

OWNERS CONTRACTORS AND SURETIES
PROPOSE MODIFICATION OF THE
AMERICAN INSTITUTE OF ARCHITECTS A312 PAYMENT BOND

A payment bond assures that laborers, material suppliers and subcontractors on a construction project will be paid. Most payment bonds obligate the contractor and its surety to pay both persons who worked for the contractor and persons who worked for a first tier subcontractor. On public projects, payment bonds are required by law. On private projects, owners often require payment bonds to assure that there will be no unpaid subcontractors or suppliers who could file mechanics liens against the owner's property.

From its publication in 1984 until 2005, the American Institute of Architects (AIA) A312 Payment Bond was a widely used form generally perceived as fair to all project participants. Since 2005, however, two courts misinterpreted paragraph 6 of the A312 Payment Bond to prevent contractors and sureties from contesting claims if the surety failed to dispute the claim within 45 days. The most recent decision held that the surety had to pay the amount stated in the claimant's notice, and forfeited any defenses, even though the claimant had not provided any supporting documents or information to enable the contractor and surety to investigate the claim.

If a contractor and its surety are barred from contesting the amount demanded, they could have to pay exaggerated, invalid or even fraudulent claims. Such payments would reduce the bond penalty available to pay legitimate claims and expose the owner's property to mechanics liens if the bond penalty were exhausted.

Contractors and sureties have ample reasons to respond promptly to payment bond claims, including regulations, prompt payment statutes, and their own self interest in avoiding unnecessary expense. A waiver of defenses to invalid claims is not needed, was not intended by the drafters of the A312 bond form, and was not read into the bond by the courts for over 20 years after the bond was published.

In spite of numerous requests, AIA has to date failed to revise the A312 Payment Bond to remove the potential forfeiture of defenses to invalid claims. Many contractors and sureties, therefore, have refused to provide payment bonds on the A312 form unless it is modified to require claimants to support their claims and permit the contractor and surety to assert valid defenses.

An example of one such modification is:

1. Amend paragraphs 4.1 and 4.2.3 dealing with notice to the surety by adding at the end of each paragraph "and furnished to surety an explanation of the claim and copies of documents on which the Claimant relies to support the claim."

2. Amend paragraph 5 by changing “or” to “and” so it reads:

5. If a notice required by paragraph 4 is given by the Owner to the Contractor and to the Surety, that is sufficient compliance.

3. Amend paragraph 6 to read:

6. When the Claimant has satisfied the conditions of paragraph 4 and has submitted any additional supporting documentation, and any sworn proof of claim, requested by the Surety, the Surety shall, within a reasonable period of time, which shall not be less than 45 days, respond to the Claimant and offer to pay or arrange for payment of any undisputed amount; provided, however, that the failure of the Surety to fully and/or timely discharge its obligations under this paragraph or to dispute or identify any specific defense to all or part of a claim shall not be deemed an admission of liability by the Surety or otherwise constitute a waiver of any rights or defenses the Contractor and/or Surety may have or acquire as to such claim, including, without limitation, any right to dispute such claim. In no event shall the Surety’s liability to any Claimant under this Bond exceed the sum properly due such claimant.

There are different ways to modify the A312 Payment Bond to address concerns created by the erroneous court decisions, and many owners, contractors and sureties have developed their own set of changes. The point is to foreclose any waiver or forfeiture of defenses and assure that all funds available under the bond are used to pay valid claims of persons who worked on the project. In effect, the proposed modifications restore the original intent of the drafters of the bond form and its well-understood meaning within the construction industry prior to the recent, erroneous court decisions.