

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

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SURETY LAW UPDATE

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I. Enforcement of Surety's Rights of Indemnification and Exoneration

Hartford Cas. Ins. Co. v. Cal-Tran Assocs., Inc., 2008 WL 4165483 (D.N.J. 2008) involved a suit by Hartford Casualty Insurance Company ("Hartford") against its principal and indemnitors for indemnity and the deposit of collateral under the terms of an indemnity agreement executed by the parties. Hartford moved for partial summary judgment seeking indemnification for its paid losses and the deposit of collateral for anticipated future losses.

The Court held that the surety was entitled to be indemnified for all payments made in good faith. According to the Court, a determination of whether a contractor is actually in default is immaterial to the surety's rights to indemnification. Absent bad faith, fraud or extravagance, the surety is entitled to be indemnified. Although the defendants argued there was a genuine issue of material fact regarding whether the surety acted in bad faith in taking over completion and questioned the manner in which the project was completed, the Court disagreed and granted Hartford's motion as to the liability of the principal and indemnitors. The Court also granted specific performance of the collateral deposit provision of the indemnity agreement.

In *Fidelity & Guar. Ins. Co. v. Star Equip. Corp.*, 541 F.3d 1 (1st Cir. 2008), the surety filed a declaratory judgment action to obtain a determination of its rights and obligations for work undertaken on a construction project on which its principal had been defaulted. The surety also included a claim against its principal and indemnitors for indemnification. The principal filed a cross-claim against the obligee seeking payment for work it had performed, while the obligee cross-claimed against the principal for breach of contract.

The parties engaged in mediation and reached a hand-written settlement agreement resolving all issues, except the surety's indemnification claim, that was signed by all parties and their counsel. When the principal/indemnitors refused to carry out the terms of the settlement, Fidelity and the obligee filed a motion to enforce the settlement which the lower court granted. The surety then filed a summary judgment motion on its indemnification claim, which the principal/indemnitors opposed asserting bad faith on the part of Fidelity as a defense to the enforcement of the indemnity agreement. The lower court granted the surety's motion.

On appeal, the principal/indemnitors contended that the agreement to settle with the obligee was contingent on the resolution of Fidelity's indemnification claim. They also claimed they were assured by Fidelity's representative at the mediation that she would work with the indemnitors to resolve the surety's claim. The Court rejected these arguments, finding that the parties agreed in writing to settle all claims except those involving the indemnity agreement. Moreover, the principal/indemnitors' subjective belief that the settlement agreement was not "final" did not bar enforcement, especially in light of their assent in writing to the unambiguous terms of the agreement.

The Court also upheld entry of summary judgment as to the surety's indemnification claim. Provided a surety acts in good faith which, under Massachusetts law, carries an implication of a dishonest purpose, conscious doing of wrong, or breach of duty through motive of self-interest or ill will, a surety is entitled to a judgment as a matter of law when seeking to enforce an indemnity agreement. Although the principal/indemnitors maintained Fidelity settled with the obligee out of motives of self-interest because it was financially expedient to do so, the Court disagreed. According to the Court, "the Indemnitors cannot charge Fidelity with bad faith for making a payment that the Indemnitors agreed Fidelity should make. Fidelity is entitled to indemnification." *Id.* at *7.

The Court in *International Fid. Ins. Co. v. Anchor Env'tl., Inc.*, 2008 WL 1931004 (E.D. Pa. 2008) granted the surety's summary judgment motion against its principal and indemnitor in the amount of the surety's paid losses and issued an injunction directing the defendants to deposit collateral to cover the surety's anticipated future liability on bonds issued on the defendants' behalf on a public works project in Pennsylvania. In so ruling, the Court rejected the defendants' contention that the surety acted in bad faith by not providing financial assistance in completing the work on the project. The Court agreed with the surety that it had no obligation to bail out the principal, even had the surety promised such assistance would be forthcoming. The Court further dismissed the defendants' argument that the surety should have litigated and defended the payment bond claims. Relying on the plain language of the indemnity agreement, the Court noted that the surety had the right to settle any claim, whether or not liability existed, unless the defendants requested that the surety litigate or defend such claims and, at the time of the request, deposited with the surety collateral to be used in paying any judgments and costs. The Court found that the defendants produced no evidence of any request that the surety litigate and defend against the claims, nor did the defendants post collateral as set forth in the indemnity agreement.

The Court also granted the surety's request for injunctive relief with respect to potential liability to the obligee under the performance bond. In a good discussion of the traditional factors weighing towards the propriety of injunctive relief, the Court held that the surety was likely to succeed on the merits because the indemnity agreement gave the surety the right to be collateralized as soon as liability was asserted. The Court also noted that the surety would suffer irreparable injury absent a preliminary injunction given its exposure to claims under the bonds, and that the defendants would not suffer irreparable harm if the injunction were issued. Finally, the Court determined that the issuance of a preliminary injunction would further the public interest by recognizing and enforcing the plain language of the indemnity agreement. The Court observed that "Pennsylvania has an important interest in seeing that the contractors on public works projects use contract funds to perform the work and pay subcontractors and suppliers." *Id.* at *8.

The surety for an Ohio bridge painting contractor in *International Fid. Ins. Co. v. Vimas Painting Co.*, 2008 WL 926577 (S.D. Ohio 2008), sued its principal and the

individual indemnitors for the specific performance of a collateral security provision of an indemnity agreement after it was separately sued by the obligee under a warranty maintenance bond. The principal and indemnitors filed a counterclaim alleging that the surety acted in bad faith in, among other things, demanding that the defendants post excessive collateral and refusing to accept the principal/indemnitors' offer to defend the surety in the underlying suit. The surety moved to dismiss the principal/indemnitors' counterclaim, which the Court granted. The Court held that the principal/indemnitors had no bad faith cause of action against the surety. While the principal may assert any alleged bad faith as a defense to the surety's indemnification action, it cannot assert an affirmative claim for bad faith against the surety.

In *Kennerson v. LaBarbera*, 537 F.Supp.2d 305 (W.D.N.Y. 2008), a subcontractor on a construction project for a county water authority sued the general contractor, its surety and the owner to recover for labor and materials furnished on the project. The surety settled the subcontractor's claim and paid several bond claims to other suppliers and subcontractors on the project. The surety then moved for summary judgment under the terms of an indemnity agreement executed by the principal. In response, the principal did not dispute its obligations to the surety under the indemnity agreement, but took issue with the amount of the surety's payments. The Court held that the indemnitors, having agreed to be bound by the surety's settlement determination, waived all rights to later object to the settlement. The Court granted summary judgment in favor of the surety.

Travelers Cas. & Sur. Co. v. Dale, 542 F.Supp.2d 260 (S.D.N.Y. 2008) involved a suit by Travelers to enforce the collateral security provision of an indemnity agreement arising from anticipated losses under two international carrier bonds issued in favor of the United States Customs Service. The bonds were provided on behalf of Great Western Steamship Company ("Great Western") in reliance upon the personal indemnity of the former president of Great Western. In response to Travelers' summary judgment motion, the indemnitor contended that he was absolved from liability based upon an assignment of assets to a third party by Great Western for the benefit of its creditors which occurred several months before demand was made under the bonds. According to the indemnitor, he no longer exercised any control over the principal after the assignment, and Travelers' sole recourse should have been against the assignee.

The Court rejected the indemnitor's arguments and granted the surety's summary judgment motion. A collateral security provision, according to the Court, imposes an obligation upon an indemnitor to provide a surety collateral security after the surety has received demand from the bond obligee, and prior to any actual bond loss. The fact that there was an assignment for the benefit of Great Western's creditors did not relieve the indemnitor of his contractual obligations to Travelers. In short, there was no basis to conclude that the parties to the assignment agreement contemplated or agreed that the assignee would assume responsibility for the indemnitor's obligations to Travelers under the indemnity agreement.

In *United States Fid. & Guar. Co. v. E.L. Habetz Builders, Inc.*, 2008 WL 852030 (W.D. La. 2008) four separate claims on two bonded projects were filed against E.L. Habetz Builders, Inc. (“Habetz”) and USF&G, as surety. With respect to two of the claims, USF&G initially tendered its defense to Habetz and its counsel, but later retained separate counsel to represent its interests. On the third and fourth claims, USF&G simply retained the same counsel it had previously hired to represent its sole interest in the defense of the first two claims. Following the resolution of the claims, USF&G filed suit to enforce its indemnity rights against the principal and indemnitors, and later sought summary judgment.

The principal opposed USF&G’s motion on the grounds that the fees paid by USF&G were not reasonable, and because provisions of the *Louisiana Civil Code* were ignored by USF&G. The Court disagreed, finding that the Master Surety Agreement did not restrict USF&G in retaining counsel of its own choosing, and that USF&G had satisfied its “initial burden of showing an absence of evidence demonstrating the fees and expenses it seeks are unreasonable.” *Id.* at *12. The Court properly granted the surety’s summary judgment motion and entered judgment for the full amount of the fees and expenses incurred after retention of its chosen counsel.

In *Fidelity & Deposit Co. of Md. v. D.M. Ward Constr., Inc.*, 2008 WL 2761314 (D. Kan. 2008), Fidelity and Deposit Company of Maryland (“Fidelity & Deposit”) filed suit seeking specific performance of a collateral security provision of an indemnity agreement. The principal/indemnitors claimed Fidelity & Deposit was not entitled to the requested relief because it had acted inequitably in handling various performance and payment bond claims submitted on different construction projects bonded on the principal’s behalf. The principal/indemnitors filed a counterclaim against Fidelity & Deposit for breach of the indemnity agreement, civil conspiracy and breach of fiduciary obligations, and also pleaded the affirmative defense of “unclean hands.”

Fidelity & Deposit moved for summary judgment which was granted by the Court. In so doing, the Court observed that the indemnity agreement gave Fidelity & Deposit the unfettered discretion to handle claims unless and until the principal/indemnitors posted collateral. Because the principal/indemnitors did not post any collateral, they “bargained away the right to contest how plaintiff handled the claims upon the bonds.” *Id.* at *3. The Court further observed that when a surety has demanded that a principal post collateral security and the principal refuses, the legal remedy of damages is not adequate, and the surety is entitled to specific performance of the collateral security provision of the indemnity agreement.

Travelers Cas. & Sur. Co. of America v. Atlas Fence Co., 2007 WL 4754881 (Conn. Super. Ct. 2007) involved an action for indemnification brought by Travelers Casualty and Surety Company of America (“Travelers”) against its principal and individual indemnitors to recover amounts paid by the surety to various payment bond

claimants. Travelers moved for summary judgment which the principal and indemnitors resisted on the grounds that the indemnity agreement ran in favor of Reliance Insurance Company (“Reliance”), Travelers’ predecessor in interest, and that Travelers therefore lacked standing to bring the action or to enforce the terms of the indemnity agreement. In response, Travelers submitted affidavits of senior representatives of Travelers and Reliance, both of whom had personal knowledge of the negotiations between Travelers and Reliance and testified that the parties intended to transfer any indemnity rights and remedies to Travelers. The Court agreed and entered summary judgment in favor of Travelers.

The evidence reflected that the surety repeatedly, and without success, attempted to gain information from the principal and its attorney to assist with the evaluation and defense of the plaintiff’s claim. Given the lack of assistance and impending trial date, and because the analysis by the surety and its counsel confirmed the validity of the claim, the surety negotiated a settlement favorable to both the principal and surety. In light of the foregoing, and given that the indemnity agreement explicitly provided that the surety had the right to settle or compromise any claim and its decision thereon would be “final and binding,” the Court held that the principal waived any right to object to any of the surety’s payments and granted the surety’s summary judgment motion.

In *Travelers Indem. Co. v. Harrison Constr. Group Corp.*, 2008 WL 4725970 (E.D.N.Y. 2008), the surety sued its principal and indemnitor to recover losses and expenses related to a claim by the obligee on a performance bond. The defendants argued that they were not liable to the surety because the surety owed nothing to the obligee due to the obligee’s failure to formally terminate the bonded contract. The Court held that under New York law the surety did not have to prove that it was liable to the obligee. Under the indemnity agreement, the surety was permitted to settle claims at its discretion and was entitled to indemnity so long as the settlement was made in good faith and the amount paid was reasonable. The Court held that a showing of a lack of good faith on the part of the surety required proof of fraud or collusion and not simply negligence.

The Court of Appeals of Arizona in *Capitol Indem. Corp. v. Super Lath & Stucco, Inc.*, 2008 WL 4444627 (Ariz. Ct. App. 2008), affirmed the lower court’s summary judgment in favor of the surety on its claims for indemnity against the principal and indemnitors. The principal appealed from the summary judgment arguing that the surety did not act in good faith in settling underlying claims for which the surety sought indemnity. The Court of Appeals held that the surety acted in good faith and the settlements were reasonable as the principal was unable to meet payroll, pay suppliers, or buy materials for the project. Furthermore, the surety negotiated settlements with the claimants for approximately two-thirds of the amounts claimed.

In *Safeco Ins. Co. of America v. Taragon Corp.*, 2008 WL 4279691 (M.D. Fla. 2008), the surety, which had issued a lien bond, sued its principal and indemnitors to enforce the provisions of an indemnity agreement after the principal failed to collateralize the surety upon demand. The surety sued for breach of contract, *quia timet*, exoneration, and specific performance. The principal and indemnitors filed a motion to dismiss claiming that the complaint, as drafted, failed to state valid claims against the defendants. The Court analyzed the pleading requirements for each of the claims and ultimately denied the defendants' motion as sufficient facts were alleged to state valid claims under Florida law.

II. Surety's Defenses

In *Developers Sur. & Indem. Co. v. Dismal River Club, LLC*, 2008 WL 2223872 (D.Neb. 2008), Dismal River Club, LLC ("Dismal River") hired a contractor to install an irrigation system at a golf course. There were problems from the date of substantial completion. The owner, however, spent hundred of thousands of dollars over a period of three years before advising the surety that there were "problems." Ultimately, Dismal River requested a meeting pursuant to the A312 performance bond form. On the day of the meeting, the surety filed suit seeking a declaratory judgment as to its liability under the bond.

The District Court entered summary judgment for the surety, finding that notice was not given and that the surety was not provided with a reasonable opportunity to investigate the claim. The Court added that because the surety's ability to discharge its obligation under paragraph 4 of the bond would be prejudiced, the owner could not attempt to satisfy the conditions precedent retroactively.

The Court in *Current Builders of Florida, Inc. v. First Sealord Sur., Inc.*, 984 So. 2d 526 (Fla. Dist. Ct. App. 2008) upheld a lower court's ruling that a general contractor, as obligee on a subcontract performance bond, failed to comply with the provisions of the bond necessary to trigger the surety's obligations. The Court also set aside the lower court's award of attorney's fees to the surety because the lower court failed to award the surety the full extent of its fees on its claim against its principal.

Current Builders of Florida, Inc. ("CB") was the general contractor on a construction project. CB hired Morgado Plumbing Corporation ("Morgado") to perform certain plumbing work. First Sealord Surety, Inc. ("First Sealord") issued subcontract performance and payment bonds on Morgado's behalf on the project. From the outset, CB was not happy with Morgado's performance and wrote several letters to Morgado and First Sealord. Each letter declared the principal in default and demanded that First Sealord, as surety, be responsible for any delays or damages. CB, however, did not terminate Morgado until a year into the project, after which it hired another company to correct and complete Morgado's work. CB did notify both Morgado and First Sealord of its decision to terminate, neither of which responded. CB subsequently filed suit against

First Sealord under the performance bond. Morgado filed a separate action against CB alleging CB breached the subcontract by failing to make payroll payments, and CB counterclaimed against Morgado.

The cases were consolidated and tried before a jury. The jury determined that CB did not comply with the provisions of the performance bond necessary to trigger the surety's duties and obligations under the bond and entered judgment in First Sealord's favor. Post-trial, First Sealord moved for attorney's fees and expenses. Because the same attorney represented Morgado and First Sealord, the trial court awarded First Sealord only one-half of its attorney's fees.

On appeal, the Court agreed with the jury's findings as to the surety's obligations under the performance bond. The Court observed that:

Paragraph 4 of the performance bond addresses the manner by which First Sealord's obligation to perform arises:

4. If there is no Contractor Default, the Surety's obligation under this Bond shall arise after:

. . . .

4.1 The Contractor has notified the Subcontractor and the Surety...that the Contractor is declaring the Subcontractor in Default, of any Sub-subcontractors' obligations under the Contract, (including punch list warranty items after substantial completion); or

4.2 The Contractor has declared a Subcontractor Default and formally terminated the Subcontractor's right to complete the Contract; and

4.3 The Contractor has agreed to pay the Balance of the Contract Price, if any, to the Surety in accordance with the terms of the Construction Contract or to a subcontractor selected by Surety to perform the Construction Contract in accordance with the terms of the Contract with the Contractor.

In light of the "or" separating sections 4.1 and 4.2, First Sealord's obligations arise if CB complies with *either* 4.1 *or* both 4.2 and 4.3. Section 4.1 does not apply, because no sub-subcontractor was involved.

984 So. 2d at 530-31 (emphasis original).

Although CB produced letters showing a declaration of default, those letters did not trigger First Sealord's duties and obligations because Morgado was allowed to

continue to work on the project. The “termination letter” that eventually was sent was insufficient because it did not comply with the termination provisions of the subcontract and, therefore, did not trigger First Sealord’s obligations. Furthermore, CB did not give notice to First Sealord that it agreed to pay the balance of the subcontract to the surety or to a subcontractor selected by the surety. Instead, CB simply took over those obligations and did not permit the surety to perform under the bond. Given the foregoing, the Court agreed that there was abundant evidence that First Sealord did not receive proper notice to invoke its obligations under the bond. The Court also reversed the trial court’s finding that the surety was only entitled to one-half of its attorney’s fees. In so ruling, the Court agreed with First Sealord that the issues tried regarding its liability were inextricably intertwined with CB’s breach of contract claim against Morgado and that the trial court erred in making an arbitrary division of the fees.

United States ex rel. McKenney’s, Inc. v. Government Technical Servs., LLC, 531 F.Supp.2d 1375 (N.D. Ga. 2008) considered whether a surety could use a pay-when-paid clause in its bonded principal’s contract as a defense to a subcontractor’s Miller Act claim. The subcontractor moved for summary judgment, which the Court granted. Although a pay-when-paid provision is valid and enforceable under Georgia law, the Court recognized that the Miller Act provides a federal cause of action, and the rights and remedies available under it are matters of federal, not state, law. As such, a subcontractor’s right of recovery on a Miller Act payment bond accrues ninety (90) days after the subcontractor has completed its work, not “when and if” the prime contractor is paid by the government. The Court observed that if the pay-when-paid clause could be used as a defense to a payment bond claim, the subcontractor’s suit would be time-barred if payment by the government did not occur within one (1) year after the date the claimant last furnished labor and materials on the project. Such a result would run counter to the “highly remedial” nature of the Miller Act and deny the subcontractor its federal remedy.

The Court in *C & I Entm’t, LLC v. Fidelity & Deposit Co. of Md.*, 2008 WL 4755413 (N.D. Miss. 2008) denied the surety’s motion for summary judgment on statute of limitations grounds. There, the surety issued an AIA A312 performance bond which stated that before suit could be filed against the surety there must be a meeting between the parties, notice of termination to the surety, the surety’s exercise of specific options – including the surety’s denial of the claim – and an additional notice if the obligee thought the surety was taking too long to exercise its options. Even though the obligee was aware of alleged construction defects by December of 2002 and had sued the principal in August of 2003, demand was not made to the surety until May of 2004 and the surety denied liability on March 3, 2005. The obligee sued the surety on December 28, 2007. The surety’s motion for summary judgment was based on Mississippi’s three year statute of limitations for breach of contract.

The Court held that the obligee could not have sued the surety on the performance bond until the surety denied liability. That did not occur until March 3, 2005. Therefore, the statute of limitations did not begin to run until the date on which the surety denied liability.

In *The Public Bldg Auth. of The City of Huntsville, Ala., et al. v. Dawson Bldg. Contractors, Inc.*, Circuit Court of Madison County, Alabama, Case No. CV-06-1943 (unreported decision), a contract for the construction of a new \$30 million jail facility was suspended after cracks were discovered in modular concrete cellblocks, raising concerns over the structural integrity of the project. Extensive engineering testing was conducted with inconsistent results. Faced with the contractor's claims for extended overhead, delay, and reorganization costs, the owner exercised its option to terminate the contract for convenience. Subsequently, the owner hired a new completing contractor to complete the project. After the general contractor sued to recover the balance due on the contract and for delay costs, the owner sought to convert the termination for convenience into a termination for default and filed a countersuit against the original contractor and its surety.

The contractor moved for summary judgment, arguing that termination for convenience put an end to its contractual obligations and precluded any action against the bond. The trial court agreed in part, but held that "cure" provisions of the contract survived termination. On later motions, the surety obtained summary judgment based upon the owner's failure to comply with the conditions precedent set forth in the A312 bond form. Motions for interlocutory appeal were then granted as to whether termination for convenience precludes claims against the general contractor and its surety and whether the owner's obligations to give notice are suspended pending termination for cause. The appeal remains before the Alabama Court of Appeals/Supreme Court of Alabama.

III. Bad Faith

In *Arch Ins. Co. v. Douglas Asphalt Co.*, 2008 WL 4360687 (S.D. Ga. 2008), the surety moved for summary judgment against its principal and indemnitors. In response, the principal/indemnitors argued they were relieved of their obligations under the terms of the indemnity agreement because the surety breached its fiduciary duty by failing to act in good faith. Specifically, the principal/indemnitors contended that the surety acted in bad faith by, among other things, failing to assert valid defenses, diverting contract payments without the principal's knowledge, coercing the principal to execute voluntary letters of default, failing to timely take over defaulted projects and failing to fund and removing the principal from projects.

The Court observed that there is authority under Georgia law for the proposition that a surety acts as a fiduciary and, therefore, has a duty to act in good faith and with loyalty. Although the surety had the exclusive right under the terms of the indemnity agreement to decide whether any bond claim should be paid, compromised or resisted, and the surety's decision in that regard was binding upon the indemnitors, the surety still has the duty, according to the Court, to act in good faith in the exercise of its exclusive right to settle bond claims.

Because the Court determined that there were some, “albeit few,” *id.* at *2, issues as to whether the surety acted in good faith in discharging its payment and performance bond obligations, the Court denied the surety’s motion for summary judgment.

The surety in *Liberty Mut. Ins. Co. v. Northeast Concrete Products, LLC*, 756 N.W.2d 93 (Minn. Ct. App. 2008) sought indemnity and exoneration from its principal relative to performance bond claims by the obligee. The issue before the Court was whether, under Minnesota law, fraudulent intent is required to prove bad faith – or lack of good faith – on the part of the surety. Recognizing that a majority of courts considering the issue have concluded that bad faith does not mean negligence, lack of diligence, or bad judgment, but rather implies a conscious doing of wrong because of dishonest purpose or moral obliquity, the Court noted that no Minnesota court has taken the affirmative step to require bad faith to rise to the level of fraud before an indemnitor is released from its obligations. Therefore, the Court held that a showing of fraudulent intent is not required to prove that a surety acted in bad faith in settling an underlying performance bond claim.

The surety in *International Fid. Ins. Co. v. Podlucky*, 2008 WL 1829904 (W.D. Pa. 2008) moved for summary judgment with respect to the amount of its payment bond losses. In opposing the motion, the indemnitors argued that the surety acted in bad faith by paying claims the indemnitors told the surety not to pay and by failing to tender a defense of the claims to the indemnitors’ counsel. One of the indemnitors submitted an unsworn affidavit expressing his belief that the surety did not sufficiently investigate the claims and paid them in bad faith. The Court stated, “Mr. Podlucky’s personal belief that Fidelity acted in bad faith is insufficient to satisfy the Podlucky’s burden to provide sufficient evidence that Fidelity acted in bad faith in order to survive summary judgment. The Podlucky’s utter and complete failure to produce any evidence in support of their position, regardless of the reason, is fatal at this point in the case.” *Id.* at *3. As a result, the Court entered summary judgment in the surety’s favor.

In *Intercon Constr., Inc. v. Williamsport Mun. Water Auth.*, 2008 WL 239554 (M.D. Pa. 2008) an owner, which had been sued by a contractor on a public works project, counterclaimed against the contractor for breach of contract and filed a third-party complaint against Safeco, the contractor’s performance bond surety. The owner’s third-party complaint included a count for bad faith under Pennsylvania’s insurance bad faith statute. Safeco argued that the statute did not apply to a surety bond and moved to dismiss the bad faith claim. In considering the surety’s motion, the Court stated that the critical question was whether a surety bond could be considered “an insurance policy” for purposes of the statute. The Court, after reviewing various cases decided under Pennsylvania law, held that Safeco, as surety, could not be held liable for bad faith and granted the motion to dismiss.

IV. Defaults Binding Against Surety

The Court in *United Fire & Cas. Co. v. Eldridge*, 2008 WL 1991641 (Ky. Ct. App. 2008) held that the surety was conclusively bound by a default judgment entered against its principal. There, the surety was sued, along with its principal, in an action brought by a payment bond claimant. The plaintiff secured a default judgment against the principal and later successfully obtained summary judgment against the surety based upon the default entered against the principal. In upholding the judgment of the lower court, the Court of Appeals noted that sureties are generally bound by judgments entered against their principals where the sureties have notice and an opportunity to defend in actions against their principals. Because the surety was a party to the litigation and did not assert any issue that would controvert its principal's liability "despite ample opportunity and notice," the Court concluded that the lower court did not abuse its discretion in entering summary judgment in the plaintiff's favor.

In *McAlpine v. Zangara Dodge, Inc.*, 183 P.3d 975 (N.M. Ct. App. 2008) is another case in which a Court held that the surety was conclusively bound by a default judgment entered against its principal. There, a truck purchaser filed suit against a motor vehicle dealership for fraud and unfair trade practices, alleging that the truck had sustained serious damage in an accident. The dealership filed a third-party complaint against the vendor from which it bought the truck.

The vendor filed an answer and initially participated in the litigation, but its counsel was later permitted to withdraw. Although the lower court directed the vendor to retain new counsel, it failed to do so. The dealership, in the meantime, filed a motion to compel the vendor to respond to discovery, or alternatively, a motion to enter default.

The dealership later filed an amended third-party complaint seeking to recover against a bond issued by Great American Insurance Company ("Great American"), as surety, to the vendor, as principal. After Great American entered an appearance in the case, a hearing was held on the dealership's motion to enter default. A couple of days later the lower court entered a default against the principal for failure to participate in discovery. Shortly thereafter, Great American timely filed an answer to the amended third-party complaint. Great American later filed a motion for summary judgment on the grounds that the dealership could produce no evidence of fraud by the vendor. The trial court denied the motion.

The truck purchaser and the dealership eventually settled. The dealership requested a hearing to prove damages against the vendor pursuant to the default entered almost a year earlier. Great American objected on the grounds that the entry of default was not binding on Great American. The lower court subsequently entered judgment in favor of the dealership and against the vendor.

Some ten months later, the dealership filed a motion for summary judgment against Great American and argued that the entry of default against the vendor was binding on Great American. The lower court found that Great American was bound by the entry of default against its principal and entered a judgment in favor of the dealership in the penal sum of the bond.

In an issue of first impression in the State of New Mexico, the Court of Appeals held that as long as the surety has notice and an opportunity to defend, it is bound by a default judgment entered against its principal. The Court noted that Great American appeared in the case before the hearing on the dealership's motion to enter default against the principal and had ample notice of same. The Court further noted that Great American had an opportunity to defend its principal against the default judgment, but did not do so. Specifically, the Court observed that the language of the indemnity agreement was sufficient to convey to Great American the right to intercede on behalf of its principal at the default hearing. "Accordingly, we affirm the trial court and hold that Great American is not entitled to present a defense to liability on the bond because Great American had both notice and an opportunity to defend against the default judgment of the principal." *Id.* at 982.

V. Lien Discharge Bonds

The Court in *Cranesville Block Co. v. Spring Apts., LLC*, 2008 WL 2917622 (N.Y. App. Div. 2008) affirmed summary judgment for a property owner and its surety on a mechanic's lien release bond. There, a supplier to a subcontractor filed a lien on February 2, 2004, after which the owner bonded off the lien. The supplier's subsequent suit to enforce the lien was stamped received by the clerk on February 3, 2005. The owner and surety moved for summary judgment on the grounds that the last date to sue was February 1, 2005. The lower court agreed and granted the motion. Although the supplier argued on appeal that its lawyer mailed the suit papers on January 31, 2005, the Court ruled that the controlling date was the date the papers were received by the clerk, not the date they were mailed. There was a presumption that the clerk's stamp established the date the papers were received unless unequivocal evidence showed otherwise. Because there was no such evidence, the Court affirmed summary judgment dismissing the claim against the mechanic's lien release bond.

Harris Ventures, Inc. v. Mallory & Evans, Inc., 662 S.E.2d 874 (Ga. Ct. App. 2008) involved an action on a materialman's lien discharge bond against Mallory & Evans, Inc. ("Mallory"), the general contractor on a construction project, and Travelers Casualty and Surety Company of America, Inc. ("Travelers") brought by a supplier to a subcontractor on the project. The parties filed cross-motions for summary judgment. The trial court granted summary judgment to Mallory and Travelers, holding that the lien was barred due to the supplier's failure to provide a Notice to Contractor required by Georgia law. The Notice to Contractor, however, was required only if a proper Notice of Commencement was initially filed by the contractor under Georgia law. The trial court thought the Notice of Commencement substantially complied with the statute even though it misstated the name of the owner and did not include a legal description of the property. The Court of Appeals held otherwise, finding that the defects in the Notice of Commencement relieved the supplier from any obligation to give a Notice to Contractor. The Court vacated the judgment and remanded the case for further proceedings.

In *Central Atlanta Tractor Sales, Inc. v. Athena Dev., LLC*, 657 S.E.2d 290 (Ga. Ct. App. 2008), a supplier sued to recover against a property owner and a surety which issued a lien discharge bond on the owner's behalf. There, the claimant supplied certain equipment to the general contractor on a private construction project. After not getting paid, the claimant filed a timely notice of mechanic's lien and sued the contractor. The owner subsequently obtained a bond to discharge the claimant's lien on the project. After obtaining a default judgment against the contractor, the claimant sued to recover against the owner and the surety on the bond.

Under Georgia law, a lien claimant must first pursue recovery from the contractor before seeking to recover from the property owner or a surety under a lien discharge bond. At issue was whether the supplier pursued its claim in a timely fashion against the contractor by commencing an action against the contractor to recover the amount of the claim within twelve (12) months of the date the claim became due. The supplier contended that the 12-month period for filing suit did not start until it had inspected the equipment for damage. The lower court disagreed, and entered summary judgment in favor of the owner and the surety, holding that the 12-month period contemplated by the statute began on the date that the last materials were furnished. On appeal, the Court of Appeals agreed and affirmed the judgment.

In *Crace Constr. Co. v. Anthony Crane Rental, LP*, 2008 WL 4181978 (Ky. Ct. App. 2008), a supplier to a subcontractor filed a lien on the property where the project was located. The surety for the general contractor issued a release of lien bond conditioned upon "the obligors satisfying any judgment that may be rendered in favor of the person asserting the lien." *Id* at * 3. The supplier obtained a judgment against the subcontractor which included substantial amounts for interest and attorney's fees. The issue presented was whether the surety on the release of lien bond was obligated to pay interest and attorney's fees over and above the amount claimed by the lien.

The surety argued, and the Court acknowledged, that the bond served as a mere substitute for the lien, and that the purpose of the mechanic's lien statute is to protect a mechanic or materialman to the extent of the value of improvements that are made to the property. Consequently, the surety contended that any recovery on the bond must be limited to the value of the improvements and not extend to additional amounts allowed by the underlying contract.

The Court held that while the general contractor's statutory liability was limited to the amount of the lien, the general contractor and its surety assumed liability for the full amount of the judgment against the subcontractor by executing a release of lien bond conditioned upon their satisfying "any judgment that may be rendered in favor of the person asserting the lien." Because the trial court's final judgment included amounts for interest and attorney's fees, the Court held that the bond covered the full amount of the judgment rendered against the subcontractor.

VI. Bankruptcy

In *In re Hastings*, 2008 WL 5383586 (Bankr. N.D. Ala., Dec. 23, 2008), Safeco Insurance Company of America (“Safeco”) filed an Adversary Proceeding objecting to the indemnitors’ discharge under §523(a)(4) of the Bankruptcy Code for defalcation while acting in a fiduciary capacity. Specifically, Safeco argued that the indemnitors failed to properly apply contract funds received from the owner to pay subcontractors and suppliers on a bonded project in violation of the trust fund provision of the indemnity agreement. The surety filed a summary judgment motion which the Bankruptcy Court granted. The Court held that the indemnity agreement created an express trust on behalf of the surety and that a fiduciary relationship existed between the parties. The Court also found that use of the contract funds for purposes other than paying subcontractors, suppliers and materialmen, even if the funds were used for the principal’s overhead and legitimate business expenses for the project, constituted a defalcation for purposes of §523(a)(4).

The surety in *Cincinnati Ins. Co. v. American Glass Inds., Inc.*, 2008 WL 2117148 (E.D.Va. 2008) filed an action seeking indemnification from its principals and individual indemnitors arising from losses on bonds issued on the principals’ behalf. After suit was filed, one of the principals filed for protection under Chapter 11 of the Bankruptcy Code. The remaining principal and indemnitors requested that the case against them be stayed pending resolution of the other principal’s bankruptcy proceeding. The Court initially granted the principal/indemnitors’ request, but later set aside and vacated its Order. In so doing, the Court noted that the automatic stay does not extend to non-debtor co-defendants unless the bankrupt party is in an indispensable party to the suit. Because the principals and indemnitors are jointly and severally liable under the indemnity agreement, a bankrupt party is not indispensable and, accordingly, the remaining principal/indemnitors were not entitled to an automatic stay of the lawsuit.

VII. Miscellaneous

The Court in *In re Guardianship of Pacheco*, 199 P.3d 676 (Ariz. Ct. App. 2008) affirmed a judgment holding that a surety was liable for misappropriations occurring before its bonded principal was appointed Conservator over an Estate. According to the Court, the Conservator’s continuing failure to recover amounts that had already been misappropriated when the bond was issued constituted a breach of the bond for which the surety should be liable. The Court also rejected the surety’s argument that the penal sum limited the amount of pre-judgment interest that could be awarded against it.

Given that the claim was liquidated, the Court enforced the general Arizona rule allowing pre-judgment interest.

The Court in *Fleming Steel Co. v. W.M. Schlosser Co.*, 2008 WL 291165 (W.D. Pa. 2008) entered a judgment in favor of a general contractor against a subcontractor's surety which included attorney's fees even though the subcontractor was not liable to the general contractor for attorney's fees. The subcontract did not have an attorney's fees provision, but the bond stated that the general contractor would be held harmless from any and all loss, damage, and expense, including costs and attorney's fees, which the general contractor sustained by reason of the subcontractor's default. Although the surety did not oppose the general contractor's request for attorney's fees, the subcontractor argued that the surety's liability could not exceed that of its principal, and since the subcontract did not provide for the recovery of attorney's fees, the surety could not be liable for such fees. The Court awarded attorney's fees against the surety noting that obligations of the bond are an exception to the rule that the surety's liability is co-extensive with that of its principal.

In *Shores of Panama, Inc. v. Safeco Ins. Co. of America*, 2008 WL 4417558 (S.D. Ala. 2008), the District Court held that the surety of the general contractor was entitled to a stay of the proceedings while arbitration was pending between the owner of a condominium project and the general contractor for breach of contract claims. The Court found that the bond claims against the surety were tied directly to performance under the contract, and all claims arising out of or relating to the contract were subject to an arbitration clause in the contract between the owner and the general contractor. Over the surety's objection, however, the Court compelled the surety to participate in the ongoing arbitration based upon language of the bond which incorporated the underlying contract by reference. Safeco asserted that it was not obligated to arbitrate because the disputes between the plaintiff and Safeco under the bond were different from those arising under the contract. Safeco argued that its defenses related to the plaintiff's breach of the bond rested strictly on the terms of the bond and required no reference to the contract or the arbitrable disputes arising under the contract. The Court noted that "Safeco is asking this Court to enter a stay because the issues relating to the Bond and Contract are inextricably linked or intertwined, but to simultaneously ignore Eleventh Circuit precedence and refrain from compelling arbitration because the issues are different. Safeco can neither disregard precedence, nor have it both ways." *Id.* at * 8.

The opinion in *Goodbys Creek, LLC v. Arch Ins. Co.*, 2008 WL 4279693 (M.D. Fla. 2008), relates to a discovery dispute whereby an owner sought all communications between the principal and surety during a specific time period, regardless of whether those communications related to the bonded project or other, unrelated bonded projects. The plaintiff contended that the information sought was relevant to prove its claim that the surety violated the duty of good faith and fair dealing with respect to the performance bond because the plaintiff believed that the surety knew the principal was

having serious financial problems and that the surety encouraged the principal to wrongfully terminate the bonded contract. The Court ruled that the plaintiff's request for "all communications" was overly broad, but compelled the surety to produce documents and correspondence relating to other projects if those documents evidenced, reflected, substantiated, or related in any way to the surety's knowledge of the principal's lack of solvency, lack of economic viability, or lack of ability to perform the underlying contract.

Lee & Rua Co. v. Great American Ins. Co., 2008 WL 1868633 (W.D. Wash. 2008) involved the tension created when a subcontractor files suit against a general contractor and a Miller Act surety, and the contract contains an arbitration provision. Under federal law, arbitration provisions are generally enforceable; however, the "exclusive remedy" provisions of the Miller Act would defeat any effort to enforce the arbitration clause against the surety.

In a common sense decision, the District Court agreed that the arbitration clause was enforceable against the general contractor, and granted its motion to refer the subcontractor's claim against it to arbitration. However, the Court stayed the action against the surety pending completion of the arbitration, noting that to hold otherwise would create a *de facto* waiver of the subcontractor's Miller Act rights.

In *Essex Contracting, Inc. v. Jefferson County*, 2008 WL 1957532 (Mo. Ct. App. 2008), a subdivision developer filed suit to have bonds declared released after completion of construction of streets and roads in a development. The subdivision homeowners' association intervened, and various subcontractors were joined. The trial court ordered the developer to forfeit all bonds to the association, notwithstanding undisputed evidence that the project was completed substantially in accordance with the plans and specifications. Evidence at trial suggested, however, that the roadways were prematurely failing and that certain test borings showed roadway thicknesses less than specified.

The trial court ruled in favor of the association on all issues and ordered the developer and surety to forfeit the bonds and deliver the cash proceeds to the association. On appeal, the Missouri Court of Appeals reversed and rendered a decision in favor of the developer and surety, finding that the fact that the specifications were not met did not establish that the developer had breached its development agreement and, given that the bond was a "performance" rather than a "warranty" undertaking, there could be no recovery under the bond because the project had been substantially completed.

This case is currently pending before the Supreme Court of Missouri.