverable because the surety knew from the construction contract that time was of the essence and the purpose of the bond was to secure the faithful performance of the contract); *Downington Area School Dist. v. Int’l Fid. Ins. Co.*, 769 A.2d 560 (Pa. Commw. 2001) (performance bond surety was not responsible for delay damages).

1. Delay damages;
2. Failure to meet production requirements;
3. Damages resulting from the contractor's failure to provide required insurance;
4. Liabilities arising out of the contractor's failure to pay certain taxes;
5. Loss of use of the bonded project or other work;
6. Loss of profits on the resale of the bonded project or other work;
7. Attorney's fees;
8. Prejudgment interest;
9. Extra-contractual damages;
10. Compensatory damages in excess of the bond amount; and
11. Return monies improperly withheld or paid out by principal.³¹

Under general contract law, a non-breaching party generally may recover two types of damages: (i) "general" damages, or those which "naturally arise from the breach," and (ii) "consequential" damages, or those which may not naturally flow from the breach but which may reasonably have been "in the contemplation of the parties" at the time of contracting.³² The distinction between the two has been explained as:

There are two broad categories of damages Ex contractu: direct (or general) damages and consequential (or special) damages. . . . Direct damages are those which arise 'naturally' or 'ordinarily' from breach of contract; they are damages which, in the ordinary course of human experience, can be expected to result from a breach. Consequential damages are those which arise from the intervention of 'special circumstances' not ordinarily predictable. If damages are determined to be direct, they are compensable. If damages are determined to be consequential, they are compensable only if it is determined that the special circumstances were within the "contemplation" of both contracting parties. Whether damages are direct or consequential is a question of law. Whether special

³¹ 4 BRUNER & O'CONNOR CONSTRUCTION LAW §12:34 (May 2007).

³² *Hardwick Props., Inc. v. Kenneth P. Newbern*, 711 So. 2d 35, 39-40 (Fla. 1st DCA 1998).

damages were within the contemplation of the parties is a question of fact.³³

Thus, as a general rule, consequential damages arise from special circumstances and are recoverable if the breaching party was or should have been aware of such special circumstances at the time of contracting and resulting loss was foreseeable.³⁴ The RESTATEMENT (SECOND) OF CONTRACTS (1979) §351 further defines the foreseeability of damages as follows:

- (2) Loss may be foreseeable as a probable result of a breach because it follows from the breach
 - (a) in the ordinary course of events, or
 - (b) as a result of special circumstances, beyond the ordinary course of events, that the party in breach had reason to know.

As such, consequential damages, as the ones set forth above, may be recoverable if they are reasonably foreseeable at the time of contracting as *directly flowing* from a breach of the bonded contract.³⁵ But such recovery, however, is conditioned upon the specific terms of the performance bond and bonded contract.³⁶

Paragraph 6 of the A312 Bond, however, limits the type of delay damages that may be sought when there is a formal termination and the surety has selected the completion option under paragraph 4 of the A312 Bond.³⁷ In particular, paragraph 6 of the A312 Bond provides:

After the Owner has terminated the Contractor's right to complete the Construction Contract, and if the Surety elects to act under Subparagraph 4.1, 4.2, 4.3 above, then the responsibilities of the Surety to the Owner shall not be greater than those of the

³³ *Roanoke Hosp. Ass'n v. Doyle & Russell, Inc.*, 214 S.E.2d 155 (Va. 1975).

³⁴ *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 145 (8154); RESTATEMENT (SECOND) OF CONTRACTS §351.

³⁵ *Cates Constr., Inc. v. Talbot Partners*, 980 P.2d 407, 414-415 (Cal. 1999) (delay damages were recoverable because the surety knew from the construction contract that time was of the essence and the purpose of the bond was to secure the faithful performance of the contract); *In re Technology For Energy Corp.*, 140 B.R. 214 (Bankr. E.D. Tenn. 1992) (surety's liability was limited to the penal sum despite the total sum of change orders totaled in excess of the penal sum).

³⁶ *McNally Wellman Co., v. New York State Elec. & Gas Corp.*, 63 F.3d 1188 (2d Cir. 1995) (court upheld clause providing that contractor was exempt of any liability for any special, incidental, indirect or consequential damages); see also *Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F. Supp. 91 (D.R.I. 1999) (holding that surety was not liable, under subcontractor's performance bond, for consequential damages arising from subcontractor's default, where the bond provided that measure of surety's liability would be amount by which cost of completion exceeded unpaid balance of subcontract price and made no provision for consequential damages); *Salvino Steel & Iron Works, Inc. v. Fletcher & Sons, Inc.*, 580 A.2d 853 (1990) (finding that bond and statute were silent as to delay damages).

³⁷ *Int'l Fid. Ins. Co. v. County of Rockland*, 98 F. Supp. 2d 400, 437 (S.D.N.Y. 2000).

Contractor under the Construction Contract. . . .To the limit of the amount of this Bond, but subject to commitment by the Owner of the Balance of the Contract Price to mitigation of costs and damages on the Construction Contract, the Surety is obligated without duplication for:

- 6.1 The responsibilities of the Contractor for correction of defective work and completion of the Construction Contract;
- 6.2 Additional legal, design professional and *delay costs* resulting from the Contractor's Default, *and resulting from the actions or failure to act of the Surety under Paragraph 4*; and
- 6.3 Liquidated damages, or if no liquidated damages are specified in the Construction Contract, *actual damages caused by delayed performance or nonperformance of the Contractor.*³⁸

Because delayed completion of a bonded project due to inexcusable contractor delays often results in delay damages that the obligee seeks to later recover from the performance bond surety, sureties should pay particular attention to the language of Paragraph 6. At first glance, the A312 Bond form appears to be favorable to the surety. Section 6.3, however, can be a cause for concern if the bonded contract, for example, includes provision 4.3.10 of the AIA A 201 General Conditions (1997)³⁹, which waives the recovery of consequential damages altogether.

³⁸ AIA A312 Performance Bond, Paragraph 6 (emphasis added).

³⁹ Specifically, Section 4.3.10 of the General Conditions of the Contract provides:

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

- .1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
- .2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Subparagraph 4.3.10 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

The inclusion of provision 4.3.10 is potentially problematic because section 6.3 of the A312 Bond appears to contradict the language of the bonded contract, and since courts have an inconsistent view on what constitutes consequential damages, this opens the door for obligees to recover where they would not otherwise have been able to. As such, “[a]bsent language of limitation in the performance bond or bonded contract or in a valid liquidated damage provision in the bonded contract, reasonable direct damages for delay, if proven, are recoverable within the bond amount.”⁴⁰ The surety should keep this mind while it is investigating a bond claim and weighing which performance option to elect.

CONCLUSION

Absent a thorough understanding of the terms of the A312 Bond, a performance bond surety may suffer the same fate as Daedalus: getting trapped in the very labyrinth the surety created. For that reason, a surety—upon receipt of a bond claim—should review the underlying bonded contract and the bond to determine, among other things, whether there is a waiver of consequential damages provision and whether the A312 Bond provides for the recovery of delay damages to the obligee in the form of liquidated damages—all the while keeping in mind the notice requirements and its performance options set forth in each document. Moreover, the surety must also keep the bond language in mind when investigating the claim and determining how to proceed. It is imperative that the surety quickly determine whether it is in the surety’s best interests to waive some of the notice requirements in order to avoid further delay in a project (and, thus, becoming potentially liable for increased delay damages while its navigates its way out of the labyrinth).

Because of the complexities of the construction process, the limited time available for investigation, as well as the frequency of competing contentions between obligees and principals, there is no surefire “right” way to proceed. But by following the foregoing suggestions, the performance bond surety can at least minimize the risk of being trapped in its own labyrinth.

⁴⁰ 4 BRUNER & O’CONNOR CONSTRUCTION LAW §12:34 (May 2007).

Maria del Carmen Ramos is an associate in the Tampa, Florida office of Shumaker, Loop & Kendrick, LLP. Ms. Ramos is a graduate of Yale University (B.A., 1996) and the University of Miami School of Law (J.D., 2000). Her areas of practice include fidelity and surety litigation, labor and employment, immigration, intellectual property, and general commercial litigation. Ms. Ramos is a member of the Florida Bar and the American Bar Association, and she is admitted to practice in all Federal Courts in Florida. Ms. Ramos can be reached by e-mail at mramos@slk-law.com.

Nancy Manno, a resident of New Jersey, has been a Surety Claims Specialist for Atlantic Mutual Insurance Company in Madison, New Jersey since 2002. Mrs. Manno handles predominantly performance bond and payment bond claims. Prior to working for Atlantic Mutual, Mrs. Manno began her career in the fidelity and surety industry as a bond claim specialist for Selective Insurance Company, where she predominantly handled payment bond claims, some performance issues, commercial and fidelity claims as well. Ms. Manno can be reached by e-mail at nmanno@atlanticmutual.com.