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**THE TENDER OF DEFENSE LETTER:
A FEW REASONS IT'S A GOOD THING**

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When an unpaid laborer or materials supplier or unsatisfied obligee opts to seek relief through litigation, they typically sue the principal and its surety. When the principal notifies the surety that counsel has been engaged to represent both of them, the surety claims professional often faces an interesting dilemma. The ever-present interest in managing expenses is balanced against the need for representation by competent counsel. Interest in preserving the rights afforded by the general agreement of indemnity contrast with the need to resolve litigation with a satisfactory result.

The surety must not treat lightly the principal's offer to defend. Numerous issues must be addressed by the surety before responding to the principal. This is compounded by the fact that the surety must respond quickly. Rejection of the offer often draws threats from the principal and other indemnitors alleging that the surety will not be entitled to recover the fees and costs resulting from its usage of separate counsel.¹ Central Towers Apartments, Inc. v. Martin² is probably the leading case dealing with the issue of surety's right of reimbursement for attorneys' fees. It held that a surety is entitled to be reimbursed for fees resulting from usage of separate counsel when, under the circumstances, "...it was reasonably necessary for the surety to so act in its own defense, and [if] the surety acted in good faith toward the principal."³

This paper is intended to identify some of the key factors the surety claims professional should take into consideration before responding to a principal's offer to defend. Additionally, it is intended to provide suggestions as to how to tender a suit to a principal.

I. FACTORS TO CONSIDER IN DETERMINING WHETHER TO ACCEPT THE PRINCIPAL'S OFFER TO DEFEND

- The degree and amount of the surety's exposure;
- Whether the principal is solvent;
- Whether the surety demanded the principal to provide it with collateral to cover its exposure and how the principal responded;
- Whether there is a conflict of interest between the parties; and
- The competency of the attorney the principal desires to represent them

This list is based on the assumption that in conjunction with its offer to defend the surety the principal is providing reasonable cooperation.

The first three factors are closely related. Bona fide defenses of the principal benefit the surety. Additionally, there may be defenses unique to the surety. If the principal is not solvent, the surety has little choice but to retain separate counsel. It becomes more difficult for the surety to reject the defense offer if it is clear that the principal has the ability to satisfy the exposure. The surety should demand the principal's compliance with the general agreement of indemnity when it has doubts about the principal's defenses and intentions as to resolving the pending litigation. The surety's demands should require the principal and

indemnitors to deposit funds with the surety in an amount sufficient to cover its exposure.⁴ If the principal disregards the surety's demand for collateral or other demands made pursuant to the general agreement of indemnity it has breached that agreement. In United Riggers & Erectors, Inc. v. Marathon Steel Co.⁵, the Tenth Circuit Court of Appeals found the surety had acted in good faith where it declined the principal's offer to defend and hired separate counsel after the principal was not able to post collateral with the surety.

In the surety relationship, the surety often finds itself confronted with conflicting demands from its obligee and principal. These conflicting demands sometimes make it impractical or impossible for one attorney to properly represent both the surety and its principal.⁶ Conflicts of interest often arise because of legal defenses unique to the surety. However, there may be other causes. Unique surety defenses typically result from the language in the bond, discharge theories, or acts of the obligee. Courts seem curiously inconsistent about deciding whether it was reasonable for a surety to reject a solvent principal's offer to defend because of a conflict of interest. Reimbursement for attorneys' fees resulting from the surety's decision to engage separate counsel is not a certainty. Once again, the goal of achieving the desired result must be balanced against the desire to be reimbursed for expenses.

The need to have competent counsel is obvious. However, this factor is greatly influenced by the preceding factors. If the surety's exposure is not significant and the principal is solvent and there are no conflicts, the surety risks accusations of acting unreasonably if it hires separate counsel. The line quickly blurs if the exposure to the surety appears to be significant and there are doubts about the principal's solvency.

II. TIPS ON PREPARING A TENDER OF DEFENSE LETTER

If it is determined that the circumstances are appropriate for the surety to tender defense of the suit, a tender of defense letter agreement should be sent to the principal, indemnitors and the principal's attorney. In Payment Bond Claims Handling and the Law of Bad Faith, Ch. 14, THE LAW OF PAYMENT BONDS (ABA, Lybeck & Shreves, Eds. 1998)⁷, the author recommends express inclusion of the following covenants in the tender letter:

- (1) Attorney and Surety agree that an attorney-client relationship exists between them;
- (2) Principal and Indemnitors hereby waive any actual or potential conflict of interest that would prevent Attorney from disclosing to Surety all facts about the case, good or bad, notwithstanding the possibility that such facts may be contrary to the interests of Principal and Indemnitors;
- (3) Attorney agrees to report all facts about the case, good [or bad], to Surety, notwithstanding the possibility this such facts may be contrary to the Indemnitors' interests;
- (4) Attorney will report in writing to Surety regarding the status of the case on a 60-day cycle; and
- (5) Attorney will look only to Principal and indemnitors for payment of Attorney's invoices for representation of Surety.⁸

(6) Attorney agrees to discuss, in advance, with surety, any settlement negotiations.

Additionally, the following points should be considered:

- ! Mail two originals to each addressee, one by certified mail and the other first class mail. These people have a deadline in which to respond. This minimizes their ability to claim they never received the tender letter;
- ! Require the attorney to submit drafts of all pleadings to the surety to allow for review and comment before they are filed;
- ! Require the principal and indemnitors to reaffirm that the indemnity agreement remains in full force and effect ;
- ! Specify a date by which they must sign the tender letter agreement and return it; and
- ! The surety may withdraw its tender of defense at any time.
- ! Even though the attorney representing the surety is obligated to discuss any settlement prior to negotiations, there are many instances where principal's attorney has settled and has waived surety's unique defenses

A sample letter is attached.

III CONCLUSION

In some instances where the surety's principal has offered to engage counsel to defend both of them, the surety will have to decline the offer after determining that its interests diverge with the principal's. In situations where the surety believes it is acceptable to tender defense of the suit to the attorney engaged by the principal, it should attempt to do so in a way that minimizes its risks and does not compromise the rights it holds under its general agreement of indemnity.

1. See generally, Allbritton and Langfitt, Legal and Practical Problems with Joint Representation of the Principal and the Surety, Fidelity & Surety Law Committee, ABA Tort & Insurance Practice Section, August 13, 1991.
2. Central Towers Apartments, Inc. v. Martin, 453 S.W.2d 789 (Tenn. Ct. App. 1969).
3. Id. at 799.
4. See generally, Shahinian, The Strategic Use of the General Agreement of Indemnity Agreement in Settling Bond Claims Over a Principal's Objection, Fidelity & Surety Law Committee, ABA Tort & Insurance Practice Section, January 26, 1996.
5. United Riggers and Erectors, Inc. v. Marathon Steel Co., 725 F.2d 87 (10th Cir. 1984).
6. See generally, Dyer, Ethical Considerations to Multiple Representation in Construction and Surety Bond Litigation, 17-APR Construction Law 14.
7. Niesley, Payment Bond Claims Handling and the Law of Bad Faith, Ch.14, 351, THE LAW OF PAYMENT BONDS (ABA, Lybeck & Shreves, Eds. 1998).
8. Id. at 357.

Thomas C. Finley, Esquire

Thomas C. Finley is the Surety Unit Claim Manager of National American Insurance Company. He received his B.A. from the University of Central Oklahoma in 1980 and his Juris Doctorate from Oral Roberts University in 1984. He is a member of the Oklahoma Bar Association and was Staff Counsel with Memorex Telex Corporation prior to joining National American Insurance Company in 1991.

Stanley R. Van Ostran, Esquire

Stanley R. Van Ostran is the Director of Auditing and Staff Counsel for National American Insurance Company. Stan holds a B.A. in Accounting and an A.S in Computer Programming from Missouri Southern College. He received his Juris Doctorate from the University of Tulsa in 1996. Stan is a Certified Public Accountant, Certified Internal Auditor, Certified Fraud Examiner and Certified Financial Services Auditor. Prior to his employment with National American Insurance Company, Stan was employed as Senior Auditor for McDonnell Douglas Corporation and worked closely with the defense Contract Audit Agency auditing government contracts, including the construction of several federal defense facilities.

Via Certified Mail
Return Receipt No. 1234
And First Class Mail

March 16, 1999

Mr. Bobby Ray Smith
Bobby Ray's Construction
Pleasantville, TX 7000

Mr. Bobby Ray Smith
123 Primrose Lane
Pleasantville, TX 7000

Mr. Claude Sniffle, Esq.
Sniffle & Wheeze
Pleasantville, TX 7000

Ms. Billi Sue Smith
123 Primrose Lane
Pleasantville, TX 7000

Principal: Bobby Ray's Construction
Obligee: City of Pleasantville, TX
Project: Sanitation truck maintenance garage; Contract no. P9872
Bond No.: B4321
Claim No.: SB-99-7601
Lawsuit: Boscoe's Electric v. Bobby Ray's Construction and Goodguy Surety
Company; Case No. 3456

Dear

On March 15, 1999, Goodguy Surety Company ("Goodguy") was served with a Summons and Complaint in a lawsuit initiated by Boscoe's Electric. It is our understanding that Boscoe's Electric was one of your subcontractors on the referenced project. A copy of the Summons and Complaint is enclosed.

Bobby Ray's Construction, Bobby Ray Smith and Billi Sue Smith (the "Indemnitors") signed a General Agreement of Indemnity on behalf of Goodguy dated August 1, 1999 (the "GAI"). Among other things, the GAI requires the Indemnitors to indemnify Goodguy and hold it harmless from any claim loss, cost and attorneys' fees incurred as a result of the execution of the referenced bond. In accordance with the terms and conditions of the GAI, we hereby tender defense of this litigation to the Indemnitors and request that Mr. Sniffle make court appearances on behalf of Goodguy, file necessary pleadings and otherwise protect our interest in this litigation.

The Indemnitors expressly agree that:

- the GAI remains in full force & effect and with their signatures below, they reaffirm all of their obligations and responsibilities pursuant to the GAI;
- they waive any actual or potential conflicts of interest that would prevent Attorney Sniffle from disclosing to Goodguy all facts about the case, notwithstanding the possibility that such facts may be contrary to their interests;
- they have sole responsibility to pay attorney Sniffle's fees and expenses; and
- they will assist us with our investigation, including furnishing all documentation or information in their possession concerning this claim including copies of subcontractors, notices, and correspondence with Boscoe's Electric.

Attorney Sniffle expressly agrees:

- that upon signing this document, an attorney-client relationship will exist with Goodguy;
- to provide written reports to Goodguy regarding the status of the case every 60 days;
- to provide a detailed report explaining the defenses of Bobby Ray's Construction to this litigation;
- to report all facts about the case to Goodguy, notwithstanding the possibility that such facts may be contrary to the Indemnitors' interests;
- to provide drafts of responsive pleadings prepared on our behalf for approval prior to filing as well as any other documents pertinent to the suit;
- to look solely to Bobby Ray's Construction or other Indemnitors for payment of fees and expenses;
- In the event this matter is settled, to include Goodguy in Settlement Agreements and Dismissal Orders and to provide Goodguy a copy of same; and
- to fax a copy of Goodguy's Entry of Appearance and Answer at least three days before it is due
- if circumstances change during the course of this litigation which increases Goodguy's exposure, notify the undersigned immediately.

If this tender of defense is acceptable, please acknowledge such acceptance by signing the enclosed copy of this letter and returning it immediately. In the event the tender of defense is not acceptable, please notify me at the number indicated above. If we do not receive this executed letter from you or otherwise hear from you by March 25, 1999, we will assume that the tender of our defense has been refused, and Goodguy will undertake its own defense in this action, and will seek reimbursement for all costs, fees, and expenses under the GAI.

Goodguy reserves the right to withdraw this tender of defense at any time should it decide it is in its best interest to do so. This tender of defense is not intended, nor should it be construed to be a waiver of our right at our sole discretion to retain counsel to represent our interests at any time during this matter and seek reimbursement for all costs, fees and expenses under the GAI. We will forward to Attorney Sniffle copies of the bonds and documentation in our file pertaining to Boscoe Electric's claim upon our receipt of this document bearing signatures of all parties. This document may be signed in counterpart and returned via fax.

Sincerely,

Goodguy Surety Company

Enclosures

Acknowledged and Agreed:

Bobby Ray Smith, as authorized representative
of Bobby Ray's Construction

Bobby Ray Smith, as personal Indemnitor

Billi Sue Smith, as personal Indemnitor

Claude Sniffle, Esq.
