

Appeals Court Affirms *JDS* Discharge of Surety's Performance Bond Obligations

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A New York appellate court recently confirmed that surety performance bond liability is limited by the language of the bond, including notice and termination "conditions precedent" provisions, and by the scope and status of the underlying bonded work.¹ By affirming the lower court's decision dismissing the obligee-construction manager's \$60 million claim against the surety, the court reiterates that a performance bond is not insurance against the cost of any breach, but rather, a guarantee of the principal's performance of the bonded work only.

The matter stems from a \$40 million private construction subcontract between construction manager, *JDS Development, LLC* ("*JDS*"), and subcontractor *Parkside Construction Builders Corp.* ("*Parkside*"), to provide superstructure work to build the 85-story Steinway Building in New York City. *Parkside's* surety, *Allied World Insurance Co.* ("*Allied*"), could not bond the entire subcontract work due to a \$25 million per bond/transaction restriction under its reinsurance treaty. Instead, in March 2016, the parties "carved out" a separate \$24.9 million subcontract and rider limited to *Parkside's* work from the superstructure to the 36th floor

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Contract Waiver Does Not Preclude Consequential Damages Against Surety Denying Performance Bond Claim

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New York's Appellate Division, First Department reminds sureties that a performance bond, like any other contract, will be enforced per its terms, while drawing a distinction between the obligations owed by the surety's bonded principal and the independent obligations owed by the surety to the obligee.¹ The court held that consequential damages against the surety for breach of the bond terms "were not foreclosed as a matter of law based solely on a waiver of consequential damages in the [underlying] construction contract." The appellate ruling reversed the lower court and granted judgment on liability against the surety.

In 2020, the obligee sought to build 21 units of affordable and supportive housing for homeless individuals with mental illness in New York City. It contracted with a construction company to do so via an industry standard AIA contract that required surety bonds. A \$7.5 million AIA A312™ 2010 Performance Bond was issued by the surety. After problems arose with the contractor's performance of the work, the obligee sent the required Section 3.1 bond notices to the surety and subsequently terminated the contract, calling on the surety to perform.

Upon investigation, the surety denied the claim based on alleged prejudice caused by the obligee's failure to notify the surety of the principal's ongoing default-worthy performance months earlier, and alleged failure to comply with conditions precedent apparently for that earlier "default."² The obligee sued the surety solely for breach of contract, based upon alleged breach of its performance bond obligations in delaying action and denying the claim. The obligee was ultimately able to secure a replacement contractor with additional funding from government-related resources.

The obligee sought summary judgment on liability, dismissal of the surety's affirmative defenses, and an assessment of damages. The surety in defense argued it was discharged by the obligee's delayed notification of default, and that the obligee had no direct damages, as it had been "made whole" by the outside funding for completion.³ The lower court denied the motion in a three-sentence decision, citing the waiver of consequential damages in the underlying bonded construction contract and the obligee's lack of evidence that its damages were "not consequential in nature."⁴

The appellate court unanimously reversed, siding with the obligee to find the action involved the breach of an independent bond obligation, separate from the performance of the principal's obligations under the construction contract. Here, the surety acted per Section 5.4.2 of the bond by denying liability and notifying the obligee of the reasons for denial. The court relied on Section 6 of the bond that entitles the obligee to "enforce any remedy available" when the surety denies the claim under Section 5.4. The court stated:

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Performance Bond
Obligations**

**Discharge Undone
for Failure to
Notify Surety**

Discharge Undone for Failure to Notify Surety

NELL M. HURLEY

A recent Maryland federal court decision highlights the standard required for creditor notification in a ruling that allowed an unnotified surety-creditor to assert previously discharged claims against a debtor/co-indemnitor.¹ While the standard is not an exacting one (“reasonably diligent efforts”), the facts of the case show how easily an unknowing surety-creditor can slip through the cracks, putting recovery and salvage efforts against indemnitors at risk.

The matter stems from surety bonds issued in Maryland in 2016. The construction company that sought the bonds from North American Specialty Insurance Company (“NASIC”) was required to execute a standard indemnity agreement, as were the husband-and-wife company owners, each in their individual capacities. NASIC then issued seven construction surety bonds. Following the contractor’s financial difficulties a few years later, claims were made on some of the bonds. NASIC was obligated to pay and did.

In 2019, the wife filed a Chapter 13 bankruptcy petition, listing “North American Surety” as a creditor but providing the address of another unrelated surety industry company.² Having not been notified, NASIC did not file a proof of claim. The wife completed her plan payments, and the case was closed in January 2020.

Soon after, the husband filed a bankruptcy petition, listing the surety-creditor and address in the same manner as the wife. Months later, his schedules were amended to include NASIC at its correct address. NASIC was notified of the couple’s bankruptcy cases and filed a proof of claim in the husband’s case. NASIC then sought a declaratory judgment that its claims were not discharged by the wife’s bankruptcy and was granted summary judgment on the issue by the bankruptcy court. The husband appealed to the U.S. District Court.

That court affirmed, finding that not only did NASIC lack actual notice as

required for the wife to obtain discharge, but that she failed to use “reasonable diligence” to identify and notify NASIC as a creditor. The wife’s failure to make a careful examination of her own books and records when listing her creditors meant that her obligation to NASIC under the indemnity agreement was not discharged by her bankruptcy.

The most obvious record ignored was the indemnity agreement itself, stated the court, which expressly lists NASIC as “Surety.” Other records available included (1) seven bonds issued to the construction company; (2) nine letters sent to the company and to the husband; and (3) one letter sent directly to the wife and copies of another two addressed to the company. All these documents provided NASIC’s name and correct address. The couple failed to ask counsel for assistance and instead “stitched the address of one company to the name of another,” neither of which belonged to NASIC. This decision lacked reasonable diligence, ruled the court.

The court rejected arguments that NASIC received actual notice of the wife’s bankruptcy through other means. The husband claimed to have mentioned the

wife’s bankruptcy to the surety bond producer. The agent denied being notified of that bankruptcy and there was no proof that he had knowledge of facts sufficient to apprise NASIC that a case was filed or where it was pending.

The husband further asserted that the couple discussed the wife’s bankruptcy in 2019 with its bank and sought to impute that knowledge to the bank’s subsidiary insurance company which had procured the bonds from NASIC. This chain was too attenuated and lacked support in the record to show actual knowledge, concluded the court.

Facts like these may be all too common when bonding smaller contractors, with unsophisticated owners and their spouses as indemnitors. While comforting for sureties that the discharge was lifted, it was not without additional and unexpected costs to the surety for the mere right to file a proof of claim, through no fault of its own. **E&D**

¹ *Foxson v. N. Am. Specialty Ins. Co.*, 2024 WL 3252957 [D. Md. July 1, 2024].

² The address was that of JW Surety Bonds in Pipersville, PA, a bond producer that was not involved with the NASIC bonds at issue here.



From left, E&D’s Cavan Boyle, John Dreeste, Brian Streicher, and Brian Sanvidge of Anchin. The foursome played at the Gilbane 16th Annual Upstate New York Charity Golf Tournament at Bellevue Country Club in Syracuse in September. Both E&D and Anchin sponsored holes.

Cavan Boyle (center) participated in the Chicago Surety Claims Association’s Annual Golf Outing held in August, in which E&D was a sponsor. Todd Braggins also attended.

CONTINUED "CONTRACT WAIVER DOES NOT PRECLUDE CONSEQUENTIAL DAMAGES AGAINST SURETY DENYING PERFORMANCE BOND CLAIM "

Since the language of the performance bond provides an independent cause of action [against the surety], the waiver of consequential damage in the construction contract does not affect [obligee's claim].⁵

The court thus simply applied the plain terms of the bond and granted judgment to the obligee on liability only, with damages to be determined by the trial court.⁶

Denial of a performance bond claim can present additional risks to the surety, and this court's contractual interpretation of the commonly used AIA A312™ Performance Bond certainly highlights this danger. Surety professionals and

counsel must be aware that damages limitations or similar terms within the construction contract (such as a waiver of consequential damages) may be lost under the terms of Sections 6 and 7 of the A312 should the surety not complete its principal's obligations per bond Sections 5.1, 5.2 or 5.3. Per this court, a surety's breach of its bond obligations can give rise to damages flowing from that breach, including increased financing costs, carrying costs for delayed completion, and lost profits, despite any limitation in the bonded contract. **E&D**

¹ *OH 126th St. Housing Dev. Fund Corp. v Berkley Ins. Co.*, 2024 WL 4628153 [1st Dept 2024].

² The bond did not require additional notice to the surety of the principal's default within a specified time frame. The bond also expressly provided that any failure of notice shall not constitute failure of a condition precedent, nor release the surety except to the extent of actual prejudice.

³ The surety may well have been granted summary judgment dismissing the action by the motion court except for an issue regarding proper noticing of its cross-motion.

⁴ The application of the waiver provisions to the bond obligations was not addressed in motion papers but was raised by surety's counsel at oral argument.

⁵ This contrasts with Section 7, which limits the surety's obligations to be not greater than the contractor under the construction contract had the surety chosen to complete under Sections 5.1, 5.2 or 5.3. That limitation is absent where the surety denies liability under Section 5.4.2.

⁶ The trial court has yet to rule on obligee's motion for dismissal of the surety's affirmative defenses.

CONTINUED "APPEALS COURT AFFIRMS JDS DISCHARGE OF SURETY'S PERFORMANCE BOND OBLIGATIONS"

("Bonded Subcontract"). In April 2016, Allied issued an industry standard form AIA A312™ (2010) performance bond covering the Bonded Subcontract, with Parkside as principal and JDS as obligee.

Nearly immediately, Parkside struggled, and JDS assisted Parkside to correct deficiencies with funds from the project owner. After more defaults, JDS considered terminating Parkside but did not, nor did JDS notify Allied of Parkside's defaults pursuant to the bond. In early 2017, while failing its subcontract obligations, Parkside asked for more money, despite no remaining subcontract funds. JDS agreed to a \$20 million change order/price adjustment, increasing the overall subcontract to \$60 million. By October 2017, Parkside completed 100% of the Bonded Subcontract work (superstructure through the 36th floor), a full one year late.

Problems with the project continued and, in May 2018, while working on the 60th floor, Parkside was indicted for wage theft and fraud and abandoned the project. For the first time, JDS notified Parkside and Allied that it was considering declaring default and requested a conference to discuss methods of completing the remaining work. Soon after, JDS declared Parkside in default and terminated the subcontract. Asserting compliance with the bond's notice and termination provisions, JDS demanded that Allied fulfill its bond obligations. Allied denied JDS's claim. JDS sued Allied and Parkside for subcontract breaches, including delay damages, and on the performance bond. Parkside defaulted in the lawsuit, and Allied and JDS cross-moved for summary judgment, resulting in judgment on both motions in Allied's favor.

At issue on appeal, explained the court, is the A312 bond, "one of the clearest, most definitive, and widely used...com-

mon law performance bonds in private construction" that "was developed to define clearly...the trigger of the surety's obligation to perform." Found under paragraph 3 of the A312 bond are terms that "create mandatory conditions precedent," such that failure to adhere to the notice and termination requirements precludes surety liability under the bond.

Thus, the court affirmed that Allied's bond was limited to Parkside's work from the superstructure through the 36th floor only, which Parkside completed (and was paid for) in 2017. Only after Parkside completed the bonded work did JDS attempt to comply with the bond's notice terms. JDS's failure to invoke its rights while the bonded work was still in progress prevented Allied from any opportunity to perform, and JDS's inaction was fatal to its claim.² The court rejected Parkside's argument that the provisions were not conditions precedent because the damages sought were "delay" damages.

The appellate court recognized that JDS may have made the correct business decision to keep a deficient contractor on the job instead of hiring a new one. But its failure to follow the bond's notice and termination terms while the bonded work was in progress discharged the surety's bond obligations. Unfortunately for JDS, the work beyond the Bonded Subcontract (above the 36th floor) was performed unbonded and without the protection of a surety bond or subcontractor default insurance. **E&D**

¹ *JDS Dev. LLC v. Parkside Const. Builders Corp.*, 2024 WL 3817696 [1st Dept 2024].

² See also *153 Hudson Dev., LLC v. DiNunno*, 8 AD3d 77 [1st Dept 2004].



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FIRM NEWS

Ernstrom & Dreste, LLP was featured by the Rochester Business Journal in an article about boutique law firms published July 30, 2024, noting E&D's 30-plus years of success as a Surety & Construction law firm.

Todd Braggins was quoted in an article published in the Fall 2024 NASBP *Surety Bond Quarterly* entitled "Bond Producers Providing Support to Clients with a Surety Claim."

Brian Streicher was a speaker at the 30th Annual Pearlman Conference, held in the Seattle, WA area September 4-6, 2024. Brian addressed the topic "Payment Bond Roundup: How to Analyze Claims for Payment."

Mike Higgins attended the 2024 Fidelity Law Association's Annual Meeting and the TIPS Fidelity & Surety Law Committee's Fall Fidelity Meeting, held in Philadelphia, PA, September 25-27.

Todd Braggins and Brian Streicher participated in the 2024 Annual Meeting of the National Bond Claims Association, held October 9-11 at The Ritz Carlton Reynolds, Lake Oconee in Greensboro, GA.

Brian Streicher was a featured speaker at Syracuse Surety Association's 2024 Surety Day on November 6, 2024, presenting "New York Prevailing Wage Law and Certified Payrolls, 2024/2025 Update."

Todd Braggins and Cavan Boyle will attend the 2025 ABA TIPS/FSLC Midwinter Meeting January 15-17, 2025, in Austin, TX.