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## **Payment and Performance Bonds: Common Issues That Impact Acceptance or Denial of the Surety Claim**

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This paper outlines common issues that arise with claims on payment and performance bonds and describes the general steps necessary to evaluate and perfect payment bond claims on private, state and federal projects. The section on performance bonds addresses the various options for completing a project that might arise when a claim is made against the surety. That part of the paper also describes general defenses that might exist to a performance bond claim.

## **DETERMINING THE TYPE OF BOND**

In order to know the statutory framework and requirements for enforcement of a bond, it is first necessary to know what, if any, type of bond might be in place. This can be determined by evaluating whether the project is a private project, a state project, or a federal project.<sup>1</sup> If it is a private project, then the terms of the Texas Property Code will control. If it is a state project, then the terms of the Texas Government Code will control, and if it is a federal project, then the terms of the Miller Act will control. There may also be situations where the bond does not fit with any of the above statutory frameworks, in which case the existing bond is called a common law bond.

If the owner on the project is an individual, a business entity, and not a United States or state government entity, it is considered a private job. On private jobs, there is no statutory requirement that there be payment or performance bonds. That is up to the parties. Typically when a bond is issued on a private project, it is issued under the Texas Property Code. However, if the bond does not comply with the requirements of the Property Code, it will be considered a common law bond, determined by the terms of the bond itself and not by the Property Code.

Construction contracts with state government entities in Texas in excess of \$25,000 are required by statute to have surety bonds. Tex. Gov. Code 2253.001 et seq. “Government entity” under the government code is a defined term that means “governmental or quasi-governmental authority authorized by state law to make a public contract, including: (A) the state, a county, or a municipality; (B) a department, board, or agency of the state, a county or a municipality; and (C) a school district or a subdivision of a school district.” Tex. Gov. Code 2253.001(1). If it is a state contract in excess of \$25,000 but a bond is not provided, Tex. Gov. Code 2253.027 imposes penalties and liabilities on the government entity.

If the owner is the federal government, then the Miller Act applies. 40 U.S.C. § 3131. Bonds are required under the Miller Act if a contract is for more than \$100,000.

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<sup>1</sup> If a party does not have a copy of the bond or is unable to obtain it informally, there are statutory procedures for getting this information. On a private project, Tex. Prop. Code § 53.159 outlines the framework for obtaining information regarding the bond or obtaining a copy of the bond itself. Sec. 53.159 specifically provides that upon written request to the owner, to the original subcontractor or to the subcontractor, they must provide information regarding the existence of a surety bond along with a copy of the bond. Sec. 2253.024 of the Texas Government Code provides the basis for obtaining information regarding the applicable bond on a state project. The primary avenues for such information on a state project are written request to the prime contractor, the subcontractor, or the government entity involved on the project. On a federal project, the framework for obtaining a copy of the applicable bond is found in 40 U.S.C. § 31.33.

## **PROPERTY CODE BONDS**

### **1. Bond Replaces Lien**

If a valid statutory Property Code bond is in place on a private project in Texas, any liens filed against that property attach to the bond instead of the property. A claimant may not file suit against the owner or the owner's property. Tex. Prop. Code § 53.201. Subcontractors and suppliers cannot foreclose liens against the project and instead look to the bond if their claims remain unpaid.

### **2. Requirements for Property Code Bond**

In order to be considered a statutory Property Code bond, the bond must:

- be in a penal sum at least in the amount of the contract between the original contractor and the owner;
- the bond must be signed by both the original contractor and the bonding company;
- be in favor of the owner;
- be endorsed and approved by the owner;
- be issued by a bonding company authorized and admitted to execute bonds in Texas;
- the bond must be filed, with a copy of the written contract, with the county clerk of the county in which the project is located.

Tex. Prop. Code §§ 53.202 and 53.203.<sup>2</sup>

### **3. Is it a Property Code Bond?**

A bond is construed to comply with the Property Code if it is (1) furnished and filed in attempted compliance with the Property Code, or (2) evidences by its terms an intent to comply with the Property Code. Tex. Prop. Code § 53.211. In the absence of compliance or attempted compliance, the bond will not qualify as a statutory payment bond. With respect to attempted compliance, one court has held that it is "reasonable to expect that a bond intended to fall within the statutory payment bond provision would use statutory terminology, such as "prompt payment" or make reference to the "15%" in section 53.202(5). *Laughlin Environmental v. Premier Towers, L.P.*, 126 S.W.3d 668, 671-74 (Tex. App.—Houston [14<sup>th</sup> Dist.] 2004, no pet. hist.). The bond does not necessarily need to identify or reference the Texas Property Code. And reference to the Property Code when terms contained in the bond itself are contrary to the Property Code may not qualify it as a Property Code bond.

If it is unclear whether the bond is a statutory Property Code bond or a common law bond, it would be wise to comply with both sets of requirements. Depending on any specific

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<sup>2</sup> The property code does not identify a specific deadline for filing the bond and contract. Presumably, the bond could be filed well after work has begun on the project.

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