

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

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**SURETY LAW UPDATE AND CASE STUDY**

**PRESENTED BY:**

**JOHN V. BURCH**  
**BOVIS, KYLE & BURCH, L.L.C.**  
53 Perimeter Center East  
Third Floor  
Atlanta, Georgia 30346-2298  
770-391-9100

**WAYNE R. WALTON**  
**CHUBB GROUP OF INSURANCE COMPANIES**  
15 Mountain View Road  
Warren, New Jersey

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## **I. PAYMENT BONDS**

The court addressed a claim of fraudulent inducement in ***Halifax Paving Inc. v. U.S. Fire Ins. Co.***, 481 F.Supp.2d 1331 (M.D. Fla. 2007). Halifax, a provider of labor, services, and materials brought an action against the surety that issued a labor and material payment bond on a construction project performed on behalf of city, seeking to recover money owed to it by the project's general contractor, the principal on the payment bond.

The claimant had entered into a letter agreement with the general contractor in which money received from a third party on a previous joint venture would be credited against the money the general contractor owed the claimant in their present venture. However, the claimant claimed that it would never have entered the agreement had it known that the general contractor had not paid all of the vendors on the previous joint venture. Upon finding this out, the claimant reversed the credit to the contractor and used the money to pay the vendors on the prior project. The issue was whether this means that the general contractor "failed to pay or cause to be paid in full all sums of money which may be due."

The claimant asserted that the general contractor fraudulently induced it to enter into the letter agreement. However, the court found that under Florida law, a party who claims fraudulent inducement has two options: rescission of the contract or a suit for damages. *Id.* at 1282-83. The claimant did not rescind the agreement. Moreover, the surety was in no way involved with the general contractor's alleged fraud. The court also found that since the principal under the bond had already paid the claimant, requiring the surety to pay under the bond would result in double payment.

The court in ***U.S. ex rel. Quality Trust, Inc. v. Cajun Contractors***, 486 F.Supp.2d 1255 (D.Kan. 2007), analyzed the issue of quantum meruit versus a breach of contract claim. In *Cajun*, a general contractor contracted with the defendant subcontractor to erect eight metal buildings to be used as a new wastewater facility. After construction had begun, the general contractor terminated the subcontract alleging that the subcontractor did not meet the time requirements and had used substandard materials. The subcontractor alleged that the general contractor wrongfully terminated the contract for cause and refused to pay the plaintiff accordingly. The subcontractor sued for breach of contract and the general contractor counterclaimed alleging that the subcontractor breached the contract. The case came before the court on the subcontractor's motion summary judgment on its breach of contract claims against the contractor and the contractor's cross-motion for summary judgment on the subcontractor's claims and on its counterclaim.

The subcontractor asserted claims on theories of breach of contract and quantum meruit. Although the subcontractor lost on the breach of contract claim, the court held that a subcontractor may recover in quantum meruit from the prime contractor and surety in at least two instances. Those two instances are: (1) where there is a substantial breach of the subcontract, the subcontractor 'may forego any suit on the contract and sue for the reasonable value of his performance,' or (2) the subcontractor may recover in quantum meruit where it has performed work outside the terms for the contract that benefits the prime contractor. The court found that failure to pay for work done under the terms of a subcontract when due is a substantial breach of the contract entitling the subcontractor to recover in quantum meruit for the reasonable value of the work performed. The court found that the subcontractor could

forego its suit on the contract and pursue a claim for quantum meruit for the general contractor's failure to pay sums due under the subcontract.

A workers' compensation insurer in ***Alaska Nat'l Ins. Co. v. Northwest Cedar Structures, Inc.***, 153 P.3d 336 (Al. 2007), issued a policy to a general contractor who failed to pay their premiums. The workers' compensation insurer then brought suit against the general contractor's surety to recover the unpaid premiums under the contractor's statutory bond.

Under the terms of the bond, the workers' compensation insurer could pursue the bond if the claim is for "any of the items referred to in Alaska Statute 08.18.071." Section (a)(3) of that section specifies that a bond must cover "amounts adjudged against the contractor for tortious conduct, breach of contract, or damage to public facilities." The surety argued that AS 08.18.071(a)(3) is "clear and unambiguous." It contended that the words "breach of contract in the conduct of the contracting business" are not limited to "the actual construction of improvements or performance of work on a construction project pursuant to a construction contract," but rather extend to the broader realm of "contracts entered into in connection with the conduct of [a contractor's] contracting business." The workers' compensation carrier urged that any contract that is in some way related to a contractor's business must be covered by the bond. The surety defended that the compensation carrier "employs ... a technical reading of the statute" that ignores the legislative intent and leads to "a harsh and unrealistic result." The court concluded that to avoid rendering "in the conduct of the contracting business" superfluous, the phrase must be read as limiting the scope of "breach of contract." The court concluded that the former phrase must have been intended to distinguish between those contract breaches to be covered by the statutory bond and those not covered. Without this distinction the bond would cover *all* breaches of contract by a contractor, without regard to whether the contract has any connection to the contractor's contracting business. The Court affirmed the judgment in favor of the surety.

***Patent Construction System v. Puerto Rican American Ins. Co.***, 2007 WL 2007948 (D.P.R. July 5, 2007) was a collection action by a supplier against the surety of a subcontractor on a private construction project. The money claimed against the surety was allegedly owed by a subcontractor for the rental of scaffolds used during the construction. The subcontractor was in bankruptcy and due to procedural difficulties the claimant did not renew its Motion Requesting Lift of Stay to Litigate. The bond provided that the principal and surety were jointly and severally liable, but also stated that the principal had to be joined in the suit if the principal could with reasonable diligence be found. The surety moved to dismiss the complaint because the principal was not a party.

The court held that joinder was not required, and denied the defendant's motion. The court stated that under Puerto Rican law, because the Payment Bond binds the surety jointly and severally with the principal debtor, it can be sued independently without joining the subcontractor, and the contractor is not required to comply with any condition precedent to suit against the surety. The court noted that the surety was simply trying to avoid the obligation it contracted to pay by means of a technicality.

***United States of America v. Allen's Construction, Inc.***, 2007 U.S. Dist. LEXIS 3847 (S.D. Miss., 2007) is a Miller Act case involving a joint check agreement. In this case, a general contractor wrote joint checks payable to both the supplier and subcontractor. All checks were

endorsed by the supplier, however, the supplier claimed that it had been underpaid by the subcontractor and filed a Miller Act claim against the general contractor's surety.

The surety claimed that the supplier was essentially paid by the joint checks, or that the supplier was negligent in endorsing the checks without retaining the portion due. The court held that joint check agreements do not automatically act as a waiver of rights under the Miller Act because when there is no detrimental reliance. The general contractor who issued the checks did not allocate a portion to the supplier, nor did they even know how much the supplier was to be paid from the checks. The surety also failed to provide any evidence that would show that the general counsel detrimentally relied on the basis of its knowledge that the supplier endorsed the joint checks that were being issued.

On a motion for summary judgment, the court in ***Walbridge Aldinger Co. ex rel. Prospect Steel Co. v. CBN Steel Construction, Inc.***, 2007 WL 2214329 (E.D.Mich. July 27, 2007) looked at the following question: whether construction bonds issued by a surety and guaranteed by a reinsurer ought to be viewed as a performance bond or a payment bond.

The use plaintiff was a steel fabricator who worked for a steel subcontractor. The general contractor's bid specifications required the contractors to furnish "performance and payment bonds covering the faithful performance of the contract and the payment of all obligations arising thereunder." The steel subcontractor could not furnish a bond for the amount of its contract, and the construction manager and public owner permitted it to furnish performance and payment bonds in the amount of the erection portion of the subcontract and get bonds from the steel fabricator for the fabrication portion. The subcontractor went out of business before finishing the job and failed to pay the fabricator. The fabricator sued the subcontractor's surety and an alleged reinsurer of the surety. The surety and reinsurer moved for summary judgment arguing that the bonds it issued did not benefit the fabricator because the bond covered only steel erection work and did not include the fabrication work. The fabricator pointed to another section of the contract in which the surety agreed to pay "any claimant." The surety argued that the fabricator should make a claim against its own surety for payment of the obligation.

The court looked to the plain language of the subcontractor's bond, which incorporated the subcontract by reference, and held that it covered the obligation to pay for the fabricated steel. The court found that accepting the surety's argument would mean that only part of the subcontract, the part obligating the subcontractor to "erect structural steel" was incorporated by reference. The court also stated, "It is nonsense to suggest that the fabricator should turn to its own surety company to guarantee payment to itself."

In ***H & E Equipment Services, Inc. v. Slater***, 2007 WL 2174595 (W.D.La. July 25, 2007), the claimant filed suit seeking to recover against a general contractor and its surety for a debt incurred by a subcontractor. The defendants filed a motion for summary judgment contending that the plaintiff's Miller Act claim must fail because they failed to expressly or impliedly give adequate notice within 90 days.

The claimant on the Miller Act payment bond rented equipment to a subcontractor but had no privity with the prime contractor. The defendants argued that depositions showed that in all conversations the claimant never told the prime contractor that the claimant was looking to the prime contractor for payment. At most, the claimant asked the prime for help in getting the

subcontractor to pay or for a joint check. The court stated, “the writing must inform the prime contractor, expressly or by implication, that the supplier is looking to the contractor for payment of the subcontractor’s bill.” The court found in considering all conversations and correspondence that that this requirement was not met and the court granted summary judgment to the prime contractor and surety.

In ***Safari Circuits, Inc. v. Chicago School Reform Board of Trustees***, 474 F.Supp.2d 993 (N.D. Ill. 2007), a dispute arose over the meaning of “public work” in the Illinois bond statute. A subcontractor who was hired by the general contractor on a public project claimed that as a subcontractor it was a third-party beneficiary of the contract and that the public owner breached that agreement when it failed to obtain a payment bond for the benefit of any subcontractors as required by the Illinois Public Construction Bond Act.

However, the Bond Act § 1 requirement does not apply to every contract entered into by an Illinois public entity, but only to “contracts for public work” valued at more than \$5,000. Because there was no dispute about the “public” nature of the Project, the real focus was on whether the substance of the Project was a kind of “work.” For guidance the court looked to the mechanics’ lien statute and answered the question by considering whether the work improved the land or structures thereon. This inquiry focused on whether the equipment has become a permanent fixture to the building. The court found that the sound equipment installed by the subcontractor was not a permanent fixture since it could be removed without damage to the property and did not increase the value of the land. The court reasoned that on a private project no mechanics’ lien would be available and the bond was intended to substitute for the lien remedy.

***U.S. ex rel. Greenmoor, Inc. v. Travelers Cas. & Sur. Co. of America***, 2007 WL 2071651 (W.D.Pa. July 13, 2007), was before a District Court in Pennsylvania on a motion to stay pending completion of a parallel state court action. The initial suit was filed in state court by a subcontractor on a Miller Act project. The subcontractor was terminated by the general contractor and was re-instated by order of the state trial court. The general contractor appealed the decision of the trial court while the subcontractor instituted a suit in federal court against the general contractor’s surety. The general contractor intervened and filed a counter-claim. The subcontractor then moved to stay the federal action pending resolution of the state suit between it and the contractor. The court discussed the facts of the case in relation to the factors set forth in *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 817-819, 96 S.Ct. 1236, 47 L.Ed.2d 483 (1976) decision, to wit, (1) the preference accorded to the first court assuming jurisdiction over property; (2) the relative inconvenience of the federal forum; (3) the desirability of avoiding piecemeal litigation; (4) the relative order in which jurisdiction was obtained by the concurrent forums; (5) whether a federal question is presented; and (6) whether either action was a contrived, defensive reaction to the other. Finding that none of the above-noted factors counseled against concurrent state and federal proceedings, the court denied the subcontractor’s motion.

***U.S. ex rel. Straightline Corp. v. American Cas. Co. of Reading, Pa.***, 2007 WL 2050323 (N.D.W.Va. July 12, 2007), involved a contract dispute between a surety and a subcontractor hired to work on the annex to the federal courthouse in Wheeling, West Virginia. The owner entered into a construction agreement with a general contractor and the contractor subsequently entered into a subcontract with the plaintiff. The subcontract provided that the plaintiff subcontractor would furnish and install the interior architectural woodwork in the

building. The subcontractor now claims that it was directed to perform additional work that was outside the scope of the parties' original agreement. The cost and value of this additional work was allegedly \$233,958.46 of which \$232,079.76 was allegedly still due. The subcontractor sued the Miller Act surety for the money allegedly owed for extra work. The surety moved for summary judgment arguing that under the subcontract the contractor only had to pay after receiving payment and the Government had not paid the principal for the allegedly extra work. Defendant also claimed that it was entitled to judgment as a matter of law because the plaintiff should have asserted its claims against the government, not the contractor, because it was the government that refused to pay for the additional work.

The court held that federal law controlled a Miller Act claim and stated that the Miller Act "conditions payment of the subcontractor not on payment by the government to the contractor, but rather on the passage of time from completion of the work or provision of materials." The court stated "thus, because 'pay if paid' provisions are inconsistent with the rights and obligations created by the Miller Act, they cannot be raised as a defense by the surety." The court also found that the government was not a party to the contract nor did it consent to have the subcontractor bring a claim against it. Since the purpose behind the Miller Act is to protect subcontractors *precisely* because they generally have no remedy against the government, the court found that the only remedy was against the bond. The court denied the surety's summary judgment motion.

A statute of limitations provision and notice were contested in ***Dynamic Electrical Contractors v. Southport Contracting, Inc.***, 2007 WL 2318112 (Conn.Super. July 31, 2007). The case arose when an aggrieved subcontractor filed a breach of contract action against the general contractor and also sought recovery on a surety bond made pursuant to Connecticut law. Connecticut law provides a one year statute of limitation on claims against sureties on contracts for public buildings and works. The one year runs from the last date that the claimant has worked or supplied materials. The claimant made a demand on the principal in May, 2005 and gave the surety notice in October, 2005 but did not sue until January, 2007. The defendants moved to dismiss on the ground that the limitation period of one year from the date the claimant last worked on the project had expired. Though the court recognized that the one year limitation provision was a jurisdictional requirement it held that the record in the case did not establish the last date the claimant supplied work or supplies. Hence, the court denied the motion to dismiss as to the surety.

***SureTec Ins. Co. v. Myrex Industries***, 232 S.W.3d 811 (Tex.App. - Beaumont 2007), is another case concerning a statute of limitations provision. The relevant Texas statute provided that "to recover in a suit under Section 2253.073 on a payment bond for a claim for payment for public work labor performed or public work material delivered, a payment bond beneficiary must mail to the prime contractor and the surety written notice of the claim...The notice must be mailed on or before the 15th day of the third month after each month in which any of the claimed labor was performed or any of the claimed material was delivered." In this case the claimant on a public works payment bond mailed its notice of claim on the 16<sup>th</sup> day of the third month after it last worked on the project. In defense of the tardy mailing, the claimant cited the Code Construction Act arguing that because the 15<sup>th</sup> day was a Sunday it got an extra day. The court disagreed and held that the Code Construction Act provision did not apply to the statute at issue because the statute established "a date certain" and the Code Construction Act only applied to statutes with periods "computed by counting days." The court reversed the trial court's judgment for the claimant and granted summary judgment to the surety.

***U.S. ex rel. Shannon v. Federal Ins. Co.***, 251 Fed. Appx. 269 (5<sup>th</sup> Cir. 2007), involves a contract dispute between a general contractor and project manager. The contract between the parties was unwritten, and though the parties to this case all agreed that a contract existed, they disagreed about the terms. Unable to resolve the dispute, the project manager brought a Miller Act claim against the contractor. The court determined that the manager's claim under the Act turned on whether or not he performed "labor" as that term is used in the statute. The court held that his claim was not covered by the bond because it did not amount to direct supervisory labor performed at the job site. The term "labor" in the Miller Act was primarily designed to encompass physical or manual labor. The work for which he alleged he had not been paid was "negotiating new contracts, determining bid amounts and change orders, preparing bid proposals, negotiating and signing new subcontracts and purchase orders." Accordingly, the court found that summary judgment was proper. Since the manager's contract claim was barred by the statute of limitations, they found that his quantum meruit claim was also improper.

***U.S. ex rel. Lighting and Power Services, Inc. v. Interface Construction Corp.***, 2007 WL 2710030 (E.D.Mo. Sept. 11, 2007), concerned the enforceability of an arbitration and forum selection clause on a non-signatory. The facts were as follows: A contractor entered into a prime contract with the United States to perform repairs on a federal building in St. Louis. To perform the repairs, the prime contractor entered into a subcontract to provide labor and materials. The use plaintiff was a sub-subcontractor. Alleging that money was owed for work performed, the sub-subcontractor sued the subcontractor, the prime contractor and the prime contractor's Miller Act surety. The prime contractor moved to dismiss the case for lack of jurisdiction and to compel arbitration based on forum selection and arbitration clauses in the subcontract. The claimant refused to arbitrate because they were not a party to the subcontract and did not agree to arbitrate or to the forum selection clause. The court found that the sub-subcontract did not incorporate the subcontract by reference and therefore the sub-subcontractor was not bound by its terms. The court also found that there is no parent-subcontractor relationship, or principal-agent relationship, between the sub-subcontractor and subcontractor which could support a finding that the forum selection clause was valid.

***Comm. of Labor v. C.J.M. Services, Inc.***, 2007 WL 2596758 (Conn.Super. Aug. 24, 2007), concerned a dispute over the alleged failure of a subcontractor to pay prevailing wages. The prime contractor and its surety pled several special defenses that the claimant Commissioner of Labor moved to strike. The prime contractor relied on a Connecticut statute that provides that the statute "shall not be construed to prohibit a general contractor from relying on the certification of a lower tier subcontractor." The prime contractor asserted that they relied in good faith on a subcontractor's certified payrolls. However, the court held that the statutory provision cited applied only to criminal sanctions not to the wage claim at issue. The court also held that the lack of privity between the prime contractor and the Commissioner did not bar the statutory claim and that there was no defense of payment based on the prime contractor's payment to the subcontractor. Finally, the court held that it had discretion to award double the wages plus attorney's fees even though the defendants were correct in pointing out that the payment bond statutes do not provide for attorney's fees or double damages. The court found that the fees and damages were available pursuant to the statute under which the commissioner was bringing the action. That statute provides that in all actions against a covered employer for unpaid wages, "the Labor Commissioner may bring any legal action

necessary to recover twice the full amount of unpaid wages ... and the employer shall be required to pay the costs and such reasonable attorneys fees as may be allowed by the court.”

**Oldcastle Precast, Inc. v. St. Paul Fire & Marine Ins. Co.**, 2007 WL 2904208 (D.Conn. Oct. 1, 2007), concerns a retainage that a subcontractor maintained was unpaid on a federal housing project. The subcontractor sued the prime contractor and its surety alleging that it completed work but the prime contractor did not repay the entire retainage. The subcontractor demanded that the contractor place the disputed amount in an escrow account pursuant to Conn. Gen. Stat. §42-158j. The prime contractor refused to do this and the subcontractor filed suit and alleged breach of contract as well as various extra contractual counts.

The prime contractor alleged that it did not pay the balance because the owner had not released all the funds and asserted a counterclaim against the subcontractor for poor workmanship and delays. On the issue of the escrow, the court found that under the Connecticut State law a construction contract does not include “a contract or project funded or insured by the United States Department of Housing and Urban Development.”

The court also found that the subcontract required releases and lien waivers as a precondition to payment of the retainage. In so finding, the court rejected the subcontractor’s argument that it did not have to comply with the contract because any lien or bond claims were now time barred. The court granted the prime contractor and surety summary judgment on the breach of contract claims.

Finally, the court denied the surety summary judgment on the various failures to investigate, CUTPA and CUIPA claims. The court noted that the subcontractor failed to point to any contractual provision that was violated. The court found that the record was not clear enough to show that there were no issues of material fact related to the extra contractual claims.

**A.E.R. Construction, Inc. v. Travelers Casualty & Surety Company of America**, 2007 WL 3046324 (N.D.W.Va. Oct. 17, 2007), concerned the enforcement of an arbitration clause and conditions precedent to suit on a surety. In this case, a subcontractor sued the payment bond surety on a West Virginia public school project. The surety sought a stay or dismissal of the action. The surety invoked West Virginia Code §45-1-1, *et seq.* which required a claimant to sue a resident principal on demand by the surety. The court stayed the federal suit against the surety pending resolution of the state court suit against the principal.

In the alternative, the claimant sought to compel arbitration of the claim. The court found that the owner had deleted the arbitration provision from the standard form general conditions of the prime contract, therefore there was no agreement to arbitrate by virtue of the incorporation of the prime contract into the bond or subcontract. The court denied the surety’s motion as to arbitration.

**U.S. ex rel. R.C. Professional Services, Inc. v. Great American Ins. Co.**, 2007 WL 3034363 (D.P.R. Oct. 15, 2007), involved the tolling of a Miller Act claim. The prime contractor on a public project submitted an invoice to the principal demanding payment for work. The invoice included a listing of the addresses of the properties purportedly repaired. The latest work date according to these lists was Sept. 24, 2004. The complaint in this case was filed on October 15, 2005, which fell outside the statutory period by 20 days. The claimant did not contest the date it last worked, but it argued that correspondence with the surety should equitably toll the

running of the one year period or that the surety was equitably estopped from asserting the limitations defense. The court held that equitable tolling did not apply to Miller Act claims and that nothing in the surety's correspondence to the claimant could be the basis of an estoppel. The court found that the plaintiffs had not pointed to any untrue or false data in the surety's two responses and had not presented any argument to the effect that they relied in any way upon information provided by the defendants or that they were prejudiced as a consequence thereof. The court entered judgment dismissing the Miller Act claim.

In ***U.S. ex rel. Countryside Industries, Inc. v. Integrated Construction Technology Corp.***, 2007 WL 2893122 (N.D.Ill. Sept. 28, 2007), a subcontractor sued the prime contractor and its surety under the Miller Act. The defendants, citing the subcontract, moved to stay the action pending mediation. The court found that neither of the parties ever signed the subcontract and determined that there was no agreement to mediate.

***Berlin Steel Construction Co. v. Trataros Construction, Inc.***, 2007 WL 2482521 (Conn.Super. Aug. 17, 2007), concerns a time-barred Little Miller Act claim. The subcontractor on a town project filed suit in May of 2005 over three years after the prime contractor had completed the work and received payment. The court found that the suit was time-barred under the Little Miller Act. The subcontractor argued that the surety waived the statute of limitations defense because it responded to the tardy claim by sending a proof of claim form. The court found that the claim for that was sent stated that the claim may be barred and did not affect a waiver. The court also found that the surety did not act in bad faith and did not violate CUTPA. The surety's motion for summary judgment was granted.

***Triboro Hardware & Supply Corp. v. Fed. Ins. Co.***, 45 A.D.3d 134, 841 N.Y.S.2d 600 (N.Y.A.D. 2 Dept. 2007), came before the court on the parties' cross motions for summary judgment. The supplier to a subcontractor on a construction project sued the surety on a payment bond, seeking recovery of unpaid the balance for ordered materials. The subcontractor alleged that the supplier was required to give notice within 90 days of each separate delivery of materials to the project. Under this logic, the subcontractor argued that the supplier's claim was untimely as to materials supplied from June 11, 2004.

The supplier argued that the bond should be interpreted to require notice within 90 days of the last delivery and not of each separate delivery. The bond required the claimant to "[h]ave furnished written notice to the contractor and sent a copy, or notice thereof, to the Owner, within 90 days after having last performed labor or last furnished materials or equipment included in the claim stating, with substantial accuracy, the amount of the claim and the name of the party to whom the materials were furnished or supplied or for whom the labor was done or performed." The court thought that the bond should be "governed by the usual rules of construction of adhesion contracts" and interpreted against the surety. They also noted that the argument advanced by the surety would "unduly burden" suppliers using an open account, as it would require a separate notice no matter the volume of deliveries or the amount owed for each delivery. The court held that notice within 90 days of the last delivery for the job was sufficient and granted summary judgment to the claimant.

***U.S. ex rel. E&H Steel Corp. v. C. Pyramid Enterprises, Inc.***, 2007 WL 4166245 (3<sup>rd</sup> Cir. Nov. 27, 2007), was a payment bond case which turned on the issue of whether a person was a subcontractor or a supplier. The prime contractor issued a "purchase order" to Havens Design-Build to provide structural steel for a building's framework. Havens in turn contracted

with a steel company to fabricate the steel and deliver it to the construction site. The steel company had a valid claim only if Havens was found to be a subcontractor, not a materialman. The prime contractor erected the steel framework for the building and did most of the remaining construction itself. The steel company brought suit against the prime contractor and its sureties, asserting entitlement to reimbursement from the payment bond. The court began with the premise that the Miller Act is to be interpreted liberally to protect persons who supply labor or materials for government construction projects. The court found that the *MacEvoy* and *F.D. Rich* cases established broad criteria under which "subcontractor" status applies to one who performs a specific part of the original contract and has a substantial and important relationship with the prime contractor. The court found that the relationship here was a substantial and important one. The court found that Havens arranged for the fabrication and delivery to the site of a substantial amount of structural steel necessary for the skeleton of the hangar building. Havens also prepared shop drawings and erection drawings, designed the connectors, and performed some "design-assist engineering." The shop drawings were also submitted to the prime contractor for approval and the parties communicated about the connectors design and design-assist work. Thus, even though Havens merely supplied materials, it was nevertheless found to be a subcontractor.

***U.S. ex rel. Rocking D & R Ranch, Inc. v. James Talcott Construction, Inc.***, 2007 WL 4334170 (D.Mont. Dec. 7, 2007), dealt with a claim by a sub-subcontractor against the prime contractor and its payment bond surety. The subcontractor directed the claimant to return to the job, and the claimant finished the test and balance work. The claimant then gave the 90 day required notice and, after its claim was denied, filed suit. The court held that the balancing was original contract work, not repair or corrective work, and thus the notice was timely. The court entered judgment for the claimant including prejudgment interest.

***Preussag International Steel Corp. v. March-Westin Co.***, 655 S.E.2d 494 (W. Va. 2007), addressed the distinction of whether a steel fabricator was a subcontractor or materialman. As a materialman the fabricator would not be covered by the bond. The court found that the steel fabricator was a subcontractor. The court adopted the rule as enunciated in *Theisen*, 352 P.2d 529 (Cal. 1960), that does not require a subcontractor to have done work at the construction site. The court found "that the essential feature which constitutes one a subcontractor rather than a materialman is that in the course of performance of the prime contract he constructs a definite, substantial part of the work of improvement in accord with the plans and specifications of such contract." The court also found that one of the most important factors to consider is the nature of the material or service supplied. If the goods are fungible and do not require a specialized or customized manufacturing process the work is usually done by a material supplier rather than a subcontractor. As applied to the facts of the case, the court found that it was clear that the subcontractor was to furnish all structural steel, ornamental iron, and miscellaneous work for the prime contractor in strict accord with plans and specifications. Hence, the subcontractor was a subcontractor and not a materialman.

In ***G.D. Deal Holdings, Inc. v. Cincinnati Ins. Co.***, 2007 WL 3306109 (W.D.Ky. Nov. 6, 2007), the court analyzed whether the claim was liquidated or unliquidated. The court found that when the surety issued the bonds it knew that it could be held to pay the Plaintiffs a fixed and easily ascertainable sum and therefore the claim was liquidated. The court construed the bonds at issue to require the surety to pay only after the court determined what the principal owed. Therefore, the court awarded prejudgment interest at the legal rate of 8% against the surety from the date of its summary judgment against the principal.

**Gawez v. Inter-Connection Electric, Inc.**, 44 A.D.3d 898, 845 N.Y.S.2d 367 (N.Y.A.D. 2007), was brought by a class of laborers against contractor and surety defendants on the grounds that the laborers had not been paid the prevailing wage that they were entitled to under New York law. The court held that the laborers did not have a private right of action to sue for the alleged violation under the Federal Davis-Bacon Act. The court affirmed dismissal of the plaintiffs' claims.

**U.S. ex rel. Kentucky Industrial Metals, Ltd. v. Hartford Fire Ins. Co.**, 2007 WL 3231436 (W.D.Ky. Oct. 30, 2007), concerned the timeliness of a Miller Act payment bond claim. The court found that the plaintiff had the burden establish the one year jurisdictional requirements of the Miller Act. The court found that the plaintiff's evidence "lacked the specificity that one would expect, particularly where it is necessary to overcome the evidentiary force of contrary company documentary evidence." The court noted that the only evidence provided was an undated payroll and an affidavit that contained more conclusions than facts. The court dismissed Plaintiff's complaint with prejudice.

**United States v. Dick/Morganti**, 2007 WL 3231717 (N.D.Cal. Oct. 30, 2007), arose from a dispute between the general contractor and a number of subcontractors who performed work on the San Francisco Federal Building. The standard subcontract entered by the parties provided "subcontractor agrees ... to stay any action filed by the Subcontractor until the dispute resolution and appeals process between the Contractor and the Owner is exhausted." When the subcontractors brought suit, the general contractor moved to stay the litigation pending a 'Global claim' that the contractor planned to bring against the owner. The subcontractors objected to the stay arguing that the contract provision amounted to a waiver of its Miller Act rights and was void under 40 U.S.C. §3133(c). Although the court thought that a temporary stay was not a waiver, they granted the stay on the condition that the contractor file its global claim by a date certain. They also required that the parties meet later to address whether all the Miller Act claims were included in the global claim.

In **C&I Steel, LLC v. Travelers Cas. & Sur. Co. of America**, 70 Mass.App.Ct. 653, 876 N.E.2d 442 (Mass. 2007), a subcontractor on a school construction project brought an action against the general contractor and surety under the payment bond, asserting claims for breach of contract, breach of the covenant of good faith and fair dealing, quantum meruit, and unfair trade practices. The general contractor filed a motion to stay judicial proceedings and compel arbitration, and the surety filed a separate motion to stay pending conclusion of arbitration. The subcontractor demanded arbitration against only the prime contractor, and the arbitrator entered an award against only the prime contractor for breach of contract plus attorney's fees and punitive damages. Although the surety did not participate in the arbitration, the trial court nevertheless "confirmed" the award as to the surety and entered judgment against both the prime contractor and surety for the entire amount. The surety paid the breach of contract portion of the award and appealed as to the rest. The court agreed with the surety, finding that the bond terms did not cover punitive damages. The court also found that since no arbitration clause appeared, or was incorporated in any contract to which the surety was a party the surety was not obligated to intervene.

In **Datastaff Technology Group, Inc. v. Centex Construction Co., Inc.**, 2007 WL 4376142 (E.D.Va. Dec. 11, 2007), the plaintiff, a second tier subcontractor, sued the prime contractor and its surety on a federal project to recover for work performed on a project pursuant to a

contract with a defaulting first-tier subcontractor. The plaintiff's Miller Act claim was untimely but the plaintiff argued that equitable estoppel barred the defendants from asserting a limitations defense. The plaintiff also alleged constructive fraud. Part of the dispute concerned whether the plaintiff was a second-tier subcontractor or a third-tier subcontractor because first- and second-tier subcontractors are covered by the bond, while third-tier subcontractors are not. There was a conversation in which the plaintiff alleges that the prime contractor lead them to believe that they were third-tier subcontractors and thus ineligible to sue under the bond. The court held that the claimant did not reasonably rely on any statements by the principal or surety. The court found that the record was devoid of any evidence that the prime contractor or its surety did or said anything to lull the plaintiff into a false security that its claim would be paid. The court also noted that the plaintiff made no effort to determine for itself whether it had a viable Miller Act claim, choosing instead to rely on the assertions of adverse parties. Because reliance by the claimant on the alleged misrepresentations was not reasonable, the fraud claim was also without merit. The court granted summary judgment dismissing all claims.

***U.S. ex rel. Concrete Formwork & Accessories, Inc. v. Ross Group Construction Corp.***, 2007 WL 3119691 (W.D.Tex. Oct. 23, 2007), concerns the validity of a forum selection clause. The clause provided "This Subcontract shall be governed by and interpreted in accordance with the laws of the State of Oklahoma and Subcontractor further agrees that the venue of any action hereunder shall lie exclusively in either the District Court for Tulsa County, State of Oklahoma or in the United States District Court for Northern District of Oklahoma, as may be the case." The claimant subcontractor sued in the western district of Texas which was where the project was located and in accordance with the Miller Act venue provision. The defendants moved to transfer the case to the United States District Court for the Northern District of Oklahoma. The court held that the parties could contract around the Miller Act venue provision and granted the defendants' motion to transfer.

***J.C. Gibson Plastering Co., Inc. v. XL Specialty Ins. Co.***, 521 F.Supp.2d 1326 (M.D.Fla. 2007), considered the effect of the 45 day provision in the AIA A312. The plaintiff subcontractor brought this action against the surety alleging that the prime contractor failed to pay all amounts due. The bond provided that the surety was required to "send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed and to "pay or arrange for payment of any undisputed amounts." When the general contractor failed to pay, the subcontractor sent the surety and owner notice including the factual and legal bases for the claim. The surety wrote back requesting documentation in support of the claim. The subcontractor sent the supporting documents and the surety said that it would investigate. 47 days after the initial notice letter the subcontractor brought suit and moved for summary judgment arguing that the surety failed to comply with the terms of the bond.

In defense, the surety argued that the 45 days should run from the date the subcontractor sent the supporting documentation because the initial notice did not contain enough information for XL to verify the claim. The court found this to be immaterial because paragraph 4 did not require notices to contain such information. Although the surety sent a letter 48 days later, the court found it insufficient both because it was late and because it did not state the amount of the claim that was undisputed.

In considering the effect of the late response, the court found no Florida case law on point. The subcontractor argued that XL's failure to timely answer its claims operated as a waiver of defenses XL may have had. The court agreed and followed the Maryland and Virginia cases holding that the 45-day time requirement of Paragraph 6 would be rendered "essentially nugatory" if sureties were allowed later to dispute claims that had not been properly answered. The court granted the subcontractor's summary judgment motion.

***North Marion School District #15 v. Acstar Insurance Co.***, 343 Or. 305, 169 P.3d 1224 (Or. 2007), concerned a surety's obligation to pay a statutory penalty for late payment of wages. A subcontractor went out of business leaving wages unpaid. The surety paid the wages within 30 days. However, under Oregon law, wages must be paid on time or a penalty is assessed. The court had to decide whether the surety was liable for the penalty. Although there was no question that the employer would be liable for the penalty, the court held that the surety would not be liable for it. The court found that there was nothing in the statute or in the bond to suggest that a surety would have the obligation. The court affirmed the decision of the Court of Appeals.

***John A. Russell Corporation v. Fine Line Drywall, Inc.***, 2007 WL 2821651 (D.Vt. Sept. 27, 2007), came before the court on cross motions for summary judgment. The sole issue for the court to resolve was the timeliness of the suit. The bond provided "[N]o suit or action shall be commenced hereunder after the expiration date of one year following the date on which Principal ceases work on said contract or the date on which final payment under the contract falls due, or the date on which goods and services were received by obligee, whichever occurs first." The plaintiff conceded that the time limitation provision, unless void, would preclude action on the Bond. The plaintiff contended that the limitation was void under a Vermont Statute. § 3663 provides that "a surety or fidelity contract or bond issued or delivered in this state by an insurance company doing business herein shall not contain a condition or clause limiting the time of commencement of an action on such policy or contract to a period less than twelve months from the occurrence of the loss, death, accident or default.... Any such conditions or clauses shall be null and void."

The court first determined when the default occurred and found that there was a material breach on November 18, 2004. Adding on the seven day cure period the court found that the plaintiff was justified in terminating the contract on November 25, 2004. The court reasoned that since the limitation provision in the bond gave a claimant less than one year from November 25 to sue, it was void. The court denied the surety's motion for summary judgment and granted the prime contractor's motion for summary judgment as to the timeliness of the action.

***Alberici Constructors, Inc. v. Ohio Farmers Ins. Co.***, 866 N.E.2d 740 (Ind. 2007) was an action by a third-tier material supplier on a bridge construction project. The third-tier supplier brought the action in federal court against the surety that issued the performance bond to the project's general contractor, seeking payment under the performance bond. The United States District Court for the Northern District of Indiana certified a question of state law that the court answered it in this case. The Indiana Supreme Court held that the statute governing performance bonds issued to general contractors on state highway contracts did not afford coverage to claimants who did not have privity of contract with the general contractor or a subcontractor. The statute did not define subcontractor but the claimant argued that "subcontractor" should include all tiers of contractors no matter how remote if it had an

intimate, immediate and exclusive relationship to the construction project. The court rejected this argument in favor of a bright line test – a subcontractor must be in privity with the prime contractor. They defined subcontractor as any person or organization entering into a contract with a contractor to furnish labor and materials used in the actual construction of a state highway project.

***Reliance Nat. Indem. Co. v. Advanced Temporaries, Inc.***, 227 S.W.3d 46 (Tex. 2007) was brought by a temporary employment agency which provided employees to a subcontractor. The action was brought against the payment bond surety. The claimant asserted a mechanics' lien and sought to recover under the payment bond. Following a bench trial, the court entered judgment for the agency against the subcontractor. However, judgment against the property owner, general contractor, and general contractor's surety was denied. The agency appealed and the Court of Appeals reversed.

The Texas Supreme Court affirmed. The issue before the court was whether under the Texas Property Code a temporary employment agency “furnished labor” and could assert a mechanic’s lien and a claim on the payment bond. The court held that the agency “furnished labor,” within the meaning of mechanics' lien statutes. The court found that the agency did not merely perform administrative services but rather assumed actual responsibility as the employer of the workers. The court concluded that, because the temporary workers were the agency’s employees, the agency furnished labor by providing these workers to the prime contractor for work at the construction project.

## II. BAD FAITH

### a. FLORIDA LAW

In ***Dadeland Depot, Inc. v. St. Paul Fire and Marine Ins.***, 483 F.3d 1265 (11<sup>th</sup> Cir. 2007), a surety issued a performance bond to a general contractor. When a number of structural and design defects were discovered, the developer and general contractor selected an arbitrator to settle their disputes. The arbitrator awarded the developer over a million dollars for the contractor’s defective workmanship and the contractor timely paid the award. The developer then brought an action alleging that the contractor’s surety had acted with bad faith and had failed to perform its duties under the performance bond. Specifically, they alleged that the surety had intentionally attempted to avoid and delay the arbitration as it had been unfolding and had effectively ignored its obligations under the bond by repeatedly failing to address the developer’s complaints concerning the defects with the development; and that the surety had done so without ever conducting any independent investigation into the developer’s complaints.

The first issue the court had to decide was whether the developer satisfied the condition precedent under Florida law to bring a bad-faith refusal-to-settle claim. In order to establish this, the plaintiff had to establish that he was entitled to a payment of the claim, either via a judicial adjudication of damages in the plaintiff's favor or via a settlement agreement. In the absence of some judicial determination that St. Paul had breached an obligation under the performance bond and was liable for a “sum certain,” the court would have to conclude that Dadeland had failed to satisfy the condition precedent necessary for an action for the bad-faith refusal-to-settle a claim, and that, therefore, its action failed as a matter of law. The court found that the arbitration decision was enough to establish the condition precedent. The

threshold will be satisfied by alleging that “a determination has been made with regard to ‘the existence of liability on the part of [an uninsured principal]’ and ‘the extent of the plaintiff’s damages.’” The arbitrator’s decision was a sufficient determination of liability.

The court also found that the evidence presented a sufficient disagreement as to the conduct of the surety and whether it constituted bad faith that issues of material fact existed such that the District Court’s grant of summary judgment in favor of the surety was reversed.

In ***Plumbing Service Co. v. Travelers Cas. & Sur. Co.***, 962 So.2d 1056 (Fla.App. 5th Dist. 2007), the subcontractor on a public project hired a sub-subcontractor to do part of the plumbing work. A dispute arose over payment and the sub-subcontractor eventually stopped work. When payment was not made, the sub-subcontractor sued on the prime contractor’s statutory payment bond.

While the suit was pending the sub-subcontractor sent a “Civil Remedy Notice of Insurer Violation” to the insurance department and the surety. This notice is required before asserting a bad faith claim under the relevant Florida statute that also provides for a 60 day cure period. The payment bond claim was eventually settled and the parties signed mutual releases. The surety released the sub-subcontractor from all claims “from the beginning of the world through the date hereof.” The sub-subcontractor released the surety from all claims “from the beginning of the world through February 14, 2001.”

After the settlement the sub-subcontractor proceeded to sue the surety for bad faith under §624.155. The trial court granted summary judgment to the surety on the ground that the claim had been released. The Court of Appeals reversed and held that because of the 60 day cure period, the bad faith claim did not accrue until after February 14, 2001. The bad faith claim was therefore not affected by the release.

#### b. GEORGIA LAW

Although not a surety case, we include ***BayRock Mortgage Corp. v. Chicago Title Insurance Co.***, 286 Ga.App. 18, 648 S.E.2d 433 (2007) because of its precedential impact on bad faith in Georgia. In this case an insured mortgagee brought an action against a title insurer to recover for a bad faith failure to pay claim within 60 days of demand. Quoting ***Arrow Exterminators, Inc. v. Zurich American Insurance Co.***, 136 F.Supp.2d 1340 (N.D. Ga. 2001), the Court of Appeals found that although no specific language is required, “the language used must be sufficient to alert the insurer that it is facing a bad faith claim for a specific refusal to pay so that it may decide whether to pay the claim.” Also, an insured or bond claimant cannot make an effective bad-faith demand and start the clock until payment is due, so a provision in the bond or policy allowing an investigation by the surety or insurer for a specified period (or any other unsatisfied condition) will postpone the time when an effective demand can be sent. In a surety context, this case makes it clear that a 60-day bad faith letter to the surety is a condition precedent to a bad faith claim.

### III. REINSURANCE

The plaintiff in ***AXA Corporate Solutions Ins. Co. v. Lumbermens Mutual Cas. Co.***, 241 Fed.Appx. 718, 2007 WL 2013519 (2<sup>nd</sup> Cir. July 11, 2007), appealed from the District Court’s dismissal of the surety’s breach of contract and indemnity claims. (Reported at 2006 WL

1458306 (S.D.N.Y. May 25, 2006) and 2005 WL 1649045 (S.D.N.Y. July 13, 2005)). The plaintiff, as surety and the country of Valenzuela executed a Performance Bond and a Payment Bond in favor of the United States of America, as obligee, in connection with a Valenzuela construction project. Subsequently, the Defendant entered into a written agreement with non-party First Indemnity of America Insurance Company ("FIA"). By this agreement, the Defendant agreed to share proportionately in all losses. Although the Plaintiff was not a signatory to the agreement they claimed that, by custom, FIA entered into the agreement as agent and attorney-in-fact for AXA. When the Plaintiff sustained losses on the bonds, they sued the Defendant for breach of contract and indemnity. On appeal after the District Court's dismissal of both claims, the court noted that the contracts were ambiguous and held that if a contract is ambiguous as applied to a particular set of facts, a court has insufficient data to dismiss a complaint for failure to state a claim. The court also noted the documents could be read to memorialize an intent to enter into a reinsurance contract. Noting the custom and practice of the reinsurance industry to make binding commitments in advance of any document spelling out all of the terms and conditions of the agreement, the Second Circuit treated the co-surety agreements as reinsurance obligations. The court vacated and remanded the District Court's dismissal.

#### **IV. INDEMNITY**

***Western Sur. Co. v. Bradford Elec. Co., Inc.***, 483 F.Supp.2d 1114 (N.D.Ala. 2007), involved a surety who issued performance and payment bonds on behalf of a subcontractor. The subcontractor agreed to indemnify the surety for any and all loss or anticipated loss which might result from issuance of the performance bond. When the general contractor terminated its contract with the subcontractor, they demanded payment under the performance bond. All claims were later settled, except for a claim by the surety against the subcontractor for indemnification on the amount it paid under the payment bond, attorney fees and related expenses it incurred in the suit. The subcontractor alleged the legal expenses were unreasonable and unnecessary.

The court found that an indemnity agreement is not a blank check; it does not entitle the surety company to reimbursement for legal expenses which are unreasonable or unnecessary. The court found that the weight of authority allows reimbursement for legal costs under the terms of an indemnity contract only if it is necessary for the surety to retain separate counsel, if the amount of the fees claimed is reasonable, and if the surety has acted in good faith toward the bond principal. Applying this rule, the court found that the surety's retention of separate counsel was reasonable and that an out of state expert's travel expenses were unreasonable, as were an attorney's travel expenses for an out-of-state deposition.

In ***Travelers Prop. & Cas. Ins. Co. v. Triton Marine Construction***, 473 F.Supp.2d 321 (D.Conn.2007), a surety brought an action against a government contractor seeking indemnification for amounts paid under a performance bond to complete a construction project after the contractor's termination for default.

Under the indemnity agreement the surety was required to have an authorized representative submit and swear to an itemized statement before the contractor was required to pay. Since the contractor received only a demand for a dollar amount, followed by an itemized, but unsworn statement, the court found that the requirements for indemnification were not fulfilled.

Further, the court found that there was no language in the agreement that imposes on the surety the duty to pursue a claim or appeal.

The Contractor also alleged that it had entered into a separate, completion contract with the surety whereby the contractor would complete the remediation work in exchange for the surety's reserving and preserving the contractor's claims regarding the termination before the government. The court found that a reasonable jury could not construe the contract to include the requirement that the surety pursue the contractor's re-work claim against the government. In so deciding the court considered the fact that the parties never executed a written contract, and the surety resisted executing a completion agreement that contained a disputed term.

The contractor also had a claim for breach of the implied covenant of good faith and fair dealing. Under Connecticut law the court found that a surety's failure to conduct sufficient investigation into the validity of a claim upon a payment bond, when accompanied by other evidence that reflects improper motive, may be considered evidence of bad faith.

To constitute a breach of the implied covenant of good faith and fair dealing, the court found that the surety must have, in bad faith, impeded the contractor's right to receive benefits that the contractor reasonably expected to receive under the contract. Finding that no factors supplied by the contractor supported these conclusions, the claim for breach of the implied covenant of good faith and fair dealing failed.

In ***Massachusetts Bay Ins. Co. v. Bailey***, 2007 WL 2156388 (D.Conn. July 25, 2007) a surety commenced an action against the principal on an estate administrator's bond. The surety sought to enforce its rights under an indemnity agreement between the parties. On its face, the agreement provided that the principal post collateral in an amount equal to any claim against the bond and reimburse the surety for any costs associated with enforcing its rights under the agreement. Since the principal failed to plead any facts or raise any opposition to the surety's claims for partial summary judgment, the court granted the surety summary judgment directing the principal to deposit with the surety the amount of the claim against the bond and pay the surety's expenses to date.

In ***United States Fid. & Guar. Co. v. E.L. Habetz Builders, Inc.***, 2007 WL 2028163 (W.D.La. July 11, 2007), the surety sued the principal and indemnitors to recover attorneys fees incurred to defend itself against several claims. The defendants objected to the amount of the fees as unreasonable and filed a third party complaint against the surety's attorneys. The attorneys had never represented the principal in the litigation, only the surety. Nevertheless, the defendants alleged that the attorneys owed the defendants a fiduciary duty in connection with the work because it was well known that the defendants would have to reimburse the surety for the fees. The surety moved to dismiss the third party claim against its attorneys.

The court held that an attorney has a duty of undivided loyalty to his or her client, and no duty to the client's adversary, and that nothing in the indemnity agreement created any obligation on the part of the surety's attorneys to the indemnitors. The court noted that if the defendants objected to the reasonableness of the surety's fees it could raise the objection as a defense to the surety's suit. The court granted the surety's motion and dismissed the third party complaint for failure to state a claim upon which relief could be granted.

In ***Samda Investment Group LLC v. Western Surety Company***, 287 Ga.App. 235, 651 S.E.2d 152 (Ga.App. 2007), the surety on a utility payment bond paid the obligee, a county water system, for an unpaid water bill that was due from the owner of an apartment complex. The owner had signed an indemnity agreement with the surety, so the surety sued and was granted summary judgment against the indemnitor. On appeal the court affirmed summary judgment for the surety. The indemnitor argued that there was no liability on the bond because the principal never signed it. However, the court found that the principal received the benefits of the bond through the provision of water to the apartment complex. The bond was signed by the surety, delivered to the obligee and relied upon by the obligee to the principal's benefit. For this reason, the court held that the indemnitor was estopped to deny the validity of the bond. The court also noted that the principal was independently liable for the utility bills guaranteed by the surety when it had opened an account with the water company. Execution of the bond repeating that obligation would have been superfluous. The court also rejected the indemnitor's other arguments to escape liability, namely that there were additional signature lines on the indemnity agreement and other guarantors were contemplated, and that the principal was an indispensable party to the suit. The court affirmed the judgment.

In ***Washington International Insurance Co. v. Bucko Construction Company, Inc.***, 2007 WL 2384273 (N.D.Ind. Aug. 17, 2007), the surety paid losses and expenses and sued its principal and indemnitors. There was no dispute over the execution of the indemnity agreement or its terms, and the surety submitted prima facie evidence to support its claims. The defendants failed to establish a question of material fact so the court granted the surety's motion for summary judgment.

***Hartford Fire Insurance Co. v. P & H Cattle Co., Inc.***, 2007 WL 2818816 (10<sup>th</sup> Cir. Sept. 26, 2007), concerned a bond made pursuant to the Packers and Stockyards Act, 7 U.S.C. §204. The bond listed the P&H cattle company as principal but included "other registrants" as "CLEAREE." This exposed the surety to payment for the CLEAREE's debts. The surety defended and ultimately settled a claim under the Bond which arose out of default by a CLEAREE. The surety then filed an action seeking indemnification under the bond's indemnity agreement for the settlement amount and its attorney's fees and costs expended in defending and settling the claim and expenses in defending the suit and expenses in suing to enforce the indemnity agreement. The District Court granted the surety summary judgment on its contractual indemnity claim against the Indemnitors and awarded the surety its requested relief.

On appeal the indemnitors argued that the agreement did not apply because they were not involved in the loss transaction. The 10th Circuit found that all that was required was that the indemnitors be involved in securing the bond. The court found the indemnity agreement to be unambiguous and to obligate the indemnitors to reimburse the surety for its losses and expenses.

***Atlantic Mut. Ins. Co. v. Killearn, Inc.***, 2007 WL 2422041 (N.D.Ga. Aug. 21, 2007), granted the surety's motion to reopen its indemnity suit. The court had originally "administratively closed" the case because of pending arbitration between the principal, the obligee and the surety. When the obligee agreed that the surety did not have to participate, the arbitration was stayed and the surety was then successful in reopening the case.

The indemnitors also moved to dismiss the suit under the *Colorado River* doctrine because a state court proceeding involved some of the same parties and issues. The court denied the motion and noted that the state court case was based on the construction contract, not the indemnity agreement, did not include one of the indemnitors, and could not provide complete relief on the indemnity issues.

The Court in ***American Motorists Ins. Co. v. LPS Construction Co.***, 2007 WL 2422128 (S.D.Ga. Aug. 22, 2007), granted the surety summary judgment against the principal and indemnitors. The court rejected arguments by two indemnitors that there were genuine issues of fact as to lack of consideration, fraud, the validity of the bonds, and good faith. They argued that they were defrauded because they did not read the indemnity agreement before signing it or that the surety had to provide copies of the executed bonds to establish their liability. The court noted that the suit was on the indemnity agreement not the bonds, that the surety established by affidavit that it executed the bonds, and that the indemnitors presented no evidence to suggest the bonds were invalid.

In ***Swiss Reinsurance America Co. v. Airport Industrial Park, Inc.***, 2007 WL 2464504 (W.D.Pa. Aug. 27, 2007), Amwest issued to the United States as obligee, with PEC as principal, a Payment Bond and a Performance Bond for the construction of a new dock front in Pittsburgh. Swiss Re provided reinsurance on the performance bond. Amwest and PEC had previously entered into a general indemnity agreement. When Amwest eventually became insolvent, its liquidator notified PEC that the payment and performance bonds on the project would not be honored. The Army Corps of Engineers then notified PEC that its performance and payment bonds were “no longer valid” because Amwest was no longer in business. They ordered PEC to secure replacement bonds within ten days but PEC was unable to do so. The Corps issued a “cure notice” and eventually terminated the contract. The reinsurer met its obligations to complete the work and sued the contractor arguing that it was a third party beneficiary to the indemnity agreement between Amwest and PEC.

The court held that even assuming that the reinsurer was a third-party beneficiary under the contract, the indemnity agreement was nonetheless unenforceable. The court found that Amwest's insolvency constituted a failure of consideration. As consideration for the obligations undertaken by PEC in the GIA, Amwest was required to provide payment and performance bonds. Because these bonds were declared invalid after their insolvency there was a failure of consideration. Alternatively, the court found that PEC's duty to perform under the GIA was excused by Amwest's prior, material breach. The court granted summary judgment to the contractor.

***Alfred Chiulli & Sons, Inc. v. Hanover Ins. Co.***, 2007 WL 4239788 (Conn.Super. Nov. 14, 2007), concerned a dispute that arose over the construction of a middle school. Two suits were filed related to claims of unpaid bills for labor and materials. The suits were withdrawn pursuant to settlement negotiations, and this case revolved around an interpretation of those negotiations. Contract funds which were held in escrow were claimed by the surety under both the indemnity agreement and by right of subrogation. The contractor moved for summary judgment arguing that it was entitled to the escrow funds because Hanover's claims were barred on statute of limitations grounds. Connecticut has a three year statute of limitations for indemnity and the suit was filed more than three years after the surety made payments. The surety argued that the six year breach of contract limitations period applied to its claim under the indemnity agreement instead of the shorter period for indemnity. The court held that the

surety's claims against the contractor met the requirements of an indemnification action and that the indemnity statute applies to all actions for indemnification, even when the indemnity claim is contractual. However, the court found that equitable subrogation is not a type of indemnification that is covered under the statute. The indemnitors' motion was granted as to the indemnity agreement but denied as to equitable subrogation.

In ***Sun Construction Company, Inc. v. Torix General Contractors, LLC***, 2007 WL 4178505 (D.Col. Nov. 26, 2007), a subcontractor filed suit against the prime contractor and others to recover its additional costs arising from delay and changes in the scope of the project. The subcontractor claimed that the prime contractor breached its contract by failing to pay for the work it performed. A portion of the amount unpaid included the amount the subcontractor's surety paid for equipment rentals. The surety sought to intervene as of right in order to protect its interest in the amounts it has already paid and to have this court discharge the subcontractor from certain obligations under the subcontract, thereby discharging the surety's future bond obligations. The court granted the motion and held that the surety was entitled to intervene as of right in order to protect its interests in the outcome of the suit.

***Aeroplate Corp. v. Arch Ins. Co.***, 2007 WL 4170630 (E.D.Cal. Nov. 20, 2007). Aeroplate was the low bidder on a public contract. The bid exceeded the amount that the surety had authorized. The surety demanded that the plaintiff immediately declare an error and withdraw its bid and indicated it would not write the performance and payment bonds required for the project. Based on information from the surety, the Government found that the bidder was not responsible and rejected the bid. This litigation arose as a result. The court held that the Anti-SLAPP statute did not apply to the surety's communications with the government because the conversations were not protected under the statute. The court also determined that the surety did not misrepresent any information or breach any duty of care. Under the terms of the general indemnity agreement, the surety had the right to decline to execute any bond. The defendant accurately communicated this fact and the fact that the plaintiff's bid exceeded the bid bond. The plaintiff's claims were dismissed but the plaintiff had moved to amend its complaint to add other claims, so the court refrained from entering final judgment for the surety.

The Ohio Supreme Court in ***In re Application of Holbrook***, 116 Ohio St.3d 248, 877 N.E.2d 984 (Ohio 2007), held that a bar applicant's financial irresponsibility served as grounds to deny her candidacy for bar membership. The bar candidate had two judgments against her by two sureties. She also had debts and a bankruptcy proceeding. To take the bar in Ohio, an applicant must demonstrate financial and moral responsibility. Although the applicant claimed that she was innocent as to her husband's gambling, and financial irresponsibility, the court found she should be rejected but held that she should be permitted to re-apply to take the February 2008 exam.

***Travelers Cas. and Sur. Co. of America v. Claude E. Atkins Enterprises, Inc.***, 2007 WL 4048780 (E.D.Cal. Nov. 15, 2007), came before the court on a motion for leave to amend. Plaintiffs were the sureties under performance and payment bonds written in connection with Defendants' construction of a physical sciences building for the University of California. The sureties sued the indemnitors for breach of express indemnity agreements, specific performance of the indemnity agreements, and for injunctive relief with respect to the indemnity agreements. Two years after filing their answer, Defendants asked to add a counterclaim for breach of contract and breach of the covenant of good faith and fair dealing

against the Plaintiff's sureties based on the indemnity agreement. The court found that a counterclaim was compulsory, and thus must be alleged in the action or be lost after its conclusion, if it arises out of the same transaction or occurrence as the plaintiff's claim. Here, the counterclaim related to the very indemnity agreement that is the principal subject of the FAC; and was compulsory. The court found that if the proposed counterclaim was not filed, that the Defendant would suffer the loss of its claim, which it estimated to amount to about twenty million dollars. The court went on to find that the plaintiffs would not be unduly prejudiced by the claim since the counterclaim was related; the scope of the litigation was not greatly altered, and the Plaintiffs would not be required to undertake at a late hour an entirely new set of issues. Defendant was granted leave to file the counterclaim.

***Travelers Cas. and Sur. Co. of America, Inc. v. East Beach Development, LLC***, 2007 WL 3407049 (S.D.Ala. Nov. 9, 2007), arose from the non-payment of a number of subcontractors who provided labor and materials in connection with two condominium projects, and those subcontractors' subsequent attempts to obtain payment from a surety, the developer, the property owners, and others. The prime contractor and owners all filed similar motions urging the court to abstain from hearing and deciding the surety's declaratory judgment claims as to them. Their position was that the legal and factual issues raised by their claims against them in this lawsuit (namely, whether they are entitled to compensation via the Payment Bond issued by Travelers for the Lighthouse project) were identical to those pending in underlying state court proceedings. They argued that the court should exercise its discretion to abstain from hearing this aspect of the dispute. The surety opposed all of these requests, reasoning that the relevant factors militate in favor of having the court decide the declaratory judgment issues in a single proceeding, rather than deferring to fragmented state court litigation. The court exercised its discretion not to consider the declaratory judgment action but retained jurisdiction over the claims for which there was no parallel state action.

***National Environmental Services Corp. v. Insurance Co. of the State of Pennsylvania***, 2007 WL 3330215 (E.D.Mo. Nov. 6, 2007), was an interpleader action filed by a prime contractor to determine who was owed money from an arbitration award. Arbitration concluded with an award in favor of the subcontractor's assignee and against the prime contractor. The prime contractor alleged that following the arbitration, it requested that the subcontractor's assignee execute a release and indemnification in its favor upon satisfaction of the award. The subcontractor's assignee rejected the offer of release and indemnification. The surety then made a claim on the arbitration award, demanding that the prime contractor pay over money to set-off a separate debt the subcontractor owed to the surety. The court held that as a non-party to the arbitration, the surety had no standing to come before the court to seek review of the award. The court found that the arbitrator acted within the scope of her authority when she awarded the assignee monetary relief and that the award should be given significant deference.

In ***Hartford Fire Ins. Co., Inc. v. Edgewater Construction Co., Inc.***, 45 A.D.3d 1304, 845 N.Y.S.2d 894 (N.Y.A.D. 4 Dept. 2007), the surety under a performance bond sued the principal, seeking recovery of expenses incurred in defending a third party suit on the bond and in completing work. In the first appeal the court found that the surety was entitled to recover reasonable losses and expenses. On remand however the trial court found certain fees to be unreasonable, including attorney's fees and building stabilization costs. On appeal the court found that, pursuant to the terms of the indemnity agreement, the plaintiff was entitled to recover the legal fees reasonably incurred in defending the two underlying actions against it

even in the event that the actions were groundless. However the court found that the indemnity agreement did not encompass expenditures with respect to the costs of hiring experts and contractors to stabilize the building because those payments were not required under the terms of the performance bond.

In ***Western Surety Co. v. Beck Electric Company, Inc.***, 2007 WL 3165679 (W.D.N.C. Oct. 26, 2007), the surety sued the principal and indemnitor for breach of a general indemnity agreement. The defendants who were pro se were ordered to comply with discovery obligations but were spared attorney's fees in light of their pro se status.

***Travelers Cas. and Sur. Co. v. J.K. Merz Construction, Inc.***, 2007 WL 4468680 (N.D.Cal. Dec. 17, 2007). The surety sought indemnification for the amounts it paid under certain project bonds, as well as payment of collateral in amounts sufficient to cover claims that it may be required to pay under those bonds. The surety sought attachment before judgment. A dispute arose over the collateral security clause. The contract provided that Defendants are required to "pay" the surety, "upon demand, an amount sufficient to discharge any claim or demand made against the Company on any bond." The defendants argued that though there was a pending claim, that it was invalid and for more than the amount owed. The court reasoned that "The whole point of the collateral-security provision was to collateralize a *potential* indemnity duty. It was not limited to only *probable* indemnity duties. Defendants made a promise to collateralize. Now they should live up to it." The court granted the attachment before judgment and directed the surety to submit an appropriate order.

***Berlanger v. North American Specialty Insurance Co.***, 504 F.3d 147 (1<sup>st</sup> Cir. 2007), came before the court on an appeal of summary judgment entered in favor of the surety. The parties did not dispute that the surety suffered a loss based on a claim on the bond and that a valid indemnity agreement existed. However, the construction company's principals argued that the indemnification is barred by the Maine Insurance Guaranty Association Act. Amwest, who issued a performance and payment bond to guarantee the performance of the parking lot subcontractor, was insolvent at the time of the suit. When an insurer becomes insolvent, the MIGA uses the assessment monies collected to provide for the payment of "covered claims." However, the court held that the contractor was not entitled to the protection of the MIGA Act because they were not "claimants [under] or policyholders" of a policy issued by an insolvent insurer. The only insolvent insurer relevant to the case was Amwest, and the Amwest bond named only the construction company as obligee. The court held that the indemnitors, who had no rights against the Amwest bond, were not within the statute.

While not an indemnity case, ***K2 Construction, Inc. v. Anjani Investments, Inc.***, 2007 WL 2269814 (Cal.App. Aug. 9, 2007), is worth noting. Sureties sometimes find themselves involved in litigation where one of the items of damage claimed is lost profits on work not obtained because of loss of bonding capacity. A California court denied a wrongfully terminated contractor recovery of lost profits on prospective contracts allegedly incurred as a result of impaired bonding capacity. The owner contracted for the construction of a hotel but prior to completion, the owner terminated the contract with the general contractor. The contractor then served a bonded stop notice on the owner's construction lender, recorded a mechanic's lien against the property and filed an action against the owner, lender and others. The owner argued that the contractor breached the contract by failing to pay subcontractors. The contractor argued that the owner had breached the contract by failing to make payment.

After a trial, a jury found that the owner had breached the contract and awarded damages to the contractor. The trial court denied the contractor's claim that the owner's wrongful termination had impaired its bonding capacity. The trial court ruled that lost profit on separate contracts is not recoverable under California law and each party appealed.

The California Supreme Court has ruled that lost profit incurred as a result of impaired bonding capacity is recoverable as consequential damages for breach of contract if such losses were foreseeable at the time of contract formation. To be foreseeable, the project owner must have known the state of the contractor's finances and the criteria used by the contractor's surety to establish bonding limits. Only then does lost profit on prospective contracts become recoverable as consequential damages for breach of the present contract.

The court ruled that K2 Construction had not met the heavy evidentiary burden necessary to recover for impaired bonding capacity. "K2 essentially contended that Anjani's experience with construction projects in general and the fact that a performance bond was used in connection with its current project were sufficient to establish that, at the time of contracting, the impairment of its accessibility to bonding for future projects was a foreseeable consequence of a wrongful termination of the contract. However, K2 did not proffer any evidence that Anjani was familiar with its financial condition or knew that a termination of the contract would preclude it from getting bonded by its surety for future jobs." The court upheld the jury's award of damages.

a. PARTY PROFESSIONAL

Poor construction of a sewer lead to a lawsuit in ***Lyndon Property Ins. Co. v. Duke Levy and Associates***, 475 F.3d 268 (5<sup>th</sup> Cir. 2007). In this case, a surety for a county sewer project brought an action against the engineer hired by the county, alleging breach of contract, breach of warranty, and negligence and it sought to recover the amount it allegedly paid to fix and test work done by the sewer contractor that was inspected and approved by engineer.

A professional services agreement existed between the engineering firm and the public owner of the project. As part of the agreement, the engineering firm was to inspect the project as part of the payment certification process. The surety was not a party to the contract but claimed that the engineering firm breached its duty to the public owner because they were negligent in their inspection. The surety asserted its rights against the firm under equitable subrogation arguing that by paying completion costs, the surety stepped into the shoes of the public owner. However, a clause in the agreement provided that none of the engineer's work under the contract would give rise to any "duty or responsibility" to any contractor, subcontractor, or supplier for the job or to any of its sureties. A Mississippi federal District Court, relying on this clause granted summary judgment to the engineer. However, on appeal the court found that the public owner could not "bargain away" the potential duty of the engineer to the surety.

In ***New Jersey Property-Liability Ins. Guaranty Association v. Hill International, Inc.***, 395 N.J.Super. 196, 928 A.2d 836 (N.J.Super.A.D. 2007), a performance and payment bond was issued for the work of a subcontractor on a public school project. The subcontractor eventually ceased work on the project and filed for Chapter 7 bankruptcy. After the subcontractor ceased work, the surety retained contractors to complete the work remaining under the contract. By this time, however, the subcontractor had received all of the payments he was entitled to under the contract with the Board.

Having paid to complete the project, the surety sued the project construction manager for negligence in approving payments to the principal for work that had not been performed. The surety alleged that these payments increased its loss in completing the contract. The construction manager was insured under a liability policy issued by Property-Liability Guaranty Association (PLIGA). PLIGA argued that the NJ statute covering claims excludes from the definition of covered claims “*any amount due any reinsurer, insurer, insurance pool, or underwriting association, as subrogation recoveries or otherwise.*”

The surety argued against this exclusion because it asserted that the claims against the construction manager were not subrogation claims, but direct claims and were incurred in the process of fulfilling its surety obligations under the performance bond. The court found that the surety was not asserting a claim against the construction manager in its capacity as an insurer and therefore the claim was not excluded by statute.

In ***Auto-Owners Insurance Co. v. Midwest Agency***, 2007 WL 2885345 (E.D.Mo. Sept. 27, 2007), a surety received claims on unauthorized bonds and sued the agent involved in procuring the unauthorized bonds as well as other individuals. The defendants moved to dismiss the action for failure to state a claim upon which relief could be granted. The court found that a question of fact existed as to the surety’s claims for breach of contract and fiduciary duty and denied the defendant’s motion to dismiss. The court found that the agreements entered into between the parties provided that the agents are deemed the trustees of the Plaintiff and that the Agency Contract authorizes Defendants to alter the legal relationship of Plaintiff. However, the court granted the motion as to the breach of contract against an individual who did not sign the bond and as to the surety’s negligence claims. The surety alleged only economic damages, and the defendants owed no special duty of care. Under Missouri law the economic loss rule barred the negligence claims.

***NAS Surety Group v. Cooper Ins. Center, Inc.***, 2007 WL 3347821 (W.D.Mich. Nov. 8, 2007), came before the court on cross-motions of the parties for summary judgment. The surety sued an agency and the individual principal of the agency because the agency allegedly failed to remit bond premiums. The complaint included counts of fraud-piercing the corporate veil; fraud-alter ego; and conversion. The individual defendant filed a counterclaim alleging that the counts of the complaint were defamatory. The court found that in averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. This requirement was interpreted to mean that a complaint must give the time, circumstances and content of the false statements which are alleged to be fraudulent. The court granted the defendants’ motion on the fraud and conversion counts because they found that allegations in the complaint were too vague. The court also dismissed the defendant’s counterclaim because the statements in the complaint before the court and in the administrative proceedings before the Insurance Department were privileged. The court found that if statements made in the course of judicial proceedings are relevant, material, or pertinent to the issue, their falsity or the malice of their author is not open to inquiry.

In ***Merchants Bonding Company v. Skinner Bonding of Oregon, Inc.***, 2007 WL 4563523 (D.Ore. Dec. 21, 2007), the surety entered into an agency agreement with the defendant who allegedly failed to remit premiums and wrote unauthorized bonds and failed to report them. The surety sued for breach of contract, breach of fiduciary duty and conversion. The surety

moved for summary judgment and the court awarded summary judgment and ordered that the premiums be paid together with prejudgment interest.

b. INSURANCE COVERAGE FOR CONTRACTOR'S DEFECTIVE WORK

In *U.S. Fire Insurance Co. v. J.S.U.B.*, 2007 WL 4440232 (Fla. 2007) the Florida Supreme Court held that defective work by a subcontractor was a covered occurrence under the prime contractor's CGL policy." The coverage dispute arose when faulty workmanship on the part of a subcontractor caused structural damage to manufactured homes sold by the defendant. The subject policy was a post-1986 standard form commercial general liability policy. It provided coverage for the "sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' "caused by an "occurrence" within the "coverage territory" during the policy period. The policy and renewal policy defined an "occurrence" as an "accident" but left "accident" undefined. The court concluded that the policies provide coverage not only for "accidental events," but also injuries or damage neither expected nor intended from the standpoint of the insured." The court found that defective work that results in a claim against the contractor because of injury to a third party or damage to a third party's property was a foreseeable occurrence. The court also found that breach of contract can result in an "accident." The court also noted that there is a breach of contract endorsement exclusion that is not present in the CGL policies at issue in this case that excludes coverage for breach of contract claims.

The term "property damage" was also at issue. The insurance company asserted that faulty workmanship that injures only the work product itself does not result in "property damage." However, the court found that like the definition of the term "occurrence," the definition of "property damage" in the CGL policies did not differentiate between damage to the contractor's work and damage to other property. The court differentiated between a claim for the cost of repairing the subcontractor's defective work which would not be covered, and a claim for repairing the structural damage to the completed homes caused by the subcontractor's defective work. They found that the latter would be covered under the policy.

*Auto-Owners Ins. Co. v. Pozzi Window Co.*, 2007 WL 4440389, answered a certified question from the 11<sup>th</sup> Circuit, and was decided the same day as *J.S.U.B.* It answered the question as to whether a standard form CGL policy covers a general contractor's liability to a third party for the costs of repair or replacement of defective work by its subcontractor. In this case the windows on a home were defectively installed causing water damage. The window manufacturer settled with the homeowner and also settled with the builder. As the builder's assignee, the window manufacturer filed suit against the builder's insurer who had issued two CGL policies. Pursuant to the policy, the insurer paid the homeowner for personal property damage caused by the leaking windows, but refused to provide coverage for the cost of repair or replacement of the defective windows. The Eleventh Circuit noted that there was a split in Florida case law on the issue of liability for repair and replacement costs and certified the question to the Florida Supreme Court.

The Florida Supreme Court found the decision in *J.S.U.B.* dispositive. The Court found that "faulty workmanship that is neither intended nor expected from the standpoint of the contractor can constitute an 'accident' and, thus, an 'occurrence' under a post-1986 CGL policy." Since there was no indication in the record that the builder expected the windows to be defectively

installed, the Court found that the defective installation was an occurrence under the terms of the policy.

However, the Court noted that in order to determine whether the policies provide coverage they also must determine whether the “occurrence” caused “property damage.” It was on this issue that the Court distinguished *J.S.U.B.* Unlike *J.S.U.B.*, which involved a claim for the costs to repair structural damage to homes caused by the subcontractor's defective work, this case involved a claim for the costs to repair or replace defectively installed windows. The Court recognized that there is a difference between a claim for the costs of repairing or removing defective work, which is not a claim for ‘property damage,’ and a claim for the costs of repairing damage caused by the defective work, which is a claim for ‘property damage.’ Hence, the Court found that the repair and replacement of defective windows was not property damage and therefore the CGL policy did not provide coverage for the costs. (One other thought about the case: the window sub settled and took an assignment from the general contractor of claims against its insurer. Thus the window sub – or perhaps even its carrier - was suing the carrier of the G.C. for the cost of replacing the defective windows, not damage resulting from the defect. The court refused to find that there was property damage, and the net effect in this case was to deny the window sub the right to recover from the G.C.’s carrier. Could the relationship and posture of this case have had an impact on the outcome?)

In ***Travelers Indem. Co. of America v. Moore & Associates***, 216 S.W.3d 302 (Tenn. 2007), the court looked at whether water penetration resulting from faulty window installation is an “occurrence” as defined by a CGL policy. To determine whether an “accident” has occurred under the terms of a CGL the court asked whether damages would have been foreseeable if the insured had completed the work properly. Because the court concluded that the water penetration was an event that was unforeseeable to the insured, they found that the alleged water penetration was both an “accident” and an “occurrence” for which there is coverage under the “insuring agreement.” They also found that the water damage was property damage under the terms of the policy.

A Texas court in ***Lamar Homes, Inc. v. Mid-Continent Cas. Co.***, 242 S.W.3d 1 (Tex. 2007), also found that a general contractor's allegedly defective construction or faulty workmanship was an “occurrence” within the meaning of the CGL insurance policy. The carrier contended that extending CGL coverage under these circumstances would transform liability insurance into a performance bond. The court distinguished the two: “an insurance policy spreads the contractor's risk while a bond guarantees its performance. An insurance policy is issued based on an evaluation of risks and losses that is actuarially linked to premiums; that is, losses are expected. In contrast, a surety bond is underwritten based on what amounts to a credit evaluation of the particular contractor and its capabilities to perform its contracts, with the expectation that no losses will occur. Unlike insurance, the performance bond offers no indemnity for the contractor; it protects only the owner.” The court found that defects may be sufficient to trigger the duty to defend under a CGL policy.

Water damage was the cause of the suit in ***Essex Builders Group, Inc. v. Amerisure Ins. Co.***, 2007 WL 1839409 (M.D.Fla. 2007). In a previous action, the owner of the water-damaged property had brought suit against the general contractor, its surety, and the general contractor’s CGL carriers. The surety ultimately paid \$6,250,000 to the property owner. The insurer, who resisted the claim, paid nothing. The instant action concerns a suit that the general contractor filed against the CGL carriers who resisted the claims.

The general contractor alleged that it was the insurer's responsibility to pay the claim of the property owner and as a result of the general contractor's surety having to pay the property owner, the general contractor is now "unbondable" and their business is destroyed.

On a motion for summary judgment, the court considered whether the destruction of the general contractor's business "was a consequence within the contemplation of the parties at the time the insurance policies were issued." The court found even though this consequence might be common knowledge to those involved in surety bonding, there was no evidence that the insurer knew or should have known that denying the claim would result in the general contractor being unable to obtain surety bonds.

The courts in the South were not uniform in finding insurance coverage available to contractors. **Hathaway Development Co., Inc. v. Illinois Union Ins. Co.**, U.S.D.C., 1:07-CV-118-MHS (M.D. Ga. 2007), continued a line of Georgia cases holding that defective work was not covered by a CGL policy because defective work was intentional and, hence, was not an "occurrence" under the policy. Remarkably, the court reached this conclusion even though the lawsuit was against the general contractor for defective construction of its plumbing subcontractor. The court never explained what the GC did that was intentional.

## **V. FIDUCIARY BOND**

**Lawton v. Bank of America Corp.**, 2007 WL 4480222 (D.R.I. Dec. 17, 2007) arose out of the Estate of Magda L. Burt who passed away in 1987. The Plaintiffs alleged that the defendant "breached the conditions of its bond and its fiduciary duties to the Probate Court, the Decedent and the residuary beneficiaries of Decedent's Estate; breached and continues to breach its fiduciary duties to the Probate Court, the Decedent and the residuary beneficiaries; and, neglected and continues to neglect its trust and has failed and continues to fail to administer Decedent's Estate faithfully, competently, carefully, thoroughly and in the exercise of due care." The parties agreed in a consent order to litigate the executor's breach via a consolidated action on the bond. At the center of the dispute are some 2,256 shares of stock that were controlled by the estate after Magda Burt's death. The shares were sold for \$327,932.00. Two years later when the company was bought out the same shares sold for \$3,761,609.20. The executor moved to dismiss the bond claim on the ground of the statute of limitations. The parties agreed on the applicability a ten year limitations but disputed from whence the ten year period began. The Defendant argued that the period began when the stock was first sold. The court held that the ten-year limitations period started to run upon entry of the consent order. The court reasoned that to hold otherwise would render the consent order meaningless because the parties would have bargained for the initiation of a time-barred suit. The court denied the executor's motion to dismiss the bond claim.

A conservator's bond fueled the dispute in **In re May (Beck v. Continental Casualty Co.)**, 2007 WL 2669571 (D.C. Sept. 13, 2007). In this case a woman was appointed guardian and conservator of her son upon his father's death. The court required that she secure a bond for the faithful discharge of her duties as conservator. She was later required to secure a second bond after the estate received a personal injury judgment. A few years later, her conservatorship was terminated because the court found that she had failed to account to the court for some \$193,444 in annuity and Social security income payments. The court entered judgment against her and her surety individually and severally.

The surety paid the penal sum of the bonds, but the successor conservator demanded that it pay the entire judgment. The conservator asserted that the surety bonds were renewed each year with the payment of the annual premium, and that the full penalty amount of each bond therefore was available for each year the bond was in effect to cover Ms. Snead's defalcations in that year. (It appears that no losses in any single year exceeded the sum of the face amounts of the two bonds.) In other words, the conservator asserted the surety's liability under each bond was cumulative from year to year while the bond was in force, exactly as if the original conservator had purchased a separate bond covering each year of her tenure as conservator.

The court found the bond itself and the statute requiring it to be unambiguous and rejected the argument. The court stated, "We conclude, however, that annual premiums are not inconsistent with a continuous bond, and that the bonds in this case are unambiguously continuous. In the absence of ambiguity (or misrepresentation, which has not been alleged), '[w]e cannot give the [May estate] a new bond, different from the one [the conservator] paid for, and carrying greatly extended coverage.'"

In *Patterson v. Travelers Cas. and Sur. Co.*, 104 Conn.App. 824, 936 A.2d 241 (Conn.App. 2007), a beneficiary brought an action against the executors of his grandfather's estate and surety of probate bond issued to executor, alleging breach of fiduciary duty. The surety did not receive notice of a preliminary hearing and failed to appear. The court entered a default but set it aside when the surety explained that they had failed to receive notice. The court eventually granted a directed verdict to the defendants finding that the plaintiff's claims were barred by the statute of limitations and res judicata. The estate was probated in 1994 and the plaintiff had filed the action pro se in 2004. The plaintiff appealed and the Court of Appeals affirmed, finding that there was good cause to set aside the surety's default. The court found that the 1994 decree that affirmed the asset accounting was not subject to collateral attack on the grounds of breach of fiduciary duty. The court found that the only grounds for collateral attack would have been fraud.

In *In re Guardianship of Dorson*, 934 A.2d 545 (N.H. 2007), guardians petitioned to surcharge a former guardian for amounts the former guardian improperly withdrew from guardianship accounts. The trial court entered an order surcharging the former guardian, and former guardian's surety appealed. The former guardian fled the country after misappropriating over \$100,000 from the estate. The court found that any surcharge that the Probate Court decided to impose upon Nelson, whether it took the form of interest or lost appreciation, was part of this debt, and not an award of prejudgment interest. The court held further that "when a breach of trust occurs, the beneficiary of the trust is entitled to be put in the position he would have been if no breach of fiduciary duty had been committed." Accordingly the court found that the surety for the defaulting conservator owed the investment gain the stolen assets would have earned. "Appreciation damages," proven by the claimant's expert, were appropriate to make the estate whole.

## **VI. PUBLIC OFFICIAL BOND**

*County of Hudson v. Janiszewski*, 2007 WL 4554227 (D.N.J. Dec. 21, 2007) concerned a bribery scheme that the defendant was allegedly involved in while he served as County Executive. Western Surety issued a series of Official Bonds to the defendant. The court denied the surety's motion for summary judgment. This case came before the court on a

motion for reconsideration. The court refused to reconsider, finding that Western Surety did not identify an intervening change in controlling law, newly available evidence, a clear error of law, or a need to prevent manifest injustice.

## **VII. MISCELLANEOUS BONDS**

**AA Remodeling v. White**, 140 Wash.App. 1016, 2007 WL 2379726 (Wash.App. Div. 2 2007), involved a dispute arising from the remodel of a lake front cabin. A contractor sued a homeowner for money allegedly due and the homeowner counterclaimed and also filed a third party claim against the surety on the contractor's license bond. The contractor recovered much of what it claimed, and the trial court found that it was the prevailing party. Both the homeowner and contractor contend that the trial court erred in denying them attorney fees. The homeowner contended that although the contractor prevailed on the breach of contract claim, it merely demurred on its counterclaim against the bond, and therefore the contractor "exposed itself to an award of fees." The court held that such fees were available to a prevailing party on the bond claim, but only for fees to litigate the bond claim not to litigate the underlying breach of contract dispute. Although the trial court found generally for the contractor, it did not enter a specific order on the bond claim or make a fee award, and the Court of Appeals remanded the case for such specific findings.

Termination of a supersedeas bond was the issue raised in **Goss International Corp. v. Tokyo Kikai Seisakusho, Ltd.**, 2006 WL 4757279 (N.D.Iowa Aug. 9, 2006). The judgment debtor filed a motion to terminate its supersedeas bond. The judgment creditor did not deny that the judgment had been paid, but it was seeking post judgment injunctive relief in the action. The court reviewed the purpose of supersedeas bonds and held that the judgment debtor had paid the judgment, costs, interest and fees as well as costs associated with the appeal and therefore no longer has any obligations under the terms of the supersedeas bond. The court found that the supersedeas bond, which was posted to protect the original judgment of the court, cannot be held in a speculative fashion to protect a possible award for attorney fees and costs spent on a possible decision granting a permanent anti-suit injunction that may possibly be appealed.

In **Western Surety Co. v. Cardinal Point Trucking Inc.**, 2007 WL 2688472 (C.D.Ill. July 18, 2007), the Plaintiff issued a Property Broker's Surety Bond on behalf of a principal. Numerous claims were asserted against the bond, seeking payment for services rendered to the principal. The claims far exceeded the penal sum of the bond. As a result, the surety filed a statutory interpleader action and deposited the penal sum of the bond with the court. No claimant appeared in this matter. Rather than move for default, the Plaintiff proceeded to negotiate for a pro rata distribution. Having reached an agreement with all Claimants, a motion for pro rata distribution was filed. All claimants to the bond were served with the motion. No opposition to the motion or to pro rata distribution had been filed so the court granted the motion finding that pro rata distribution was an appropriate method for resolving the claims against the bond and held that the surety's liability under the bond was "fully resolved."

In **G. Rama Construction Enterprises, Inc. v. 80-82 Guernsey Street Associates, LLC**, 43 A.D.3d 863, 841 N.Y.S.2d 669 (N.Y.A.D. 2 Dept 2007), a subcontractor asserted a mechanics lien for extra work allegedly completed on a construction project. The contractor argued that the parties' written contract required that any extra work be memorialized in writing. The lien was eventually bonded off. The claimant alleged that at an underlying third-party action, a

judicial hearing officer (hereinafter JHO) had upheld the validity of its lien in the amount of \$469,000, and the claimant now sought payment of that amount from the surety. The surety argued that the J.H.O.'s decision merely denied their underlying motion to void the lien for willful exaggeration and denied claimant's underlying cross motion to increase the lien, adjusting it, instead, to \$469,000. The court held that the claimant's characterization of the J.H.O.'s action was incorrect, there had been no judicial establishment of the validity of the lien and, therefore, no obligation of the surety to pay. The court also held that summary judgment was properly granted to the defendants because they showed that the contract required written authorization for extra work and the claimant raised no triable issue of fact to prevent summary judgment.

In ***Rand-Whitney Containerboard Limited Partnership v. Town of Montville***, 245 F.R.D. 65 (D.Conn. 2007), the issue was before the court on the judgment debtor's motion to approve a supersedeas bond. Defendants argued that the language in the bond they submitted was "Traveler's standard bond for federal appeals, is consistent with federal law and conforms to industry standards" and, as such, it should be approved by the court. The court refused to approve either of two forms of supersedeas bonds submitted by the judgment debtor. The court held that the Plaintiff was correct in asserting that a supersedeas bond is not a "one size fits all" proposition and the court's role is not to rubber-stamp whatever bond the judgment debtor presents. The court was persuaded that any bond it approves must be drafted with precision and clarity, so that it accurately reflects the agreement and intent of its parties, the defendants and the surety, as to their respective rights and responsibilities regarding the judgment. If defendants do not know what the bond requires of them, they will not know how to perform. For example, from the two proposed bonds, the court could not determine if the intent of its parties was that Montville be given an opportunity to satisfy the judgment first, or if Rand Whitney should seek recourse against the surety in the first instance.

***State ex rel. Wagner v. Amwest Surety Ins. Co.***, 274 Neb. 110, 738 N.W.2d 805 (2007), concerned lease bonds that were canceled after the surety was ordered to liquidate. Following the termination of the lease bonds, the principal provided the surety with written notice of default. The liquidator denied all of the claims. The claimant, Strategic appealed.

Following the termination of the lease bonds, Strategic provided Amwest with written notice of Saxton's default. The liquidator denied all of Strategic's claims. The court held that the claimant did not meet the bonds' conditions precedent to the surety's liability.

Three of the bonds required written notice of default within 30 days. The fourth bond required that the obligee give the principal the notice and opportunity to cure which was provided in the underlying lease. Finding that the conditions precedent were not complied with the court held that the surety was not liable.

***Schweitzer v. Westminster Investments, Inc.***, 157 Cal.App.4th 1195, 69 Cal.Rptr.3d 472 (Cal.App. 4 Dist. 2007), concerned the bonding of a home purchaser pursuant to state statute. The plaintiff's home mortgage was in foreclosure and the defendant agreed in writing to purchase Schweitzer's home. Six months after the deed was conveyed, the plaintiff filed this action to void the deed, arguing the purchase contract was voidable under the Home Equity Sales Contracts Act because, among other things, the defendant did not provide proof that it was bonded. The trial court allowed rescission of the sale and the purchaser appealed.

The Court of Appeals reversed by holding that the bond requirement was unconstitutionally vague. A statute is void for vagueness if persons of common intelligence must guess as to its meaning and differ as to its applications. The statute required a bond “by an admitted surety insurer in an amount equal to twice the fair market value of the real property which is the subject of the contract.” The court found that there were two conflicting interpretations as to the amount of the bond. The first interpretation is that the representative must proffer proof that he or she has a separate bond for each transaction in an amount equal to at least twice the fair market value of the home subject to that transaction. The alternative interpretation is that a representative may conduct multiple transactions under the umbrella of a single “blanket” bond as long as the blanket bond is at least twice the amount of the fair market value of the real property on any individual transaction. The court also found that the obligee was uncertain; the conditions on and beneficiaries of the bond were undefined; and the delivery or posting requirements were unidentified.

***Southern Ins. Co. v. ADESA Austin***, 2007 WL 3408556 (Tex.App. – Dallas Nov. 16, 2007), involved a claim on a motor vehicle dealer’s surety bond. The vendor brought an action against the purchaser’s surety, seeking to collect on its claim against the purchaser’s motor vehicle dealer’s surety bond. This case was an appeal of the vendor’s grant of default judgment. The surety argued that the default judgment was obtained by “extrinsic fraud” because the unpaid draft was not endorsed or authorized by the dealer. The dealer provided an affidavit that he did not authorize the signature. The trial court granted summary judgment against the surety. The Court of Appeals held that normally the surety is bound by a judgment against the principal, but a judgment based on fraud is an exception. The surety made a sufficient showing of fraud to raise a genuine issue of fact, and the court reversed summary judgment for the claimant and remanded the case.

***Comm. Money Center, Inc. v. Illinois Union Ins. Co.***, 508 F.3d 327 (6<sup>th</sup> Cir. Ohio 2007), arose out of the collapse of an equipment leasing business in what is alleged to have been a Ponzi-type scheme. This dispute involved whether Illinois Union was a credit insurer or surety. The distinction mattered because Illinois wanted to assert as a defense fraud in obtaining the policy. A surety cannot assert fraud as a defense in an action in which the obligee does not join. The court held that the substance of the transaction was suretyship and substance was controlling over labels. The court found that Illinois Union asserted a right to indemnification. While an insurer generally does not have a right of subrogation against its insured, a suretyship confers rights of recourse to the surety against the principal obligor. Since the banks, the intended obligees, did not have knowledge of the fraud, Illinois Union could not avoid its obligations. The court affirmed the order granting motions in favor of Chase/Citibank and against Illinois Union with respect to liability.

In ***Hartford Fire Ins. Co. v. United States***, 507 F.Supp.2d 1331 (Ct. Int’l Trade, 2007), an insurer filed suit seeking declaratory judgment that its basic importation and entry bond guaranteeing payment of antidumping duties was unenforceable, under Continued Dumping and Subsidy Offset Act.

The Byrd Amendment provided that antidumping and countervailing duties collected by Customs would be deposited into a special account and eventually distributed to the domestic producers. Plaintiff claims that, under contract and surety common law, it is not obligated by the terms of its bond to pay what amounts to a subsidy to the U.S. domestic industry. The Byrd Amendment has since been repealed for entries of goods on or after October 1, 2007.

However, the court found that the surety failed to exhaust administrative remedies. The court dismissed the case for lack of jurisdiction without ever reaching the merits of the surety's argument that the Byrd Amendment discharged its bond obligations.

In ***Warren v. State Farm Fire and Casualty Co.***, 2007 WL 2127839 (E.D.Ark. July 25, 2007), the plaintiff recovered an \$110,000 judgment against State Farm. State Farm appealed and posted a supersedeas bond with an affiliated company as the surety. The plaintiff objected to approval of the bond. State Farm claimed that the bond was nothing more than an unsupported statement of Defendant that it can satisfy the judgment. State Farm asserted that the Defendant and surety are related companies. They have the same business address, the same agent for service and the State Farm Insurance website describes the surety as "a property insurance affiliate." In reply, the Defendant asserts that "Rule 62(d) entitles a party who files a satisfactory supersedeas bond to a stay of money judgment as a matter of right." They also stated that they were capable of paying the bond. Finding that there was no reason to doubt that State Farm could pay the judgment, the court approved the bond and stayed execution on the judgment pending appeal.

***Nickle v. Board of County Commissioners of Platte County***, 162 P.3d 1208 (Wyo. 2007), affirmed a judgment against a landowner's supersedeas bond. The County and the landowner had a long-running zoning dispute over the landowner's operation of either a junkyard or a scrap recycling business (depending on who you asked) without the proper zoning variance. At one point the landowner appealed an order permitting the County to remove the junk at the landowner's cost, and to stay the order the landowner posted a supersedeas bond. The appeal was dismissed, and the trial court awarded the county the costs for its contractor to remove the junk and held that those costs were recoverable from the bond. The landowner appealed. On its face, the landowner would seem to have an argument that the amount awarded was not caused by the delay while the first appeal was pending, but the Wyoming Supreme Court held that the record on appeal was so inadequate the court had to assume that the complete record would support the trial court's judgment.

## **VIII. PERFORMANCE BONDS**

A government entity, the City of Houston, moved to dismiss a suit against it on the grounds of legislative immunity. In ***City of Houston v. Continental Insurance Co.***, 2007 WL 2173364 (S.D.Tex. July 26, 2007), the City sued the performance bond surety; the surety filed a third party complaint against the principal, and the principal counterclaimed against the City. The suit occurred when the city discovered that the company with whom it contracted to operate a water treatment plant had failed to maintain some equipment as was required under the contract. The principal alleged that it was owed money for the balance due for the work performed and also for additional costs that they bore during the course of the contract.

The City argued that United Water (contractor) had not stated a claim upon which relief can be granted because a federal court sitting in diversity should not resolve issues of governmental immunity; rather, the Texas legislature alone should decide these matters. While recognizing that the legislature is generally better suited to address waivers of sovereign immunity, the Texas Supreme Court had noted that the judiciary remains a guiding force in defining the boundaries of sovereign immunity and the circumstances under which immunity may exist in the first instance. However, the court acknowledges that there can be a waiver of

governmental immunity if the government entity injects itself into a lawsuit. The court notes that the Supreme Court of Texas has found this waiver just because “it would be fundamentally unfair to allow a governmental entity to assert affirmative claims against a party while claiming it had immunity as to the party's claims against it.”

However, the waiver was restricted to only those claims which share a nexus with the governmental entity's claims. The City argued that the principal's counterclaims did not meet this test and should be dismissed. The court found that both the City's claims and the principal's counterclaims involved performance of the bonded contract and the counterclaims were germane to and connected with the City's claim against the surety. The case means that by suing the surety a government obligee waives immunity for a claim by the principal.

***Gulf Insurance Co. v. Fidelity & Deposit Co. of Maryland***, 16 Misc.3d 1116(A), 847 N.Y.S.2d 896 (Table), 2007 WL 2162885 (N.Y.Sup.), involved a dispute between a subcontractor's surety and a sub-subcontractor's surety. The dispute arose from a public project in New York. The subcontractor hired a sub-subcontractor using the AIA A101 contract. In the termination section the contract called for seven days' notice and required that the architect certify that sufficient cause existed to justify termination. The sub-subcontractor's bond was conditioned on the sub-subcontractor's being in default and the subcontractor having performed its obligations under the subcontract. The subcontractor terminated the sub-subcontractor with only three days notice and did not get a certification of just cause from the architect. The subcontractor did not pay the sub-subcontractor and allegedly did not pay the replacement either. Eventually, the construction manager terminated the subcontractor who filed for bankruptcy. The subcontractor's surety settled with the construction manager for the penal sum of its bond.

The subcontractor's surety (as subrogee and assignee) sued the sub-subcontractor and its surety claiming that the sub-subcontractor's breach and its surety's refusal to perform caused the subcontractor to default on its own subcontract. In response, the sub-subcontractor's surety argued that the termination was invalid. The subcontractor's surety argued in response that the more lenient termination provisions of the subcontract took precedence over the harsher terms of the sub-subcontract and that it was impossible to obtain a certificate from the architect. The court rejected these arguments and granted the sub-subcontractor and its surety summary judgment dismissing the claims against them.

However, the court denied the sub-subcontractor's summary judgment motion for money allegedly owed because there was no counterclaim in the case so the issue was not before the court. The court noted that the sub-subcontractor had a separate action pending against the subcontractor's surety.

***Independent School District No. 74 of McCurtain County v. Shurtleff-Gaharan, Inc.***, 2007 WL 2248159 (E.D.Okla. Aug. 2, 2007), is an amazing case because it contradicts what was believed to be established law. The court held that the performance bond surety was not liable for latent defects!

The suit came as a result of a contract for the installation of a metal roof on an elementary school. The school district found defects in the construction over 9 years later and filed suit against the contractor and its surety. The court found that the surety was not liable for the defects because latent defects were “beyond the scope of the performance bond.” “A

performance bond protects the owner of the property by assuring completion of a project in the event of *default* by the general contractor and a payment bond guarantees payment to subcontractors in the event of default.” Here, the court claims, there was no “default.” The contractor finished its work, but allegedly created a latent defect in so doing. In the court's view, a performance bond does not establish a surety as a guarantor of work quality *ad infinitum*. The court also noted that the suit was filed after expiration of the statutory five year limitation period. The court rejected the owner's argument that the five years should run from discovery of the alleged defect. The court also held that the owner breached the bond by not giving the surety notice of the alleged default and an opportunity to exercise its options to cure. The court granted the surety's motion for summary judgment.

***Harlandale Independent School District v. C2M Construction, Inc.***, 2007 WL 2253510 (Tex.App. – San Antonio Aug. 8, 2007), was another dispute that arose over the construction of an elementary school. In this case in order to obtain the bond for the project, the contractor was required to enter into an Indemnity Agreement with a surety and its affiliates. When the contractor failed to finish the project, the sureties stepped in and completed it. The contractor/principal then filed a suit against the school district for breach of contract. The surety intervened and objected to the principal's attempt to assert claims that had been assigned to the surety. The school district moved to dismiss the principal's suit for lack of jurisdiction because the principal did not have standing to assert the assigned claims, and the surety and principal filed cross motions for summary judgment on the standing issue. The trial court denied all the motions, and the school filed an interlocutory appeal. The Court of Appeals reviewed the assignment provisions of the indemnity agreement and held that the principal could not assert the claims because they had been assigned to the surety. The court reversed the trial court and dismissed the principal's claims against the obligee.

In ***Augusta Fuel Co. v. Bond Safeguard Insurance Co.***, 502 F.Supp.2d 124 (D.Me. 2007) Augusta Fuel, the obligee pre-paid a supplier for delivery of 1,300,000 gallons of fuel under a supply contract. When the price of fuel went up, the supplier failed to satisfy its promise to deliver the full quantity of fuel. The obligee bought replacement fuel elsewhere then sought to redeem the bond posted by the supplier and issued by the surety defendant. The suit was for the cost, plus interest.

In response to the claim, the surety argued that the obligee and principle materially altered the payment terms of the bond without the surety's knowledge or consent. The surety argued that by requiring full payment up front for all oil to be delivered under the sales confirmation, rather than prepayment before a specific oil delivery, the Subsequent Sales Confirmation “fundamentally altered the nature of the transaction and is not a transaction which the surety would have bonded.” The surety argued that it is black-letter law that “any material alteration in the terms of a contract for the performance of which a surety is bound, if made without the surety's consent, releases him from liability.”

The court found that there was no material change, in part because the sales confirmation agreements referenced and incorporated the initial sales agreement. The court found the initial agreement was just a framework and all the details were written into the sales confirmations for each transaction. The court also noted that even if there were a material change, the surety did not do due diligence in failing to investigate the true nature of the contract. The court granted the obligee's motion for summary judgment as to liability and directed further submissions as to the amount to which the obligee was entitled.

In ***St. Paul Fire & Marine Insurance Co. v. T.U. Parks Construction Co.***, 2007 WL 2385960 (E.D.Tenn. Aug. 16, 2007), the principal completed a bonded contract, but the work was alleged to be defective. The obligee put the principal and surety on notice of the defective work and requested a meeting to discuss the possibility of a contractor default. The conference never took place because the obligee and principal negotiated a settlement agreement. However, disputes eventually arose over the settlement terms and the surety filed a declaratory judgment action asking the court to declare that it owed no obligation under the bond. The defendants moved to dismiss because the surety could establish no actual case or controversy since there had been no bond claim. The court agreed and dismissed the case without prejudice as premature but noted the surety could re-file if there were a future bond claim.

In ***International Fidelity Ins. Co. v. China Construction America (SC) Inc.***, 375 S.C. 175, 650 S.E.2d 677 (S.C.App. 2007), a subcontractor became insolvent, and several of the subcontractor's suppliers and subcontractors filed mechanic's liens. The subcontractor failed to complete the subcontract on time, delaying the project for eighty-three days. In response, the contractor demanded that the subcontractor and its surety discharge the liens pursuant to their obligations. Ultimately, the surety bonded off the liens and paid the subcontractor's lien creditors such that the contractor's only remaining claim was a breach of contract claim against the subcontractor. On the day of trial, the subcontractor failed to appear, and the surety moved to be dismissed from the case and the contractor consented and proceeded to try its breach of contract claim against the subcontractor. The circuit court found in favor of Contractor.

Sometime after the contractor filed its action, the surety filed a separate action against the contractor seeking the balance of the subcontract as the subcontractor's subrogated surety. The contractor counterclaimed averring the judgment against the subcontractor was binding and conclusive on its surety, and as a matter of law, the contractor was entitled to judgment against the surety for the full amount of the judgment against the subcontractor. In response, the surety argued the prior judgment was not binding because it was beyond the scope and coverage of the bond and that there were issues of fact as to whether the judgment in the previous case was obtained by fraud or collusion.

The Court of Appeals held that the surety was bound by the judgment against its principal. The surety was a party to the underlying proceeding and had an opportunity to present any evidence on the issue of the principal's obligations. The court, however, went on to suggest that the result would be the same even if the surety had no notice of the prior suit and no opportunity to participate. The court recognized that fraud, collusion or lack of jurisdiction would be defenses, but they were not issues in the case.

***Colorado Structures, Inc. v. Ins. Co. of the West***, 161 Wash.2d 577, 167 P.3d 1125 (Wash. 2007), reviewed the Court of Appeals opinion reported at 106 P.3d 815 (Wash. App. 2005). Wal-Mart planned a grand-opening of a new store on a particular date and the prime contractor was working under the threat of enormous financial penalties if work were not completed in time. The prime contractor hired a subcontractor to do some of the sewer work and required that they secure a performance bond. The bond had the "declared in default" language of the A311 performance bond. Nearing the end of the subcontract, the prime contractor felt that the work was seriously behind schedule. Because of its pressing deadline,

the prime contractor decided that instead of incurring the delays associated with terminating the subcontract and bringing in a new sewer contractor, they would supplement the subcontractor's crews in an effort to complete the sewer work as scheduled. However, even with the additional crews, the subcontractor was not able to complete the work on time. Because the cost of supplementing the subcontractor's crew was more than the subcontract, the prime contractor asked the performance bond surety to make up the difference. The subcontractor subsequently went out of business and the prime contractor sued the surety.

The Court of Appeals held that the bond did not require a declaration of default because the bond paragraphs after the condition that the principal faithfully perform were just options the obligee could elect if it chose to terminate. The Court of Appeals also held that the *Washington Olympic Steamship* rule on attorney's fees applied to performance bonds.

The Supreme Court made its decision in four separate opinions. Six of the Justices agreed with the Court of Appeals' interpretation of the bond. Two other Justices thought a declaration of default was required but that giving the surety notice that the principal's performance was unsatisfactory was sufficient. That is, that a declaration of default did not have to be a termination of the bonded subcontract. Only one Justice agreed with the surety that termination of the bonded subcontract was a precondition to the surety's obligation.

Five of the Justices held that *Olympic Steamship* applied to the bond, and allowed the obligee to recover fees in excess of the penal sum.

An issue of civil procedure was disputed in ***Henry County School District v. Action Development, Inc.***, 2007 WL 2683726 (N.D.Ga. Sept. 6, 2007). Dissatisfied with work completed by the contractor on a new elementary school, the obligee terminated the contractor for default and made a demand on the surety to perform under the performance bond. The obligee and surety entered into a partial settlement and the surety made a substantial payment to the obligee for completion costs. However, the settlement agreement recognized the penal sum of the bond as the limit of the surety's liability and reserved both side's arguments on what payments, in addition to the settlement payment, should reduce the penal sum.

The obligee sued the principal and surety in state court. The surety removed the case to federal court based on diversity jurisdiction. The surety and obligee were diverse, but the principal and obligee were not. The surety argued that joinder of the principal was fraudulent. Citing *Tapscott v. MS Dealer Service Corp.*, 77 F.3d 1353 (11th Cir.1996), *abrogated on other grounds by Cohen v. Office Depot, Inc.*, 204 F.3d 1069 (11th Cir.2000), the surety argued that "where a diverse defendant is joined with a non-diverse defendant as to whom there is no joint, several or alternative liability," the parties have been fraudulently joined. The surety argued that the basis for the obligee's breach of contract claim against the principal occurred prior to the surety's expense of funds to complete the Project and that the PSA replaced the original Performance Bond. Thus, there is no "real" connection between the principal and surety. It argued that because the obligee did not expressly state in the complaint that the principal and surety are jointly and severally liable, the Plaintiff has failed to properly allege any basis for joint and several liability. The court disagreed, finding that principal and surety are jointly and severally liable to the School District under the express terms of the performance bond, which was incorporated by reference into the complaint, and under Georgia law. The court also held that there was no objectively reasonable basis for removal and remanded the case to state

court. The court also noted that it would have awarded attorneys fees to the obligee but for the fact that the obligee did not submit an affidavit or calculation to support its fee claim.

In ***Klewin Building Company, Inc. v. Heritage Plumbing & Heating, Inc.***, 840 N.Y.S.2d 144 (N.Y.A.D. July 31, 2007), the construction manager for a building project brought an action against a subcontractor and on its performance bond. The suit alleged that the surety breached the performance bond. The surety moved for summary judgment on the ground that the prime contractor did not meet conditions precedent to the surety's liability. The trial court denied the surety's motion, and the surety appealed. The Appellate Division affirmed the trial court and held that the surety did not establish that the prime contractor failed to satisfy any condition precedent.

***Gemini Energy, Inc. v. Division of Mineral Resources Management***, 2007 WL 2800323 (Ohio App. Sept. 27, 2007), has a procedural history which is important to detail. The Chief of the Division of Mineral Resources Management ordered the forfeiture of a certificate of a deposit filed by appellant which was required to secure restoration and plugging of non-productive wells. The Commission vacated the Chief's order of forfeiture, but the common pleas court reversed the decision of the Commission. The contractor argued that the bond, required under O.R.C. § 1509.071, is a performance bond and is not a penal bond, and the forfeiture of the bond is not allowed as a means of punishing an operator. The contractor argued that the attempted forfeiture by the Chief was an unconstitutional violation of the excessive fines and Due Process Clauses of both the Ohio and United States Constitutions.

The court found that a performance bond by its very nature is not a penalty bond unless the amount to be forfeited is substantially in excess of the amount necessary to secure performance. The court acknowledged that the bond was not a forfeiture obligation, but noted that the cost to meet the permit holder's obligations would substantially exceed the amount of the cash deposit the operator used in place of a bond. The bond was for \$15,000 and covered approximately 34 wells. The Contractor testified he had invested approximately \$85,000 and estimated it would cost \$75,000 to \$100,000 to complete the tasks. Thus, the court affirmed the forfeiture.

In ***CC-Aventura, Inc. v. Weitz Co. LLC***, 2007 WL 2986371 (S.D.Fla. Oct. 10, 2007), the owner and operator of an assisted living community sued the prime contractor and surety for alleged defects in design and construction that resulted in problems such as mold and leaking in various areas of the project facility. Thereafter, the prime contractor and surety each sued several subcontractors and their sureties. The subcontractor's surety moved for summary judgment on the ground that the prime contractor did not declare a default as required by the bond and they argued that the prime contractor waived all potential claims on the Bond because it had notice of any alleged problems with the subcontractor's work during the project's construction, but did not take legal action at that time. The bond language required that the subcontractor be in default and be declared in default. The court held that a declaration of default sufficient to trigger the surety's obligations must be a direct, unequivocal termination of the bonded contract. Here, the prime contractor relied on a letter to the subcontractor and surety in which it demanded that the subcontractor correct any defective work while notifying the surety that it would look to it if the principal failed to act. Although the letter stated that it was a formal demand, the court found that it was not unequivocal because it still looked to the subcontractor to perform under the contract. Hence, the court held entered summary judgment for the surety.

In **Memphis-Shelby County Airport Authority v. Illinois Valley Paving Co.**, 2007 WL 2904539 (W.D.Tenn. Oct. 3, 2007), a subcontractor installed underground lighting cable that did not meet the specifications. The owner demanded that the contractor replace the cable and, after various correspondences, hired another contractor to do so. The owner, however, never gave the surety an opportunity to do the work. The owner recovered summary judgment against the contractor and moved for summary judgment against the surety. The bond required that the contractor be in default and be declared in default, and the contract required a ten day cure notice to the contractor and surety. The court followed *L & A Contracting and Elm Haven Construction* and held that the bond, and the contract incorporated by reference into the bond, required that the obligee give the surety notice of its intent to terminate the contract and an opportunity to cure. The surety raised genuine issues of fact as to whether the owner declared a default or advised the surety of the owner's intent to terminate the contract. The court denied the owner's summary judgment motion.

In **La Liberte LLC v. Keating Building Corp.**, 2007 WL 4323687 (E.D.Pa. Dec. 11, 2007), a hotel sued the contractor for breach of contract, breach of implied warranty, and breach of express warranty in connection with work the defendant performed at a hotel. Thereafter, the defendant filed a third-party complaint against its subcontractors and their respective sureties. Before the court were the motions of the sureties to dismiss the third-party complaints against them because the suit limitations provisions in the bonds required suit within two years. The hotel brought suit over seven years after the certificate of occupancy was issued for the work. The court enforced the contractual limitations provision in the bonds and granted the sureties' motions.

**Dooley and Mack Constructors, Inc. v. Developers Sur. and Ind. Co.**, 2007 WL 3274333 (Fla.App. Nov. 7, 2007), is an appeal from a final summary judgment granted to the surety. The plaintiff had alleged that its masonry subcontractor defaulted by abandoning the job, and that it completed the masonry work. The surety defended by arguing that the contractor did not give the surety notice of the default or the opportunity to cure it as was required by the bond. Though this much was true, the contractor showed that the subcontract, which was incorporated into the bond by reference, provided that the contractor had the right to complete the work as it deemed necessary with the surety liable for loss or damage. In a two to one decision, the Court of Appeals reversed the summary judgment award. The majority thought that the subcontract changed the bond by allowing the prime contractor to complete the work. The dissent pointed out the bond is necessarily the primary determinant of surety liability and that the subcontract which usually precedes the issuance of the bond should not be the measure of obligations.

**Liberty Mutual Insurance Co. v. Mandaree Public School District # 36**, 503 F.3d 709 (8<sup>th</sup> Cir. N.D. 2007), concerns a dispute of the applicability of an arbitration provision. The construction contract contained an arbitration provision. The bond at issue incorporated the construction contract by reference but also provided that "[a]ny proceeding, legal or equitable, under this Bond may be instituted in any court of competent jurisdiction [where] the work is located ... within two years after the Surety ... fails to perform its obligations under this Bond." When a dispute arose between the principal and obligee, the principal demanded arbitration. The obligee asserted a counterclaim to add a claim against the surety under the bond. The surety refused to join the arbitration and the arbitrator denied the obligee's motion to amend. The surety filed suit for a declaratory judgment that its bond obligations were discharged. The

obligee sought to compel the surety to arbitrate because the bond incorporated the contract by reference, and the contract required arbitration. Alternatively, they asserted that because the surety offered at one point in time to voluntarily participate, the promise was irrevocable pursuant to the Federal Arbitration Act. The court held that the surety's consent could be withdrawn and that the incorporation clause in the performance bond at issue did not mandate that the surety arbitrate.

In ***U.S. ex rel. Platinum Mechanical, LLC v. United States Surety Co.***, 2007 WL 4547849 (S.D.N.Y. Dec. 21, 2007), a subcontractor sued the prime contractor and its surety, and the prime contractor counterclaimed against the subcontractor and filed a third party claim against the subcontractor's surety. The subcontractor's surety brought this motion for summary judgment on the counterclaim on the ground that the contractor ignored the pre-default notification requirements of the performance bond. The court agreed and granted summary judgment dismissing the third party claim against the subcontractor's surety.

In ***Homes for America Holdings Inc. v. United States Fidelity & Guaranty Co.***, No. 7 Civ. 4592 (S.D.N.Y. Aug. 22, 2007) the general contractor terminated its subcontractor and executed a takeover agreement with the surety. The contractor alleged that the surety had failed to perform the takeover work in accordance with the provisions of the takeover agreement and performance bond. The bonded contract included both a mutual waiver of consequential damages and an arbitration clause. The surety moved for summary judgment based on the waiver of damages and arbitration.

The court found that the surety's obligations to complete the project under the takeover agreement were defined by the construction contract because the takeover agreement substituted the surety's name for the contractor's name. Thus, the arbitration provision applied to the contractor's claims under the takeover agreement.

However, the plaintiff sought leave to file an amended complaint alleging other damages including the contractor's delays prior to notification of default and execution of the takeover agreement. The court found that while the plaintiff may claim damages under the performance bond, it may not claim consequential damages, as defined – and waived – under the original construction contract. The court recognized that the waiver of consequential damages in the contract amounted to a waiver of any claim against the surety for such damages. However, the court found that there were claims on the bond that were not waived - e.g. claims for additional legal fees available under ¶ 6.2 of the performance bond. The court found that these claims were not futile because there was no duty to arbitrate as the bond did not contain an arbitration clause and seemed to contemplate litigation.

On these findings, the court granted the plaintiff's motion to amend its complaint to state claims under the performance bond. The court also granted the surety's motion for summary judgment as to claims for damages under the takeover agreement and under the performance bond for damages related to defendant's delay or failure to perform under the construction contract following execution of the takeover agreement but denied it as to claims under the performance bond for damages resulting from the contractor's delay or failure to perform the construction contract prior to execution of the takeover agreement.

***St. Paul Fire & Marine Ins. Co., Inc. v. La Firenza, LLC***, 2007 WL 2010759 (M.D.Fla. July 6, 2007) concerns the validity of an arbitration agreement between an owner and principal. The

owner of a construction project terminated the performance bond principal. The principal demanded arbitration pursuant to a general arbitration provision in the contract, disputing the propriety of its termination. The surety was not a party to the arbitration. The surety, but not the principal, sued the owner and a dual obligee for a declaratory judgment determining the surety's obligations under the performance bond to the owner and dual obligee. The defendants moved to abate the declaratory judgment action.

The court noted that if it is determined that owner's termination of the bond principal was unjustified; the surety would have no obligation under its bond to the owner and dual obligee. In that circumstance, the court noted that the declaratory action would not present an actual controversy and Article III jurisdiction would be lacking.

The surety argued that the FAA was inapplicable because there is no written agreement to arbitrate between itself and the owner. The court found, however that the surety's argument was mistaken, as its bond incorporates by reference the underlying construction contract between the owner and contractor. Moreover, the arbitration provision in that contract contemplates the participation of "other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration." The court stated that if a bond incorporates a contract by reference, and the contract contains a general arbitration clause, the bond obligations of the surety are subject to arbitration." In Florida, sureties are bound to arbitrate disputes where the bond incorporates the underlying contract containing an arbitration provision. The court held that although no party has demanded arbitration, a stay of this action would be consistent with the intent and purpose of the FAA."

***Solai & Cameron, Inc. v. Plainfield Community Consolidated School District No. 202***, 374 Ill. App. 3d 825, 871 N.E.2d 944 (2007), arose as the result of a dispute on a school building project. The action was brought by a subcontractor against the general contractor, the general contractor's bonding company and the school district. The general contractor filed a counterclaim against the subcontractor and a third-party claim against the subcontractor's surety. The subcontractor and its surety moved for summary judgment.

The AIA A312 bond contained a provision that allowed the surety options for completion of the contract work. It also provided that the surety's obligation will only arise after the "Owner agrees to pay the Balance of the Contract Price to the Surety in accordance with the terms of the Construction Contract or to a contractor selected to perform the Construction Contract in accordance with the terms of the contract with the Owner." The surety alleged that the obligee did not comply with these provisions of the bond and, because conditions precedent were not satisfied, it was entitled to treat the bonds as null and void.

The obligee pointed to language in the subcontract that gave it the right to hire a replacement subcontractor. However, the Court found that this contrary language did not nullify the bond language. The subcontracts were written after the bonds and did not refer to the bonds.

The Court found that the obligee violated the bond by failing to agree to pay the surety the balance of the electrical subcontract and by hiring a new electrical subcontractor prior to declaring the obligor subcontractor in default and terminating it from the project. The Court found that this negated the surety's options under the bond to mitigate its damages, and thus, the surety's duty to perform under the performance bond was nullified by obligee's actions.

## **IX. EQUITABLE SUBROGATION**

In ***Grochal v. Ocean Technical Services Corporation (In re Baltimore Marine Industries)***, 476 F.3d 238 (4th Cir. 2007), a contractor hired a subcontractor to assist with repairs to the owner's ship. The contractor on an unbonded ship repair contract filed for bankruptcy, and the ship owner filed an interpleader action. The subcontractor filed a claim against the interpleaded funds, asserting that the contractor owed sums for its work.

The Bankruptcy Court appointed Grochal as the liquidating agent for the contractor. The Bankruptcy Court ordered payment to the subcontractor from the interpleaded funds because "the purpose of the fund...is to protect the unpaid materialmen and subcontractors."

The Court of Appeals held that a surety who has paid all subcontractors has a greater right to retained funds than does an unpaid subcontractor, such as in this case. The surety "combines the subcontractor's interest in the funds with those of the Government and the general contractor." The court stated that a surety, unlike an unpaid contractor, "steps into the shoes" of the general contractor and acquires legal title and other rights to withheld funds. The court held that an unpaid contractor is not subrogated to the contractor's interest in the funds and, thus, the contractor's interest remains in the bankruptcy estate. Therefore, the lower courts erred in awarding the interpleaded funds directly to the subcontractor.

In ***National American Insurance Co. v. United States***, 498 F.3d 1301 (C.A.Fed. 2007), (C.A.Fed - 2nd Cir.?) a payment bond surety sued the United States, alleging that the government violated its duty as a stakeholder in a Miller Act payment bond case by making final payments to the contractor. The final payment was not to be made because the government was notified by the surety that a Miller Act claim had been filed by an unpaid subcontractor on the project. After settling the claim with the subcontractor, the surety requested that all remaining contract funds be held for its benefit. The government, however, did not follow the request and made its final contract payment to the general contractor. As a result, the surety filed a complaint in the Court of Federal Claims seeking damages from the government. The Court of Federal Claims granted summary judgment in favor of the surety and the government appealed.

On appeal the United States asserted that a surety can only stand in the shoes of the subcontractor whom it paid, and since here the subcontractor has no privity with the United States, there can be no Tucker Act waiver of sovereign immunity. The court rejected the argument, finding that it has been well-established that a payment bond surety that discharges a contractor's obligation to pay a subcontractor is equitably subrogated to the rights of both the contractor and subcontractor. The court reasoned that the part of the *ICW* case relied on by the government was *dicta*. The court affirmed summary judgment for the surety.

In ***National Environmental Services Corp. v. Ins. Co. of the State of Pennsylvania***, 2007 WL 2736260 (E.D.Mo. Sept. 17, 2007), the plaintiff contracted with the St. Louis Housing Authority to perform demolition work on a housing project. The defendant issued a payment and performance bond on the project with the prime contractor as principal. A subcontractor who was performing work on the project applied to the surety for payment, alleging that the prime contractor failed to pay. The subcontractor then assigned its claim to a bank, which reassigned it to a collection entity, and the collection agency filed a demand for arbitration with

the prime contractor. The prime contractor's surety was also surety for the subcontractor on another project and had a judgment against the subcontractor for indemnity. The assignee obtained an arbitration award but refused to execute a release and indemnification in the prime contractor's favor upon satisfaction of the award. The surety then contacted the prime contractor and demanded payment of the arbitration award. It demanded that the contractor pay the award to set-off a separate debt that the subcontractor owed to the surety. Faced with what it believed to be competing claims on the funds awarded in the arbitration, NESC filed a complaint in interpleader. The main dispute was whether the surety or the assignee was entitled to the fund. The prime contractor also asked for a determination that payment of the award fully discharged its obligations to the subcontractor and assignee and several parties asked for attorney's fees.

The court held that the interpleader was proper and confirmed the arbitration award and found that the award was a settlement of all claims. The court went on to hold that the assignee was entitled to the arbitration award. The surety based its claim on the theory of set-off and subrogation. The right of setoff allows entities that owe each other money to apply their mutual debts against each other thereby "avoiding the absurdity of making A pay B when B owes A." The court found that "to be considered mutual, debts must be in the same right and between the same parties, standing in the same capacity." The court found that the debts at issue were not between the same parties. The surety's claim was based on a debt in the amount of \$794,964.38 plus interest, running from the subcontractor to the surety as a result of a previous judgment. The set-off is claimed against the debt in the amount of \$209,412.39, running from the prime to assignee as a result of the arbitration proceeding between those two parties.

The court found further that the surety had no subrogation rights because it had not made any payment on the bond and would not be subject to such payment because the prime contractor's payment fully satisfied all claims. Because the surety has not and will not suffer liability pursuant to the project bond it has no subrogation rights to the judgment. The court reserved ruling on the various parties' claims for attorney's fees until after entry of a final judgment.

***Employers Insurance of Wausau v. St. Clair Contractors, Inc.***, 2007 WL 4299843 (D.Idaho Dec. 4, 2007), concerned the construction of a storage lagoon to hold treated effluent. The city terminated the contractor citing defects in performance and the surety elected to complete the work. The city and surety eventually disagreed over whether the contract was substantially complete and the city hired another contractor to complete the project. The surety sued the city to obtain payment and sued the contractor under the indemnity agreement. The contractor and surety recovered a judgment against the public owner, and the owner issued a check in partial payment payable jointly to the contractor and surety. The city left it up to the surety and contractor to reach an agreement on how to divide up the proceeds of the check. Unable to agree, they asked the court to decide. The surety argued that it has a priority equitable lien and is equitably subrogated to the contractor's contract proceeds. The contractor argued that they have a tax lien that has priority over whatever interest the surety has. The court reasoned that the surety's equitable right of subrogation related back to the date it executed the bonds and predated an IRS lien. The surety's equitable lien did not have to be recorded under the U.C.C. The court held that the money belonged to the surety and ordered the contractor to endorse the check.

## **X. CLAIMS OF LOSS OF BOND CAPACITY**

***Denny Construction, Inc. v. City and County of Denver***, 170 P.3d 733 (Colo.App. 2007), involved a dispute between Denver Water, the obligee and the general contractor who was hired by Denver to construct an office facility. The dispute arose over delays and costs and Denver Water eventually terminated the bonded contract and the surety completed the work. The principal and obligee asserted claims and counterclaims and the jury returned a verdict of \$1,063,000 to the principal including \$845,000 in lost profits based on impairment of bonding capacity. The trial court entered judgment on the jury verdict in favor of the contractor on the cross-claims, but denied the contractor's request for costs. Denver appealed the judgment and the contractor appealed the trial court's order denying its request for costs.

On appeal the contractor claimed that as a result of Denver's declaration of default and claim against the performance bond, its surety initially reduced the number of performance bonds it would issue to it and ultimately ceased writing bid, payment, and performance bonds for it. According to the contractor, this caused it not to be able to bid on and obtain other public works projects. Denver argued that the award of damages to the contractor for lost profits must be set aside because such damages are too speculative as a matter of law and was not reasonably foreseeable under the circumstances of this case. The court agreed and held that "a claim that a party would have received profits from future public project contracts if its bonding capacity had not been impaired is speculative as a matter of law." The court reversed the lost profits aspect of the damage award.

## **XI. BANKRUPTCY**

***Big Idea Liquidating Creditor Trust (In re Big Idea Productions, Inc.)***, 372 B.R. 388 (Bankr. N.D.Ill. 2007), concerned two companies that entered into a contract concerning the distribution of a product. A dispute arose and led to a lawsuit. The court granted a preliminary injunction against Big Idea to prevent the other company from distributing the product. However, the court ordered Big Idea to post a \$500,000 bond for preliminary injunction (the "Bond") in the event the District Court later determined the other company was wrongfully enjoined. Big Idea obtained a surety on the bond and entered into an indemnity agreement. When a jury found for the other company, the surety paid and Big Idea went into bankruptcy. The Fifth Circuit later reversed the judgment and held that the injunction was not wrongful and the \$500,000 should be refunded. By this time however, Big Idea had already gone into bankruptcy and its successor argued that it should receive the \$500,000. The debtor's theory was that the \$500,000 was property of the estate and the surety, as an unsecured creditor, had no rights to it other than to file a proof of claim and receive a pro rata share.

The court held that the surety was subrogated to the principal's right to receive the refund, that the surety's rights related back to execution of the bond prior to the bankruptcy petition, and that the surety should receive the \$500,000 refund. The court, citing *Pearlman*, agreed with the surety that the refund was never property of the bankruptcy estate to be distributed among the debtor's creditors.

***In re Electric Machinery Enterprises, Inc.***, 371 B.R. 549 (Bkrty.M.D.Fla. 2007), held that the surety, as an unsecured creditor, was not entitled to enforce its contractual right to recover post petition attorneys fees. In this case a surety issued a subcontractor performance bond on

behalf of a contractor on a construction project. As an accommodation to the Contractor who procured the Bond, the Debtor executed an indemnity agreement in favor of the surety agreeing to indemnify the surety from any losses incurred with respect to the Bond. The Contractor defaulted in its obligation to pay a subcontractor obligee, who thereafter sued and obtained a judgment against the Contractor and surety for \$432,471.16. The indemnitor filed for bankruptcy and the surety filed a proof of claim that included both pre and post petition attorneys fees. Under the indemnity agreement the surety was entitled to fees incurred to enforce the agreement. The debtor objected to the post petition attorneys fees. The court found that unsecured or under-secured creditors cannot recover post petition fees provided by contract. The Bankruptcy Code permits fully secured creditors to recover such fees, and by implication other creditors cannot. The court noted that to hold otherwise would permit certain types of unsecured creditors, typically holders of contract claims under agreements with attorneys' fee provisions, to recover their fees while other unsecured creditors (tort claimants and trade creditors) would not be able to recover fees as part of their unsecured claim.

In ***Hutson v. Greenwich Ins. Co. (In re E-Z Serve Convenience Stores, Inc.)***, 377 B.R. 491 (Bkrcty.M.D.N.C. 2007), the debtor operated a convenience store business. In connection with the business, the debtor was required to post various bonds including bonds related to money orders and moneygrams. The parent corporation, but not the debtor itself, signed a general agreement of indemnity that gave the surety the right to demand collateral. Knowing that the debtor's financial situation was deteriorating the surety demanded collateral. Within 90 days prior to the bankruptcy petition, the debtor transferred to the surety \$950,000 of collateral. As of the Transfer Date, no claims had been made or had accrued under any of the bonds. Claims were subsequently made and settled by the surety for amounts exceeding the collateral.

The Trustee in Bankruptcy sued the surety to recover the \$950,000 alleging that it was either a preference or a fraudulent transfer. Both parties moved for summary judgment as to the preference claim and the surety moved for summary judgment as to the fraudulent transfer claim.

The parties did not dispute that the transfer was of an interest of the Debtor in property, made within 90 days of the petition date, while the debtor was insolvent, and that the transfer resulted in the surety receiving a greater distribution than a hypothetical Chapter 7 distribution. However, the surety argued that the transfer was not on account of an antecedent debt and therefore could not be a preference. To answer this question, the court considered whether the surety was a creditor at the time of the transfer. The court concluded that the surety was a creditor. They found that the surety was obligated to pay any claims made by obligees under the bonds as the debtor's surety. The debtor, in turn, was obligated to indemnify the surety for any such payments. As a result, the surety had a contingent claim against the debtor for reimbursement that became fixed if and when a claim was made against a bond. As an entity that had a claim against the debtor, the court reasoned that the surety was a creditor. The court therefore denied the surety's summary judgment motion and effectively found that the trustee established a preference.

The surety, however, asserted statutory affirmative defenses of "new value" and "ordinary course of business." To establish the affirmative defense of "ordinary course of business" the creditor must show that the debt was incurred in the ordinary course of business or financial affairs of the debtor and the creditor. The creditor must also prove that the debtor made the

transfer in the ordinary course of business between the parties. Lastly, the creditor must show that the transfer was made in accordance with ordinary business terms. The trustee pointed to evidence that the transfer was not made by the due date originally established by the surety, was in an amount less than the amount originally demanded, and was made reluctantly only after the surety threatened to terminate the bonds. The surety presented some evidence that the transfer may have been in keeping with the ordinary course of dealings between surety and debtor. The court found genuine issues of fact precluding summary judgment for the trustee.

The preference provides that a trustee may not avoid a transfer to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor- not secured by an otherwise unavoidable security interest; and on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor. The surety argued that that there was reasonably equivalent value given for the transfer. The court held that the trustee established a genuine issue of fact on that issue. Hence, the court denied each of the summary judgment motions.

***In Re St. Paul Fire and Marine Ins. Co. v. Century Asphalt Materials, LLC***, 2007 WL 1468549 (S.D. Tex. 2007), was an appeal that resulted from a Bankruptcy Court ruling denying the surety's motion for summary judgment and granting appellee's motion for summary judgment. The material facts were undisputed. The appellee supplied materials to the prime contractor on a public works project and was paid for the materials by the prime contractor in May of 2005. The payments to Appellee were challenged by the Bankruptcy Trustee pursuant to 11 U.S.C. § 549 as unauthorized post-petition transfers. The trustee and appellee settled this dispute by appellee agreeing to pay the bulk of the payments it received to the trustee. The Bankruptcy Court approved the settlement.

The Texas Government Code § 2253.041 requires the payment bond beneficiary to provide written notice to the surety by the "15th day of the third month after each month in which ... any of the claimed material was delivered." Because Century Asphalt did not provide St. Paul with the statutorily required notice of non-payment on or before June 15, 2005, as required by § 2254.041, the Bankruptcy Court held that the doctrine of equitable estoppel applied to extend the deadline for Century Asphalt to provide the § 2253.041 written notice.

On appeal, the appellee argued that the avoided transfer excused compliance with the notice provisions in the Code or that equitable estoppel tolled the notice period. The court held that even if the effect of Appellee's settlement with the Trustee was to return Appellee to the position it would have held in May 2005 if the Debtor (prime contractor) had not paid for the material provided, Appellee would still be required under § 2253.041 to provide written notice "on or before the 15th day of the third month **after ... any of the claimed material was delivered.**" The court held further that the § 2253.041 notice requirement is not a statute of limitations, but is a substantive condition precedent to maintaining a claim on a payment bond. The equitable tolling doctrine applies only "to the affirmative defense of limitations" and not to cases involving a "jurisdictional statutory prerequisite.

***Travelers Cas. and Sur. Co. of America v. Pacific Gas and Elec. Co.***, 127 S.Ct. 1199, 167 L.Ed.2d 178, (2007). The surety in this case issued a bond to a principal to guarantee payment of state workers' compensation benefits. When the principal went bankrupt, the surety asserted a claim in the bankruptcy action to protect itself should the principal default on the

benefits. With approval of the court, the principal agreed to insert language into its reorganization plan and disclosure statement to protect the surety in case of such a default. However, the language was eventually disputed and the court then stipulated that the surety could assert a general unsecured claim for attorney's fees, which were authorized in the parties' original indemnity agreements. When the surety filed an amended claim for these fees, the principal, relying on a Ninth Circuit decision, argued that where the litigated issues involve not basic contract enforcement questions, but issues peculiar to federal bankruptcy law, attorney's fees generally will not be awarded. The Bankruptcy Court rejected the surety's claim on that basis, and the District Court and the Ninth Circuit affirmed.

In reviewing the bankruptcy code the Supreme Court could find nothing that disallowed the surety's claim. The court determined that the 9<sup>th</sup> Circuit rule that the principal relied on finds no place in the bankruptcy code. The court states that it is generally presumed that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed.

In ***Butler v. Citicorp Credit Services, Inc. (In re Butler)***, 2007 WL 2669261 (Bankr. W.D.Tex. Sept. 5, 2007), the plaintiff had a credit card account with the defendant and eventually filed for relief under chapter 7 of the Bankruptcy Code, disclosing the defendant as a creditor. The debtor assigned the plaintiff's discharged debt to a debt collection company and was required to post a "Debt Collector Bond" with the Texas Secretary of State. The plaintiff sued the credit card company, the debt collection agency and the surety alleging that defendants contacted the plaintiff on multiple occasions seeking repayment of the pre-petition debt. The plaintiff stated three bases for relief: (1) violation of chapter 392 of the Texas Finance Code, (2) the tort of unreasonable collection efforts, and (3) violation of the bankruptcy discharge injunction. The court held that it did not have jurisdiction over the plaintiff's state law claims for violation of the Texas statute and common law "unreasonable collection efforts." The court dismissed those claims, but held that it did have jurisdiction of a claim for violation of the bankruptcy discharge injunction.

In ***Schmitt v. O'Brien (In re O'Brien)***, 2007 WL 3047112 (Bankr. W.D.N.Y. Oct. 19, 2007), an individual indemnitor filed for bankruptcy but was denied a discharge of his debts. A surety was the only unsecured creditor listed. The trustee, U.S. Trustee and Surety joined in a proceeding to deny the debtor's discharge because they alleged that he had numerous false oaths in the bankruptcy proceeding. The court denied the discharge noting that there had been concealment of assets and fraudulent transfers.

***Travelers Cas. & Sur. Co. v. Desselle (In re Fries)***, 378 B.R. 304 (Bkrcty. D.Kan. 2007), concerned a debtors' Chapter 13 plan obligation to assign a lawsuit to the plaintiff free and clear of liens. In this case a series of settlement agreements were reached among the parties to a public construction project. As part of the settlement, the prime contractor assigned to its surety a collateral security interest in the contractor's claim against the City for actions by the City relating to the project. In return, the surety agreed to forbear from pursuing the prime contractor personally until the claim was resolved. The surety, prime contractor, and subcontractor also entered into a settlement agreement in which the subcontractor accepted \$60,000.00 and a percentage of any recovery on the claim. As part of effectuating these settlements, the parties engaged a lawyer on a contingency fee basis to pursue the claim against the city and any counterclaim the city may assert.

The lawyer took three years to file the claim. After three years, the surety no longer wanted the attorney to file suit against the city because they were in the process of negotiating with the city. The attorney actually filed the suit without permission and the negotiations ground to a halt. The parties discharged the attorney but the attorney wrote the city asserting a lien on any proceeds of the claim, whether paid or used as an offset. The principal and surety made a second agreement that the principal would assign the claim to the surety free and clear of all claims or interests, including any attorney's lien. The surety wanted complete control over the claim against the city so it could have unbridled authority to reach a global settlement with the city. The surety filed an adversary proceeding asking the court to determine that the claim had been assigned to the surety free of any lien, that the attorney was not entitled to a lien, and that the contingent fee, even if enforceable, would be computed only on any net recovery actually paid not including any setoff or reduction in the obligee's claim.

The court granted all of the relief and held that under Missouri law the discharged attorney was entitled only to payment based on quantum meruit, but that any lien for fees depended on the contingency being met (a positive recovery for the principal). Since his services were of no value and there had been no positive recovery, he had no lien and so the debtors met their obligation of assigning the claim to the surety free and clear of all liens. The court also held that by filing suit against the client's instructions and with the intent to protect his own lien claim rather than promote the client's interests, the attorney forfeited any right to compensation.

***In re Roy Frischertz Construction Co., Inc.***, 2007 WL 2460998 (E.D.La. Aug. 24, 2007), concerns the representation by one firm of both the debtor and surety in a bankruptcy proceeding. Prior to the bankruptcy petition, the principal and surety had disputes with three obligees and the law firm was representing both the principal and its surety in those disputes. The law firm filed an application seeking court approval for its employment as special counsel to the debtor with respect to litigation contemplated by the debtor regarding several construction contracts that the debtor was a party to at the time of the filing of the Chapter 11 petition. The debtor was represented by different counsel in the bankruptcy. The surety was also represented by different counsel in the bankruptcy. The court approved the application, however the obligees opposed the law firm's fee applications. They argued that the law firm concealed its conflict of interest and could not, under Bankruptcy Code §327, represent both the debtor and the surety.

The court examined exceptions in §327 and decided that the issue was whether there was a conflict of interest between the debtor and the surety in the construction actions, which were the only aspects of the case in which the law firm was involved. The court held that there was no conflict since the debtor and the surety had the same interest in opposing the obligee's claims and since the debtor was obligated to pay for the surety's defense in the actions. The court found that this arrangement avoided cost. Although the fee application should have been more explicit, this defect did not bar approval. The court approved the fee application but declined to rule at the interim application stage on the obligee's objections to the reasonableness and amount of the fees.

***National Union Fire Ins. Co. of Pittsburgh, Pa. v. Garber***, 2007 WL 3407257 (E.D.Cal. Nov. 14, 2007), induced fraudulent transfers in a bankruptcy proceeding in an attempt to avoid indemnifying a surety. The defendants executed certain promissory notes and subsequently defaulted. The surety sued the defendants and was ultimately awarded damages but the defendants did not pay the civil judgment and filed for bankruptcy. The surety alleged that they

fraudulently transferred their assets to a family member. Meanwhile, the surety filed suit to void the transfers and enforce payment of the previous civil judgment. Eventually, the surety was paid for its loss and part of its fees but appealed the court's failure to award all of the fees. The surety also filed an adversary proceeding asserting that the civil judgment in the bond case is nondischargeable. The court denied the surety's motion on the ground that the adversary proceeding had been closed years earlier and the issue of the fees determined. The court held that since the defendant's debt to the surety had been paid in full, the surety no longer had standing. The surety's motion for reconsideration was denied.

In *In re Contractor Technology, Ltd.*, 376 B.R. 156 (S.D.Tex. 2007), 376 B.R. 156 (S.D.Tex. 2007), the surety took over work of its bankrupt principal. The surety entered into a ratification agreement with the subcontractor-claimant under which it was agreed that the surety would pay a specific amount of money and the claimant would release rights it had under the payment bond. The bankruptcy trustee had notified the claimant of a preference claim, contending that a payment the claimant had received from the principal was voidable. The claimant failed to take the amount of the voidable payment into account when it agreed to release the surety. When the claimant ultimately came to grips with the preference, it turned around and made a claim against the surety, claiming it was entitled to recover under the payment bond. It asserted theories of mutual mistake and failure of consideration to get around the ratification agreement's release. The court found that the claimant was bound by the ratification agreement, that there was no mutual mistake or failure of consideration, and enforced the release in favor of the surety.

*Askenaizer v. Seacoast Redimix Concrete LLC (In re Charwill Construction, Inc.)*, 2007 WL 4570330 (Bankr. D.N.H. Dec. 21, 2007), was a dispute over a bankruptcy preference claim arising out of money paid to the defendant by a debtor within the 90 days preceding the filing of a bankruptcy petition. The plaintiff, as trustee for the debtor filed a complaint to avoid payments the debtor transferred to the defendant in that period. The defendant moved for summary judgment on two grounds: (1) the subject payments could not be avoided because new value was contemporaneously exchanged for them; and (2) the funds at issue were not the debtor's property but trust funds.

The defendant had statutory lien rights against the debtor and had agreed to release its rights in exchange for the payments. The court held that the defendant's release of statutory lien rights was "new value," because it caused the coincident release of the owner's fully secured indemnity claim against the debtor, which in turn left the bankruptcy estate whole for unsecured creditors. The court granted summary judgment on this issue. On the second defense the court found a genuine issue as to whether the owner intended to create a trust and denied the defendant's motion for summary judgment.

## **XII. MISCELLANEOUS**

*Fireman's Fund Ins. Co. v. Safeco Ins. Co. of America*, 2007 WL 4233317 (W.D.N.C. Nov. 28, 2007), was a claim brought by a surety who voluntarily financed its insolvent principal against other sureties who concurrently bonded the same contractor. The Fireman's Fund brought its claims under theories of unjust enrichment and reservation of rights. Several surety companies had issued payment and performance bonds for multiple construction projects of J.A. Jones and its related subsidiaries. Fireman's Fund agreed to finance Jones, and then sued two other sureties alleging that funds it had advanced to Jones which unjustly enriched

the other two sureties because Jones was also working on those projects. Jones could not distinguish their costs between the projects Fireman's Fund bonded and those bonded by other sureties, and Fireman's Fund argued that its support benefited the other sureties' bonded projects as well. The court agreed that the other sureties benefited from the financing but held that Fireman's Fund did not state a claim for unjust enrichment because its actions were "officious." The court found that absent inducement or solicitation, the other sureties were not liable for unjust enrichment, even if they did benefit from the plaintiff's actions. The court held that reservation of rights was not a cause of action and granted the defendant's motion to dismiss.

***St. Paul Fire and Mar. Ins. Co. v. Nolen Group, Inc.***, 2007 WL 4245740 (E.D.Pa. Nov. 30, 2007), arose in the aftermath of flood damage from tropical storm Alison six years ago. The case involved a property loss dispute involving numerous subrogated insurers. Baringer Land Clearers, though found by the jury to have been 1% liable for the damage suffered by Plaintiffs' insureds, remained jointly and severally liable for approximately \$8.9 million from the aggregate \$28,265,167.55 verdict ultimately entered in favor of all four insurer plaintiffs in the underlying case. Selective Way, the garnishee, was the excess ("umbrella") liability insurer for Baringer. After the judgment was entered Baringer filed a motion to stay proceedings to enforce the judgment against it pending disposition of post-trial motions and appeal or, in the alternative, for approval to post security in an amount less than the outstanding judgment. The court ordered a stay conditioned on a bond in the full amount of the judgment. The liability carrier for the defendant arranged for a related company to post a supersedeas bond in the amount of the liability coverage, and the defendant asked the court to reduce the bond requirement to that amount. Baringer eventually posted a bond that was 1/3 of that which was ordered by the court. Baringer, who has a potential bad faith claim against Selective Way assigned the claim to the plaintiffs, along with all of Baringer's rights under the two insurance policies. The plaintiffs argued that they could pursue the liability policies as assignees and also collect on the supersedeas bond if they prevailed in the appeal. Selective Way argued that plaintiffs were trying to subject Selective Way to double exposure, i.e., the \$2 million limits of liability (plus interest) via the execution and/or garnishment gambit while preserving their rights to collect the face amount of the bond in the event Baringer's appellate efforts are unsuccessful. This would mean the liability carrier paying twice – once under the policies to the claimants and a second time to the surety as an indemnitor on the supersedeas bond. The plaintiff insurers contended that the bond is a separate contractual obligation from the policies. The court found that Selective Way was under no compulsion to post a bond for the full (or any) amount of the judgment against Baringer and that Selective Way's exposure to others purporting to sue it for its obligations to Baringer for coverage under the policy is similarly limited. Therefore, the insurer met its obligation to the insured by arranging for the bond in the amount of the limits of liability. Thus, there was no breach of the insurer's obligation to the insured under the policies and, therefore, nothing for the claimants to garnish.

In ***Nelson Construction Co. v. United States***, 79 Fed.Cl. 81 (Fed. Cl. 2007), a subcontractor and its owner brought suit against the United States seeking to recover contract funds wrongfully paid to the defaulting prime contractor. The defaulting prime contractor was a Native American, and the subcontractor served as mentor and also indemnified the surety that wrote the Miller Act bonds. The subcontractors alleged that the prime contractor "created a false claim against it" and refused to pay funds owed to the subcontractor. The subcontractor obtained a judgment against the prime contractor but was unable to collect. The subcontractor informed the FHA's contracting officer that the prime contractor had made "false applications

for subsequent payment” claiming that it had paid the subcontractor when in fact, it had not. The subcontractor eventually refused to perform further work unless payment arrangements were made, and the contractor assigned future payments to the surety. The prime contractor assigned to Travelers all payments due under the Contract to “assure that future Project performance would be made to the surety as an escrow holder for the benefit of [the subcontractor].” The FHA received notice and made six consecutive payments to Travelers pursuant to the assignment. However, the contractor and the government later agreed to settle all claims pursuant to the contract, and the government made a final payment to the contractor, instead of the surety. The subcontractor then sued the United States, and the Government filed a motion to dismiss on jurisdictional grounds.

The United States brought a motion to dismiss alleging that the subcontractor’s claims were barred by sovereign immunity. The subcontractor set forth three theories for recovery. First, it asserted that the contractor assigned its rights to payment under the contract to the performance and payment bond surety. Second, it was alleged that because the government failed to pay the surety, the plaintiffs, in their role as indemnitors to the surety, were equitably subrogated to the surety’s’ rights to pursue a claim against the government for those funds. Finally, it was argued that the subcontractor was an intended third party beneficiary of the modification of the payment provisions of the contract to provide for payment to the surety, and as a third party beneficiary it could sue the United States directly for breach of the modified contract.

The United States countered that because plaintiffs were not named as assignees in the Assignment, the Court of Federal Claims lacks jurisdiction over their claim for wrongful payment.

Under the first theory, the court found that the subcontractor was not an assignee because it was not a party to the assignment and therefore could not sue for breach of the assignment. On the second theory, the court found that since the subcontractor was not the surety it had no basis to claim subrogation to the rights of the contractor and thus no basis to assert a Tucker Act claim. On the third theory, however, the court thought that the mentor had alleged facts which could support a third party beneficiary argument.

Because an intended third party beneficiary can sue under the Tucker Act, the court held that the information in the complaint was sufficient to defeat a motion to dismiss.

### **XIII. LIEN BONDS**

In *DBM Consulting Engineers, Inc. v. United States Fidelity and Guaranty Co.*, 170 P.3d 592 (Wash.App. 2007), the plaintiff recorded a lien against a client to secure a debt. The property owner obtained a lien bond to allow it to sell the property. The plaintiff then sued for breach of contract and prevailed at trial. Next, the plaintiff sued the bond surety to compel it to pay the amount of the bond. The trial court granted the plaintiff’s motion for summary judgment. However, on appeal the court reversed finding that under the mechanics’ lien bond statute because the plaintiff failed to obtain a judgment upon the lien, only obtaining a judgment on the breach of contract claim, the surety was not obligated to pay on the lien bond.

*Pansini Stone Setting, Inc. v. Crow & Sutton Associates, Inc.*, --- N.Y.S.2d ----, 2007 WL 4463775 (N.Y.A.D. 2 Dept. 2007), was an action to recover on a lien discharge bond. The

subcontractor filed a mechanics' lien on the property after abandoning the job due to a contract dispute. The contractor obtained a mechanics' lien release bond with the same surety who issued the payment bond. The parties stipulated that the dispute would be arbitrated and the arbitrator found in favor of the subcontractor. Subsequently, the subcontractor moved to confirm the award; the contractor moved to vacate it and the surety moved to intervene. The court confirmed the award against only the contractor.

The subcontractor then moved to file an amended complaint to name the surety and add a claim on the payment bond. The trial court denied the motion, but the Appellate Court reversed. The only prejudice that the defendants asserted was that they would be exposed to additional potential liability as a result of the amendment. The court found however that prejudice requires that "the defendant has been hindered in the preparation of his [or her] case or has been prevented from taking some measure in support of his [or her] position." The court also found that since the plaintiff's claim against the surety arose from the assumption of the obligations that are otherwise at issue in this action, the plaintiff's motion satisfied all of these requirements.