# What You Need to Know About Bond Claims

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So you have a claim on a bonded job. Now what? We could literally write an entire book on the claims process and the various case laws that apply to each. Instead, we are briefly going to focus on some common procedure and what the contractor should know in both performance and payment bond claims. It's important to keep in mind that unlike insurance, bonds are written on a "no loss basis" and the contractor usually must indemnify the surety for all losses including attorney fees, delay damages, etc.

## Performance Bond Claims

Simply put, a performance bond is an agreement where the surety (bond company) guarantees that the principle (contractor) will perform the bonded contract to the obligee (project owner or contractor). The first step in the claims process is to read the contract and the bond forms. Every bond is different and some spell out the claims process in detail while others are more ambiguous. Some contracts require the contractor and obligee to meet and try to cure the default first which is a good idea even if it's not in the contract. Regardless of the bond form, almost every performance bond requires four events to occur before the surety has to act under the bond:

1. The contractor has to be in default (breach of contract)
2. The obligee has to declare the contractor in default
3. The obligee must have performed its obligations under the contract
4. The obligee must terminate the principle's right to proceed

Once these requirements have been met, it is the bond company's responsibility to investigate the claim. If the default is found to be accurate the surety will have four options to pursue. There are positives and negatives to each option. These options include:

1. Financing the contractor – This option entails the surety providing financial assistance to the contractor to complete the job. It's important to keep in mind that all financial assistance from the surety adds to the loss and the surety will expect reimbursement from the contractor. Typically, in a financing situation, the surety will require the contractor to reaffirm its pledge of personal assets and or set up joint checking accounts to handle contract proceeds.

2. Takeover – This option allows the surety to basically step into the contractor's position on the contract and complete the work according to the contract. The surety will then subcontract the work to a completion contractor. Consequently, this is the surety's least preferred option and the obligee's most preferred option.
3. Tender New Contractor – The surety chooses a completion contractor, negotiates the price and terms of the contract and then submits to the obligee for approval. One reason a surety may take this option is if the principle believes disputes the default. The surety can tender a new contractor and later dispute their liability with the obligee.
4. Obligee Completion – Sometimes referred to as owner completion or "do nothing" option. This is an option if hazardous waste is involved, the surety believes the contractor has a valid defense,the obligee will not have damages because the remaining contract proceeds will cover the cost of completion or the cost to complete will be more than the penal sum of the bond.

**Payment Bond Claims**

Payment bonds benefit the subcontractors, laborers and suppliers of the principle or subcontractors of the principle. Payment bond claims can be particularly aggravating to an otherwise financially sound contractor because they might not know there is an issue until a claim is filed. It also may result in a principle paying for labor or material twice. For example, suppose a material supplier of one of the principle's subcontractors has not been paid. However, the principle has already paid the subcontractor for the material. This could result in a payment bond claim and the principle may be forced to pay for the material again to satisfy the claim. One way for the principle to protect itself is to require bonds from its subcontractors.

Again, it is important to read the bond form regarding what a payment bond cover especially on private jobs but case law has established what is covered under Federal and State work. Typically the following will be covered in a claims situation:

- Wages – Includes contributions to pension funds. Does not include taxes.
- Materials – Must be used in the work
- Parts and Repairs – Could be covered if used only for the job
- Equipment – Lease and rental value typically is but purchase and loans are not.

Fortunately, valid payment bond claims are settled pretty quickly. However, the surety is only liable for the penal sum of the bond so once that amount is exhausted their obligation typically ceases.

Regardless of the bond claim, it is typically in everyone’s best interest to get a fair and fast resolution. One of the potential mistakes that contractors make is waiting to get the surety involved or withholding information. Once again, surety bonds require indemnification from the contractor’s business and often personal indemnification from the owners, their spouses and others. For this reason, it is in the best interest of the contractor to help the surety limit the loss and the surety will eventually look to be reimbursed from their claims.