CONDITIONAL & UNCONDITIONAL CONDITIONS: THE 2010 A-312 BOND

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I. INTRODUCTION

The 2010 version of the AIA Form A-312 performance bond is an effort to establish the rights and duties of the obligee and the surety. It replaces the 1984 version with a few tweaks and one major shift of risk, in Section 4. As with almost all bonds, those rights are subject to certain conditions. Even the most rudimentary performance bond usually begins, "NOW THEREFORE, the *condition* of this bond is . . . ." The A-312 bond, though, sets out perhaps the most developed set of conditions of any form.

The core conditions are contained in Section 3 of the bond:

> § 3 If there is no Owner Default under the Construction Contract, the Surety's obligation under this Bond shall arise after
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> .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;
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> .2 the Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety; and
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> .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.

In addition, Section 6 adds one more condition:

> If the surety does not proceed as provided in Section 5 with reasonable promptness, the Surety shall be deemed to be in default on this Bond seven

days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform its obligations under this Bond, and the Owner shall be entitled to enforce any remedy available to the Owner. If the Surety proceeds as provided in Section 5.4, and the Owner refuses the payment or the Surety has denied liability, in whole or in part, without further notice the Owner shall be entitled to enforce any remedy available to the Owner.

The purpose of those conditions, discussed at length below, is to allow the surety to choose its response from among the options listed in Section 5. That section states:

> 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:
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> 5.1. Arrange for the Contractor, with the consent of the Owner, to perform and complete the Construction Contract;
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> 5.2. Undertake to perform and complete the Construction Contract itself, through its agents or independent contractors;
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> 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 a contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract, 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 Contactor's default; or
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> 5.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances:
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> 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
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> 2. Deny liability in whole or in part and notify the Owner citing the reasons for denial.

The entire structure of the bond fits together. The obligee must satisfy the conditions, without which the surety cannot select an option as agreed in the bond.

That form and its conditions result from the evolving understanding and intent of the drafter, the American Institute of Architects, after receiving comments from numerous

industry groups, including the ABA Forum on the Construction Industry, the Associated Builders & Contractors, the Associated General Contractors of America, NASBP, SFAA, and others.[1] Although the "collaborative" drafting process may have intended to balance carefully the rights and obligations of the parties, how the bond functions in use ultimately is determined by the courts. Courts can be unpredictable generally; how much can sureties depend on the conditions contained in the bond?

II. What Are the Conditions of the A-312 Performance Bond?

Eight conditions appear in the bond, in the following order. The obligee must

1. Not be in default (a defined term) § 3;
2. Notify principal and surety that declaring default is contemplated § 3.1*[2];
3. Attend a conference if the surety timely requests it § 3.1;
4. Declare principal to be in default § 3.2;
5. Terminate the contract with principal § 3.2;
6. Notify surety of the default declaration and termination § 3.2;
7. Agree to pay the balance of the contract price § 3.3; and
8. Send a third notice to surety if an option is not chosen promptly § 6.

The first of the eight conditions is unconditional, as "Owner Default" discharges the surety's obligation. That defined term means "Failure of the Owner, which has not been remedied or waived, to pay the Contractor as required under the Construction Contract or to perform and complete or comply with the other material terms of the Construction Contract." Materiality is the key concept, just as it is regarding "Contractor Default."[3]

While "no-owner-default" clearly is a condition of the surety's obligation, at least one court has held that it is not a "condition precedent" for pleading purposes and therefore need not be affirmatively pled by the obligee nor specifically raised in defense by the surety. *See Deluxe Bldg. Systems, Inc. v. Constructamax, Inc*.[4] Whether or not it qualifies technically as a condition precedent, though, the absence of default (or material breach) by the obligee is foundational to its ability to claim on the bond.

For example, in *Milton Regional Sewer Auth. v. Travelers Cas. & Sur. Co*.,[5] the obligee breached the right-to-cure provision of the bonded contract by hiring a

[1] AIA Bond Form Commentary and Comparison, p. 1 (2010).

[2] The "*" results from Section 4 and its imposition of a prejudice provision; see II.A. below.

[3] The bond defines "Contractor Default" as "Failure of the Contractor, which has not been remedied or waived, to perform or otherwise to comply with a material term of the Construction Contract."

[4] Civ. No. 2:06-cv-02996 (KM)(MAH); 2013 U.S. Dist. LEXIS 126866; 2013 WL 4781012 (Sept. 5, 2013) (obligee's non-default considered "status quo," but failure to pay per the contract discharged Travelers).

[5] 648 Fed. Appx. 215 (3d Cir. 2016).

replacement contractor without affording the principal (or surety) a chance to remedy the alleged performance failures. Due to its own breach, the obligee lost its claims against both principal and surety, despite the fact that principal's performance was deficient. As the court noted, if merely deficient work could justify denying a right to cure, the right would be "severely undercut."[6]

Moreover, the question of who is in default often is the ultimate issue in dispute. Unless the principal is conceding inability to perform or joining with the obligee in calling on the surety to do so instead, the surety will be challenged to know whether it will be found at the end of the day to be obligated under the bond. The A-312 procedure presumes the surety knows whether or not the obligee or the contractor is in default, which often is not the case. The answer on default many times will have to wait, but the bond's other conditions do not.

A. First Notice from Obligee to Surety

Section 3.1 of the bond still requires a notice to the principal and the surety "that the Owner [obligee] is considering declaring a Contractor Default." That condition, under the 1984 version of the bond and in the majority view, was an unconditional condition. In *School Board of Escambia County v TIG Premier Insurance Co*.,[7] the obligee claimed it was "commercially impracticable" to stop the work, notify the surety, allow the investigation, and then wait for performance under the bond. The board offered that excuse for going forward with the work despite the bond conditions and the surety's rights. The court disagreed with the obligee, primarily because lack of notice deprived the surety of its options under the bond, and declared the bond "null and void."

In *Int'l Fidelity Insurance Co. v. Americaribe-Moriarty, JV*,[8] both the bond and the incorporated contract required notice to principal and surety before default and termination. Although the bond's notice provision did not specify a time, the contract did, and the obligee already had hired a replacement contractor before the contract's cure period had run. The untimely notice "stripped the surety of its bargained for right and relieved the surety of its liability for the instant claim."[9] Likewise, in *Enterprise Capital, Inc. v. San-Gra Corp.*,[10] the surety was discharged where the obligee hired a replacement contractor before telling either the surety or the principal of any default or termination. Similarly, most courts recognize that the bond conditions and the surety's options are indivisible parts of the suretyship framework, both equally important. For example, even

[6] *Id.* at 218.

[7] 110 F. Supp. 2d 1351, 1353-1354 (N.D. Fla. 2000).

[8] 681 Fed. Appx. 771 (11th Cir. 2017).

[9] *Id.* at 777, *citing INA v. Metro Dade Cty.*, 705 So. 2d 33, 35 (Fla. 3d DCA 1997) (failed notice condition deprived surety of the ability to exercise its performance options, discharged surety).

[10] 284 F. Supp. 2d 166 (D. Mass. 2003).

where the surety owed no duty because its principal won on the merits, a district court stated that failure to afford the rights protected by the bond conditions was a separate ground for denying the obligee's claim in *Flatiron-Lane, JV v. Chase Atlantic Co.*[11]

What if the obligee does not seek completion of the work but only enforcement against the surety of other contract duties, such as indemnification? The correct view is that the Section 3.1 conditions apply to *all* of the surety's obligations under the bond, because that's what it says. That was the view recently taken by the court in *Prismatic Dev. Corp. v. Int'l Fid. Ins. Co.*[12] The obligee knew about the costs incurred by other subcontractors resulting from principal/subcontractor's deficiencies but neither notified the surety nor defaulted or terminated the principal, at least not for nine years. That was when another sub sued the obligee for those costs, and the obligee sought indemnification from the surety. The court enforced the conditions precedent under the bond, noting the surety was deprived of the ability to investigate or remedy the principal's alleged default.

But despite the majority view, a few outlier courts still manage to disregard the clear language of the bond, even under the prior version. One of the most notorious is *Colorado Structures, Inc. v. Insurance Co. of the West*,[13] where the court broke the bond into two separate parts to evade the conditions beginning in Section 3. Viewing suretyship as insurance and subject to the same strict rules, the court latched onto Section 1—where the surety bound itself for the performance of all obligations under the incorporated contract—and found this to be a separate undertaking not governed by the conditions precedent in Section 3. That undertaking, according to the court, allowed the obligee to supplement the principal's work, incur a penal-sum loss, and impose it on the surety without ever satisfying the Section 3 conditions. (If the obligee had wanted the surety to take over and complete the work, the court acknowledged, Section 3 could not be disregarded.) The court did not explain how the broad scope described in Section 3—"the Surety's obligation under this Bond"—somehow omitted any obligation under Section 1. Fortunately, the rationale of the Washington supreme court in *Colorado Structures* has not been adopted or followed extensively.[14]

The notice requirement in Section 3 of the A312 bond is not difficult to understand or satisfy, yet obligees regularly fail to do so. Sending notice to the principal's bonding agent, not the surety at the address on the bond, was not enough to qualify in *Eddystone*

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[11] 121 F. Supp. 3d 515, 549 at fn. 23 (M.D.N.C. 2015).

[12] No. 650402/2013; 2022 N.Y. Misc. LEXIS 967 (N.Y. Sup. Ct. Feb. 28, 2022).

[13] 167 P.3d 1125 (Wash. 2007).

[14] In fact, the decision has been criticized for ignoring the structure of the bond and the surety's options in the face of its principal's default. *Hunt Constr. Group, Inc. v. Nat'l Wrecking Corp.*, 587 F.3d 1119 (D.C. Cir. 2009). *But see Forest Manor, LLC v. Travelers Cas. & Sur. Co.*, No. X06UWYCV156029923; 2018 Conn. Super. LEXIS 208; 2018 WL 1137580 (Jan. 30, 2018); *Int'l Fid. Ins. Co. v. City of Rockland*, 98 F. Supp. 2d 400 (S.D.N.Y. 2000) (claims for indemnity do not trigger Section 3 conditions) (*superseded by Stonington Water St. Assocs., LLC v. Nat'l Fire Ins. Co.*, 472 Fed. Appx. 71 (2d Cir. 2012), per *Forest Manor, supra*.

Borough v. Peter V. Pirozzi General Contracting LLC.[15] In that case (under an analog to the 1984 version of the bond), the public obligee touted multiple letters or e-mails as satisfying the notice condition, but the court found each to be defective—primarily for failing to start the process contemplated by the bond. That process allows the surety to become involved and informed *before* declaration of default or termination and at a time when principal's contractual status may be salvaged. The court found obligee already had defaulted and terminated principal before ever notifying the surety.

This case addresses the bond's notice requirement, but it also highlights the major change from the 1984 bond to the 2010 version: Section 4 of the latter provides:

> 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 from its obligations, except to the extent the Surety demonstrates actual prejudice.

The Borough argued that the surety was not prejudiced by any lack of notice, but the court found proof of prejudice was not required under the 1984 bond because notice was a condition precedent.[16] Had the same question presented under the 2010 version of the bond, though, Section 4's express requirement of prejudice might have put the surety to the task of demonstrating its earlier involvement could have mitigated the loss or otherwise changed the situation for the better.

Therefore, what previously was an unconditional condition of advance notice to the surety, before declaration of default or termination, now has become conditioned on a showing of prejudice. That might be considered a question of fact under the particular circumstances of the project. However, prejudice to the surety should be inherent and presumed when the obligee fails to give notice under Section 3.1. The surety issued the bond in reliance on the conditions stated within it, including the right to notice before the obligee changes the situation on the ground and the right to select among several options in the event the surety has any obligation under the bond. Obligees who go off on their own and ignore the surety's rights violate those conditions and deprive the surety of its options. That was not the surety's agreement and should not be imposed on it otherwise.

For example, in *U.S. ex rel Agate Steel, Inc. v. Jaynes Corp*.,[17] the obligee chose to supplement the principal without notifying the surety and without terminating the contract. The 2010 version of the bond required prejudice to the surety upon failure of notice under Section 3.1, and the court observed that the surety had proven that defense.

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[15] No. 2:13–cv–01470–PBT; 2015 U.S. Dist. LEXIS 45079; 2015 WL 1542284 (E.D. Pa. April 7, 2015).

[16] *Id*. at Lexis *41-42. *See, e.g.*, *School Bd. of Escambia County v. TIG Premier Ins. Co.*, 110 F. Supp. 2d 1351 (N.D. Fla. 2000), where the obligee argued impracticability for failing to notify the surety. The court enforced the plain language of the bond nonetheless and held that the obligee forfeited its rights under the bond without regard to proof of prejudice.

[17] No. 2:13-CV-01907-APG-NJK; 2016 U.S. Dist. LEXIS 79888 (D. Nev. Jun. 17, 2016).

> Jaynes' failure to terminate the contract and notify Ohio Casualty of the termination is more than a mere technical violation. Rather, it deprived Ohio Casualty of its rights under the bond. *See Seaboard Sur. Co.,* 370 F.3d at 220 (rejecting the argument that failure to give a termination notice was a technical breach because "the notice provision . . . provides an opportunity for the surety to cure the breach and thus mitigate damages," and "even if [the surety] must show injury, loss, or prejudice, it meets this hurdle, given its deprivation of mitigation opportunities") (quotation omitted).[18]

Any time the obligee disregards the surety's rights, prejudice is likely, if only because the surety has the right to choose its own options in the face of a default and termination. Lack of notice almost always accompanies failure to declare default and terminate, at least unless matters already have progressed beyond the surety's control.

Section 3.1 contains a "notice requirement" that is subject to a showing of prejudice per Section 4, but it also contains a requirement that the obligee "shall attend" a 3.1 meeting if the surety requests it within five days. Nothing in Section 4 requires a showing of prejudice if the obligee fails to participate in a meeting that the surety requests. That requirement should continue to be considered a condition precedent, but also the surety is deprived of the option even to require the meeting if it receives no notice the obligee is considering declaring a default.

The courts may conclude that the potential meeting is subject to the obligee's decision to provide notice or to take the risk of prejudicing the surety. Again, the surety loses its options under the bond (including the option to request a meeting) in the absence of notice, which therefore should be considered inherently prejudicial.[19] The Section 4 requirement for the surety to "demonstrate actual prejudice" truly should be a burden shifted to the obligee, to demonstrate that its breach of the Section 3 conditions actually did *not* prejudice the surety.

B. Declaration of Default, Termination, and Notice of Same

Section 3.2 of the bond contains three conditions: declaration of default, termination, and a notice to the surety that those two conditions have been met. These conditions are **not** subject to the requirement of prejudice imposed by Section 4 on the previous notice requirement. Other than the outlier decisions rejecting the bond's

[18] *Id.* at Lexis *24.

[19] *See Western Sur. Co. v. United States Engineering Constr., LLC*, 955 F.3d 100, 106 (D.C. App. 2020) (in *dictum*, lack of notice of default considered "inherent prejudice").

conditions precedent entirely, the majority of courts enforce these requirements. Cases under the 1984 version of the bond remain equally applicable to the 2010 version.

In *Sonoma Springs Ltd. P'shp v. Fidelity & Deposit Co. of Md.*,[20] the obligees notified the surety of the alleged contractor default, demanded performance under the bond, and even tendered the balance of the contract price. Plaintiff obligees never did terminate the bonded contract, though, and the court stated simply, "This is fatal to plaintiffs' claim. . . . Plaintiffs failed to satisfy the § 3.2 condition precedent, and that failure was a material breach of the performance bond that excuses the Surety's obligation."

The obligee in *Arch Ins. Co. v. Graphic Builders LLC*[21] found the principal's work to be more than a little defective—260 leaking windows and misaligned exterior components—but chose not to terminate the subcontract. According to the obligee, doing so "would be the equivalent of shooting [itself] in the face," and termination did not give it "the warm and fuzzies."[22] Regardless, the court held the failure to terminate materially breached the 2010 A-312 bond and discharged Arch from "any and all liability relating thereto, including investigating and indemnifying [obligee's] claims thereunder."[23]

In *Western Sur. Co. v. United States Engineering Constr., LLC*,[24] the obligee defaulted and terminated the principal for various alleged breaches of the bonded subcontract but failed even to notify the surety until nearly nine months later. When Western Surety sought summary judgment on those facts, the obligee argued the bond had no deadlines for notice of default or termination, which therefore should not be required in any particular time. Seeing the flaw in that argument, the trial court held that the explicit grant to the surety of a right to choose options in remedying any default "necessarily implies that *timely* notice is required to trigger Western Surety's obligation under the Bond because Section 5 operates only if timely notice is given."[25] The appellate court approved that statement and held that "the owner must provide timely notice to the surety of any default and termination before it elects to remedy that default on its own terms."[26]

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[20] 409 F. Supp. 3d 946 (D. Nev. 2019) (2010 A-312).

[21] 519 F. Supp. 3d 54 (D. Mass. 2021).

[22] *Id.* at 61 (the court's quoting of the obligee's testimony).

[23] *Id.*

[24] 955 F.3d 100 (D.C. App. 2020).

[25] *Id.* at 103 (emphasis in original).

[26] *Id.* at 105. The court relied heavily on *Hunt Constr. Grp. v. Nat'l Wrecking Corp.*, 587 F.3d 1119 (D.C. Cir. 2009), where the decision used the terms "nonsensical" in reference to no timeliness requirement for notice of default and "nearly meaningless" as applying to the surety's options unless the obligee was required to provide timely notice.

Notwithstanding the above line of cases and many others they cite in agreement, some judges can be determined to find a way around the bond's clear provisions. North American Specialty encountered just such a judge in *Burke Constr. Grp., Inc. v. Benson Security Systems, Inc.*[27] The obligee had sent three letters, two of which informed principal and NAS that the obligee was considering declaring a default (but without mentioning a meeting). Fifteen days after the first letter and nine days after the second, the obligee sent the third letter, declaring default, terminating the contract immediately, and stating its intent to complete the work and charge the principal and surety. That is what the obligee did, beginning one week later, to the tune of $555,594.

The surety rejected the bond claim and defended based on the obligee's failure to satisfy Section 3.1 (specifically regarding a meeting, which the court shrugged off). The court held the third letter satisfied the requirements of Section 3.2 for notice of default and termination, even though such steps are allowed only *after* the 3.1 meeting if required by the surety—which had no reasonable chance to do so in this case. The court also completely ignored the surety's options upon default and termination and instead relied on the bonded contract's general supplementation provision, which made no reference to the surety or the bond. The district judge was distracted by the surety's internal e-mail noting receipt of a claim on the bond, despite failure to satisfy the bond conditions, which the judge considered to be evidence of ambiguity as to what an obligee must do to make such a claim.[28]

West Virginia and Michigan likewise have been unfriendly to sureties relying on the A-312 bond conditions. In *Mid-State Surety Corp. v. Thrasher Eng'g, Inc.*,[29] the obligee failed to satisfy the conditions of the bond, at least as to termination, but the court was unconcerned. As in *Int'l Fid. Ins. Co. v. Rockland*,[30] the claim was for indemnification of the obligee's damages, not for performance of work, and the court similarly refused to apply the bond's conditions to a duty to pay. The court chose to treat the declaration of default as also a termination of the contract, blithely declaring that to hold otherwise "would be to find forfeiture on technical grounds."[31] Ironically, the court also castigated the surety for failing to protect itself by learning the indemnity-claim details that the obligee failed to provide. Instead of simply enforcing the protections built into the bond, the court disregarded them and presumed the surety could have obtained the same level of protection by more active investigation.

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[27] No. CV-20-01863-PHX-JJT; 2021 U.S. Dist. LEXIS 188726; 2021 WL 4478393 (D. Ariz. Sept. 30, 2021).

[28] *Id.* at Lexis *19-20.

[29] 575 F. Supp. 2d 731 (S.D. W. Va. 2008).

[30] 98 F. Supp. 2d 400 (S.D.N.Y. 2000). *See* fn. 9, above, regarding the continuing force of *Rockland.*

[31] *Id.* at 742.

Michigan law apparently allows a general prejudice rule to override express conditions precedent, according to the court in *LaSalle Grp., Inc. v. JST Props., LLC*.[32] The obligee notified the surety that it had defaulted and terminated the principal, then proceeded to hire another contractor to complete the work. In defense of the claim for almost half a million, the surety raised the 1984 A-312 bond conditions. Although the obligee clearly failed to provide notice under Section 3.1 and failed to wait before notifying of default and termination, the court applied a questionable state law rule from surety cases decided over 45 years before the A-312 bond even existed: "The rule in Michigan is that failure to give notice promptly as required in the bond does not in and of itself release the surety unless the surety has been prejudiced or suffered loss by reason of such failure."[33] On reconsideration, the court doubled down even though the cases construed a different bond form and the surety unquestionably was deprived of its options to complete or relet.[34]

Beyond the unfriendly jurisdictions, the bonded contract may well be a pitfall for the surety. While the A-312 bond has its own provisions, it also incorporates the bonded contract, making those provisions part of the bond. The specifics in the bond should govern over general terms in the contract, but the contract can become a backdoor for a creative court. In *Commercial Cas. Ins. Co. v. Maritime Trade Ctr. Builders*,[35] the obligee failed to satisfy the conditions of the 1984 A-312 bond, although it did inform the surety that the principal was having difficulty. After supplementing the principal and incurring over $200,000 in damages, the obligee demanded reimbursement under the bond. The contract contained a supplementation clause, and the court held that the bond did not address supplementation instead of a demand for performance. Based on that conclusion, the court held that the obligee was not required to satisfy the bond conditions in a case of supplementation.

Some contracts go further. A recent manuscripted subcontract form allowed the obligee to take over the work, complete it, and charge the costs to the principal/subcontractor, with no mention of the A312 conditions. That supplementation clause is not unusual. The language that followed, though, is less common: "Subcontractor's guarantors, surety, or sureties agrees to be bound to Construction Manager with respect to such remedies notwithstanding any provision of the bonds provided pursuant to Article 10 thereof." When the incorporated contract supersedes the express conditions of the bond, underwriters should take note. At a minimum, the surety

[32] No. 10-14380; 2011 U.S. Dist. LEXIS 83548; 2011 WL 3268099 (E.D. Mich. Jul. 29, 2011).

[33] *Id.* at Lexis *13.

[34] 2011 U.S. Dist. LEXIS 144156, *10 (E.D. Mich. Dec. 15, 2011). See also *Kilpatrick Bros. Painting v. Chippewa Hill Sch. Dist*., No. 262396; 2006 Mich. App. LEXIS 736; 2006 WL 664210 (Mich. App. Mar. 16, 2006) (Mich. law requires prejudice despite conditions precedent, and surety failed to object when obligee stated its intent to hire replacement contractor, so surety was obligated to reimburse).

[35] 572 S.E.2d 319 (Ga. App. 2002).

will need to confirm that the obligee in fact complied with the requirements of its own supplementation clause before accepting the contract's override of the bond.

The flipside also is true: the incorporated contract provisions may supplement the *surety's* rights under the bond conditions. In *Donald M. Durkin Contracting, Inc. v. City of Newark*,[36] the obligee City followed the bond conditions to the letter but overlooked the additional seven days required by the contract after notice and before termination. In an unusual case where the surety lost on summary judgment initially, the court nonetheless granted reconsideration and reversed itself, based on the City's judicial admission that its only written notice neither stated the intent to terminate nor declared a default but described itself as only a "precautionary letter."[37]

Another trapdoor is the argument of waiver. In *C&I Entertainment, LLC v. Fidelity & Dep. Co. of Md.*,[38] limited and delayed communications from the obligee slowed the surety's investigation. The obligee did not comply timely with the conditions of the bond, which the court held to raise factual questions, but F&D denied the claim solely on the basis of the bond's two-year contractual suit limitation. The court considered that denial to be evidence of a possible waiver of the bond conditions (that already should have been satisfied) and relegated the surety's fate to the jury.

A precedent relied on in *C&I Entertainment* was *AgGrow Oils, LLC v. Nat'l Union Fire Ins. Co.*[39] There, the obligee failed to declare a default, terminate the contract, or offer to pay the balance of the contract price. The court acknowledged that these were failures of conditions precedent that normally would have discharged the surety. However, the surety's "resounding and unequivocal" denial of liability under the bond was held to have rendered any notices or offers by the obligee "futile" and a "useless formality," so that the conditions were waived.[40] The courts leaning this way do not seem concerned with the timing problem caused by breach of the bond conditions before the surety's denial. A practice pointer is to include any failed conditions in the denial letter even if the primary basis for that denial is different.

C. Agreeing to Pay the Balance of the Contract Price

Section 3.3 of the bond requires the obligee to agree to pay the contract balance, in accordance with the contract, to the surety or to a contractor selected to perform the work. Some obligees believe they can select that contractor unilaterally, so that this condition actually can be argued to justify supplementation without proper notice. But the

[36] No. CVIA 04-163 GMS; 2006 U.S. Dist. LEXIS 68221; 2006 WL 2724882 (D. Del. Sept. 22, 2006).

[37] *Id.* at Lexis *8.

[38] No. 1:08CV00016-DMB-DAS; 2014 U.S. Dist. LEXIS 99505; 2014 WL 3640790 (N.D. Miss. Jul. 22, 2014).

[39] 276 F. Supp. 2d 999 (D.N.D. 2003).

[40] *Id.* at 1018.

bond gives the option to the surety, albeit with the obligee's consent, so the bond condition does not mean the obligee can just spend the money on any contractor of its choice.

In *Stonington Water St. Assocs., LLC v. Nat'l Fire Ins. Co.*,[41] the obligee violated the bond conditions by hiring replacement workers during the delay it caused the surety in choosing its option under the bond. Moreover, the obligee also failed to agree to pay the contract balance, under the excuse that the balance was zero. The court found, however, that the obligee could not demonstrate it had disbursed the contract funds in accordance with the contract. That demonstration would have been required both by the language of Section 3.3 ("pay . . . in accordance with the terms of the Construction Contract") and the initial language of the section ("If there is no Owner Default under the Construction Contract . . . .").

In *East 49th St. Dev. II, LLC v. Prestige Air & Design, LLC*,[42] the obligee failed to satisfy multiple conditions under the bond, including failing to agree to pay the balance of the contract price. In defense, the obligee pointed to known claims and damages exceeding the remaining balance. None, however, actually had been paid at the time. The court quoted the bond's definition of what constitutes "the Balance of the Contract Price":

> The total amount payable by the Owner to the Contractor under the Construction Contract after all proper adjustments have been made . . . reduced by all valid and proper payments made to or on behalf of the Contractor under the Construction Contract.[43]

Amounts potentially owed but not yet paid cannot qualify as "payments made," and the court noted that such an accounting would have been improper under the contract as well. The obligee's failure even to offer to pay the amounts it was holding barred its claim on the bond.[44]

What can the obligee "properly" deduct from the balance of the contract price before agreeing to pay it to the surety? In *Whiting-Turner Contr. Co. v. Guaranty Co. of N. America*,[45] the obligee reduced that balance by almost $257,000 paid to the principal's subcontractors, and by another $553,707 principal had agreed for a scope reduction (to which surety apparently had consented, at least in concept). Without explaining why, the

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[41] 472 Fed. Appx. 71 (2d Cir. 2012).

[42] 938 N.Y.S.2d 226 (N.Y. Sup. Ct. 2011).

[43] *Id.*, quoting Section 14.1 of the bond.

[44] *Id.*

[45] 440 P.3d 1282 (Colo. App. 2019). The obligee also deducted about $30,000 in unspecified damages that the trial court reduced and then denied. Because the surety provided no argument or authority to the court supporting its position that disallowed damages could not be deducted, the appellate court declined to address the apparent error. *Id.* at 1290.

court of appeals distinguished payments to a replacement contractor hired by the obligee and approved payments to existing subcontractors of the principal. Possibly, the distinction is that the latter are existing job costs not subject to the obligee's control or influence, while a replacement contractor should be selected by the surety. As for the scope deduct, the court simply bound the surety to its principal's agreement and likewise approved that amount.

D. Third Notice to Surety

The surety is afforded ("promptly and at the Surety's expense") the options under Section 5 of the bond, "[w]hen the Owner has satisfied the conditions of Section 3." If the obligee disagrees with the surety's option or with its promptness, Section 6 comes into play. The surety shall be deemed in default under the bond "seven days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform it obligations." At that point, the obligee may enforce any available remedy.

In *Seaboard Sur. Co. v. Town of Greenfield*,[46] the surety was engaged in its investigation of the disputed default and termination of its principal. During that investigation, the obligee and the surety negotiated for emergency work, and the surety agreed in principle to take over and complete the school building. However, the obligee abruptly decided to hire its own completion contractor and exclude the surety from the completion process. Both the trial court and the court of appeals agreed that the obligee failed to notify the surety, as required, that the lack of a "prompt" response was a default under the bond. The obligee's communications failed to alert the surety clearly and with certainty that it would be deemed in default. That failure was a material breach that discharged the surety.

The district court in *Developers Sur. & Indem. Co. v. Dismal River Club, LLC*,[47] followed *Town of Greenfield* in holding that, for lack of a Section 6 notice, "there can be no default on the bond and no cause of action for breach of contract." The court repeatedly stated that the surety was discharged even if all other conditions had been met, even if it in fact had failed promptly to elect one of its Section 5 options, and even if it had not been prejudiced by the obligee's method of completion. The omission of the required notice of default under Section 6 was sufficient to discharge the surety because it prevented the surety from taking action to avoid its default.

III. CONCLUSION

The 2010 A-312 performance bond and its conditions precedent are fairly well settled after almost 12 years, but agreement on the parties' rights and obligations is not uniform. Obligees continue to raise arguments against the surety's protections, mostly based on their insistence that the bond be treated as insurance rather than a simple

[46] 370 F.3d 215 (1st Cir. 2004).

[47] No. 4:07CV3148; 2008 U.S. District Lexis 122962 at *23 (D. Neb. May 22, 2008).

contract allocating risks. The conditions of the bond are not burdensome, requiring generally only communication and clarity, and they are not “technicalities” to be ignored. The carefully crafted and balanced form expects the obligee to notify, inform, and involve the surety at appropriately early stages. It then requires the surety to decide reasonably promptly how to respond, and it provides for the obligee to alert the surety if that response is unacceptable or too delayed. Sureties should be able to depend on those conditions, but careful attention to the judge and jurisdiction are unavoidably essential.

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