

## Can the Texas Performance Bond Surety Be Liable After Substantial Completion?

By: Max Langley

As our firm focuses heavily on surety litigation, we have noticed a proliferation of post-completion performance bond claims. The question becomes: can the Texas performance bond surety be held liable after substantial completion? In many states, the answer is yes. In Texas, the answer used to be a resounding no. Now, after a non-binding intermediate case, obligees will argue the performance bond surety can be on the hook even after the architect has certified substantial completion, and the obligee has paid all the contract balance and occupied the project. A smart surety will carefully explain the policy and pragmatic reasons why the majority of Texas courts have held:

It is well settled that a surety on a performance bond is entitled to rely on the architect's Certificate of Completion as the final discharge of its duty on the bond...

*Hartford Fire Ins. Co. v. City of Mont Belvieu, Tex.*, 611 F.3d 289, 295 (5th Cir. 2010) (Texas law) (quoting *Transamerica Ins. Co. v. Hous. Auth. of Victoria*, 669 S.W.2d 818, 823 (Tex. App. – Corpus Christi 1984, writ ref'd n.r.e.)). Obligees have argued this means a certificate of “final completion,” rather than “substantial completion.” But this argument has been rejected. *Travelers Cas. & Sur. Co. of Am. v. Harlingen Consolidated ISD*, 2017 WL 7052232, \*\*3-4 (S.D. Tex. 2017) (Texas law). Indeed, the Fifth Circuit determined that Texas law uniformly holds that “substantial completion” of a construction contract is regarded, in legal parlance, as full performance. *Hartford Fire Ins Co.*, 611 F.3d at 295.

Some of the policy reasons behind the surety being discharged upon substantial completion were aptly explained in an appellate case our law firm handled. The Houston Court of Appeals held:

[P]erformance bonds are conditional obligations that are triggered by, among other requirements, the principal's material breach of the bonded contract sufficient to warrant termination . . . If a contractor has substantially complied with a construction contract, it cannot be said to have materially breached the construction contract . . . Thus, in such a circumstance, the surety is not liable on the bonds.

*Gulf Liquids New River Project, LLC v. Gulsby Engineering*, 356 S.W.3d 54, 81 (Tex. App. – Houston [1st Dist.] 2011, reh'g overruled). Other policy reasons include:

- Allowing post-completion performance bond claims incentivizes obligees to take the path of least resistance by dissipating the contract balance and not calling on the surety during construction.
- The surety loses its protections via its collateral stake in the contract balance, because by the time of the claim the contract balance is zero. If the obligee made the claim during construction, the surety would have the contract balance available to choose its option.
- Post-completion claims greatly prejudice the surety's ability to investigate the merits of the claim, compared to an investigation prior to completion. After completion, the principal, other witnesses, and other key evidence are often unavailable.
- After completion, there generally is no “pre-default meeting” as is customary and often required by performance bonds.
- Many post-completion claims involve the obligee having already “corrected” the issues, or the obligee only demanding money instead of performance – because the building is already built. Thus, the surety's options are often restricted or removed, thereby prejudicing the surety.
- The owner and its architect have already accepted the project as legally complete by paying the principal and issuing the certificate of substantial completion.
- The bonded contract often requires the architect to first resolve any disputes before suit can be filed. However, after substantial completion, the architect is no longer on the project and no longer in a role to resolve disputes. Accordingly, this condition precedent cannot be met in the post-substantial-completion context.



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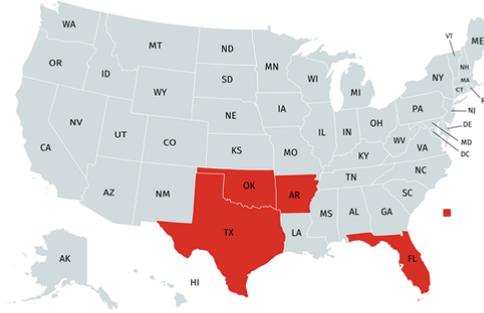
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We hope that these changes make big differences in the future.

*Well done is better than well said.*

- Benjamin Franklin



- Performance bonds typically require, among other conditions precedent, “default” or “termination.” Neither of these are possible after substantial completion. See Philip L. Bruner, *The Surety’s Response to the Obligor’s Declaration of Default and Termination*, 17-JAN Construction Law 3, 9 (1997) (“Since the owner may not terminate the contract for default after it has been substantially performed, the owner is not permitted to pursue the surety under the performance bond.”); *L&A Contracting Co. v. Southern Concrete Services*, 17 F.3d 106, 110-111 (5th Cir. 1994) (“To constitute a legal default, there must be a (1) material breach or series of material breaches (2) of such magnitude that the obligee is justified in terminating the contract. Usually, the principal is unable to complete the project, leaving termination of the contract the obligee’s only option.”).

Despite these policy rationales and despite the great weight of Texas authorities holding surety obligations end at substantial completion, obligees may point to a non-binding intermediary case that held, in some circumstances, a surety may have liability after substantial completion. *City of Wolfe v. Am. Safety Cas. Ins. Co.*, 557 S.W.3d 669 (Tex. App. – Texarkana 2018, pet. denied). This may be a case of “bad facts create bad law.” There, the city’s architect prematurely issued a certificate of substantial completion despite a significant portion of the scope of work not even being installed. It was undisputed that the system was not fully functional. After the certificate of substantial completion was issued, the architect also issued a change order, adding even more units and meters to be installed and adding more time for completing the project. This does not make sense, because a certificate of substantial completion should be issued when the project is usable for its intended purpose — if more time is necessary, if the system is not usable for its intended purpose, and if major components of the project are not installed, by very definition substantial completion should not be certified. The obligee made a demand on the performance bond a few months after the change order was issued, and the principal ceased working shortly thereafter. 11 months after substantial completion was prematurely certified, the obligee filed suit. The appellate court determined that the bond incorporated the underlying contract by reference, and the certificate of substantial completion did not automatically discharge the surety. Therefore, the appellate court reversed the trial court’s granting of summary judgment in favor of the surety (importantly, the appellate court did not hold that the surety was liable).

The Texas Supreme Court declined to hear the *City of Wolfe* case, leaving a potential conflict in Texas law. Again, the great weight of authority in Texas is that substantial completion discharges the surety.

We also practice in Florida, Oklahoma, and Arkansas. In Florida, latent defect claims against the performance bond can, in some cases, extend beyond substantial completion. *Federal Ins. Co. v. Southwest Florida Retirement Center*, 707 So.2d 1119 (Fla. 1998). However, this does not include delay damages against the surety. *Am. Home Assur. Co. v. Larkin General Hosp.*, 593 So.2d 195 (Fla. 1992).

Notably, the surety in *City of Wolfe* appears to have tendered the defense to the principal, which can cause difficulties for sophisticated surety issues, such as whether the surety is liable after substantial completion. Our firm was recently able to secure a full discharge for a performance bond surety facing an 8-figure post-completion performance bond claim during a tough AAA 3-panel arbitration, despite the obligee’s strong arguments based on *City of Wolfe*. Accordingly, sureties should carefully weigh the pros and cons before tendering the defense; be aware of the arguments obligees will make in the post-completion context; and stay sharp on the policy rationales and legal authorities supporting the surety’s arsenal of defenses.

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