Surety Post Completion Liability

Performance bonds, as the name plainly states, are issued to guarantee performance. If a contractor doesn’t perform its obligations, the surety must complete the work or pay the owner to do so. But what happens if the contractor completes its work? Is the surety discharged? Not necessarily. Owners frequently make warranty and latent defect claims against performance bonds. This article discusses the primary post-completion defenses available to a surety: waiver, expiration of the contractual or statutory limitations period, and failure to satisfy conditions precedent. This article also provides some practical guidance for owners and other performance bond beneficiaries to avoid a surety’s post-completion defenses.

Waiver

Final acceptance of the work by the owner may allow the surety to use the common law defense of waiver against a claim on the performance bond. By accepting the work, the owner waives the right to bring a claim against the performance bond. This defense, however, applies only to patent defects—defects discoverable by reasonable inspection—not latent defects.

Sureties should investigate post-completion defect claims to determine how and when the defect first was or could have been discovered. Owners should always take reasonable steps to inspect a contractor’s work before formally accepting the work or providing final payment.

When the contract imposes warranty or repair obligations, final acceptance by the owner may not result in waiver. This is the case so long as the owner discovers the defective work and requests that it be repaired within the period dictated by the contract. If the contractor fails to meet its warranty or repair obligations, the surety may be required to step in.

Limitations Period

Almost all performance bonds on private jobs will contain a limitations period within which a claim on the bond must be made. Two years is a common period contained in several standard payment bonds. For example, the ConsensusDocs 260 performance bond’s limitations period is “two years after default of the Contractor or Substantial Completion of the Work, whichever occurs first.” Courts will enforce these types of limitations periods so long as they are reasonable.

In addition to limitations imposed by the bond itself, some limitations are imposed by statute. On public works in Georgia, for example, a lawsuit must be filed within a “year from completion of the contract and the acceptance of the public work by the state.” O.C.G.A. § 13-10-42. A similar limitations period also exists on payment bonds for public works in Georgia.

It is imperative that contractors and owners alike know any limitations periods within the bond itself or if there are any imposed by statute. It is also important to pay special attention to when the clock starts running, as it may be sooner than you think.

There are at least several states that apply the doctrine of *nullum tempus regi*
or, in English, time does not run against the king. Pursuant to this doctrine, a bond’s limitations period will not prevent a government body from bringing a claim against the bond after the limitations period has expired.

**Conditions Precedent**

A condition precedent is an event that must occur before performance under a contract becomes due. Performance bonds usually contain conditions precedent; for example, a requirement that the owner declare the contractor to be in default. If such conditions are not met, there is arguably no obligation on the part of the surety. A common scenario is when the owner finds a replacement contractor, the replacement contractor completes the work, and only then does the owner inform the surety while simultaneously asking the surety for payment. In that scenario, it is unlikely the owner has satisfied the conditions precedent contained in the bond and the owner’s claim against the surety may fail.

For there to be a valid condition precedent, there should be clear language showing that the parties intended to establish a condition. Absent such clear language, courts may not imply a condition. That said, if the court determines that an express condition precedent exists, it should enforce the intent.

For example, before the Surety’s obligation arises under an AIA A312-2010 bond, there are three conditions precedent, which courts have determined meet the clear language requirement and are therefore enforceable:

1. The Owner “provides notice to the Contractor and the Surety that the Owner is considering declaring a Contractor Default...”;
2. “the Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety; and”
3. “the Owner has agreed to pay the Balance of the Contract Price in accordance with the terms of the Construction Contract ...”

That said, § 4 of the AIA A312-2010 bond indicates that the failure of an owner to comply with the first condition precedent is not detrimental to the owner’s claim unless the surety can demonstrate it was actually prejudiced. The AIA A312-1984 bond did not have an actual prejudice requirement and most courts did not write such a requirement into the bond.

When the conditions precedent contained in the bond are not complied with, owners asserting post-completion claims have argued that their failure should be excused by futility, that the condition was substantially complied with, or it was commercially impractical under the circumstances. Sureties typically counter that the bond language is clear and that the surety was deprived of its opportunity to prevent the default, investigate the claim, or choose the replacement contractor and the manner in which the underlying contract will be completed.

Performance bond beneficiaries will be wise to read and understand the conditions set forth in their performance bond. Any and all conditions should be carefully complied with, regardless of how onerous or futile the conditions may seem.