



What You Need To Know About Performance Bonds

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Question:

When is a Performance Bond not a Performance Bond?

Answer:

When the Performance Bond is really a Completion Bond.

The term “performance bond” is used in a variety of ways. On one hand, a performance bond is one of two bonds required on most government projects after a contractor has been awarded a job. On the other hand, a “performance bond” is required by the City of Phoenix if it issues a permit for work being done within the public right of way. Even though both bonds are called performance bonds, their guarantees are very different.

The statutory performance bond form used in Arizona pursuant to Titles 28, 34 and 41 contains language that says, “The condition of the obligation is such, that if the Principal faithfully performs and fulfills all of the undertakings, covenants, terms, conditions and agreements of the contract... the above obligation is void. Otherwise it remains in full force and effect.”

The City of Phoenix performance bond form, in accordance with the Code of the City of Phoenix, however, requires a bond to “guarantee that the work will be completed in accordance with the Permit...” The statutory bond is truly a performance bond but the City of Phoenix bond is a completion bond.

The critical difference in these two types of bonds is that the statutory performance bond guarantees performance of the terms of the contract—in exchange for payment of the agreed upon contract price. Both parties to the contract have obligations to fulfill and there is an expectation of payment for the work being performed. The bond’s guarantee is given to the party paying for the work and if payment is not made, the contractor may have grounds to stop working.

By contrast, the City of Phoenix completion bond guarantees:

that work will be completed to the satisfaction of the City, but the City has no corresponding obligation to pay for that work. Payment to the contractor comes from the owner/developer of the project. Once a contractor provides the completion bond to the City, however, he is obligated to complete the work even if he is not paid by the owner/developer of the project.

In a best case scenario, completion bonds should be provided by the project owner/developer since they control the financing arrangements. There are times, however, when a contractor may be asked to provide a completion bond so it is important to understand the difference.

Don’t subject yourself to more liability than necessary. It is a subject worth considering.