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USE OF PRE- AND POST- JUDGMENT REMEDIES

PRESENTED BY:

**JONATHAN BONDY, ESQ.
WOLFF & SAMSON PC
140 Broadway - 46th Floor
New York, New York 10005
(973) 530-2052
(973) 530-2252**

**ROBYN L. SONDAK, ESQ.
ST. PAUL TRAVELERS
1 Tower Square, 4PB
Hartford, CT 06183**

PRE-JUDGMENT AND POST-JUDGMENT REMEDIES: USING THE COURTS TO ENFORCE THE SURETY'S SALVAGE AND SUBROGATION RIGHTS

When confronted with claims made under its bonds, a Surety has well-settled rights, against various parties, of which it can avail itself to try to mitigate its potential, or actual, losses, both before and after those losses are incurred. The contractual and legal rights afforded the Surety under the General Indemnity Agreement it customarily obtains from its Principal, as well as the Surety's rights under the doctrine of equitable subrogation, are numerous and varied. These rights can be used in many different ways, against the Principal and Indemnitors as well as against third parties such as obligees, the Principal's other creditors, and other parties indebted to the Principal.

How the Surety elects to proceed to enforce its rights when faced with potential losses requires an analysis of a number of business and legal considerations. Some critical decisions may need to be made by the Surety and its counsel, sometimes very early in the claims handling process and often within only days of receiving the initial claim. Will the Surety finance the Principal? Is the Principal trustworthy and cooperative? Is it solvent or is it diverting contract funds or otherwise making itself insolvent? What are the merits of the Principal's defenses to the claims the Surety is receiving? Who else does the Principal owe money to, and who may owe money to the Principal? Are other parties trying to recover contract funds that may otherwise be due the Surety? Will third parties recognize the Surety's rights? These are just some of the questions with which the Surety is frequently confronted, even at the initial stage of its claims investigation process.

Once an initial decision is made as to how the Surety will proceed, it is often necessary for the Surety to seek judicial intervention to enforce the Surety's rights. The relief sought may be monetary (having the Principal provide collateral or exonerate the surety), declaratory (having third parties recognize the Surety's rights), or equitable (seeking temporary restraints against the Principal and Indemnitors to, among other things, preserve assets, provide an accounting, or give access to books and records) in nature. The tactical approach the Surety elects to take early in the claims process largely dictates what relief it may want to seek from the Courts.

A. INJUNCTIVE RELIEF

It is far from uncommon for the Surety to find that the Principal, while denying its liability to the parties making claims under the Surety's bonds refuses to cooperate with the Surety or otherwise comply with its obligations under the General Indemnity Agreement. The Surety may already have concluded, even without setting a loss reserve, that it will incur losses in responding to performance or payment bond claims. Even if the Surety believes there may be merit to the Principal's defenses, the Surety may decide, for example, that it makes better fiscal sense for the Surety to mitigate its potential loss by attending to the completion of a bonded contract (subject to a reservation of its and the Principal's rights and defenses) and litigate with the obligee regarding the default. Under such circumstances, the General Indemnity Agreement

usually provides that the Principal and Indemnitors must, on demand of the Surety, exonerate the Surety from the potential loss. A separate right under the General Indemnity Agreement allows the Surety to demand that the Principal and Indemnitors provide collateral.

A General Indemnity Agreement typically provides that the Principal and Indemnitors, jointly and severally promise that they:

shall exonerate, indemnify and keep indemnified the Surety from and against any and all liability for losses and/or expenses of whatsoever kind or nature (including, but not limited to, interest, court costs and counsel fees) and from and against any and all such losses and/or expenses which the Surety may sustain and incur: (1) By reason of having executed or procured the execution of the Bonds, (2) By reason of the failure of the Contractor or Indemnitors to perform or comply with the covenants and conditions of this Agreement or (3) In enforcing any of the covenants and conditions of this Agreement. Payment by reason of the aforesaid causes shall be made to the Surety by the Contractor and Indemnitors as soon as liability exists or is asserted against the Surety, whether or not the Surety shall have made any payment therefor. Such payment shall be equal to the amount of the reserve set by the Surety. In the event of any payment by the Surety the Contractor and Indemnitors further agree that in any accounting between the Surety and the Contractor, or between the Surety and the Indemnitors, or either or both of them, the Surety shall be entitled to charge for any and all disbursements made by it in good faith in and about the matters herein contemplated by this Agreement under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed; and that the vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety.

If the Surety's demand for exoneration or collateral has been rejected or ignored, the Surety can either wait for its losses to become fixed and seek indemnification, or it can take more aggressive measures to enforce its rights under the General Indemnity Agreement and seek to be placed in funds, or secured by other assets, prior to actually incurring a monetary loss. If, as is often the case, the Surety needs to move quickly to seek collateral prior to incurring a loss, it can bring an action seeking specific performance of the Principal's and Indemnitors' obligations to exonerate, or post collateral with, the Surety. In such a case, it will frequently benefit the Surety to seek, with the filing of its complaint, an order from the Court, in the form of a preliminary injunction, compelling the Principal and Indemnitors to live up to their obligations under the General Indemnity Agreement.

The grounds for obtaining injunctive relief vary from state to state, but usually require the following: (i) the likelihood of ultimate success on the merits, (ii) irreparable injury in the absence of a preliminary injunction, (iii) a balancing of the equities in favor of the party seeking the injunction.¹ It may frequently be in the Surety's interest to commence such a proceeding, and make its application for injunctive relief in federal court given the often higher quality of the judiciary; depending on the speed with which the appropriate District Court may decide such an application. While the substantive law of the forum state will usually control, it is important to take note of the procedural requirements imposed by federal law. Fed. R. Civ. Pro. 64 provides that:

At the commencement of and during the course of an action, all remedies providing for seizure of person or property for the purpose of securing satisfaction of the judgment ultimately to be entered in the action are available under the circumstances and in the manner provided by the law of the state in which the district court is held, existing at the time the remedy is sought, subject to the following qualifications: (1) any existing statute of the United States governs to the extent to which it is applicable; (2) the action in which any of the foregoing remedies is used shall be commenced and prosecuted or, if removed from a state court, shall be prosecuted after removal, pursuant to these rules. The remedies thus available include arrest, attachment, garnishment, replevin, sequestration, and other corresponding or equivalent remedies, however designated and regardless of whether by state procedure the remedy is ancillary to an action or must be obtained by an independent action.

As to the specific procedures in federal court regarding injunctions, Fed. R. Civ. Pro. 65(a)(1) provides that "No preliminary injunction shall be issued without notice to the adverse party, and Fed. R. Civ. Pro. 65(b) states that:

A temporary restraining order may be granted without written or oral notice to the adverse party or that party's attorney only if (1) it clearly appears from specific facts shown by affidavit or by the

¹ See *Evans-Freke v. Showcase Contracting Corp.*, 3 A.D.3d 549, 770 N.Y.S.2d 640 (App. Div. 2004); see also, *Crowe v. DeGoia*, 90 N.J. 126, 132-134, 447 A.2d 173 (N.J. 1982), holding under New Jersey law that the criteria for injunctive relief are that (i) the injunction is necessary to prevent irreparable harm;(ii) the legal right underlying the claim must be settled; (iii) there are no material contested facts; and (iv) an analysis of the relative hardship to parties by granting or denying the relief sought; *Department of Transportation v. Armacost*, 299 Md. 392, 404-405, 474 A.2d 191 (1984), stating under Maryland law that the criteria for injunctive relief are (i) the likelihood that plaintiff will succeed on the merits, (ii) whether plaintiff has an adequate remedy at law or will be irreparably harmed if the injunction is not issued; (iii) the "balance of convenience," determined by whether the harm to the plaintiff if the injunction is not granted outweighs the harm to the defendant if the injunction is granted; and, (iv) the injunction will not harm the public interest

verified complaint that immediate and irreparable injury, loss, or damage will result to the applicant before the adverse party or that party's attorney can be heard in opposition, and (2) the applicant's attorney certifies to the court in writing the efforts, if any, which have been made to give the notice and the reasons supporting the claim that notice should not be required. Every temporary restraining order granted without notice shall be indorsed with the date and hour of issuance; shall be filed forthwith in the clerk's office and entered of record; shall define the injury and state why it is irreparable and why the order was granted without notice; and shall expire by its terms within such time after entry, not to exceed 10 days, as the court fixes, unless within the time so fixed the order, for good cause shown, is extended for a like period or unless the party against whom the order is directed consents that it may be extended for a longer period. The reasons for the extension shall be entered of record. In case a temporary restraining order is granted without notice, the motion for a preliminary injunction shall be set down for hearing at the earliest possible time and takes precedence of all matters except older matters of the same character; and when the motion comes on for hearing the party who obtained the temporary restraining order shall proceed with the application for a preliminary injunction and, if the party does not do so, the court shall dissolve the temporary restraining order. On 2 days' notice to the party who obtained the temporary restraining order without notice or on such shorter notice to that party as the court may prescribe, the adverse party may appear and move its dissolution or modification and in that event the court shall proceed to hear and determine such motion as expeditiously as the ends of justice require.

In its application to the Court, the Surety should present proofs in the form of the General Indemnity Agreement, the bonds issued, the claims received, the potential loss (even if the loss is nowhere near being fixed with a degree of certainty), the demands the Surety has made of the Principal and Indemnitors for the deposit of collateral or exoneration, and the refusal to provide same. Assuming the execution of the General Indemnity Agreement is not contested, the Surety, should be able to show a likelihood of success on the merits. The more significant issue to be established by the Surety is that of "irreparable harm". The argument that Surety has been irreparably harmed by the Principal's and Indemnitors' failure to provide collateral is that the Surety's right to be placed in funds prior to making any payment is a bargained-for right, the denial of which has been held to be a source of immediate and irreparable harm.² The Surety's

² See, e.g., *Colonial Sur. Co. v. MedTek, Inc.*, 2005 WL 459642 (E.D.Pa. 2005) granting the Surety summary judgment and ordering the immediate deposit of collateral security on the grounds that failure to provide collateral security was a breach of the General Indemnity Agreement; *Travelers Cas. and Sur. Co. v. Ockerlund*, 2004 WL 1794915 (N.D.Ill. 2004) granting the Surety's request for a preliminary injunction and ordering the deposit of collateral security on the grounds that the loss of a contractual right

right to be indemnified after the fact for losses it incurs is separate and apart from the Surety's right to be placed in funds so that those losses are paid in the first instance from the Principal's or Indemnitors' funds. The right to be collateralized is lost, effectively forever, if the Surety has to pay first and chase the Principal or Indemnitors later.

The Surety may also seek, in its application for a preliminary injunction, a temporary restraining order. This would ordinarily be in the form of a request for an order of attachment on the grounds that the Principal or Indemnitors are dissipating their assets.³

In the case of *United States Fidelity & Guaranty Co. v. J. United Electrical Contracting Corp.*, 62 F.Supp.2d 915 (S.D.N.Y. 1999), the Surety filed an order to show cause seeking an order attaching some of the Indemnitors' assets, enjoining the Indemnitors from disposing of them, and requiring the Indemnitors to post collateral in accordance with the General Indemnity Agreement. The Surety was faced with performance and payment bond claims, some of which it had paid and some of which were still pending. The Court held on the attachment issue that the Surety was requesting a "mandatory" injunction and therefore, had to meet a higher standard of proof that it would need to meet for the issuance of a preliminary injunction, and that the Surety therefore, had to show either "clear" entitlement to relief or that "extreme or very serious damage" will result from a denial of its application. The Court issued the order of attachment as requested by the Surety after finding that the indemnitor had attempted to improperly transfer his assets, and issued an injunction restraining the Indemnitor's from further disposing of their property.

The Court also found that the Surety had met its burden of showing it was entitled to specific performance of the General Indemnity Agreement's collateral deposit provision. Citing to New York law, the Court found that the collateral deposit clause

and the subsequent financial exposure demonstrated a lack of an adequate remedy at law and the potential for immediate and irreparable harm; *American Motorists Ins. Co. v. United Furnace Co., Inc.*, 876 F.2d 293, 302 (2d Cir. 1989), holding that where the bargained-for right to have collateral is denied, the harm is "real and immediate."

³New York's Civil Practice Law and Rules § 6201, for example, allows an order of attachment "where the plaintiff has demanded and would be entitled, in whole or in part, or in the alternative, to a money judgment against one or more of the defendants, when . . . (4) the defendant, with intent to defraud his creditors or frustrate the enforcement of a judgment that might be entered in plaintiff's favor, has assigned, disposed of, encumbered or secreted property, or removed it from the state, or is about to do any of these acts." Procedurally, CPLR § 6212 (a) provides that the application for such an order must be supported by an affidavit showing that there is a cause of action, it is probable that that applicant will succeed on merits, that one or more grounds for attachment exist, and that the amount demanded from the defendant exceeds all counterclaims known to the plaintiff. See also *U.S. v. Mizrahi*, 606 F.Supp. 703, 708 (C.I.T. 1985) holding that under California law, where the Surety sought to obtain an *ex parte* order of attachment, the "danger that the property sought to be attached would be concealed, substantially impaired in value, or otherwise made unavailable to levy if issuance of the order were delayed until the matter could be heard on notice," was sufficient where the indemnitors had substantial assets and there was evidence that the indemnitors intended to conceal or dispose of the assets.

was enforceable “as long as the amount demanded by a Surety is reasonable and the transaction is at arm’s length and with relative equality of bargaining power.” *Id.* at 922 (internal citations omitted). The Court further held that the Indemnitors had the burden of showing that the costs and expenses were unreasonable or were incurred in bad faith (presumably, but not expressly stated by the Court, this standard would apply as well to the amount of the collateral demand).

The Court also stated that the Surety was entitled to specific performance because it met the criteria needed for such relief: “(1) there is a valid contract; (2) plaintiff has substantially performed under the Contract and is willing and able to perform its remaining obligations; (3) defendant is able to perform its obligations; and (4) plaintiff has no adequate remedy at law.” *Id.* at 921 (internal citations omitted). The Court found that the Surety had established a lack of an adequate legal remedy for breach of the collateral deposit provisions set forth in the General Indemnity Agreement. Citing to the United States Court of Appeals for the Second Circuit in the case of *American Motorists Insurance Co. v. United Furnace Co.*, 876 F.2d 293, 302 (2d Cir. 1989), the Court stated that because the Surety’s total loss was not yet fixed, “where liability had not yet been determined but claims were expected, the Surety had no legal remedy under that provision for an indemnification award, but it did have an equitable remedy for specific performance of the collateral security provision.” Finally, addressing the issue of irreparable harm, the Court agreed with the Surety that “the defendants’ breach of the collateral security clause will result in immediate harm since the Sureties risk being deprived of bargained-for collateral and becoming a general unsecured creditor [of the Indemnitors].”

B. DECLARATORY JUDGMENT

The Surety may also need the Court’s intervention in declaring other rights the Surety may have. The assignment provisions of the General Indemnity Agreement frequently give the Surety rights against third parties with whom the Principal had contracts, or those parties against which the Principal has claims. The standard language in a General Indemnity Agreement makes the broad assignment rights granted to the Surety contingent upon the occurrence of several conditions precedent. As a default under a bonded contract almost always qualifies as a triggering occurrence, the Surety has a colorable right to contend that its assignment rights have ripened and can proceed accordingly once a performance bond default is declared. Third parties, however, are frequently reluctant to recognize the Surety’s unilaterally-declared assignment rights, and may therefore refuse to honor, or delay in honoring, those rights. For example, the Surety may approach obligees on other bonded contracts where they may be no loss to the Surety to assert claims for payment of the funds due the Principal. Obligees not fully conversant with the Surety’s rights, or reasonably looking to protect their own interests, may not be particularly accommodating to the Surety. Commencement of a declaratory judgment action can aid the Surety in having these rights judicially established on notice to all interested parties.

Similarly, there may be competing claims to assets the Principal has which have been assigned to the Surety under the General Indemnity Agreement. The Surety may find itself in competition with the Principal's lender and other creditors, including, potentially, state or federal taxing authorities and labor bureaus. Commencement of a declaratory judgment action may be necessary to establish either the Surety's assignment rights or the priority of its equitable subrogation rights insofar as these rights relate to bonded contracts for which the Surety has incurred a loss. The assignment rights as to non-bonded contracts (if the General Indemnity Agreement contains broad assignment language), or bonded contracts for which there are no losses, may also be established. A situation may well arise where a public owner, when served with a tax levy or notice of withholding from state taxing authority or labor department, may not release even those contract funds that have not yet been earned by the Principal and which are due a completing surety. If the Surety is completing the bonded contract, it should be able to prevail, in most jurisdictions, on its claim that it has a priority interest in the contract funds still held by the owner and not disbursed to the Principal.

Parties that owe debts to the Principal may similarly be reluctant to pay the Surety simply upon the Surety's demand, with the reasonable apprehension that this debtor to the Principal may be called upon to pay twice for the same debt. While the Surety, if confident in its position, may agree to indemnify the third party against such a risk, the third party, even if a stakeholder which acknowledges its debt to the Principal, may insist upon an order from a court in order to fully protect its own interests.

C. POST JUDGMENT REMEDIES

Once the Surety has obtained a judgment against the indemnitors, there are several means by which the Surety can enforce its rights as a judgment creditor. These remedies are governed by state law and include restraining notices⁴, garnishment, post-judgment attachment⁵, appointment of a receiver in aid of execution⁶, and the rarely used remedy of civil arrest or *capias ad respondendum*⁷. This last remedy available in very limited circumstances and not in every state⁸. In order to obtain an order of *capias*

⁴ See, e.g., N.Y. CPLR § 5222 providing that a judgment creditor may serve notices upon any person, subject to certain exceptions relating to wage garnishment, enjoining that person from disposing of any interest in property belonging to the judgment debtor.

⁵ See, e.g., N.Y. CPLR § 5232(b) providing that "the sheriff or support collection unit of the appropriate social services district shall levy upon any interest of the judgment debtor in personal property capable of delivery by taking the property into custody without inter

⁶ See, e.g., N.Y. CPLR § 5228; N.J. Ct. Rule 4:60-17(b);

⁷ See, e.g., N.J. Stat. Ann. § 2A:15-42, providing the grounds for civil arrest upon a writ of *capias ad respondendum*.

⁸ See, e.g., N.J. Stat. Ann. § 2A:15-42 (providing for civil arrest in aid of judgment in limited circumstances); N.Y. CPLR § 5250 (providing for the arrest of a judgment debtor), but see 42 Pa. C.S.A.

ad respondendum, the Surety must show that (1) the defendant is about to remove any of his property out of the jurisdiction of the court with intent to defraud creditors (2) fraudulent concealment of assets or choses in action, (3) the defendant has assigned, removed, or disposed of or is about to assign remove or dispose of any of his property with intent to defraud creditors (4) defendant fraudulently contracted the debt or incurred the demand. Fed. R. Civ. Pro. 64 provides that:

At the commencement of and during the course of an action, all remedies providing for seizure of person or property of for the purpose of securing satisfaction of the judgment ultimately to be entered in the action are available under the circumstance and in the manner provided by the law of the state in which the district court is held.

Thus, where the applicable state law provides for the possibility of civil arrest in aid of judgment, Federal courts will accommodate that relief.⁹

CONCLUSION

The Surety has a host of tools available to it to enforce its contractual rights under the General Indemnity Agreement, as well as its subrogation rights. In the area of injunctive relief, however, what may matter most is the tactical approach the Surety elects to take vis-à-vis the Principal and Indemnitors. If the Surety decides to take an actively adversarial position, it may need, above all else, to move quickly. The Surety will be hard-pressed to successfully argue that its collateral security rights were violated when it never demanded collateral or otherwise sought to be placed in funds or be secured from loss. This important decision may need to be made early, sometimes before the Surety has all the information it would like to have to make a decision of such importance. The decision, however, must be made, one way or the other, because certain rights are likely to be lost with the passage of time. An aggressive approach may often yield better results at the end of the day, but must be tempered by the need to avoid making a hasty decision that could, in hindsight, be harmful.¹⁰

§ 5108(b) providing that “[e]xcept in an action for fines and penalties, or as punishment for contempt, or to prevent departure from the Commonwealth, a defendant may not be arrested in any civil matter.”

⁹ See, e.g., *National American Corp. v. Federal Republic of Nigeria*, 448 F.Supp. 622, 633 n.16 (S.D.N.Y. 1978) (noting the availability of state remedies in federal court.)

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Jonathan Bondy

Jonathan Bondy is an partner with Wolff & Samson PC, which maintains offices in West Orange, New Jersey, New York City and Philadelphia, Pennsylvania. He received his Bachelor of Science in Economics from the Wharton School of Business of the University of Pennsylvania in 1988, and a Juris Doctor degree in 1991 from the Benjamin N. Cardozo School of Law, Yeshiva University, where he was a member of the Moot Court Honor Society. Prior to joining Wolff & Samson, Mr. Bondy served as an Assistant District Attorney in Kings County (Brooklyn), New York from 1991 to 1995. He concentrates his practice in surety and fidelity law, and commercial and construction litigation. He is a member of the New York and New Jersey State Bar Associations and the Fidelity and Surety Law Committee of the Tort and Insurance Practice Section of the American Bar Association. He is admitted to practice in the States of New York and New Jersey, the United States Courts of Appeals for the Second Circuit, and the United States District Courts for the Southern, Eastern and Northern Districts of New York and the District of New Jersey.