

**ELEVENTH ANNUAL  
SOUTHERN SURETY AND FIDELITY CLAIMS  
CONFERENCE**

**PURSUING THE THIRD PARTY POCKET -- RECOVERY BY  
THE SURETY AGAINST DESIGN PROFESSIONALS, AGENTS,  
CPAs AND OTHERS**

**BY:**

**Alberta L. Adams  
PREAUS, RODDY & KREBS, LLP  
650 Poydras Street  
Suite 1650  
New Orleans, Louisiana 70130-6114**

It is a familiar story -- the surety has suffered a loss and the principal and indemnitors are insolvent. But the surety is not out of options -- it is time to look for any potential third party pockets. This paper provides an overview of the potential liability of several third parties to the surety for a loss: the design professional, the agent, the accountant, and the *de facto* joint venturer.

## **I. THE DESIGN PROFESSIONAL -- ACTIONS AGAINST ARCHITECTS & ENGINEERS.**

Because of the degree of control the design professional may exercise on the project, not only in design but in payment, time extensions, and approvals, any neglect or improper performance of its duties may cause or contribute to the surety's loss. Additionally, improper certifications of payments by the design professional can deprive the surety of its subrogation rights to contract balances.

Traditionally, privity foreclosed third party negligence actions against design professionals. However, as discussed below, numerous courts have recognized that a third party may pursue tort claims against architects and engineers. A minority of courts cling to traditional privity requirements. Still other courts have used the economic loss rule to deny recovery of the types of losses generally sustained by a surety on a construction project.

### **Courts Recognizing a Right of Action in Tort against the Design Professional.**

While there is generally no privity between the surety and the design professional, courts have routinely permitted third parties to pursue tort claims against architects and engineers. See Berkel & Co. Contractors, Inc. v. Providence Hosp., 454 So.2d 496 (Ala. 1984) (subcontractor may sue architect); Carroll-Boone Water Dist. v. M&P Equip. Co., 661 S.W.2d 345 (Ark. 1983) (contractor may sue engineer); Balagna v. Shawnee County, 668 P.2d 157, 163 (Kan. 1983) (injured worker permitted to recover against architect in tort); Farrell Const. Co. v. Jefferson Parish, 693 F.Supp. 490, 492 (E.D.La. 1988) (recognizing that contractor may maintain an action in tort against the architect/engineer for allegedly preparing defective submissions, causing extra work and delay damages); Colburn v. B.F. Carvin Const. Co., 600 So.2d 719, 723 (La.App 5<sup>th</sup> Cir. 1992); S.K. Whitty & Co. v. L.L. Lambert, 576 So.2d 599 (La.App 4<sup>th</sup> Cir.), writ denied, 580 So.2d 928 (La. 1991); Standard Roofing Co. v. Elliot Const., 535 So.2d 870 (La.App 1<sup>st</sup> Cir. 1988), writ denied 537 So.2d 1166 (La. 1989); Milton J. Womack, Inc. v. State House of Representatives, 509 So.2d 62, 64 (La.App 1st Cir.), writ denied, 513 So.2d 1211 (La. 1987) (holding that contractor could recover in tort for economic injuries from the architect which negligently prepared defective plans); Gertler, Hebert & Co. v. Weyland Machine Shop, 405 So.2d 660, 662 (La.App 4th Cir. 1981) (recognizing a right of action in tort against the architect by a subcontractor for delays caused by the architect's allegedly improper plans and unreasonable withholding of approval of shop plans); Davidson & Jones, Inc. v. New Hanover County, 255 S.E.2d 580 (N.C. Ct.App. 1979) (subcontractor may sue architect); John Martin Co., Inc. v. Morse/Diesel, Inc., 819 S.W.2d 248 (Tenn. 1991) (subcontractor permitted to sue construction manager); Associated Arrchitects & Eng'rs, Inc. v. Lubbock Glass & Mirror Co., 422 S.W.2d 942 (Tex.App. 1967) (subcontractor may sue architect).

These cases recognize a common law duty of care on the part of design professionals toward persons who may be foreseeably harmed by their actions or inactions. [Limitations on

the scope of this duty are discussed below]. Sureties fall within the range of persons who may be foreseeably harmed by the design professional's errors and omissions. In fact, several courts have specifically permitted the surety to maintain an action in tort against the architect or engineer. City of Houma v. Municipal Industrial Pipe Service, Inc., 884 F.2d 886 (5<sup>th</sup> Cir. 1989); Aetna Ins. Co. v. Hellmuth, Obata & Kassabaum, Inc., 392 F.2d 472 (8<sup>th</sup> Cir. 1968); Peerless Ins. Co. v. Cerny & Assoc., Inc., 199 F.Supp. 951 (D.Minn. 1961); Seaboard Surety Co. v. Walker, 260 Cal.Rptr. 924 (Cal. Dist.Ct.App. 1963); American Fidelity Fire Ins. Co. v. Pavia-Byrne Engineering, 393 So.2d 830, 838 (La.App 2nd Cir. 1981); Calandro Dev., Inc. v. R.M. Butler Constr., Inc., 249 So.2d 254, 265 (La.App 1<sup>st</sup> Cir. 1971); U.R.S. Co. v. Gulfport-Biloxi Regional Airport Authority, 544 So.2d 824, 828 (Miss. 1989); State ex rel. National Surety Corp. v. Mulvaney, 72 So.2d 424 (Miss. 1954); In re Designed Ventures, Inc., 132 B.R. 677 (D. R.I. 1991). These courts have recognized that architects and engineers significantly impact the course of a project, and should not be insulated from harm caused by their errors and omissions. See, e.g., Colbert, *supra*, 600 So.2d at 724.

For example, in City of Houma, *supra*, 884 F.2d at 889-90, n.3, the Fifth Circuit Court of Appeals likened the engineer to other professionals who may be held liable to those who might suffer reasonably foreseeable injury because of the professional's breach of duty. The Court noted:

It was foreseeable that [the surety] would rely on [the engineer] to monitor construction and that this reliance stemmed from [the surety's] knowledge of the precautions taken by [the owner] in its contract with [the principal]. The district court's conclusion that the services of [the] engineers were for the protection of both the [owner] and [the surety] is not erroneous. As the *Calandro*, court noted, "[a]n engineer or architect must be deemed and held to know that his services are for the protection, not only of the interests of the owner, but also the surety on the contractor's bond who has no supervisory power whatsoever."

Id.

**Privity Required.** A minority of jurisdictions nevertheless require privity for a suit against a design professional. See John Day Co. v. Alvine & Assoc., 510 N.W.2d 462, 466 (Neb. Ct.App. 1993); Linde Enters., Inc. v. Hazelton City Auth., 602 A.2d 897, 901 (Pa. Super. Ct. 1992).

**Economic Loss Rule.** Other courts utilize the economic loss rule to deny recovery in tort for the types of losses suffered by the surety when the principal defaults. See Sensenbrenner v. Rust, Orling & Neale Architects, Inc., 374 S.E.2d 55 (Va. 1988); Berschauer/Phillips Constr. Co. v. Seattle School Dist. No. 1, 881 P.2d 986 (Wash. 1994). Briefly stated, the economic loss rule bars parties from recovering in tort purely economic losses, such as lost profits, costs of repair and replacement of a defective product, and delay damages, in the absence of physical property damage or personal injury.

The economic loss rule was developed in the context of products liability claims, and not professional malpractice cases. See e.g. East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 106 S.Ct. 2295 (1986) (holding that a manufacturer has no duty in tort to prevent a product from injuring itself). Application of the economic loss rule in tort cases against design professionals ignores the fact that these cases sound in professional negligence. There is no reason to differentiate between the design professional and other professionals who are held liable for economic loss.

**Use of Subrogation.** The surety may rely on its subrogation rights to avoid privity and economic loss rule limitations in states where they apply. See Unity Telephone Co. v. Design Service Co., 201 A.2d 177 (Me. 1964); Reliance Ins. Co. v. Morris Associates, Inc., 607 N.Y.S.2d 106 (N.Y. App.Div. 1994); see also Peerless, supra, 199 F.Supp. at 954 (discussing the surety's subrogation rights).

**Scope of Duty.** Courts have held that the duty assumed by the architect/engineer is governed by his contract with the owner. See Day v. National U.S. Radiator, 128 So.2d 660 (La. 1961); Yokum v. City of Minden, 649 So.2d 129, 132 (La.App 2<sup>nd</sup> Cir. 1995); see also Mulvaney, supra, 72 So.2d at 431. Duties found under owner/design professional contracts include the duty to make reasonable inspections of and properly supervise the project; City of Houma, supra, 884 F.2d at 889-90; Hellmuth, supra, 392 F.2d at 475; to exercise reasonable care in certifying payments; Peerless, supra, 199 F.Supp. at 953; and to withhold retainage. Mulvaney, supra, 72 So.2d at 431.

The performance of these duties is governed by the professional standard of care. Accordingly, as professionals, architects and engineers should be required to exercise that degree of skill or care employed by other architects and engineers in the same general area. Milton J. Womak, Inc. v. House of Representatives, 509 So.2d 62, 64 (La.App 1<sup>st</sup> Cir.), writ denied, 513 So.2d 1208 (La. 1978); Peerless, 199 F.Supp. At 953 (applying Minnesota law). For example, in Cobert, supra, the appellate court properly recognized a cause of action against the architect for negligent professional undertaking. 600 So.2d at 723.

The restriction of duty to those set forth in the contract with the owner limits the surety's rights against the architect/engineer. For example, the architect/engineer, in utilizing favorable AIA forms, can severely restrict its liability to the surety. See City of Durham v. Reidsville Engineering Co., 120 S.E.2d 564 (N.C. 1961).

However, the AIA form does not provide a completely safe harbor for the architect/engineer. For example, the architect/engineer administering a construction contract may, through his actions, arguably assume duties outside the contract. For example, some courts recognize the principal that when a person undertakes a duty not imposed by law, the person must carry out that duty in a reasonable manner. In other words, a party may be liable for the breach of a duty voluntarily assumed. See Brown v. Tesack, 566 So.2d 955, 957 (La. 1990); Harris v. Pizza Hut, 455 So.2d 1364, 1371 (La. 1984); Edwards v. Ruedlinger, Inc., 669 So.2d 541, 543 (La.App 4<sup>th</sup> Cir. 1996); see also Peerless, supra, 199 F.Supp. at 955; Mulvaney, supra, 72 So.2d at 431 (Mississippi).

Citing 38 Am.Jur., pp. 656-57, the Mulvaney court noted that:

“. . . the law imposes upon every person who undertakes the performance of an act which, it is apparent, if not done carefully, will be dangerous to other person or the property of other persons, the duty to exercise his senses and intelligence to avoid injury, and he may be held accountable at law for an injury to person or to property which is directly attributable to a breach of such duty. The duty so arising is absolute.”

Id. The court further reasoned that by supervising the performance of the contract and the preservation of retainage, the architect “undertook the performance of an act which, it was apparent, if negligently done would result in loss to the surety, and the law imposed upon him the duty to exercise due care to avoid such loss.” Id. Accordingly, when an architect assumes responsibilities beyond the contract, and acknowledges those responsibilities, his duty of care should be extended to include those responsibilities.

Additionally, while the AIA form contract purports to exculpate the architect from most liability, the architect must fulfill its duties under the contract to claim the benefit of the exculpatory clauses. For example, courts have recognized that an architect is liable, notwithstanding the protective language of the AIA form contract, when the architect fails to conduct the inspections required under that contract. See First Nat. Bank of Akron v. Cann, 593 F.Supp 419, 436 (N.D. Ohio 1980), aff’d, 669 F.2d 415 (6<sup>th</sup> Cir. 1982); Diocese of Rochester v. R-Monde Contr., 562 N.Y.S.2d 593, 596 (Sup. 1989); Hunt v. Ellisor & Tanner, Inc., 739 S.W.2d 933, 937 (Tex.App — Dallas 1987); Balagna v. Shawnee County, 668 P.2d 157, 163(Kan. 1983); see also Public Health Trust of Dade County, Florida v. George Hyman Cosnt. Co., 606 So.2d 728 (Fla.App 3<sup>rd</sup> Dist. 1992); Watson, Watson, Rutland v. Board of Educ., 559 So.2d 168, 173-74 (Ala. 1990).

In Cann, while noting limitations to the architect’s liability contained in the form contract, the court held that the failure to make any site inspections whatsoever amounts to a breach of the architect’s duty of care. The court aptly reasoned:

Other than reference to the broad guideposts of establishing a basis for issuing certificates for payment and guarding the owner’s interests, the scope of the architect’s duty generally to observe is not clearly defined. Admittedly, the contract documents are explicit on the provision that exhaustive, continuous on-site inspections are not required. **That exhaustive, continuous on-site inspections were not required, however, does not allow the architect to close his eyes on the construction site, refrain from engaging in any inspection procedure whatsoever, and then disclaim liability for construction defects that even the most perfunctory monitoring would have prevented.** Even the most general supervision would have placed [the architect] on notice as to the activities of laborers engaging in unauthorized, extensive welding and cutting of structural steel.

Id. (Emphasis added).

Similarly, in R-Monde Contractors, *supra*, 562 N.Y.S.2d at 595, the court addressed the architect's duty to conduct inspections. The contract contained a clause which provided that the architect "shall not have control or charge of and shall not be responsible for construction means, methods, techniques, sequences or procedures, or for safety precautions and programs in connection with the Work." *Id.* The court found that the architect had a duty to inspect and that the quoted language did not immunize the architect from liability flowing from a breach of his duty to inspect. *Id.* The court stated:

Although the Architect was not obliged to supervise the construction work or to make exhaustive or continuous on-site inspections, it was, nevertheless, required to visit the site periodically in order to be familiar with the progress and quality of the work, to determine generally if the work was proceeding in accordance with the contract documents, to keep plaintiffs informed about the progress and quality of the work, and to guard the plaintiffs against defects in the work.

\* \* \*

The exculpatory provision contained in subparagraph 1.5.5, excusing the Architect from responsibility for construction methods or for acts or omissions of the contractor **does not immunize the Architect from liability flowing from a breach of its duties to plaintiffs.**

*Id.* (Emphasis added). The court reasoned that the exculpatory clause is merely an agreement that the architect is not the guarantor of the general contractor's work; it does not diminish the architect's responsibilities to visit and monitor the work. *Id.*

## II. AGENTS

Agents can be guilty of a variety of acts or omissions which can result in liability to the surety. Some agents are less than candid with the surety and the underwriters, leading the surety to bond a risk it would not have, had full disclosure been made. Others may issue unauthorized bonds.

An initial question is whether the agent is an agent or broker under the relevant state's law, an issue beyond the scope of this paper.

Once agency is found, an agent or mandatory owes to the principal a duty of prudence, to provide accurate and truthful information, to act only within his authority, and to comply with limitations set by the principal. Manufacturer's Casualty Ins. Co. v. Martin-Lebreton Ins. Agency, 242 F.2d 951, 953 (5<sup>th</sup> Cir.), *cert. denied*, 355 U.S. 870 (1957); Toups v. Equitable Life Assur., 657 So.2d 142, 148 (La.App 3<sup>rd</sup> Cir.), *writ denied*, 664 So.2d 421 (La. 1995); Richard v. American Federation of Unions Local 102, 378 So.2d 564, 568 (La.App 3<sup>rd</sup> Cir. 1979); Millers Cas. Ins. Co. of Texas v. Cypress Ins. Agency, Inc., 273 So.2d 602, 604-05 (La.App 1<sup>st</sup> Cir. 1973); Equitable Surety Company v. Stemmons, 239 S.W. 1037 (Tex. App.

1922). Accordingly, a surety may maintain actions against the agent for (1) exceeding his authority; and (2) negligent or intentional misrepresentation or omission.

**Exceeding Authority.** “Where an insurer is exposed to liability for policy claims because of action by its agent beyond the agent’s authority or contrary to instructions, the agent is accountable to the insurer for the latter’s loss.” Toups, supra, 657 So.2d at 148; Manufacturer’s Cas. Ins., supra, 242 F.2d 951 (agent may not proceed without or beyond his authority); Richard, supra, 378 So.2d at 568 (agent liable for violating underwriting guidelines); Stemmons, supra, 239 S.W. at 1040 (surety has cause of action against agent for damages when agent acts beyond his authority); Cypress Ins. Agency, supra, 273 So. 2d 602 (agent liable for violating underwriting guidelines). However, the surety must show that it would not have issued the policy had the agent requested additional authority. See Continental Casualty Company v. River Ridge Insurance, Inc., 973 F.2d 437 (5<sup>th</sup> Cir. 1992) (although agent exceeded authority, agent was not liable because insurer failed to show that it would not have issued policy).

**Misrepresentation and Omission.** Additionally, “an insurance agent who fails to make a full disclosure of all matters concerning the risks and hazards of a prospective insurable interest, or to report the issuance of a policy as directed . . . , may incur liability to the insurer for exposing the insurer to liability for claims of loss under [the policy].” See Annotation: Liability of Insurance Agent, For Exposure of Insurer to Liability, Because of Failure to Fully Disclose or Assess Risk or to Report Issuance of Policy 35 A.L.R. 3d 821, 823 § 2; Michigan Mutual Liability Company v. Shuford & McKinnon, Inc., 292 F. Supp. 290 (S.D. Miss. 1968) (agent liable to the insurer for negligently writing a fire insurance policy which covered contents which were not located in the building described in the policy); US Life Credit Life Ins. Co. v. McAfee, 630 P.2d 450 (Wash App. 1981), cert. denied, 97 Wash. 2d 1004 (1982); Progressive Ins. Company v. Rivero, 509 N.W.2d 378 (Minn. 1993) (agent liable for misrepresenting insured’s driving record); United States Liability Insurance Company v. Haidinger-Hayes, Inc., 83 Cal. Rptr. 418, 463 P.2d 770 (1970).

In addition to proving duty and breach of duty, the surety must show that it relied to its detriment on the agent’s misrepresentation or omission. In other words, the surety must show that it would not have issued the bond had it know the true and complete facts.

### III. THE CPA

The surety frequently relies on financial statements prepared by CPAs in determining whether to extend bonding credit to a principal, and the amount of the bonding line. When the CPA misrepresents, intentionally or otherwise, the financial status of the principal or indemnitors, the surety may be led to bond a risk it otherwise would have declined.

Traditionally, courts did not extended the duty of the accountant to third parties with whom the accountant is not in contractual privity. The seminal case on this point is Ultramares Corp. v. Touche, 174 N.E. 441 (N.Y. 1931), which held that accountants are immune from suits by third parties. However, several modern courts have modified and/or rejected the Ultramares strict privity rule. There appear to be three schools of thought on the issue: (1)

strict privity is required; (2) liability extends to person in “near privity” with the accountant; and (3) liability extends to all third parties whose reliance on the accountant’s work is reasonably foreseeable. The latter two lines of thought are discussed below.

**Near Privity.** The “near privity” line of thought extends liability to nonclients, but only if the accountant actually knew that the financial report would be used for a particular purpose; the accountant actually knew that a nonclient is expected to rely on the report; and conduct by the accountant that links him to the nonclient and evidences the accountant’s understanding of the third party’s reliance. Credit Alliance Corp. v. Arthur Anderson, 483 N.E.2d 110, 120 (N.Y. 1985) (softening the Ultramares holding by expanding relief to third parties enjoying a relationship to the accountant that “sufficiently approaches privity”); see also Colonial Bank v. Ridley & Sweigert, 551 So.2d 390 (Ala. 1989); Idaho Bank & Trust Co. v. First Bankcorp., 772 P.2d 720 (1989); Thayer v. Hicks, 793 P.2d 784 (Mont. 1990); Citizens Nat’l Bank v. Kennedy & Coe, 441 N.W.2d 180 (Neb. 1989).

In Louisiana, a stricter form of the near privity rule was recently codified. La. R.S. 37:91 provides that no action based on negligence may be brought by a party not in privity with the accountant unless the accountant “was aware at the time the engagement was undertaken that the financial statements or other information were to be made available for use in connection with a specified transaction by the plaintiff who was specifically identified to the [accountant], was aware that the plaintiff intended to rely upon such financial statements or other information in connection with the specified transaction, and had direct contact and communication with the plaintiff and expressed by word and conduct the [accountant’s] understanding of the reliance on such financial statements or other information.” Accordingly, the accountant must have a conversation with the third party in which the accountant recognizes that the third party will rely on the financial statement.

The Restatement (Second) of Torts adopts a more moderate version of the near privity rule. Section 552 of the Restatement provides that an accountant’s liability is limited to persons for whose benefit the accountant intends to supply the information or those persons to whom the accountant knows that the client intends to supply the information, and the accountant intends or knows that the client intends to use the information to influence a transaction. Unlike the strict near privity rule, the Restatement does not require that the accountant manifest conduct underscoring his understanding of a particular non-client’s reliance upon the work product. A number of jurisdictions adopt the Restatement approach. See Selden v. Burnett, 754 P.2d 256 (Alaska 1988); First Florida Bank, N.A. v. Max Mitchell & Co., 558 So.2d 9 (Fla. 1990); Badische Corp. v. Caylor, 356 S.E.2d 198 (Ga. 1987); Ingram Indus., Inc. v. Nowicki, 527 F.Supp. 683 (E.D. Ky. 1981); Mark Twain Plaze Bank v. Lowell H. Listrom & Co., 714 S.W.2d 859 (Mo.App. 1986); Raritan River Steel Co. v. Cherry, Bekaert & Holland, 367 S.E.2d 609 (N.C. 1988); Shatterproof Glass Corp. v. James, 466 S.W.2d 873 (Tex.Civ.App -- Fort Worth 1971); First Nat’l Bank v. Crawford, 386 S.E.2d 310 (W.Va. 1989). It is not necessary that the accountant know that a particular person may rely on the information, only that the accountant or client intends to submit the information to a class of persons who may rely on it. Max Mitchell, *supra*, 558 So.2d at 15. Thus, liability extends not only to known third parties, but also to foreseen third parties.

In Amwest Surety Ins. Co. v. Ernst & Young, 677 So.2d 409 (Fla.App 5<sup>th</sup> Dist. 1996), the court applied the Restatement to permit a surety who issued payment and performance bond for a company to maintain a negligence action against an accounting firm where the accounting firm was aware that the company needed the financial statements to obtain bonding. The court noted “Ernst & Young were notified that a bonding company would utilize its audit in determining whether to issue bonds. That was enough.” Id., at 412.

**Foreseeable Reliance.** Other states have rejected the privity and near privity concepts and hold that an accountant may be liable for his defective work product to all third parties damaged as a consequence of foreseeable reliance on the accountant’s work product. See International Mtg. Co. v. John P. Butler Accountancy Corp., 223 Cal.Rptr. 218 (Cal.App. 3<sup>rd</sup> 1986); Touche Ross & Co. v. Commercial Union Ins. Co., 514 So.2d 315 (Miss. 1987); H. Rosenblum, Inc. v. Adler, 461 A.2d 138 (N.J. 1983); Raritan Roiver Steel Co. v. Chrry, Bekaert & Holland, 339 S.E.2d 62 (N.C. 1986); Citizens State Bank v. Timm, Schmidt & Co., 335 N.W.2d 361 (Wis. 1983). Thus, liability is extended to reasonably foreseeable third parties. The third party must prove that (1) he was a reasonably foreseeable user of the information; (2) who requested and received the information from the client; (3) he then detrimentally relied on the information; and (4) suffered a loss proximately caused by the accountant’s negligence. Touche Ross, *supra*, 514 So.2d at 322.

The courts following the reasonably foreseeable approach recognize that third parties make business decisions on the basis of financial statements prepared by accountants, that accountants are aware that their financial statements are prepared for submission to third parties, and that the accounting profession should be obligated to provide the public with accurate information.

The reasonably foreseeable approach appears to be the most equitable approach, as it protects accountants from liability to the universe of third parties, but holds them accountable to those they do or should expect to rely on their financial statements. Further, this approach applies basic tort concepts of foreseeability to suits against accountants.

**Subrogation.** As with an action against the design professional, the surety may assert its subrogation rights to avoid privity and near privity restrictions. See Western Surety Co. v. Loy, 594 P.2d 257 (KanApp. 1979). In Loy, the court permitted the paying surety to stand in the shoes of the obligee, a county, to assert the obligee’s claims against an accountant for negligently conducting an audit for the county of the county treasurer’s office. The court stated that a “surety on a fidelity bond for a county treasurer who is required to pay the county as a result of the treasurer’s defalcation is subrogated to the county’s right of action against a third party who is responsible for the loss.” Id., at 261. See also Maryland Cas. Co. v. Cook, 35 F.Supp. 160 (E.D. Mich. 1940).

#### **IV. INDEMNITY FROM JOINT VENTURES:**

A party is obligated to indemnify a surety for its losses, even where that party does not execute an indemnity agreement, where the party forms a joint venture or *de facto* joint venture with the principal. See American Fidelity Fire Ins. Co. v. Atkinson, 420 So.2d 691, 695 (La.App 2<sup>nd</sup> Cir. 1982), and authorities cited therein. In Atkinson, the court found that a

*de facto* joint venture existed between two contractors -- Atkinson and Thames. Id., at 693-94. The court further held that even though Thames did not sign the indemnity agreement with the surety, he was obligated for his virile share of the indemnity obligation as a joint venturer with the principal. Id., at 695.

Generally, the requisites to a joint venture are: (1) a contract between two or more persons; (2) a juridical entity or person is established; (3) contribution by all parties of either efforts or resources in determinate proportions; (4) joint effort; (5) mutual risk of losses and shared profits. Peterson v. BE & K, Inc. of Alabama, 652 So.2d 617 (La.App 1<sup>st</sup> Cir. 1995). Whether parties have formed a joint venture can be inferred from the relationship notwithstanding the parties' contentions that a joint venture was not formed. Davidson v. Enstar Corp., 860 F.2d 167 (5<sup>th</sup> Cir. 1988).

The joint venture argument is useful where a contractor is financed and/or controlled by third party. For example, a joint venture arguably exists where a contractor nominally bids a project, but a third party actually performs the work and/or funds the project in return for a share of the profits (directly or through exorbitant subcontracts). Although the third party did not execute the indemnity agreement, if a joint venture is found under applicable state law, the joint venturer may be held liable for the surety's loss.

### **CONCLUSION**

There are a variety of third parties, only some of which are addressed in this paper, who may provide an alternate or additional source of recovery for the surety. Absent solid indemnitors without a colorable defense to their indemnity obligation, potential third party recovery should be considered whenever the surety suffers a loss.