

SACRED PRINCIPLES AND OTHER MYTHS: IS A DEFAULT JUDGMENT ENTERED AGAINST A PRINCIPAL BINDING ON THE SURETY???

The question whether a judgment, rendered on the merits either for or against a principal, is binding on its surety has received substantial academic attention during the last several years.¹ Several analysts have focused on issues which can arise when a principal becomes involved in litigation or arbitration and loses the case, in the absence of the companionship of his surety. In such cases, the principal will have had its day in court, and the surety will usually have been advised of the action. Typically, courts have been reluctant to provide compensated sureties with another bite at the proverbial apple, and have generally held that the surety is bound by the result achieved by the principal, whether good or bad.

Less attention has been paid to situations wherein judgment has been rendered against a principal by default. In such cases where the merits of a controversy are not reached, let alone determined, is the surety conclusively bound?

Many surety practitioners and claims executives may be surprised - and disappointed - to learn that one of the sacred principles - that a default judgment rendered against a principal does not bind the surety - is under attack. Several recent decisions have determined that a surety is in fact bound by a default judgment entered against a principal, and at least one federal court decision from the Northern District of Alabama has ruled that the surety is bound notwithstanding its independent and active participation in litigation!

This paper will examine the nature of default and will summarize the arguments for and against imposition of liability on the surety when the principal defaults.

The Nature of "Default"

The concept of a "default" is separate and distinct from entry of judgment by default. In general terms, a condition of "default" is said to exist where a party defending an action has failed to plead (by motion or responsive pleading) or has failed to "otherwise defend" **and** this condition has been brought to the attention of and has been acknowledged to exist by the clerk or court. A "default" occurs most frequently when a party, having been served and thus being subject to *in personam* jurisdiction, fails to file a response to the complaint within the time prescribed by the applicable rules. The party asserting a claim for relief against a party who has failed to appear or defend may obtain an "entry of default" by the simple and expedient act of calling said fact to the attention of the clerk; thereafter, a condition of "default" will be entered in the court records.

The procedures for obtaining a **judgment** by default are somewhat more complex. In general, if the plaintiff is seeking a sum certain (or an amount which can be made certain by a mathematical computation) judicial action is unnecessary, and the clerk can enter a complete judgment without further judicial action. In most cases, however, a court hearing and

¹Two excellent articles in this area are Dolores A. Parr and E. A. Mills, Jr., *Res Judicata, Collateral Estoppel and the Surety*, presented to the Surety Claims Institute, June 21, 1996; and James D. Ferrucci, *Preclusive Effect of Prior Judgment or Arbitration Award Against the Principal*, presented to the American Bar Association mid-winter meeting, January, 1998.

judicial determination as to the amount of the claim is required. Substantial variables, both substantive and procedural, will exist in state courts versus federal courts, and local custom and practice concerning entry of default and renditions of judgments by default is anything but uniform.

GETTING RELIEF

Similarly, prospects for obtaining relief from entry of default, or judgment by default, can vary greatly depending upon the choice of court and a variety of other factors. Most state courts have non-standard provisions governing relief from default judgment; compare, for example, Alabama Rule 55 (c) to its federal counterpart:

Rule 55 (c) - ARCP

(c) Setting aside default. In its discretion, the court may set aside an entry of default at any time before judgment. The court may on its own motion set aside a judgment by default within thirty (30) days after the entry of the judgment. The court may also set aside a judgment by default on the motion of a party filed not later than thirty (30) days after the entry of the judgment.

Rule 55 (c) - FRCP

(c) Setting aside default. For a good cause shown the court may set aside an entry of default and, if a judgment by default has been entered, may likewise set it aside in accordance with Rule 60 (b).

An ancient maxim of equity proclaimed that “equity abhors a forfeiture.” Perhaps as a result of the litigation explosion over the last several decades, and the attendant docket congestion and the ever-expanding case loads assigned to federal and state judges, it is increasingly apparent that many courts regard disposition by default as a perfectly acceptable, if occasionally draconian, means of putting an end to litigation. Indeed, several opinions have noted that there is no difference between the enforceability of a judgment obtained by default and one based upon a bench trial, jury verdict, or arbitration proceeding. Many courts are now admonishing practitioners that conditions of default should be promptly called to the attention of the court and that failing to comply with such rules may result in dismissal of the claims of the parties seeking relief. A judgment by default has therefore become a legitimate objective and, for the surety, an increased sensitivity to exposures resulting from default scenarios is appropriate.

**The General Rule: A surety is not bound
by a Default Judgment rendered against its principal**

Relatively few cases have addressed the general issue of whether a judgment by default suffered by a principal binds the surety. What appears to be the general rule is established in the 1939 decision of United States ex rel. Vigilanti v. Pfeiffer-Neumeyer Constr. Corp.,² a Miller Act case in which the claimant sued both the contractor and the surety. Default judgment was entered against the contractor, and the court was asked to enter a matching judgment against the surety. Happily, the court declined and, in so doing, noted that if the judgment against the principal had been rendered **on the merits**, a different result would likely have obtained:

The reason for the rule of law that the surety is bound by a judgment against its principal when it had knowledge of the action, and had full opportunity to defend, is based upon common sense and reason. A surety cannot stand idly by with full knowledge of an action pending against its principal, permit a judgment to be taken against the principal, and later on, when an action is brought upon its bond, require the plaintiff to retry his case. This would result in two trials of the same issue. It would retard and not promote the administration of justice.

Pfeiffer-Neumeyer, 25 F. Supp. at 404-405.

The opinion proceeds to declare that this rule is not applicable where the judgment obtained by the claimant is rendered by default. The court explained its reasoning as follows:

This case is readily distinguishable from the cases which have been cited in this opinion. Here a judgment of default was entered against the principal in this action which the surety defended. The surety was not responsible for the principal defaulting in this action. Upon the trial of this action it was entitled to offer its defenses. It was not in any wise bound by the default judgment obtained against the principal. (citation omitted). . . . The rule which is sustained by the weight of authority is that a judgment against the principal upon a bond such as that here sued upon is not admissible in evidence against the sureties, except: First, in cases where the bond is conditioned to pay such judgment as may be rendered against the principal; and, second, in cases in which the sureties have had the opportunity to appear and defend in the action against the principal....

Pfeiffer-Neumeyer, 25 F. Supp. at 405.

The arguments which have been advanced by the claimant in Pfeiffer-Neumeyer and in subsequent cases tend to focus on the nature of the relationship between a principal and surety, but tend to distort the relationship and duties resulting therefrom. The basic arguments

²25 F. Supp. 403 (E. D. N. Y. 1938).

can be summarized as follows: First, the Miller Act, and related state statutes, creates a statutory obligation pursuant to which the surety is bound by any judgment rendered against its principal; second, the language of the bond forms “issued” by the sureties contemplate joint and several liability as between the surety and the principal; third, the surety should be bound because it is in “privity” with its principal, and is thus bound by a judgment, whether rendered by default or otherwise.

The General Rule Rejected: Drill South v. International Fidelity

In Drill South v. International Fidelity Ins. Co., an action commenced in the United States District Court for the Northern District of Alabama in 1996, a fact pattern substantially identical to the Pfeiffer-Neumeyer case was presented. Drill South, a Miller Act claimant, sued International Fidelity and its principal, Enviro-Group, claiming it was due substantial additional compensation for drilling services performed on a government project. By the time the action was filed, Enviro-Group was defunct. Drill South was able to perfect service on the corporate entity and when Enviro-Group failed to appear, the clerk entered its default. Judgment by default was subsequently ordered by the court and, thereafter, Drill South asked the court to enter a matching judgment against International Fidelity.

Drill South argued that by statute, bond language, and the principal-surety relationship, International Fidelity should be bound. Specifically, Drill South argued that the language of the indemnity agreement, pursuant to which International Fidelity was appointed as Enviro-Group’s “attorney in fact” and which further acknowledged that the surety had broad rights to “adjust, settle, or compromise any claim, demand, suit or judgment upon (the bond),” International Fidelity was entitled to assume the defense of Enviro-Group, and that its failure to do so should constitute a waiver of its right to assert any personal or derivative defenses in its own name. International Fidelity countered with the arguments and rules discussed in the Pfeiffer-Neumeyer case, and stressed the fact that the surety had **itself** been sued and was actively defending the claims advanced by Drill South as it was clearly entitled to do.

The District Court, acknowledging that existing precedent favored the surety’s position, nonetheless rejected the holding and rationale of the Pfeiffer-Neumeyer case, and entered judgment against the surety. In its opinion, the District Court displayed little regard for the decision of the Eastern District of New York:

The Pfeiffer-Neumeyer decision appears to be the only one of its kind; the court can find no other reported case law on point. This court, however, finds the policy rationale contained in Pfeiffer-Neumeyer, and relied upon by International Fidelity, devoid of any basis in law or reason. It would be an anomaly to conclude that a surety *can* be held liable under the general rule for standing idly by while its principal suffers an adverse judgment when the judgment is entered in an action where the surety is not a party, and in the same breath conclude that the surety *can* stand idly by, without liability, and allow a default judgment to be rendered against its principal merely because the surety was a co-defendant to the action. In the former case, the surety is afforded much less

opportunity to defend its interest than in the latter, where it is already a party, has full knowledge of the proceedings, and can freely oppose the judgment against its principal.

Drill South v. International Fidelity Ins. Co., No. CV-96-N-2682-5 (N.D. Ala. Sept. 5, 1997) (memorandum of opinion).

The Drill South opinion makes repeated reference to the language of the agreement of indemnity pursuant to which the surety is authorized to take all steps and measures deemed “necessary and proper . . . to give . . . full protection . . . to (the surety).” For reasons that are unclear from the opinion, the District Court was convinced that International Fidelity should have retained counsel to appear and defend the interests of Enviro-Group, and that its failure to assume and prosecute the defense in the name of Enviro-Group was, in effect, the equivalent of a default by International Fidelity.

The Drill South saga is continuing, and the default issue will be re-visited by the Eleventh Circuit Court of Appeals in due course. Pending further developments, a close reading of the opinion and an appreciation for the arguments available in opposition to the surety’s position is recommended.

Summary

At the moment, the district court’s opinion in Drill South is the only known decision which has imposed a judgment against a surety in a Miller Act action wherein the surety and the principal were both sued. However, in an era where our court systems are frequently graded solely on the basis of numbers of cases disposed of, the temptation to deviate from established precedent may be understandable. Prompt consideration should be given at an early stage in any litigation to the potential for mischief resulting from entry of default, or judgment by default, against a principal, regardless of whether the surety is a co-defendant.

**TENTH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE
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