

FIRST ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS CONFERENCE

ENFORCEMENT OF THE INDEMNITY AGREEMENT

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ENFORCEMENT OF THE INDEMNITY AGREEMENT

I. INTRODUCTION

Perhaps the feature that most distinguishes a surety bond from an insurance policy is the surety's right, after payment of a claim, to seek indemnity from the party that procured the bond. In providing a bond to its principal, the surety is acting more like a banker than an insurer. The bond is an extension of credit, much like a letter of credit or a loan that can be drawn upon once certain conditions have been met.

In order to protect the surety in the event of a loss in this credit arrangement, the common law developed certain rights for those occupying the position of surety. Exoneration, subrogation, contribution and reimbursement are chief among these rights. Nevertheless, the rights created by case law for the benefit of sureties have proved imperfect in dealing with uncooperative principals in certain cases, and as a result, sureties have expanded their traditional rights. These rights are now spelled out in the General Agreement of Indemnity("GAI")¹ between the surety,

¹ The general agreements of indemnity in use by sureties are not identical, although most are very similar in the protections and rights provided to the surety. For purposes of this paper reference will be made to the Model General Agreement of Indemnity which was drafted by J. Paul McNamara and Daniel Mungall for "Project Update 1975", published in the Ins. Couns. J. in 1975 [McNamara and Mungall, Project Update 1975 Guide for the Drafter of (continued...)]

its principals and the indemnitors.

The purpose of this paper is to examine the current state of the law with respect to some of the more important rights granted sureties under the GAI, and one of the defenses most commonly asserted by indemnitors.

II. RIGHTS OF SURETIES

A. Indemnity and Exoneration

Basic to the relationship between surety and principal is the concept that the surety should not be made to suffer loss in the event of a default by the principal. The first point of attack for the surety is provided in the GAI:

"The Undersigned shall indemnify and keep indemnified the Surety against any and all liability for losses and expenses of whatsoever kind or nature, including the fees and disbursements of counsel and against any and all said losses and expenses, which the Surety may sustain or incur, (i) by reason of having executed or procured the execution of any Bond or Bonds (ii) by reason of the failure of the Undersigned to perform or comply with the covenants and conditions of this

¹(...continued)
a Contract Bond and Indemnity Agreement. 42 Ins. Couns. J. 291 (1975)], and updated in 1985 [Illustrative Provisions of the Indemnity Agreement by Surety on Construction Contract Bond Project Update 1985, 52 Ins. Couns. J. 118 (1985)]. A copy of this Model Agreement is included in the Appendix to this paper.

Agreement, or (iii) in enforcing any of the covenants and conditions of this Agreement."²

This provision provides the surety with its contractual right of indemnity against the principal. Because additional indemnitors, typically the shareholders and executive officers of a bonded contractor, are also made parties to the GAI, the surety's rights are further expanded beyond those enjoyed under the common law, where only the principal is liable for indemnity.

The GAI goes even further than providing the surety with this all encompassing right to indemnity. It places in the surety's hands another very important right. The surety, if it establishes a reserve to cover a possible loss, may require the principal and indemnitors to deposit with the surety a sum of money equal to the reserve, and the surety can use this deposit to pay claims against the bond.³ Similarly, in instances where the principal wishes to contest a claim against the bond, it is required to deposit with the surety assets sufficient to satisfy the claim in the event it is successfully prosecuted.⁴ Thus, these two provisions give the surety the right to demand that sufficient collateral be provided when a loss is threatened, so that the surety will be assured of exoneration if the claim is resolved adversely to the principal.

² Lines 27 to 35 of the GAI.

³ Lines 59 to 77 of the GAI.

⁴ Lines 48 to 57 of the GAI.

It should be noted, however, that the surety has an obligation in most states to conduct a good faith investigation of the facts surrounding any claim against the bond, and its failure to do so can subject it to a claim for bad faith.⁵ Consequently, the prudent surety will never rely solely upon its principal's deposit of money as the basis for declining to pay a claim on the bond. It will, instead, make its decision based upon its investigation of the claim, with the reserve deposit serving simply as collateral in the event that the claim is later lost.

The obligation of the indemnitors to deposit money with the surety, before it is even determined that the claim against the bond is meritorious, is frequently resisted by the indemnitors. It is, therefore, not surprising that the enforceability of these reserve deposit provisions has been the source of much litigation.

When pared to the essentials, the surety's position in these cases is quite simple. It has provided a payment and performance bond for a contractor, who is claimed by the owner or

⁵ A discussion of the surety's good faith obligations is beyond the scope of this paper, except as it pertains to defenses to the surety's right to enforce the indemnity agreement. However, for an excellent discussion of the subject see Hart Bad Faith Litigation Against The Surety, an unpublished paper presented by B.C. Hart to the Fidelity and Surety Committee of the ABA in August, 1987.

subcontractors to be in default, and claims have been made upon the bond. The surety, after undertaking an investigation, has concluded that the claim is either well founded or contains sufficient merit to make it at least likely that a loss will be sustained. Before incurring the loss, the surety has made demand that the contractor, and if they exist, the indemnitors, provide collateral for the benefit of the surety. The contractor has refused, and the surety has filed suit to specifically enforce the reserve deposit provision of the GAI. In these cases, the litigation record for the surety has been quite good.⁶

The position of the surety on the enforcement of the reserve deposit provisions was perhaps best stated by the court in National

⁶ For cases enforcing the sureties' rights under the reserve deposit clause see American Motorist Insurance Co. v. United Furnace Co., 876 F.2d 293 (2nd Cir. 1989); Safeco Insurance Company of America v. Schwab, 739 F.2d 431, (9th Cir. 1984); Milwaukee Construction Co. v. Glens Falls Insurance Co., 367 F.2d 964 (9th Cir. 1966); Tennant v. United States Fidelity and Guaranty Co., 17 F.2d 38 (3rd Cir. 1927); United Bonding Insurance Co. v. Stein, 273 F.2d 929 (E.D. Pa. 1967), app. dismissed, 410 F.2d 483 (3rd Cir. 1969); Maryland Casualty Co. v. Straubinger, 240 N.Y.S. 2d 228 (1963); National Surety Co. v. Titan Construction Corp., 26 N.Y.S. 2d 227, aff'd, 24 N.Y.S. 2d 141 (1940); and Standard Surety & Casualty Co. of New York v. Caraval Industries, 15 A. 2d 258 (N.J. 1940).

Surety Corp. v. Titan Construction Corp.⁷:

"An agreement to give security for the performance of another promise is specifically enforceable ... A factual basis to support the action for specific performance is found clause 2 [Reserve Deposit Clause] of the agreement which is the subject of this litigation. The damage resulting from the failure to give security is not ascertainable, and the legal remedy is therefore inadequate. There is no way at this time of measuring the substantial damages of the plaintiff for the breach by the defendants, and the equitable relief sought by the plaintiff is required in order that it may be molded to fit the exigencies of the case at the time of the decree ... The very purpose of clause 2 of the agreement is to entitle plaintiff, the moment danger of possible future liability appears, to security against any loss plaintiff may subsequently sustain if such liability matures, and to save plaintiff from being in the position of a general creditor of defendants, on a parity with their other creditors. The inadequacy of the legal remedy is obvious. Plaintiff, therefore, is entitled to have clause 2 of the agreement specifically performed."

Bonded contractors have frequently tried to avoid their obligations under the reserve deposit provisions by arguing that

⁷ 26 N.Y. S. 2d 272, 230-31, aff'd, 24 N.Y.S. 2d 141, (1940).

the surety should not be entitled to collateral security until it suffers a loss, or its liability has been determined. The courts have made short work of this argument. For example, in the case of Safeco Insurance Company of America v. Schwab⁸, the court was presented with a reserve deposit provision that stated that the defendants would pay Safeco, upon demand:

"An amount sufficient to discharge any claim made against [Safeco] on any Bond. This sum may be used by [Safeco] to pay such sum or be held by [Safeco] as collateral security against any loss on any bond."⁹

The contractor had persuaded the lower court to dismiss Safeco's claim for specific performance of the provision. On appeal, the Circuit Court promptly reversed, stating:

"If Safeco has only a right to indemnity after incurring loss, the second sentence's reference to collateral would be meaningless. To make sense of both constituent sentences, paragraph 2 must be read as a collateral security provision."¹⁰

The Safeco ruling has most recently been followed by the Second Circuit Court of Appeals in American Motorist Insurance v.

⁸ Supra, n.6.

⁹ Id. at 432.

¹⁰ Id. at 433-34.

United Furnace Company¹¹. There, the court made clear that simple notice of a claim is all that is required for a surety to demand that the principal provide collateral.¹² It is not necessary that suit be filed against the surety. In fact, the court found the issue so free from doubt that it not only reversed the lower court's dismissal of the surety's claim, but instructed the lower court to enter summary judgment in the surety's favor.¹³

The reserve deposit clause, however, is not always specifically enforced. Once it has been determined that the surety is liable for a claim against the bond, and the amount of that liability has been fixed, it has been held that the surety loses the right to specific performance. This is because the surety now has an adequate remedy at law for money damages, based upon its indemnification rights, and therefore, equitable relief is not required.¹⁴ This case should not be particularly troubling to sureties because the clear purpose of the reserve deposit provision is to obtain collateral before loss, so that the collateral can be used by the surety to satisfy its obligations as they are

¹¹ Supra, n.6.

¹² Id. at 302-03.

¹³ Id. at 303.

¹⁴ Commercial Insurance Co. of Newark v. Pacific-Peru Construction, 558 F.2d 948 (9th Cir. 1977).

determined. Once the loss has already been sustained by the surety, seeking collateral gives it no greater rights than it already has pursuant to the indemnification provisions of the GAI.

More troubling to the surety industry is the very recent decision of an intermediate Florida appellate court in Transamerica Premium Insurance Co. v. Cavalry Construction.¹⁵ There, the surety faced the classic nightmare. It had provided payment and performance bonds totally approximately \$1.2 million for its contractor. Disputes later arose on the project between the contractor and the owner, culminating in claims, counterclaims, and the forceful eviction of the contractor from the project. The surety was notified that the owner was making a claim against the bonds for \$8 million, and various subcontractors and suppliers provided notice that they had not been paid. The contractor admitted that \$250,000.00 of the bills were owed. Worse still, not only was the contractor unable to pay the bills, but it was in the process of scheduling a liquidation sale where it planned to sell all of its assets. Using the proceeds from the liquidation sale to exonerate the surety was apparently not in the contractor's plans.

The surety promptly filed suit, and requested emergency injunctive relief from the court to preserve the proceeds from the liquidation sale so that they would later be available to the surety to apply against losses on the bonds. At the hearing on the motion, the surety presented general, but nonspecific, evidence

¹⁵ 552 So.2d 225 (Fla. 5th D.C.A. 1989).

that the surety might be liable for the penal sum of both bonds. The lower court refused to enter an injunction because the surety failed to establish the amount of its prospective liability under the bonds, except for the \$250,000.00 which the contractor admitted was owed to the subcontractors and suppliers. Accordingly, the trial court ruled that the first \$250,000.00 realized from the liquidation sale would be reserved for payment of subcontractors and suppliers, but otherwise denied relief to the surety. The appellate court first framed the issue:

"[T]he issue was not whether Transamerica actually feared a \$1,187,000.00 loss, but whether there was any rational basis for such a fear."¹⁶

The court then proceeded to affirm the lower court's decision, finding that, with the exception of the \$250,000.00 that the contractor admitted was owed:

"Transamerica failed to flesh-out the nature and approximate amount of the claims in liabilities it might reasonably anticipate under the bond ... [W]ithout proof that the Surety realistically faces loss under the performance bond and is in jeopardy, the trial court correctly determined that additional ... relief was not appropriate."¹⁷

¹⁶ Id. at 227.

¹⁷ Id.

The Transamerica decision requires objective evidence of the surety's exposure under the bond before it will enforce the reserve deposit provisions of the GAI. Subjective evidence of the surety's fear of loss is no longer sufficient. The burden is on the surety to come forward with specific evidence of the merits and dollar value of claims which have been asserted against the bond in order to specifically enforce the reserve deposit provision.

Under the Transamerica rule, indemnitors can defeat a claim for specific performance by presenting convincing evidence to contest the validity or amount of claims against the bond. The surety loses the benefit of one of its important protections, by being deprived of collateral to which it could look if the claims against the bond later proved legitimate.

The reasoning of the Transamerica decision is contrary to that of most other courts which have considered this issue. It is because of the very fact that the surety faces uncertain claims of a value not yet ascertained that has caused courts to enforce the surety's right to require the contractor to post collateral.¹⁸ It was for this reason that the court in United Bonding Insurance

¹⁸ E.g., National Surety Co. v. Titan Construction Corp., supra, n.6.

Co. v. Stein¹⁹ stated:

"In the instant case the only conditions precedent to defendants' obligation [to deposit collateral] were the plaintiff's estimate that a reserve was necessary and its demand upon defendants for current funds in the amount of such reserve. Once these conditions are fulfilled equity will specifically enforce such a promise ..."

Hopefully, the Transamerica decision will remain isolated, and not be followed by other courts.

B. Trust Fund Rights

Another important weapon given the surety in the GAI is the right to control the funds that its contractor is entitled to receive under the construction contract. The general expression of the surety's rights states:

"The Principal agrees and hereby expressly declares that all funds due or to become due under any contract covered by a Bond are trust funds, whether in the possession of the Principal or another, for the benefit and payment of all persons to whom the Principal incurs obligations in the performance of such contract, for which the Surety would be liable under the Bond."²⁰

This is the means by which the surety can ensure that project funds are being properly applied by the principal - to the payment of

¹⁹ 273 F.Supp. 929 (E.D. Pa. 1967).

²⁰ Lines 89 to 94 of the GAI.

subcontractors or suppliers, and not to other sources such as repayment of bank debt or obligations on other projects. Enforcement of this provision is especially important to the surety in minimizing its exposure to payment bond claims. If the surety pays any of the obligations of the contractor, the GAI provides the Surety with a specific claim to the trust funds.²¹

Apart from the general expression that contract funds are to be held in trust for payment of potential payment bond claimants, the GAI goes further to add some concrete protection for the Surety. Paragraph 4 of the GAI provides in pertinent part:

"Principal shall, upon demand of the Surety and in implementation of the trust or trusts hereby created, open an account or accounts with a bank or similar depository designated by the Principal and approved by the Surety, which account or accounts shall be designated as a trust account or accounts for the deposit of such trust funds, and shall deposit therein all monies received pursuant to said contractor's contracts. Withdrawals from such account shall be by check or similar instrument signed by the Principal and countersigned by a representative of the Surety."²²

This is a provision that, when enforced, will give the surety

²¹ Lines 94 to 96 of the GAI.

²² Lines 97 to 105 of the GAI.

effective control over contract funds.²³ Unfortunately, there is a dearth of case law on the enforceability of this provision, but since the courts have routinely enforced reserve deposit provisions no good reason exists for declining to enforce this provision as well.

Very good advice was given to sureties by two commentators when establishing a joint trust account with the principal:

"Great care should be taken by the surety in setting up the joint control account in order to preserve its status as a trust account. Funds from the joint control account should be used only to pay bonded obligations or other costs related to bonded projects against later claims of third party creditors that the account was not used as a trust account. The surety must also be aware of whether

²³ An excellent discussion of the trust account provision, including its enforceability when the principal is operating as a debtor-in-possession under Chapter 11 of the Bankruptcy Act, is found in an unpublished paper prepared by Robert L. Lawrence, Robert M. Wright, George J. Bachrach, and William M. Dolan, III, entitled "The Agreement of Indemnity-The Surety's Handling of Contract Bond Problems: Enforcement of the Surety's Rights Against the Principal and the Indemnitors Under the Agreement for Indemnity." This paper was presented at the ABA Fidelity and Surety Committee mid-winter meeting on January 27, 1989.

the bank in which the account is kept is owed money by the principal. Although the account may be established as a trust account, a creditor bank may attempt to exercise rights of set off against the trust account funds. Therefore, the account should be maintained at a bank that is not owed money by the principal."²⁴

C. Assignment and Take-Over Rights

The reserve deposit and trust funds rights can be exercised by the surety regardless of whether the principal has committed an event of default as specified in the GAI.²⁵ Once an event of default occurs the GAI confers even greater rights upon the surety.

First of all, an assignment of rights by the principal to the surety takes immediate effect. This assignment conveys to the surety all of the principal's rights in funds due under the construction contract; all of the principal's supplies, tools,

²⁴ Trecker and Ott, in an unpublished paper entitled "The Agreement of Indemnity-The Surety's Handling of Contract Bond Problems: Administration and Resolution of Performance Bond and Payment Bond Claims," page 1-20. This paper was presented at the ABA Fidelity and Surety Committee mid-winter meeting on January 27, 1989.

²⁵ The events of default are found on lines 145 to 174 of the GAI.

plant and equipment; all of the principal's rights in its subcontractor agreements; and all claims and causes of action the principal may have with its subcontractors and suppliers.²⁶ Secondly, the surety is entitled to take possession of the principal's work and complete it.²⁷

The purpose of these provisions is to allow the surety, to the greatest extent possible, to assume the position of the principal on the project in the event that the surety elects to complete the work or hire another contractor to complete it. The assignment provision in the GAI also gives the surety important salvage rights by authorizing the surety to pursue claims against others who may have liability to the contractor.²⁸

D. Enforcement of the Surety's Rights

Normally, breach of contract is redressed by an action at law for money damages. When a principal stands in breach of the GAI, the surety is certainly entitled to file suit against him for damages, as is often done in suits seeking indemnity for losses sustained by the surety. Unfortunately, the surety does not obtain a judgment granting it the relief it seeks - money damages - until the litigation has been concluded. The course of a lawsuit is all

²⁶ Lines 111 to 133 of the GAI.

²⁷ Lines 231 to 237 of the GAI.

²⁸ Lines 199 to 202 of the GAI.

too often punctuated by delay, whether caused by delaying tactics of the opponent or over-crowded courts, and in many jurisdictions it is not uncommon for several years to pass between the date that suit is filed and final judgment is entered. In the case of many bonded contractors, who are frequently in serious financial difficulty at the point the surety suffers the loss, no assets remain at the end of the litigation process. The surety has not only spent funds to prosecute the case, but finds a penniless judgment debtor at the end of the day.

Clearly, suits for money damages do not provide sureties with an adequate remedy in many cases. If the surety is to receive effective relief, it must often look to equitable remedies. These remedies include specific performance²⁹, quia timet³⁰ and

²⁹ Specific performance is an equitable remedy which compels the performance of a contract on the precise terms agreed upon or such a substantial performance as will do justice between the parties under the circumstances. It is a means of compelling a contracting party to do precisely what he should have done without being coerced by a court. McCoy Farms, Inc. v. J & M McKee, 563 S.W. 2d 409, 415 (Ark. 1978).

³⁰ Quia timet is an equitable remedy which can be used by a surety (a) to prevent the diversion of contract funds from contract obligations, and (b) require the principal and indemnitors to post
(continued...)

injunctive relief, and among other uses can require the principal to do what he agreed to do in the GAI. Proper use of these remedies before the surety has suffered loss can later serve to prevent or at least minimize the ultimate loss to the surety. Proper use, however, generally requires that the surety be aggressive, rather than reactive. These remedies must frequently be asserted in the early stages of a problem project, while there are still assets left to salvage. Temporary relief from the court, to preserve the status quo pending final resolution of the case, is generally essential.

Two very effective ways of obtaining adequate and prompt protection for the surety are through preliminary injunctions and appointment of receivers. These remedies are both available at the commencement of the lawsuit, and can be used to (a) prevent diversion of funds, (b) prevent transfers of assets, (c) require the posting of collateral, (d) require payments to subcontractors, and (e) even seek to take over the management of the principal's business or indemnitor's assets.

The Federal Rules of Civil Procedure, after which many states pattern their counterpart provisions, provide a means for obtaining temporary restraining orders and preliminary injunctions. In order

³⁰(...continued)
collateral for anticipated losses on the bonds. A very good article on quia timet is Mann and Jennings, Quia Timet: A Remedy for the Fearful Surety, 20 FORUM 685 (1985).

to obtain either of these forms of injunctive relief the moving party must show:

- (1) The existence of irreparable harm;
- (2) The absence of an adequate remedy at law;
- (3) The probability of ultimate success on the merits; and
- (4) That the public interest will not be disserved by granting the relief.³¹

In addition to these general requirements, if a moving party wishes to obtain a temporary restraining order without notice to the opponent, it must be demonstrated through an affidavit or sworn complaint that immediate and irreparable loss will result before the opposing party can be heard to argue against issuance of the order.³²

A good illustration of the use that can be made of preliminary injunctive relief is found in Doster v. Continental Casualty Co.³³. There, as a bonded contractor was nearing the completion of a project, it advised the surety that it did not have sufficient funds on hand to pay all of its contractual obligations. Further, the contractor refused to apply the substantial funds it did have in its possession to payment of those obligations. The surety

³¹ U.S. v. Phillips, 527 F.Supp. 1340, 1343 (N.D. Ill. 1981). For a good discussion of what a surety must do to establish these elements see Lawrence, Wright, et al., supra, n.23 at 2-19 to 2-23.

³² Rule 65(b), Fed. R. Civ. P.

³³ 105 So.2d 83 (Ala. 1958).

filed suit and sought a temporary injunction consistent with its prayer for relief, which requested that the funds held by the contractor be used to pay his contractual obligations. An injunction consistent with this prayer was granted.³⁴

Due to the crowded court dockets in most jurisdictions, it is often difficult enough to get the time and attention of the court to hear an emergency motion for injunctive relief at the beginning of a case. This is particularly true when seeking a temporary restraining order without notice to the opponent, where the proof requirements upon the surety are especially heavy. Having once obtained an emergency hearing before the court only to fail to provide sufficient evidence to gain the injunction relief will make it that much more difficult to get a second emergency hearing after additional proof is gathered. Moreover, an unsuccessful first effort can also leave the judge less enamored of the surety's case, and this impression can easily carry over to the second hearing, should the surety be fortunate enough to get one. For this reason, it is strongly recommended that a surety, wishing to gain immediate injunctive relief against its principal or indemnitors, resist the strong temptation to act before it has sufficient facts to win the motion.

A second, and more aggressive, form of emergency relief is to seek the appointment of a receiver for the principal's or indemnitors' property and assets. Receivers may be appointed by the court at the beginning of the litigation for the purpose of

³⁴ Id. at 85.

supervising a distressed business during the pendency of the case or protecting and preserving important rights of interested parties.³⁵ In order to get a receiver appointed it is generally necessary to show that an emergency exists and that a receiver is needed in order to protect the interest of creditors and property.³⁶ While the burden is a heavy one,³⁷ this relief may well fit the needs of a surety who, not wishing to take over the contractor's business itself, wants assurance that an independent party is appointed to manage and preserve the assets of its principal or indemnitors so that they will be available to satisfy the surety's judgment at the conclusion of the litigation.

III. THE LACK OF GOOD FAITH DEFENSE

In response to efforts by sureties to enforce their various rights under indemnity agreements, indemnitors have asserted a multitude of defenses. The number and sophistication of these

³⁵ Bracco v. Lackner, 462 F.Supp. 436, 455 (N.D. Cal. 1978).

³⁶ Meineke Discount Muffler Shops v. Noto, 603 F.Supp. 443, 444-5 (E.D.N.Y. 1985); and Sires v. Luke, 544 F.Supp. 1155, 1161 (S.D.Ga.).

³⁷ The appointment of a receiver is generally recognized to be an equitable remedy of an extraordinary nature which is to be used only where there is a showing of fraud, or there is imminent danger of property being lost, injured or diminished in value, or squandered and where the legal remedies appear to be inadequate. McDermott v. Russell, 523 F.Supp. 347, 352 (E.D. pa. 1981), aff'd 722 F.2d 732 (3rd Cir. 1983).

defenses seem to be limited only by the resourcefulness of counsel. The indemnity agreements in use by sureties over the years have been revised periodically to meet the new legal challenges made by indemnitors. The current Model General Agreement of Indemnity³⁸ is the product of the best thinking in the surety industry on how to provide the surety with the enforcement rights which it needs in order to effectively deal with indemnitors. Many of the typical defenses which have been asserted in the past are now specifically dealt within the GAI.³⁹ For example, the GAI by its terms eliminates the defenses of lack of notice to the indemnitors,⁴⁰ failure to pursue the principal before seeking indemnity,⁴¹ and waiver of the surety's rights.⁴²

Since the literal terms of the indemnity agreement have not provided any refuge for indemnitors, they have been forced to utilize legal theories that will permit them to avoid enforcement

³⁸ See appendix.

³⁹ A very good discussion of the traditional and non-traditional defenses to the indemnity agreement is contained in an unpublished paper presented by Jeffrey W. Sachs and Harvey C. Koch, entitled "The Agreement of Indemnity and the Defenses of the Indemnitors", at the ABA mid-winter meeting of the Fidelity and Surety Committee meeting in January, 1989.

⁴⁰ Lines 102 to 121 of the GAI.

⁴¹ Lines 334 to 337 of the GAI.

⁴² Lines 327 to 333 of the GAI.

of the terms of the indemnity agreement. The most important of these theories has been the obligations of the surety to act in good faith.

A. The Principle of the Surety's Good Faith Obligation.

Every agreement includes the implied promise of the parties that they will perform their respective contractual duties in good faith and that each will deal fairly with the other in their performance.⁴³ This concept of good faith has been applied to the obligations of sureties and the enforcement of the indemnity agreement against their indemnitors.⁴⁴ Furthermore, many indemnity agreements incorporate this concept, if not the words "good faith", as a condition to the surety's right to obtain indemnity.⁴⁵

⁴³ Dahly Tool Co. v. Vermont Tap and Dye Co., 561 F.Supp. 600 (N.D. Ill. 1982).

⁴⁴ Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works, Inc., 722 F.2d 1160 (4th Cir. 1983).

⁴⁵ See lines 36 to 42 of the GAI, which provide:

"The Surety may pay or compromise any claim, demand, suit, judgment, or expense arising out of such Bond or Bonds and any such payment or compromise shall be binding upon the Undersigned and included as a liability, loss or expense covered by this indemnity, provided the same was
(continued...)"

B. Application of the Principle.

1. What is good faith?

General case law has given many definitions to "good faith." One of the more common meanings of this term is "that state of mind denoting honesty of purpose, freedom from intention to defraud, and, generally speaking, means being faithful to one's duty or obligation."⁴⁶ Unfortunately, there is no one statement of law that defines with precision a surety's good faith obligation towards its indemnitors. There are, however, cases saying what it is not. One of the best, and most concise, statements of the type of conduct by a surety which will not rise to the level of constituting lack of good faith is found in Enobrock v. Federal Insurance Company, where it is said:

"At most, the pleading alleges negligence by a surety. But neither lack of diligence nor negligence is the equivalent of bad faith; and improper motive, which is not alleged, is an

⁴⁵(...continued)
made by the Surety in the reasonable belief that it was liable for the amount disbursed, or that such payment or compromise was reasonable under all the circumstances."

See also the provisions of the indemnity agreement in Fidelity and Deposit Company of Maryland v. Fleischer, 772 S.W. 2d 809, 813 (App. Ct. Mo. 1989).

⁴⁶ Efron v. Kalmanovitz, 57 Cal. R. 248, 251 (App. Ct. Cal. 1967).

essential element of bad faith."⁴⁷

Similarly, it has been said that want of good faith carries an implication of dishonest purpose, consciously doing of wrong, or breach of duty through motive of self-interest or ill will.⁴⁸

2. The Decisions

The cases in which indemnitors have raised lack of good faith by the surety as a defense to actions on the indemnity agreement have not always produced consistent results. Nevertheless, when a few decisions that are out of the mainstream are excluded, the analysis and findings by most courts has been remarkably similar.

The most common pattern found in these cases is the situation where the indemnitor is claiming that the principal was not liable on the underlying obligation, and as a consequence, the surety's payment of that claim was not made in good faith. Therefore, it loses its right to proceed against the indemnitor.

While at common law a surety was only entitled to indemnity for claims it paid and for which the principal was legally liable, this situation is changed where there is a written indemnity

⁴⁷ 370 F.2d 784, 787 (5th Cir. 1967); see also, Ford v. Aetna Insurance Company, 394 S.W. 2d 693, 698 (App. Ct. Tex. 1965).

⁴⁸ Hartford Accident and Indemnity Co. v. Mills Roofing and Sheet Metal, 418 N.E. 2d 645 (App. Ct. Mass. 1981).

agreement.⁴⁹ Typical of indemnity agreement provisions that articulate the rights of sureties to pay claims and then seek indemnity is the following:

"[T]he 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 ..."

Typical of the treatment by courts of the enforcement of these provisions is the opinion in Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works,⁵⁰ where the court held:

"Provisions such as those just cited, while strict, are common in contracts of indemnification executed by contractors and others to induce the execution of performance bonds by compensated sureties, and they have been uniformly sustained and upheld, subject to a single exception to be noted ... The only exception to this provision arises when the payment has been made 'through fraud or lack of good faith' on the part of the surety,

⁴⁹ United States v. United Pacific Indemnity Company, 697 F.Supp. 378 (D. Id. 1988).

⁵⁰ Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works, Inc., *supra*, n.44 at 1163.

but any challenge to such payment must be rested solely on that claim of bad faith or fraud."⁵¹

If an indemnitor believes that the claim against the principal does not have merit and wishes for the surety to resist the claim, the GAI provides him with a means of accomplishing this:

"If the Undersigned desires that a claim or demand against the Surety shall be resisted and litigated, the Undersigned shall (i) give notice to the Surety to this affect, (ii) simultaneously deposit with the Surety capital or collateral and satisfactory to the Surety in amounts sufficient to cover the claim or demand and interest thereon to the probable date of disposition and (iii) either deposit simultaneously with the Surety cash or collateral satisfactory to the Surety and in amounts sufficient to cover the expenses and fees of defense, or take over the resistance in litigation of the claim."⁵²

If the indemnitor fails to post the collateral, the courts have uniformly held that the surety is free to settle the claim and pursue indemnity. For example, in overturning a jury verdict against a surety on this issue the court in Fidelity and Deposit Company of Maryland v. Fleischer said:

"Under the Agreement of Indemnity, the burden was not placed on F&D to determine whether owner or contractor first breached the contract. Rather, once owner or the

⁵¹ Id.

⁵² Lines 48 to 57 of the GAI.

subcontractors made demand on F&D under the bonds, F&D could make good faith disbursements if it believed it was liable, or if it believed disbursement was necessary or expedient, 'whether or not such liability, necessity of expediency existed'. The Agreement of Indemnity did not leave Fleischers without a means to prevent such payments. Paragraph 13 provided that F&D's right to settle claims could be terminated if Fleischer (i) requested F&D to litigate the claims and (ii) at the time of the request, deposited collateral with F&D to satisfy any judgments and expenses." 53

In short, unless the indemnitor posts collateral, the surety is free to pay the claim, regardless of whether it is valid, and seek indemnity provided it does so in good faith.

The great majority of cases that have squarely considered whether the surety has acted in good faith have found that it did so, or that the indemnitor failed to establish that it had not.⁵⁴

⁵³ Supra, n.44 at 815-16. See also Firemen's Fund Insurance v. Nizdil, 709 F.Supp. 975 (D. Ore. 1989); and Hess v. American States Insurance Co., 589 S.W. 2d 548 (App. Ct. Tex. 1979).

⁵⁴ Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works, Inc., supra, n.44.; Continental Casualty Co. v. American Surety Corp., 443 F.2d 649 (D.C. Cir. 1970); Transamerica Insurance Co. v. Bloomfield, 401 F.2d 357 (6th Cir. 1968); Enobrock (continued...)

Certainly one of the most important recent cases to analyze this issue is Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works.⁵⁵ There, the bonded contractor and the owner, the Pennsylvania Department of Transportation, had a dispute over alleged deficiencies in the work. While the owner and contractor were arbitrating their dispute, the owner made demand on the surety under the bond. At first, the surety denied responsibility, aligning itself with the position of the contractor. Later, under threat by the owner to suspend the surety's right to provide bonds for other work, the surety paid the owner's claims, but retained the right to obtain a refund of the payment if the arbitration between the owner and contractor was resolved in favor of the

⁵⁴(...continued)
v. Federal Insurance Co., supra, at n.47; Firemen's fund Insurance Co. v. Nizdil, supra, n.53; Continental Casualty Co. v. Guterman, 708 F.Supp. 953 (N.D. Ill. 1989); United States v. United Pacific Indemnity Company, supra, n.49; Fidelity and Deposit Company of Maryland v. Wu, 552 A. 2d 1186 (Vt. 1988); Hess v. American States Insurance Companys, supra at n.53; United States Fidelity and Guaranty Co. v. Napier, 571 S.W. 2d 644 (App. Ct. Ky. 1978); Ford v. Aetna Insurance Company, supra, n.47; Elmore v. Morrison Assurance Co., 502 So.2d 378 (Ala. 1987); and Hartford Accident and Indemnity Co. v. Mills Roofing and Sheet Metal, supra, n.48.

⁵⁵ Supra, n.44.

contractor.

The surety then proceeded against the contractor for indemnification. The contractor resisted, claiming that by paying the claim simply to avoid being disqualified from writing further bonds in Pennsylvania, the surety had breached its duty of good faith.⁵⁶ The court observed that the surety had kept the contractor fully informed of all negotiations it had with the owner. Further, the court found that suit was only filed against the contractor as the statute of limitations on the surety's claim against it was about to expire. The court then proceeded to find that the surety did not act in bad faith, even though its motive in paying the claim was to keep from being blacklisted in Pennsylvania, and not because it believed that the owner's claim against the bond had merit. The court was apparently persuaded by the surety's exemplary efforts to fully communicate with, and to the extent possible, accommodate its principal, while at the same time recognizing that the surety had a legitimate right to take action to prevent it from being blacklisted.

Several cases where bad faith was found are also worthy of

⁵⁶ In drawing the issue the court stated:

"Contractor now takes the position - and this really is the heart of its appeal - that the payment made by the Sureties in order to secure the elimination of their disqualification as a Surety on road work in Pennsylvania constituted bad faith or fraud." Id. at 1165.

discussion. In Maryland Casualty Co. v. R&L Construction⁵⁷ the surety paid a claim resulting from the contractor's alleged failure to build a brick wall in accordance with its contract with the owner. At trial the surety did not present any evidence that the contract between the owner and the contractor required a brick wall. The court found that this was sufficient evidence to support a jury finding of bad faith. As a consequence, the indemnitor was not required to indemnify the surety. Although not discussed in any detail, it was apparently the view of the appellate court that the surety had the burden of showing that the payment was made in good faith "and that it was a reasonable and prudent settlement". Aside from the issue of who had the burden of proof, this case imposed a greater duty on the surety than is imposed by the indemnity agreement, where the surety's obligation is simply to act in good faith. Thus, this case represents a significant departure from the general body of law on the subject and fortunately has not been followed by other courts.

Another case where bad faith found is New Amsterdam Casualty Co. v. Lundquist.⁵⁸ There, the surety took possession of the assets of its bonded contractor after the contractor had defaulted on a project. Despite several requests from one of the indemnitors that the surety take steps to protect the assets, the surety failed to do so. Nor, did the surety advise the indemnitor that it would

⁵⁷ 368 S.W. 2d 134 (App. Ct. Tex. 1963).

⁵⁸ 198 N.W. 2d 543 (Minn. 1972).

not take steps to conserve the assets. In upholding a lower court finding for the indemnitor, the court stated:

"New Amsterdam had no obligation to satisfy the first mortgage on the equipment of the corporation or to liquidate these assets to minimize the loss ... However, under its general obligation of good faith, it had a duty to advise the indemnitors that it did not intend to do so. An indemnitee cannot act with complete impunity toward assets which he has under his control, and which would be available to reduce the liability of the indemnitor. ... If proper notice is given, the indemnitor is placed in a position to protect these assets on his own behalf if he finds that economically advisable."⁵⁹

C. Lessons

While it is impossible to reconcile all of the cases with one principle of law that will provide the surety industry with clear guidelines on what is safe and what is risky conduct in dealing with indemnitors, the cases do suggest several lessons:

(1) A surety will be held to a good faith standard in its dealings with indemnitors, and the surety should be prepared to demonstrate the facts upon which it relies to make its decisions.

(2) A thorough investigation of the merits of a

⁵⁹ Id. at 550.

claim against the bond is very important, and where experts have been retained to assist the surety its recommendation should be followed, or the surety should have good, well-documented reasons for not doing so.⁶⁰

(3) Before paying a claim against the bond the surety should:

(a) be able to document the validity or probable validity of the claims or otherwise establish a rational basis for its decision;

(b) provide written notice to the indemnitors explaining the decision, as well as the basis for it, and advising the indemnitors that payment will be paid and indemnity sought unless collateral is posted as provided in the indemnity

⁶⁰ See Fidelity and Deposit Company of Maryland v. Wu, supra, n.52.

agreement.⁶¹

- (4) As a general rule, when the opportunity exists seek to have your case decided by the judge and not the jury, and have the case heard in federal court rather than state court.

⁶¹ See Fidelity and Deposit Company of Maryland v. Bristol Steel & Iron Works, supra n.44; Fidelity and Deposit Company of Maryland v. Fleischer, supra, n.45; Firemen's Fund Ins. v. Nizdil, supra n.52; and Hess v. American States Ins., supra n.52.

APPENDIX

1 MODEL GENERAL AGREEMENT OF INDEMNITY

2 THIS AGREEMENT OF INDEMNITY executed and delivered
3 this ____ day of _____ 1989, by (Principal) and
4 (Indemnitors), to (Surety). The Principal and Indemnitors are
5 sometimes referred to hereafter collectively as the "Undersigned."

6 WITNESSETH:

7 WHEREAS," Principal, in his own name or as co-adventurer with
8 others may desire, or be required, to execute and deliver or
9 procure the execution and delivery of Bonds as hereafter defined,
10 or Principal or one or more of the Undersigned may request the
11 Surety to refrain from cancelling such Bonds; and

12 WHEREAS, the Undersigned understand that the Surety expressly
13 requires the delivery of this Indemnity Agreement as part of the
14 consideration for the execution by the Surety of such bonds which
15 may hereafter be furnished, or for the refraining from cancelling
16 said Bonds; and

17 WHEREAS, the Indemnitors have a substantial, material and
18 beneficial interest in the obtaining of Bonds by the Principal or
19 in the Surety's refraining from cancelling such Bonds.

20 NOW, THEREFORE, in consideration of the execution and delivery
21 by the Surety of one or more Bonds or its refraining from
22 attempting to cancel the same, the Undersigned for themselves,
23 their heirs, executors, administrators, and administrators, and
24 assigns, jointly and severally, covenant and agree with the Surety
25 as follows:

26 1. Indemnification

27 The Undersigned shall indemnify and keep indemnified the
28 Surety against any and all liability for losses and expenses of
29 whatsoever kind or nature, including the fees and disbursements of
30 counsel, and against any and all said losses and expenses, which
31 the Surety may sustain or incur, (i) by reason of having executed
32 or procured the execution of any Bond or Bonds (ii) by reason of
33 the failure of the Undersigned to perform or comply with the
34 covenants and conditions of this Agreement, or (iii) in enforcing
35 any of the covenants and conditions of this Agreement.

36 The Surety may pay or compromise any claim, demand, suit,
37 judgement or expense arising out of such Bond or Bonds and any such
38 payment or compromise shall be binding upon the Undersigned and
39 included as a liability, loss or expense covered by this indemnity,
40 provided the same was made by the Surety in the reasonable belief
41 that it was liable for the amount disbursed, or that such payment
42 or compromise was reasonable under all the circumstances.

43 In the event of any such payment or compromise by the Surety,
44 an itemized statement thereof sworn to by any officer of the
45 Surety, or the voucher or vouchers or other evidence of such
46 payment or compromise shall be prima facie evidence of the fact and
47 amount of the liability of the Undersigned under this Agreement.

48 If the Undersigned desire that a claim or demand against the
49 Surety shall be resisted and litigated, the Undersigned shall (i)
50 give notice to the Surety to this effect, (ii) simultaneously
51 deposit with the Surety cash or collateral and satisfactory to the

52 Surety in an amount sufficient to cover the claim or demand and
53 interest thereon to the probable date of disposition and (iii)
54 either deposit simultaneously with the Surety cash or collateral
55 satisfactory to the Surety in an amount sufficient to cover the
56 expenses and fees of defense, or take over the resistance and
57 litigation of the claim.

58 2. Reserve-Deposit

59 If for any reason the Surety shall deem it necessary to set up
60 or to increase a reserve to cover any possible liability or loss
61 for which the Undersigned will be obligated to indemnify the Surety
62 under the terms of this Agreement, the Undersigned will deposit
63 with the Surety, immediately upon demand, a sum of money equal to
64 such reserve and any increase thereof as collateral security to the
65 Surety for such liability or loss. The Surety shall have the right
66 to use the deposit, or any part thereof, in payment or settlement
67 of any liability, loss or expense for which the Undersigned would
68 be obligated to indemnify the Surety under the terms of this
69 Agreement. Surety shall have no obligation to invest, or to provide
70 a return on, the deposit. The Undersigned shall be entitled to the
71 return of any unused portion of the deposit upon termination of the
72 liability of the Surety on the Bonds and the performance by the
73 Undersigned of all obligations to the Surety under the terms of
74 this Agreement. The Surety's demand shall be sufficient if sent by
75 Registered or Certified Mail to the Undersigned at the addresses
76 stated herein, or at the addresses of the Undersigned last known to
77 the Surety, whether or not actually received.

78 3. Loans

79 The Surety may from time to time make or guarantee advances or
80 loans to or for the account of the Principal to be used in the
81 performance of obligations of the Principal under the contract
82 covered by a Bond without the necessity of seeing to the
83 application of the proceeds thereof; and the Undersigned shall be
84 obligated to indemnify the Surety in accordance with the terms of
85 this Agreement for the amount of all such advances and loans,
86 notwithstanding that the proceeds or any part thereof have not been
87 so used by the Principal.

88 4. Trust Funds

89 The Principal agrees and hereby expressly declares that all
90 funds due or to become due under any contract covered by a Bond are
91 trust funds, whether in the possession of the Principal or another,
92 for the benefit and payment of all persons to whom the Principal
93 incurs obligations in the performance of such contract, for which
94 the Surety would be liable under the Bond. If the Surety
95 discharges any such obligation, it shall be entitled to assert the
96 claim of such person to the trust funds.

97 Principal shall, upon demand of the Surety and in
98 implementation of the trust or trusts hereby created, open an
99 account or accounts with a bank or similar depository designated by
100 the Principal and approved by the Surety, which account or accounts
101 shall be designated as a trust account or accounts for the deposit
102 of such trust funds, and shall deposit therein all monies received
103 pursuant to said contract or contracts. Withdrawals from such

104 accounts shall be by check or similar instrument signed by the
105 Principal and countersigned by a representative of the Surety. Said
106 trust or trusts shall terminate on the payment by Principal of all
107 the contractual obligations for the payment of which the trust or
108 trusts are hereby created or upon the expiration of twenty years
109 from the date hereof, whichever shall first occur.

110 5. Assignment-Possession

111 With respect to each Bond executed by the Surety, the
112 Principal hereby assigns, transfers and conveys to the Surety but
113 subject to the trust herein created; (a) all monies due or to
114 become due to the Principal under or as a result of the contract
115 covered by the Bond, including, but not limited to, progress
116 payments, deferred payments, retained percentages, compensation for
117 extra work and proceeds of damage claims; (b) all rights, title and
118 interest of the Principal in and to all supplies, tools, plant,
119 equipment and materials of every nature and description that may
120 now or hereafter be in, on or around the site of, or the work
121 under, the contract covered by the Bond, and materials purchased or
122 ordered for the performance of said contract whether in process of
123 construction, in transit to the site or in storage elsewhere; (c)
124 all right, title and interest of the Principal in and to all
125 subcontracts, let or to be let, in connection with said contract
126 covered by the Bond and in and to all surety bonds covering such
127 subcontracts; and (d) all actions, causes of actions, claims and
128 demands whatsoever with the Principal subcontractor, laborer,
129 materialman or any person furnishing or agreeing to furnish or

130 supply labor, material, supplies, machinery, tools or other
131 equipment in connection with or on account of the contract covered
132 by the Bond, and against any surety or sureties of any such
133 subcontractor, laborer or materialman.

134 The foregoing assignment shall be effective as of the date of
135 the execution and delivery of this Agreement as to each contract
136 covered by Bonds executed prior to such date although nothing
137 herein shall limit the right of the Surety to claim under any prior
138 assignment. With respect to any Bond executed and delivered on or
139 after the date of execution and delivery of this Agreement, the
140 Assignment shall be effective as of the effective date of the Bond.
141 The assignment with respect to each Bond shall take effect on the
142 date indicated, but only in the event of one or more of the
143 following (hereinafter called "Events of Default"):

144 (a) Any abandonment, forfeiture, or breach of, or failure,
145 refusal or inability to perform, any contract covered by a Bond or
146 any Bond liability;

147 (b) The failure, delay, refusal or inability of the Principal
148 to pay bills or other indebtedness incurred in, or in connection
149 with, the performance of any contract covered by a Bond;

150 (c) The failure to perform, or comply with, any of the terms,
151 covenants and obligations to this Agreement;

152 (d) The failure to pay and discharge, when due, any other
153 indebtedness of the Principal to the Surety;

154 (e) Any assignment by the Principal for the benefit of
155 creditors, or the appointment, or an application by the Principal

156 for the appointment, of a receiver or trustee for the Principal or
157 its property, whether insolvent, or not, or an application by the
158 Principal for reorganization or arrangement under the terms of the
159 National Bankruptcy Act or any similar laws of any State,
160 possession or territory of the United States, or if proceedings for
161 the appointment of a receiver or trustee, for liquidation or for
162 the reorganization or arrangement of the Principal shall be
163 initiated by other persons, the continuance of those proceedings
164 for a period of thirty days;

165 (f) The commencement or continuation of any proceeding which
166 deprives the Principal of, or interferes with, his use of any of
167 the supplies, tools, plant, machinery, equipment or materials in,
168 on or around the site of, or the work under the contract covered by
169 any said Bond;

170 (g) If the Principal is an individual, the Principal's dying,
171 absconding, disappearing, incompetency, being convicted of a felony
172 or imprisoned, and if the Principal is any other type of entity,
173 any change or threat of change in the character, identity, control,
174 management, beneficial ownership or existence of the Principal.

175 The foregoing assignment is for the purpose of (i) enabling
176 the Surety to complete the performance of the obligations of the
177 Principal under the contract covered by a Bond and the payment of
178 obligations incurred by the Principal in the performance of such
179 contract, and (ii) providing the Surety with collateral security
180 for the obligations of the Undersigned to the Surety under this
181 Agreement.

182 Upon the happening of an Event of Default, the Principal
183 authorizes and empowers the Surety, or any person or persons
184 designated by the Surety, to execute in the name of the Principal
185 any instruments deemed necessary or desirable by the Surety to
186 provide absolute title to the Surety of any funds, property and
187 rights as are hereby assigned, transferred or conveyed, and the
188 Principal hereby authorizes the Surety or such person or persons
189 designated by the Surety to take immediate possession of such
190 funds, property and rights, to collect such sums as may be due and
191 to endorse, in the name of the Principal, and to collect, any
192 checks, drafts, warrants and other instruments made and issued in
193 payment of any such funds.

194 Upon the happening of an Event of Default, the Surety shall
195 have the right to take immediate possession of the supplies, tools,
196 plant, equipment and materials and to use, and consume if
197 necessary, the same in the performance of the contracts by itself
198 or by others.

199 The Surety is authorized to assert and prosecute any right or
200 claim hereby assigned, transferred or conveyed in the name of the
201 Principal and to compromise and settle any such right or claim on
202 such terms as it considers reasonable under the circumstances.

203 The Surety may sell any property assigned to it pursuant to
204 this Agreement at public or private sale, with or without notice,
205 at any time or place, without incurring any liability of any kind.
206 The Surety may purchase any of the property at such sale.

207 This Agreement constitutes a Security Agreement to the Surety

208 and a Financing Statement in accordance with the provisions of the
209 Uniform Commercial Code. The Surety may make such additions to this
210 Agreement as may be necessary or desirable to permit its filing as
211 a Financing Statement under such Code, and the Undersigned will
212 execute and deliver such further instruments as may be necessary or
213 desirable to permit either the filing of this Agreement as a
214 Financing Statement or the filing of a Financing Statement based
215 upon this Agreement as a Security Agreement in such states,
216 counties and other places as the Surety shall deem necessary
217 or desirable.

218 6. Attorney-in-Fact

219 Each of the Undersigned hereby irrevocably nominates,
220 constitutes, appoints and designates the Surety or any person or
221 persons designated by the Surety as his attorney-in-fact with the
222 right to exercise all of his rights assigned, transferred and set
223 over to the Surety by this Agreement and in his name to execute and
224 deliver any and all additional or other assignments, instrument or
225 documents deemed necessary or desirable by the Surety (i) to vest
226 in the Surety absolute title to any and all monies, property and
227 rights hereby assigned, and (ii) to provide the protection and
228 rights to the Surety contemplated by all of the provisions of this
229 Agreement.

230 7. Possession-Completion

231 Upon the happening of an Event of Default described in
232 paragraph 5 hereof, the Surety shall have the right, at its option
233 and in its sole discretion, and is hereby authorized, with or

234 without exercising any other right or option conferred upon it by
235 law or by the terms of this Agreement, to take possession of all or
236 any part of the work under any contract covered by a Bond and to
237 complete or arrange for the completion of the same.

238 8. Declination of Suretyship

239 The Surety may decline to execute any Bond applied for without
240 incurring any liability whatever to the Undersigned. If the Surety
241 shall execute a bid or proposal bond, or any similar undertaking,
242 it may nevertheless decline to execute any and all Bonds that may
243 be required in connection with any award made on the proposal for
244 which the bond or undertaking is given, and the Principal shall
245 have the right to procure from another surety any bonds that may be
246 required in connection with any award under the proposal for which
247 the bond or undertaking is given.

248 9. Right to Information

249 The Undersigned will furnish to the Surety such information as
250 it may request from time to time concerning the financial condition
251 of the Undersigned, the status of work under any contract covered
252 by a Bond, the condition of the performance of any such contract
253 and the payment of obligations incurred in connection therewith.
254 The Surety may at reasonable times and places and from time to
255 time, examine and copy the books, records and accounts of the
256 Undersigned.

257 The Surety may obtain information concerning the affairs and
258 operations of the Undersigned and any transaction between or among
259 the Undersigned from any banks, depositories, obligees of the

260 Bonds, material men, supply houses, credit reporting agencies or
261 other persons, who are hereby expressly authorized to furnish such
262 information to the Surety.

263 10. Premiums

264 The Undersigned will pay to the Surety when due all premiums
265 and charges of the Surety for the Bonds in accordance with its rate
266 filings, its manual of rates, or as may be agreed.

267 11. Discharge from Suretyship

268 The Undersigned will, at any time upon the request of the
269 Surety, procure the discharge of the Surety from any Bond and from
270 all liability by reason thereof.

271 The Surety may, at any time, take such action as it deems
272 necessary or proper to obtain its release from any and all
273 liability under any Bond.

274 Upon such discharge or release, the Surety shall return to
275 the Principal any portion of any premium paid which is unearned
276 as a result of such discharge or release.

277 12. Suretyship Covered

278 This Agreement applies to all Bonds executed or procured by
279 the Surety for the Principal, in his own name or as co-adventurer
280 with others, whether prior or subsequent to the execution and
281 delivery of this Agreement, and from time to time until this
282 Agreement is terminated in accordance with its terms.

283 13. Protection of Other Sureties

284 If the Surety procures the execution of any Bond by other
285 sureties or executes the Bond with co-sureties, then all the

286 terms and conditions of this Agreement shall inure to the
287 benefit, as their interests may appear, of such other sureties
288 and co-sureties who shall have the right to maintain an action or
289 actions on this Agreement to enforce their rights hereunder.

290 14. Waiver of Homestead Right

291 The Undersigned waive, so far as their respective
292 obligations under this Agreement are concerned, all rights to
293 claim any of their property, including their respective
294 homesteads, as exempt from levy, execution or sale or other legal
295 process under the laws of any state, territory or possession of
296 the United States.

297 15. Notice of Claims

298 If the Undersigned become aware of any demand, notice or
299 proceeding which may result in liability to the Surety under any
300 Bond, the Undersigned shall notify the Surety immediately thereof
301 in writing.

302 16. Waiver of Notice

303 The Undersigned hereby waive notice of the execution of any
304 Bond and of any act, fact or information concerning or affecting
305 the rights or liabilities of the Surety or the rights or
306 liabilities of the Undersigned.

307 17. Consent to Changes

308 The Surety is authorized, without notice to or knowledge of
309 the Undersigned, to assent to any change whatsoever in any Bond
310 and any contract covered by a Bond, including, but not limited
311 to, any change in the time for the completion of the contract and

312 for payments or advances thereunder, to assent to or to take any
313 assignment or assignments, to execute or consent to the execution
314 of any continuations, extensions, renewals, enlargements,
315 modifications, changes or alterations of any Bond and to execute
316 any substitute or substitutes therefor, with the same or
317 different conditions, provisions and obligees and with the same
318 or larger or smaller penalties, and the Undersigned shall remain
319 bound under the terms of this Agreement even though any such
320 assent by the Surety does or may substantially increase the
321 liability of the Undersigned.

322 18. Subordination of Indemnitors

323 The Indemnitors shall have no rights of indemnity against
324 the Principal or his property until the Principal's obligations
325 to the Surety under this Agreement have been satisfied in full.

326 19. Nature of Rights

327 All rights and remedies of the Surety under this Agreement
328 shall be cumulative, and the exercise of or failure to exercise,
329 any right or remedy at any time shall not be an election of remedy
330 or a waiver of any other right or remedy. Failure of the Surety to
331 pursue any remedy against any one or more of the Undersigned shall
332 not release or waive any right against any other of the
333 Undersigned.

334 Surety is not required to exhaust its remedies or rights
335 against the Principal or to await receipt of any dividends from the
336 legal representatives of the Principal before asserting its rights
337 under this Agreement against the Indemnitors.

338 The rights, powers and remedies given to the Surety by this
339 Agreement shall be and are an addition to, and not in lieu of, any
340 and all other rights, powers, and remedies which the Surety may
341 have or acquire against the Undersigned or others whether by the
342 terms of any other agreement, by operation of law or otherwise.

343 The Undersigned shall continue to remain bound under this
344 Agreement even though the Surety may, from time to time and with or
345 without notice to or knowledge of the Undersigned, have heretofore
346 accepted or released, or shall hereafter accept or release, other
347 agreements of indemnity or collateral in connection with the
348 execution of the Bonds from the Undersigned or from others.

349 20. Partial Invalidity or Execution

350 If any of the persons named herein as Principal
351 and indemnitors fails to execute this Agreement or if the
352 execution hereof by any of the Undersigned shall be defective or
353 invalid for any reason, such failure, defect or invalidity shall
354 not in any manner diminish or otherwise affect the obligation or
355 liability hereunder of any other of the Undersigned.

356 Failure of the Principal to sign any Bond shall not relieve
357 the Undersigned of liability under this Agreement.

358 If any provision or provisions of this Agreement are held to
359 be void or unenforceable under the laws of the place governing its
360 construction or enforcement, this Agreement shall not be void or
361 unenforceable thereby but shall continue in effect and be enforced
362 as though such provision or provisions were omitted.

363 21. Separate Action-Settlement

364 Separate suits may be brought on this Agreement against any or
365 all of the Undersigned and the bringing of a suit or the recovery
366 of judgment upon any cause of action shall not prejudice nor bar
367 the bringing of other suits upon other causes of action, whether
368 theretofore or thereafter arising.

369 The Surety is hereby expressly authorized to settle any claim
370 based upon this Agreement with any one or more of the Undersigned
371 individually, and such settlement or compromise shall not affect
372 the liability of any of the rest of the Undersigned.

373 22. Service of Process Agents

374 If any proceeding is brought against the Surety in which the
375 Surety desires to join any one of the Undersigned by reason of the
376 undertakings in this Agreement, each of the Undersigned agrees that
377 he will, upon written notice of the Surety to do so voluntarily
378 appear in such proceedings and accept service of process and other
379 papers either personally or by an attorney of the Undersigned's
380 choice. If any of the Undersigned fails upon such notice from the
381 Surety so to appear, such Undersigned hereby designates the
382 Secretary of the State or territory in which such proceedings are
383 pending as his agent for the service of process in any such
384 proceedings.

385 With respect to any action brought by the Surety on this
386 Agreement in a jurisdiction in which one or more of the Undersigned
387 reside, are domiciled, are doing business or are found, each of the
388 Undersigned not in the jurisdiction hereby designates each of the

389 Undersigned in such jurisdiction as his agent to receive on his
390 behalf service of process in such action.

391 23. Modifications

392 The rights and remedies afforded to the Surety by the terms of
393 this Agreement may not be waived or modified orally and no written
394 change or modification shall be effective until signed by an
395 officer of the Surety.

396 24. Definitions

397 As used in this Agreement, words in the singular include the
398 plural and words in the plural include the singular. The masculine
399 pronoun shall be read as feminine or neuter as circumstances
400 require. The word "person" shall mean and include individuals,
401 partnerships, corporations and associations.

402 The terms "contract" shall include all documents comprising
403 the contract documents including general and special conditions,
404 specifications and drawings.

405 The word "Bond" shall mean a contract of suretyship, guaranty
406 or indemnity, an agreement or consent to provide such a contract
407 and the continuation, extension, alteration, renewal or
408 substitution of such a contract, agreement or consent.

409 25. Termination

410 This is a continuing Agreement which remains in full force and
411 effect until terminated. This Agreement may be terminated by the
412 Indemnitors or by any one or more of them upon twenty days written
413 notice sent by registered or certified mail to the Surety at its
414 home office at _____ but any such notice

415 of termination shall not operate to modify, bar, discharge, limit,
416 affect or impair the obligations of the Undersigned under this
417 Agreement with respect to Bonds which are executed prior to such
418 termination or with respect to Bonds executed after the date of
419 such termination (i) upon the award of a contract to the Principal
420 on a bid or proposal with respect to which the Surety has executed
421 a bid or proposal bond or similar undertaking prior to such date,
422 or (ii) which the Surety has become obligated, prior to such date,
423 to execute. Further, such notice of termination shall operate only
424 with respect to those of the Undersigned upon whose behalf such
425 notice of termination shall have been given.

426 26. Representations

427 THE UNDERSIGNED REPRESENT TO THE SURETY THAT THEY HAVE
428 CAREFULLY READ THE ENTIRE AGREEMENT AND THAT THERE ARE NO OTHER
429 AGREEMENTS OR UNDERSTANDINGS WHICH IN ANY WAY LESSEN OR MODIFY THE
430 OBLIGATIONS SET FORTH HEREIN.

431 IN WITNESS WHEREOF, the Undersigned who are individuals have
432 hereunto set their hands and seals, and the Undersigned who are
433 partnerships, corporations or unincorporated associations have
434 caused this Agreement to be duly executed by their duly authorized
435 representatives, all on the date aforesaid.

436 (SEAL)

437 (SEAL)

