



## APPEALS COURT AFFIRMS DISCHARGE OF A SURETY THAT HAD NOT RECEIVED TIMELY NOTICE OF ITS PRINCIPAL'S DEFAULT SUMMARY JUDGMENT FOR THE SURETY IS AFFIRMED AFTER THE OBLIGEE FAILS TO DEFAULT THE PRINCIPAL UNTIL AFTER IT HAD COMPLETED ITS WORK

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The United States Court of Appeals for the District of Columbia Circuit recently affirmed summary judgment in favor of a surety on a performance bond claim where the surety had not received notice of its principal's default until more than three months after the principal had completed its work and left the worksite. The court's decision in *Hunt Construction Group, Inc. v. National Wrecking Corporation*, \_\_\_ F.3d \_\_\_, 2009 WL 4110379 (C.A.D.C., November 27, 2009) upholds the strict enforcement of a bond's notice of default requirements, consistent with the Fifth Circuit's holding in *L & A Contracting Co. v. Southern Concrete Services, Inc.*,<sup>1</sup> the Second Circuit's holding in *Elm Haven Construction Ltd. Partnership v. Neri Construction LLC*,<sup>2</sup> and the holdings of numerous federal district courts that have discharged a surety's liability due to the obligee's failure to fulfill the conditions precedent of a performance bond.

In *Hunt Construction*, XL Reinsurance America, Inc. and United States Surety Company issued a performance bond on behalf of National Wrecking Corporation, an excavation subcontractor on a hotel project for Hunt Construction Group, Inc. Under its subcontract, National Wrecking was obligated to complete its excavation work by February 12, 2004, however, it did not complete its work until April 6 of that year. Hunt accelerated the work of other subcontractors to make up for the delay, and asserted that it had incurred damages in excess of \$800,000 as a result of National Wrecking's tardiness. On July 13, 2004, Hunt sent National Wrecking a letter captioned "Default Notice," indicating that it constituted a "formal notice that National Wrecking Corporation is in default of its subcontract with Hunt Construction Group." On the same day Hunt also wrote to the sureties to give "formal notice" that National Wrecking was in default of its subcontract, demanding that the sureties "arrange for performance of National Wrecking's obligations under the subcontract" and advising the sureties that Hunt was looking toward them "to remedy National Wrecking's failures to

perform." However, Hunt subsequently acknowledged in court that the sureties could not have arranged for the performance of National Wrecking's excavation work because the notice of default was sent *after* National Wrecking had already completed its excavation work.

The sureties' performance bond generally followed the language found in the standard AIA A311 - 1970 bond form, and provided as follows:

- [A] National Wrecking Corporation ... as Principal ... and United States Surety Company & XL Reinsurance ..., as co-sureties ... are held and firmly bound unto Hunt Construction Group, Inc ... as Obligee ... in the amount of ... \$1,960,496...
  - [B] NOW, THEREFORE, THE CONDITION OF THIS OBLIGATION is such that, if Principal shall promptly and faithfully perform said subcontract, then this obligation shall be null and void; otherwise it shall remain in full force and effect.
- ....
- [C] Whenever Principal shall be, and be declared by Obligee to be in default under the subcontract, the Obligee having performed Obligee's obligations thereunder:

(1) Surety may promptly remedy the default subject to the provisions of paragraph 3 herein, or;

(2) Obligee after reasonable notice to Surety may, or Surety upon demand of Obligee, may arrange for the performance of Principal's obligation under the subcontract subject to the provisions of paragraph 3 herein;

(3) The balance of the subcontract price, as defined below, shall be credited against the reasonable cost of

completing performance of the subcontract...

Hunt argued that Paragraphs A and B of the bond constituted an absolute obligation on the part of the sureties to perform under the bond if their principal failed to “promptly and faithfully perform” its subcontract. Specifically, Hunt argued that Paragraph A made the sureties immediately liable to the obligee, and that, further, the liability set forth in Paragraph A was conditioned only upon the condition subsequent to Paragraph B, *i.e.*, that the principal promptly and faithfully perform its subcontract. Paragraph C, Hunt argued, set forth three events (the principal’s default, the obligee’s declaration of default, and the obligee’s performance) that constituted conditions precedent to the use of the remedies and damages described in Paragraph C, but these were not conditions precedent to the liability created by Paragraph A of the bond. The court rejected this argument. It held:

... the provisions of paragraph C are nonsensical without an understanding that the surety's duties depend on the obligee's declaring the principal to be in default and giving notice of the declaration to the principal and the surety. Under Hunt's contrary reading, paragraph C's explicit grant to the surety of a right to remedy the default itself would be operative only if the obligee chose to give it notice. Such a view would render that right nearly meaningless.

The court further held that even if Hunt had declared a default in a timely fashion, the bond made it clear that the obligee could arrange to complete unfinished work itself only “*after* reasonable notice to Surety.” Thus, even after declaring a default, Hunt could proceed to remedy the default on its own only after it gave “reasonable notice” to the sureties that it intended to do so. The

court found that Hunt gave no such notice. The court held that the requirements listed in the first clause of paragraph C were properly read as true conditions precedent to the sureties’ obligations, in the absence of which the sureties had no liability on the bond.

The D.C. Court of Appeals’ decision in Hunt Construction is yet another federal case limiting a surety’s liability to the express terms of the surety’s bond and enforcing the conditions precedent found in many surety bonds used in the construction industry today. In the seminal L & A Contracting case, the Fifth Circuit held that the notice of default requirement of the bond was satisfied only by a “sufficiently clear, direct, and unequivocal or precise declaration of default.” In Elm Haven, the Second Circuit found that the obligee’s letters complaining of the principal’s performance never “even contained the word ‘default’ or an ‘unequivocal declaration of default’.” Now, in Hunt Construction, the court found that the obligee had made an unequivocal declaration of default, but made it long after the sureties could act. In each of these cases, the courts held that the obligee had breached the performance bond by depriving the surety of its option under the bond to cure the principal’s default.

While no Third Circuit federal nor Pennsylvania state case has similarly squarely addressed the conditions precedent found in the AIA A311-1970 or AIA A312-1984 bond forms, it is well established under Pennsylvania law that a surety is obligated only to the extent of the express terms of its bond. The careful construction professional will thus always be careful to closely examine, and heed to, the provisions of a surety bond in order to preserve all the party’s rights.

<sup>1</sup> 17 F.3d 106 (5th Cir. 1994)

<sup>2</sup> 376 F.3d 96 (2nd Cir. 2004)

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