Performance and Payment Bonds

Sweetwater Bond Oversight Committee
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Legal Foundation For Rights

- California Constitutional protection (Article 14, Section 3)
  - Codified in Cal. Civil Code
  - Broadly construed by the Courts

Requirements for Action on Public Works Payment Bonds

- File Preliminary Notice (if required)
- Give statutory (Civil Code § 3227) written bond notice by certified mail to principal and to surety
  - Within **15 days** after recorded Notice of Completion
  - If no Notice, then **75 days** after completion
- Commence Action for Recovery On Bond
  - File within **6 months** after the time expires within which Stop Notices must be filed

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New Public Works Surety Bond Claim Requirements

- The right of second and third tier claimants to utilize the written bond notice provisions (if they failed to file a 20-day preliminary notice) is **ELIMINATED** if:
- (1) All progress payments, except for those disputed in good faith, have been made to a subcontractor who has a direct contractual relationship with the general contractor to whom the claimant has provided materials or services; or
- (2) The subcontractor who has a direct contractual relationship with the general contractor to whom the claimant has provided materials or services has been terminated from the project pursuant to the contract, and all progress payments, except those disputed in good faith, have been made as of the termination date.
- These provisions do not apply to a laborer, as defined in CC Section 3089.

Performance Bond Basics

Performance bonds, usually accompanied by payment bonds, are the key protection offered the tax payer on public works project. In the United States, public works projects are usually awarded based on the low bid. If it were not for the performance and payment bond, what would stop a totally unqualified bidder from bidding on the project?

For instance, let's assume the city of Jonesville decides it needs a new water treatment plant. The estimated cost of this plant is five million dollars. The taxpayers of Jonesville want to make sure that they are getting the job at the lowest possible cost, so the job is put out to public bid. This means any contractor can put in a bid on the job; if that contractor can post a surety bond.

Suppose there was not a requirement for performance and payment bonds. The tax payers still want the project at the lowest possible cost so chances are the project would still be put out for public bid. XYZ contracting looks at the plans, and even though XYZ has never built a water treatment plant before, XYZ figures they have drank enough water to do a good job on it and they put in a bid. Because there is no bond requirement no entity, like the surety bond company, is asking XYZ if it has ever built a water treatment plant before. XYZ is the low bidder.

A few months go by and it turns out XYZ does not know what it is doing. The work is not being done according to the plans and specifications and XYZ decides to use one of the progress payments to buy a new top of the line, four wheel drive truck with a custom paint job, gold plated wheels and a lift kit. Soon thereafter, XYZ gets kicked off the job, subs and suppliers are not paid, and the taxpayers of Jonesville do not have a treatment plant. The subs and suppliers cannot file a lien on public property so they take the town to court and win meaning not only does the town not have a treatment plant, the taxpayers are going to have to pay for the same work twice because no payment bond was required.

The surety bond company's primary responsibility is pre-qualification. Because public works jobs require bonding, a surety bond company would review the past experience of the bidders. The bond company would make sure the bidder has the financial wherewithal to complete the project, and best part of all, would back up this pre-qualification with substantial financial resources.

Back to XYZ; if this were a bonded job and somehow XYZ convinced a bonding company it was qualified to do the project the end of the story would be a lot different. The insurance company that provided the performance and payment bonds would have hired a new contractor to complete the job. All of the subcontractors and suppliers that had worked on the job would have been paid and all of this, at no additional cost to the taxpayers.

This is the basic purpose of the performance and payment bond.

Payment Bonds

Payment bonds protect certain laborers, material suppliers and subcontractors against nonpayment. Generally issued together with performance bonds, payment bonds guarantee that upon completion of a building project a contractor will pay certain bills for labor and materials (including those from subcontractors and suppliers) which are associated with a building contract.

A construction payment bond is generally purchased by a contractor during the bidding or negotiation phase of a construction job, and is submitted by the contractor to the owner of the project once he or she has been awarded the job. Most payment bonds specify on time and full payment to employees, suppliers, subcontractors, and others creditors. This guarantees that all suppliers and contract employees working on a construction project will be paid and won't walk out halfway through the job.

If there is a claim on a payment bond due to nonpayment or other breach of contract, the wronged party can file a claim on the bond. If the claim is found to be valid, the surety company that issued the bond backs up the guarantee of payment to the financial limit of the payment bond.