



# STOP THE CLOCK!

Improving Surety Responsiveness through the Subcontractor Performance Bond

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## KEEPING YOU INFORMED

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Imagine the scenario where you, as the general contractor on a large scale project, are faced with the possibility of the default of one of your main subcontractors, perhaps even one that is on the critical path. How will this impact your schedule? How will it impact the other subcontractors? How could it ultimately impact your relationship with the project owner? And what can you do to minimize these impacts and mitigate any damages that may arise as a result of the subcontractor's default? Requiring that a subcontractor obtain payment and performance bonds naming the general contractor as obligee is a time tested method many general contractors implement as a means of managing and mitigating some of the risks associated with the potential of a subcontractor default.

While subcontractor performance bonds have long offered general contractors broad protection from loss in this regard, a frequently referenced frustration of general contractors with the traditional performance bond claim process is the lack of time certainty in a surety's response and performance. In the current business climate, many industries have changed the way in which they deliver their products to the end consumer. A consistent evolutionary theme across many industries in the business world is the trend to provide products and services with greater timeliness; and the surety industry is no exception.

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Accordingly, in 2016 Travelers developed a new subcontractor performance bond ("Travelers 2016 Sub Bond") in an effort to respond to the needs of its contractors with respect to the surety's response time and performance under the bond.

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Travelers goal for this product is to offer general contractors a more definitive and expedient response timeline than subcontractor performance bonds have traditionally offered in the past.

With this in mind, it is important that the general contractor closely evaluate the terms and conditions of the performance

bonds it chooses to accept. We believe all GCs should take an active role in the preparation and/or selection of the bond form, rather than passively accepting what is offered by the subcontractor's surety. While there are many different subcontractor performance bond forms used throughout the construction industry, **not all bond forms are created equally.**

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Knowing and understanding the terms of your subcontractor's bond form before an issue arises is important.

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The general contractor should be aware of its bond requirements including the notification provisions required of the obligee and the response times required of the principal and its surety.

For example, some bond forms (such as the AIA A-312<sup>1</sup>) may require a pre-default meeting, whereas other forms allow the obligee to declare a default and immediately make a claim on the performance bond. Travelers 2016 Sub Bond contains a streamlined process for initiating a performance bond claim: if the Principal is in default, has been declared in default by the obligee and the obligee has performed its obligations under the subcontract, the Surety's obligations are triggered.

## Comparison of the “Triggering” of the Surety’s Obligations

Many performance bonds typically require three basic conditions to exist in order for the surety’s obligations to arise:

1) the bond principal is in default under the terms of the contract; 2) the obligee has declared the principal to be in default, and; 3) the obligee has performed its obligations under the contract.<sup>2</sup> However, as was noted above, some bond forms require additional specific actions to be taken on the part of the obligee/general contractor before the surety’s obligations to perform are triggered. Below is a comparison of the basic triggering requirements of the Consensus Docs 706 Subcontract Performance Bond<sup>3</sup> (“Consensus Docs”), the A-312, and Travelers 2016 Sub Bond.

- **CONSENSUS DOCS** – Surety must elect its completion option “promptly” after<sup>4</sup>:
  - General Contractor declares Subcontractor to be in default in writing
  - General Contractor makes demand upon Subcontractor’s Surety
  - General Contractor makes Subcontract Balance available to Surety
- **A-312** – Surety must elect its completion option “promptly” after<sup>5</sup>:
  - General Contractor notifies Subcontractor and its surety that the General Contractor is “considering declaring” a Subcontractor Default and seeks to arrange a pre-default meeting between the parties.
  - General Contractor formally declares Subcontractor to be in default in writing
  - General Contractor formally terminates the Subcontract
  - General Contractor agrees to pay the Subcontract Balance to the Surety for completion purposes
- **TRAVELERS 2016 SUB BOND** – Surety obligations triggered after:
  - The Subcontractor is in default
  - The General Contractor declares Subcontractor to be in Default under the Subcontract
  - The General Contractor has performed its obligations under the Subcontract

## Comparison of the Surety’s Investigatory Period

While the Consensus Docs, and the A-312 forms require the Surety to perform “promptly” after its obligations have been triggered, the Travelers 2016 Sub Bond establishes a definitive period of time for the Surety to perform its investigation and make its completion election under the terms of the bond.

The definition of “promptly” will be a question of reasonableness and what is reasonable in one scenario may be wholly unreasonable in a different scenario. Essentially, the surety’s investigation can take a matter of weeks, to several months or more. During that time period, under many bond forms, the subcontractor’s scope of work is at a standstill and the general contractor is forced to wait until the surety completes its investigation and makes its election before the work is recommenced. As you can imagine, a delay of this sort can be catastrophic to a general contractor and its schedule (especially if the terminated subcontractor was on the critical path) and can potentially cause stress to the relationship between the general contractor and the project owner.

The Travelers 2016 Sub Bond removes the ambiguity associated with the reasonableness of the prompt investigation and performance election by prescribing a specifically set time frame to which the surety must adhere. The Travelers 2016 Sub Bond states that once the triggering requirements have been met, the “Surety shall have 30 days (“Investigatory Period”) from the last event to occur of the following: (a) receipt of the written notice of default; (b) the date access to the Project site is provided to Surety; or (c) the date the information and documentation in Obligee’s or its agent’s possession and requested by Surety is received by the Surety, which information and documentation must be requested by Surety within 10 days of its receipt of Obligee’s written notice of default” to make its completion election.

So, notice of default to surety starts: 10 days  
to request information + 30 days for surety to analyze  
and respond once conditions met.

<sup>2</sup>The Surety’s Obligations under the Performance Bond: To Perform or Not to Perform, Pgs. 111-12, ABA Bond Default Manual, 4th Ed., Vol.1, 2015, David J. Krebs and Shannah J. Morris.

<sup>3</sup>ConsensusDOCS 706. Subcontract Performance Bond, (2007).

<sup>4</sup>Id.

<sup>5</sup>AIA A-312 at Subpara. 3.

## Comparison of the Surety's Completion Options

Both the Consensus Docs and A-312 allow the surety to find a completing contractor, secure a bid/proposal for completion, and then "tender" that completion contractor to the obligee.

Through this arrangement, the surety works with the obligee to arrange for the execution of a completion contract between the new subcontractor and the obligee, and generally, to the extent that the completion contractor's cost to complete the remaining work is more than the remaining subcontract balance, the surety will fund that shortfall.

Similarly, both the Consensus Docs and A-312 allow for the surety to reimburse, or make payment to, the obligee for the difference between the completion costs for the remaining scope of the subcontract work less the remaining subcontract balance, up to the penal limit of the bond. And of course, both bond forms allow the surety to deny the claim if they believe that there are defenses to the claim that relieve the surety from its obligations under the performance bond.

Travelers' Sub Bond contains some of the traditional completion options that are available to a surety.

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However, a critical difference between the Travelers' Sub Bond and many other standard industry forms is that it allows the obligee/general contractor to continue to perform and progress the subcontractor's scope of work during the surety's investigatory period and to deduct the costs it expends in doing so from the remaining contract balance.

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This provision is important to a general contractor in order to mitigate the impact of the subcontractor's default to the overall project schedule. Without this provision, as discussed above, the subcontractor's scope of work remains dormant and the general contractor must wait during the period of time in which the surety is performing its investigation.

## 5 takeaways for general contractors

1. Subcontractor performance bonds provide broad protection for general contractors as a means of mitigating the losses associated with a subcontractor default.
2. Not all bond forms are created equally.
3. General contractors should take an active role in the preparation and/or selection of their subcontractors' bond forms.
4. General contractors should be familiar with and understand the terms of their subcontractors' bond forms **before** an issue arises.
5. Travelers Subcontractor Performance Bond provides general contractors with a more streamlined and definitive claim handling process in the event of a subcontractor default than do many of the traditional bond forms on the market today.



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