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INSIDE

In This Issue

This issue was edited by Miller Williams, Mark Oertel, and John Rourke. There is good news in the contract surety field. Most courts continue to read and interpret the language in the Bond and Indemnity Agreement strictly. The courts are also strictly applying the rules of procedure and statutory notice requirements. *See, Derby Lofts, LLC v. J.J. Welch & Company*, FSD — 15980; *Wal-Mart Stores, Inc. v. S.C. Nestel, Inc.*, FSD — 15981; *Shaw Environmental, Inc. v. Hanover Insurance Co.*, FSD — 15984; *St Paul Fire & Marine Insurance Co. v. VDE Corp*, FSD — 15986; *ADP Marshall, Inc. v. Noresco LLC*, FSD — 15988; *BMAR & Associates, Inc. v. Midwest Mechanical Group*, FSD — 15990; *Jefferson Parish Consolidated Garbage District No. 1 v. Waste Management of Louisiana, LLC*, FSD — 15991; *Hayward Baker, Inc. v. ABS Services, Inc.*, FSD — 15992; *Weigland Construction Co., Inc. v. Stephens Fabrication, Inc.*, FSD — 15993; *Crow & Sutton Associates, Inc. v. C.R. Klewin Northeast, LLC*, FSD — 15994; *Attard Industries, Inc. v. United States Fire Insurance Co.*, FSD — 15999. *But see, Sleeper Village, LLC v. NGM Insurance Co*, FSD — 15989; *MJJ Trucking LLC. v. BD Haulers, Inc.*, FSD — 16001

There is also good news in the Fidelity area. Courts have refused to find bad faith as a result of the surety's claims handling when there is a bona fide dispute, and also are reading and interpreting the policy language strictly. *See, Fundquest Inc. v. Travelers Casualty and Surety Company*, FSD — 16009; *FDIC v. Great American Insurance*, FSD — 16010; *Adirondack Trust Co. v. St Paul Mercury Insurance Co.*, FSD — 16011; *Diebold, Inc. v. Continental Casualty Co.*, FSD — 16013; *Alerus Financial N.A. v. St Paul Mercury Insurance Co.*, FSD — 16014; *First National Bank of Davis, Oklahoma v. Progressive Casualty Insurance Co.*, FSD — 16016. But, in the case of a Supersedeas Bond, the Court allowed a recovery against the bond from a separate case between the same parties. *See, Apergis v. Boccia*, FSD — 16022.

In the commercial surety arena, the court found correctly that the liability of the surety on a Transportation Broker's Bond was limited to the bond penal sum in aggregate, not a separate penal sum per claimant as the claimant's wished. *See, RLI Insurance Co. v. All Star Transportation, Inc.*, FSD — 16034.

Finally, in the area of Surety's rights, the court continue to strictly enforce the indemnity agreement, including the surety's right to settle the claim of the principal. *See, In re Conservatorship of Montopoli*, FSD — 16063.

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Contract Bonds

Performance Bonds

FSD • 15979 Performance Bond – Takeover Surety's Obligation to Perform Insurance Provisions of Contract Was Not Clear from Documents and so a Question for the Finder of Fact

The bonded subcontractor defaulted and its surety agreed to complete the work. The surety hired a completion contractor who contracted to complete the work in accordance with the terms of the original subcontract. The surety also retained a construction consultant, and an employee of the consultant allegedly sustained personal injuries and sued, among others, the prime contractor. The prime contractor tendered defense to the liability carrier of the completion contractor, and the liability carrier refused to provide a defense. The prime contractor then sued the

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surety and the completion contractor alleging breach of the insurance provisions of the original subcontract. The trial court denied the surety's motion to dismiss, and the surety appealed.

The bond provided that the surety could "arrange for performance of the principal's obligations under the Subcontract." The Appellate Division saw the issue as whether the bond obligated the surety merely to complete the physical work, as the surety argued, or to perform all of the principal's subcontract obligations including the insurance provisions. The Court held that the two conflicting interpretations were sufficiently reasonable to meet the threshold test for ambiguity, and resolution of the ambiguity would be for the trier of fact. The Court could not find as a matter of law that the surety did not breach the bond, and so it affirmed denial of the motion to dismiss. *Caravousanos v. Kings County Hospital*, 2010 WL 2200982 (N.Y.A.D. June 1, 2010)

FSD • 15980 Performance Bond – Surety Discharged when Obligee Deprives Surety of Completion Options in Bond

The obligee hired another contractor, on a time and material basis, to assist the principal, and charged the cost to the contract balance. After holding a pre-default meeting, the obligee terminated the contract, and the principal walked off the job for non-payment. The obligee continued the work with its other contractor and hired various subcontractors on time and material terms. Several weeks later, the obligee wrote the surety offering to pay the contract balance pursuant to paragraph 3.3 of the bond but also declaring the surety to be in breach of the bond. By that time, most of the contract funds had been paid to the various completion contractors. The surety denied liability because the principal was wrongfully terminated and because the obligee breached the bond.

The court granted the surety's motion for judgment, agreeing that the obligee breached the bond by depriving the surety of the completion options called for in the bond. The court said, "the procedures outlined in sections 3 and 4 of the bond are designed to balance the rights of the obligee and the surety by allowing the obligee to terminate unsatisfactory contractors while protecting a surety's interests in choosing the most cost-efficient option for completion. . . . The obligee's actions deprived the surety of its paragraph 4 rights, violated the explicit terms of the bond and therefore rendered the bond null and void." *Derby Lofts, LLC v. J.J. Welch & Company, Inc.*, C.A. No. 2005-1776 (Mass., Essex County Sup.Ct. June 4, 2010).

FSD • 15981 Performance Bond – Contractor's Submission of False Storm Water Management Certificate Justified Termination of Contract and Judgment against Contractor and Surety

The owner was subject to strict storm water management obligations and provided extensive training to its contractors on its reporting requirements. Rather than drive several hours to the job site, a manager of the principal, who had been at the job site the week before, signed a faxed certificate without personally having done the required inspections. When the obligee discovered this, it terminated the contract.

The court found after trial that the contractor knowingly submitted the false report and that this justified termination of the contract. The parties had agreed on the amount of damages, presumably reprocurement costs, and that if the owner succeeded as to the contractor, it succeeded as to the surety. The court entered judgment against the principal and surety for

$3,176,662.11 plus prejudgment interest. *Wal-Mart Stores, Inc. v. S.C. Nestel, Inc.*, 2010 WL 2267751 (S.D.Ind. June 2, 2010).

FSD • 15982 Performance Bond – Surety's Motion to Dismiss or Stay Claim Denied

The obligee on a West Virginia project sued the prime contractor and its surety alleging that some of the work was defective and that the contractor did not perform in accordance with contract standards. The surety moved to dismiss or in the alternative to stay the action. The surety argued that (1) the obligee's claims on the performance bond were premature until the obligee prevailed in a suit against the principal; (2) the obligee's bad faith claims should be dismissed; and (3) Massachusetts law should apply to the bad faith claim because any claim handling was done in Massachusetts.

The court held that the obligee could sue the principal and surety concurrently. On the bad faith claim, the court noted that the obligee was the party protected by the bond, not a third party claimant. The performance bond was a type of insurance under West Virginia law and other jurisdictions were divided on the issue of bad faith actions against contract sureties. The court held that the bad faith claim was sufficient to withstand a motion to dismiss. The court also held that the law applicable to the underlying contract, in this case West Virginia, was also applicable to the bond. *Moundsville Water Board v. Shook, Inc.*, 2010 WL 2571228 (N.D.W.Va.

FSD • 15983 Performance Bond – The Obligee on a Fraudulent Bond Awarded Attorneys Fees

The obligee on a fraudulent performance bond sought attorneys fees in addition to the damages previously awarded in a decision reported at 2010 WL 1540827 (E.D. Ark. April 16, 2010).

The court relied on Arkansas statutes mandating fees in certain insurance disputes and making persons who aid in an unauthorized insurance transaction personally liable for the unauthorized insurer's unpaid claims. *Old St. Paul Missionary Baptist Church v. First Nation Ins. Group*, 2010 WL 2609918 (E.D.Ark. June 25, 2010).

FSD • 15984 Performance Bond – Action against Bond Stayed Pending Arbitration Between Obligee and Principal

Performance bond surety declined to takeover or complete the bonded project and the obligee sued the surety for its excess completion costs. The surety moved to stay the suit pending resolution of disputes between the obligee and principal pursuant to an arbitration provision in the bonded contract.

The court granted the surety's motion. The court had denied previous similar motions because it was not convinced an active arbitration was in process. Upon a showing that the obligee and principal were actively arbitrating their respective claims and counterclaims, the court granted the stay. *Shaw Environmental, Inc. v. Hanover Ins. Co.*, 2010 WL 2771887 (D.Minn. June 17, 2010).

FSD • 15985 Performance Bond – Issues of Fact Precluded Summary Judgment for Surety on Claim that Dishonest Funds Control Company Was Surety's Agent

A developer had difficulty qualifying for a performance bond required by the local township to guaranty completion of certain improvements. As part of obtaining the bond, the developer put funds in escrow with a third party approved by the surety. Funds Administration Services, Inc. was selected as the third party to control the funds, but it misappropriated the money, and a contractor that was supposed to be paid from the escrow sued. The bond was strictly a performance bond, and the claimant did not argue on appeal that the bond guaranteed payment. Instead, the claimant argued that the funds control company was the agent of the surety and the surety was responsible for the misappropriated funds.

The Appellate Division reversed summary judgment for the surety on that argument. The court thought that there were issues of fact as to the apparent authority of the funds control company to act for the surety. *U.S. Estates, Inc. v. American Safety Cas. Ins. Co., Inc.*, 2010 WL 2793791 (N.J.Super.A.D. June 28, 2010).

FSD • 15986 Performance Bond – Owner's Refusal to Permit Takeover Surety to Use Principal for Completion Work Discharged Surety

The obligee on an A312 Performance Bond refused to agree to let the surety take over the work pursuant to section 4.2 of the bond and use the defaulted contractor to complete the work.

The court noted that section 4.1 (financing) and 4.3 (tender) required the owner's consent to allow the principal to continue performance and that under these sections the owner would still be in privity with the contractor. Under section 4.2, by contrast, the owner would be in privity with only the surety and there was no restriction on the surety's choice of the contractor it would use. The court affirmed summary judgment for the surety holding that the owner's breach discharged the bond. *St. Paul Fire & Marine Ins. Co. v. VDE Corp.*, 2010 WL 1781941 (1st Cir. May 5, 2010).

FSD • 15987 Performance Bond – Principal Was Indispensable Party to Obligee's Suit against Surety to Enforce Settlement Agreement Between Obligee and Principal, and Since Principal Could

Not Be Joined, Case Was Dismissed

The obligee, the principal, the surety and others were involved in state court litigation that was terminated by a settlement agreement between the principal and obligee. The principal allegedly failed to perform some of its obligations under the settlement agreement, and the obligee sued the surety, but not the principal, in federal court. The surety moved to dismiss because the settlement was res judicata of its bond obligations and for lack of an indispensable party.

The court noted that the only parties to the allegedly breached settlement agreement were the principal and the obligee, and held that the principal was a necessary party. The principal and obligee were both New York citizens, however, and joinder of the principal would defeat diversity jurisdiction. Therefore, joinder was not feasible. The court found that in equity and good conscience the action should not go forward without the principal and dismissed the case. The court did not reach the surety's alternative res judicata argument. *Town of Huntington v. American Manufacturers Mut. Ins. Co.*, 2010 WL 1837729 (E.D.N.Y. May 3, 2010).

FSD • 15988 Performance Bond – Claim Barred by Bond Limitation Provision and Under Facts No Equitable Basis Existed for Subrogation

Following trial, the court found that the prime contractor's performance bond claims against its subcontractor's sureties were barred by the two year suit limitation provision of the bond. The prime also argued that it was subrogated to the rights of sub-subcontractors it had paid, but the court found no equitable basis for subrogation under the facts of the case. However, the prime was given a credit for the amount it paid to sub-subcontractors, which the court pointed out would otherwise have been paid to the subcontractor and by it to the sub-subcontractors. The court also said, since the prime had pending cross claims in state court suits filed by the sub-subcontractors, and it could seek reimbursement of its litigation expenses there. The court therefore dismissed the prime contractor's claims against the subcontractor's sureties. *ADP Marshall, Inc. v. Noresco LLC*, 2010 WL 1753585 (D.R.I. April 30, 2010).

FSD • 15989 Performance Bond – Obligee Failed to Give Surety Notice and Opportunity to Cure But Did Promise to Pay Contract Balance

The obligee wrote a series of letters and hired its own completion contractor. The surety asserted as defenses to the performance bond claim that the obligee failed to promise to pay the contract balance to the surety or completing contractor as required in Section 3.3 of the bond and failed to give the surety a notice and opportunity to cure pursuant to Section 5 of the bond.

The court thought that the obligee's letters were sufficient to meet the bond's requirements as to promising to pay the contract balance but agreed with the surety that the obligee failed to give the Section 5 notice and 15 day opportunity to cure. The court did not address the surety's argument that the obligee's hiring of another contractor deprived it of its completion options under section 4 of the bond. The court directed further briefing on the consequences of the obligee's failure to comply with Section 5. Upon consideration of the surety's motion for reconsideration, the court reviewed its prior ruling but adhered to the result. *Sleeper Village, LLC v. NGM Ins. Co.*, 2010 WL 1434306 and 1805383 (D.N.H. April 9, 2010 and May 4, 2010).

FSD • 15990 Performance Bond – Subcontractor and Its Surety Not Responsible for Design Performed by Predecessor Subcontractor

The original design-build mechanical subcontractor could not furnish bonds and was replaced after the design phase. The replacement subcontractor was not paid for the design work, and the written subcontract clearly stated that the design engineer was the original subcontractor. The subcontractor and its surety moved to dismiss the contractor's claims based on design errors.

The court held that there were no issues of fact and the replacement subcontractor and its surety did not take over responsibility for the design. The court granted summary judgment dismissing the prime contractor's breach of contract claims regarding design. *BMAR & Assoc., Inc. v. Midwest Mech. Group*, 2010 WL 1709854 (D.Md. April 23, 2010).

FSD • 15991 Performance Bonds – Bonds Conditioned only on Performance of Contract Work Not on Principal's Compliance with Other Contract Provisions

The obligee sued the principal and its sureties on two separate contracts related to solid waste management. On the first, collection contract, the obligee alleged entitlement to a substantial payment for failure of performance of waste matter collection obligations after Hurricane Katrina. On the second, landfill contract, the obligee alleged overcharging for "tipping" fees.

The court held that the surety bonds, even though they incorporated the contracts by reference, were conditioned only on performance of the contract work, and the sureties would not be liable for the alleged stipulated or liquidated damages under the collection contract or for overcharges under the landfill contract. The court interpreted the bonds to require the sureties, in the event of a default, to themselves complete the work or to pay the cost to complete the work but not to pay any stipulated damages or alleged overcharges.

The court dismissed the sureties because the complaint failed to state claims against them upon which relief could be granted. The court also refused to remand the case to state court even though the collection contract arguably barred suit anywhere else. One of the sureties had removed the case, and the court held that the bond's incorporation of the contract did not incorporate the non-removal clause. In the alternative, the court held that suing on two contracts, only one of which contained a non-removal clause, was a waiver of that clause and allowed the federal court to exercise diversity jurisdiction over the entire controversy. *Jefferson Parish Consolidated Garbage D. No. 1 v. Waste Management of Louisiana, L.L.C.*, 2010 WL 1731204 (E.D.La. April 28, 2010).

Payment Bonds

FSD • 15992 Payment Bond – Disputed Repair Work Done under Separate Agreement not Covered by Payment Bond

A subcontractor designed and installed a retaining wall. The wall bulged and cracked, and two years after its installation the subcontractor agreed that repairs were needed. The subcontractor and prime contractor disputed who was responsible for the defects and for the cost of any repairs. They entered into a separate agreement to split the cost. The subcontractor's surety was explicitly not a party to that agreement. The entity retained by the subcontractor to perform the repair work was not paid. In the trial court it recovered a judgment against the subcontractor but not the subcontractor's surety and appealed.

The court of appeals affirmed because the repair work was performed under a separate agreement not the bonded subcontract. *Hayward Baker, Inc. v. ABS Services, Inc.*, 2010 WL 2428460 (Ky.App. June 18, 2010).

FSD • 15993 Payment Bond – Bankrupt Subcontractor Could Assert Abandoned Claim, But Failure to Follow Notice Provisions of Subcontract Barred All but Subcontract Balance Part of Claim

A subcontractor on an Indiana public project recovered a judgment against the prime contractor and its surety. The defendants appealed and argued that the subcontractor could not pursue its claim because it filed for bankruptcy and because it failed to comply with the notice requirements of the subcontract.

The court found that the bankruptcy trustee abandoned the claim, so the subcontractor could prosecute it. The court affirmed the award of a small contract balance but reversed the remainder of the judgment because the subcontractor did not give notice of its claim as required by the subcontract. *Weigand Construction Co., Inc. v. Stephens Fabrication, Inc.*, 2010 WL 2546482 (Ind.App. June 25, 2010).

FSD • 15994 Payment Bond – Principal Satisfied Condition of Bond by Passing Through Payments Received from Owner

The payment bond was conditioned on the principal paying to subcontractors amounts that the owner paid the principal for the subcontractors' work. The evidence showed that the principal paid the claimant the amount paid by the owner, and the dispute was actually between the claimant and the owner as to the amount owed to the claimant.

The court granted summary judgment to the surety since there had been no breach of the bond and no evidence of bad faith by the surety. *Crow & Sutton Assoc., Inc. v. C.R. Klewin Northeast, LLC*, 2010 WL 2573954 (Conn.Super. May 21, 2010).

FSD • 15995 Payment Bond – Miller Act Suit on Project in Mexico Stayed Pending Arbitration Between Claimant and Principal Including Arbitration of Claimant's Fraud in the Inducement Claim

A subcontractor on a project at the U.S. Consulate compound in Ciudad Juarez, Mexico sued under the Miller Act. The subcontract included a broad arbitration clause.

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the Inter-American Convention on International Commercial Arbitration required stay of the suit pending arbitration. The court held that even the subcontractor's fraud in the inducement claims were subject to the arbitration agreement and stayed the case pending arbitration. *U.S. ex rel. Immobilaria y Constructora Mexcanusa, S.A. de C.V. v. Caddell Constr. Co., Inc.*, 2010 WL 2622939 (W.D.Tex. June 25, 2010).

FSD • 15996 Payment Bond – Surety Entitled to Discovery Before Responding to Claimant's Summary Judgment Motion

A subcontractor on a public project sued the prime contractor's payment bond surety, and the surety filed a third party claim against the principal and indemnitors. The subcontractor moved for summary judgment. The subcontractor argued that the surety had "admitted" that there were no genuine issues of fact because it failed to produce evidence in discovery. The surety filed an affidavit explaining why it needed discovery to respond to the motion.

The court pointed out that the surety could assert any defenses available to the principal, the principal would have possession of the evidence, and the surety had filed a proper affidavit pursuant to Rule 56(f) explaining why it needed time to conduct discovery before responding to the summary judgment motion.

The court agreed with the surety and denied the claimant's motion. *DeAngelo Brothers, Inc. v. Platte River Ins. Co.*, 2010 WL 2635983 (M.D.Pa. June 29, 2010).

FSD • 15997 Payment Bond – Second Tier Claimant on Miller Act Project Subject to State Licensing Requirements, and Claimant's Lack of License Barred It From Suing

A supplier of labor to a subcontractor on a federal project in California allegedly was not paid and sued under the Miller Act. The principal and surety moved for summary judgment on the ground that the claimant did not hold a California contractor's license and so was barred from suing.

The court found that California licensing requirements applied to the second tier claimant. The claimant supervised the work and so did not qualify for an exception to the licensing requirements as a labor service provider. The court granted the motion of the principal and surety and entered judgment in their favor. *U.S. ex rel. Technica, LLC v. Carolina Cas. Co.*, 2010 WL 2628715 (S.D.Cal. June 29, 2010).

FSD • 15998 Payment Bond — Miller Act Suit Stayed Pending Arbitration Between Claimant and Principal

A subcontractor sued the prime contractor and its Miller Act surety. The subcontract contained an arbitration clause, and the defendants moved to stay or dismiss the action pending arbitration.

The court held that the subcontractor's claim against the prime contractor was subject to arbitration but that the subcontract was not incorporated into the bond and the surety had not agreed to arbitrate. Therefore, the court ordered arbitration of the disputes between the claimant and the prime contractor and stayed the action against the surety pending completion of the arbitration. *U.S. ex rel. Vining Corp. v. Carothers Constr., Inc.*, 2010 WL 1931100 (M.D.Ga. May 12, 2010).

FSD • 15999 Payment Bond – Surety Bound by Bond Provision Allowing Suit in Either Federal or State Court

The claimant sub-subcontractor sued the surety for the subcontractor in federal court for the district where the project was located. A forum selection clause in the bond permitted suit in either federal or state court, but a similar clause in the sub-subcontract required suit in state court. The surety moved to dismiss the action based on the forum selection provision of the sub-subcontract.

The court noted that the surety itself had agreed in the bond to suit in federal or state court, and the sub-subcontract was not part of or incorporated into the bond. The court denied the motion. *Attard Indus., Inc. v. U. S. Fire Ins. Co.*, 2010 WL 1946319 (E.D.Va. May 10, 2010).

FSD • 16000 Payment Bond – Miller Act Suit Dismissed because All Issues and Parties Subject to Arbitration

The claimant's subcontract required arbitration of all disputes between the contractor and subcontractor "(including any affiliates … and sureties of either of them)." The defendants moved to compel arbitration and stay the Miller Act suit.

The court found that the claimant had agreed to arbitrate with the contractor and surety, and the surety could invoke the arbitration agreement even though it was not a signatory to the subcontract. The court also found that preliminary discovery filings did not waive the right to arbitrate and upheld a forum selection clause for the arbitration. The court ordered arbitration of the dispute and dismissed the case since all issues were subject to arbitration. *U.S. ex rel. On the Water, LLC v. Otak Group, Inc.*, 2010 WL 2044897 (S.D.Miss. May 19, 2010).

FSD • 16001 Payment Bond – Hand Delivery of Unpaid Invoices and Telephone Conversations Satisfied Statutory Notice Requirement

Claimant removed debris from a public construction project pursuant to a contract with a subcontractor. The issue was whether the claimant complied with the notice requirement of State Finance Law §137(3) to entitle it to recover from the prime contractor's payment bond.

The court credited the testimony of the claimant that he went to the prime contractor's office twice, left copies of unpaid invoices, and spoke by telephone with the president of the prime contractor. The court held that the claimant met the notice requirement and entered judgment for the amount owed. The court rejected the claimant's demand for attorneys fees under State Finance Law §137(4)(c) because the surety's position had a basis in fact and law. *MJJ Trucking LLC v. BD Haulers, Inc.*, 2010 WL 2089322 (E.D.N.Y. May 25, 2010).

FSD • 16002 Payment Bond – Surety's Motion to Dismiss Denied because Monthly Statements and Lien Waivers Were Ambiguous as to Whether They Were Conditioned on Receipt of the Monthly Payment

The claimant subcontractor provided a monthly sworn statement and lien waiver as part of the progress payment process. The claimant alleged it was not paid for the last three progress payments and sued the principal and surety. The surety moved to dismiss the claims as barred by the monthly sworn statements and lien waivers.

The court held that the sworn statements and lien

waivers were ambiguous as a matter of law because it was not clear from the face of the documents if they were effective only upon receipt of that month's payment. The court, therefore, denied the surety's motion. *Texas Contract Carpet, Inc. v. Echelon Constr. Ser., L.L.C.*, 2010 WL 2217430 (E.D.La. May 27, 2010).

FSD • 16003 Payment Bond – "Death Penalty" Discovery Sanction against Surety Not Warranted by Facts

Subcontractor on a Texas public project sued the prime contractor and surety, and the prime contractor counterclaimed. The same lawyer represented the principal and surety. After various discovery disputes, the trial court entered a default judgment in favor of the subcontractor as a discovery sanction and granted the subcontractor summary judgment on various claims and defenses. The prime contractor and surety appealed.

The subcontractor's primary complaint as to the surety's discovery responses was that the surety designated an employee of its agent as its corporate representative and produced documents from the agent's file. The Court of Appeals found that the trial court erred in not considering lesser sanctions and abused its discretion in granting the "death penalty" default judgment. The Court also reviewed the summary judgments and held that the record did not support the relief granted the subcontractor. The Court reversed the judgments and remanded the case. *Dibco Underground, Inc. v. JCF Bridge & Concrete, Inc.*, 2010 WL 1413071 (Tex.App. – Austin April 8, 2010)

FSD • 16004 Payment Bond – Payment Bond Claimant Third Party to Bond and So Not Entitled to Assert Private Right of Action under Unfair Trade Practices Statute and Surety Did Not Owe Claimant Duty of Good Faith and Fair Dealing

Subcontractor on a West Virginia public project sued the payment bond surety for the prime contractor. The claimant alleged that it was owed money for work on the project and asserted claims against the surety for breach of contract, common law bad faith, and statutory unfair trade practices. The surety moved to dismiss the latter two claims for failure to state a claim upon which relief could be granted.

The court found that the subcontractor was a third party claimant under the payment bond and so not within the class of persons entitled to a private right of action under the unfair trade practices statute. The court also held that West Virginia law does not recognize a common law bad faith cause of action by a third party claimant against an insurer. The court found that the surety had an adversarial relationship to the claimant not a contractual relationship from which a duty of good faith and fair dealing would arise. *Orange Const. Corp. v. Travelers Cas. and Sur. Co. of Am.*, 2010 WL 1506634 (S.D.W.Va. April 14, 2010).

FSD • 16005 Payment Bond – Court Denied Motion to Stay Subcontractor's Suit in Location of Project Despite Principal's Suit against Claimant in Location Required by Venue Provision of Subcontract

A subcontractor sued the payment bond surety of the prime contractor in federal court in the location of the project. Several months later, the prime contractor sued the subcontractor in state court in the venue called for in a forum selection clause in the subcontract (the location of the prime contractor's headquarters). The surety, represented by the same attorneys as the prime contractor, then moved to stay the federal court suit pending resolution of the state court litigation between the prime and the sub.

The court considered the *Colorado River* factors and denied the motion. In an earlier decision, the court had denied the surety's motion to dismiss for improper venue based on the forum selection clause in the subcontract. The court thought the state court suit and subsequent motion to stay the federal case were an end run around that decision. *M.L.R. Painting and Wallcovering, Inc. v. Hartford Fire Ins. Co.*, 2010 WL 1533128 (M.D.Ala. April 15, 2010).

FSD • 16006 Payment Bond – Claimant's Tort and Punitive Damage Claims Dismissed But Complaint Sufficiently Alleged Post-Contract Oral Agreement on Exclusive Use of Site

A subcontractor on a federal project to remove and dispose of Hurricane Katrina debris sued the prime contractor and its payment bond surety. The subcontractor alleged that it was promised exclusivity at one disposal site but other subcontractors were allowed to use the site, thereby reducing the amount of work for the claimant. The written subcontract, however, did not promise such an exclusive arrangement. The subcontractor also alleged that various failures to abide by the subcontract amounted to independent torts and sought punitive damages. The defendants moved to dismiss for failure to state a claim all of the claims except breach of contract.

The court enforced a choice of Florida law provision in the subcontract but held that under either Florida or Mississippi law the claimant's tort and punitive damages claims failed to state a claim. The defendants argued that the claim based on alleged exclusivity at the site was barred by the integrated, written contract, but the court found that reading the complaint most favorably to the claimant it alleged a post-contract oral agreement that would not be barred. The court granted the motion as to the tort and punitive damage claims but denied it as to damages for breach of the alleged promise that the subcontractor would be

the only processor of debris at the site. *JGT, Inc. v. Ashbritt, Inc.*, 2010 WL 1633530 (S.D.Miss. April 21, 2010).

FSD • 16007 Payment Bond – Claimant Granted Leave to Amend Complaint to Allege Direct Contract with Principal Because Amended Complaint would Relate Back and Not be Time Barred

The prime contractor and Miller Act payment bond surety moved to dismiss the complaint of a sub-subcontractor because it failed to allege facts showing compliance with the notice requirement of the statute. The claimant sought leave to amend the complaint to allege a direct contract with the principal, but the defendants contended that any amendment would be futile because the amended complaint would be untimely.

The court found that an amended complaint to clarify the notice contentions would relate back to the date the original complaint was filed. The amended complaint thus would not be barred by the Miller Act one year limitation provision, and the amendment would not be futile. The court denied the motion to dismiss without prejudice and gave the claimant a month to amend its complaint. *U.S. ex rel. Mendoza v. Safeco Ins. Co. of Am.*, 2010 WL 1707429 (S.D.Miss. April 23, 2010).

FSD • 16008 Payment Bond – Miller Act Suit Stayed Pending Arbitration Pursuant to Provision in Claimant's Subcontract

A subcontractor sued the prime and its Miller Act payment bond surety. The subcontract included an arbitration provision, and the defendants moved to stay or dismiss the suit. The subcontractor acknowledged the existence of the arbitration agreement, but argued that the prime contractor had not followed the contract in responding to the subcontractor's request for mediation and thus waived the right to invoke the arbitration clause.

The court disagreed and found that the Federal Arbitration Act required resolution of any doubts in favor of arbitration. The court stayed the case pending arbitration but allowed any party to move to reopen it. *U.S. for the use of Comfort Systems USA (Arkansas), Inc. v. Cooley Constr., Inc.*, 2010 WL 1753353 (E.D.Ark. April 29, 2010).

Fidelity Bonds

FSD • 16009 Fidelity Bond – Employee's Silence as to Amounts Erroneously Deposited Into His Account Was Dishonesty that Continued After He Was No Longer Employed by Insured

An employee of the insured changed banks and in switching the direct deposit of his net pay the insured deposited the pay of its CEO into the employee's account instead of the employee's pay. The employee did not inform the insured that he was receiving substantially more than the amount of his pay. Instead, he complained that he did not receive his own pay. The insured then initiated deposit of the employee's pay to the account but did not stop deposit of the CEO's pay. A few weeks later, the employee quit. The insured then stopped depositing his own pay but continued to deposit the CEO's pay into the former employee's account for fourteen and a half more months until the CEO finally noticed that he had not been paid in sixteen months. The insured alleged an employee dishonesty loss of $258,964.27 for the amount erroneously deposited into the account. The insurer paid the amount deposited before the employee quit less the deductible, and the insured sued alleging breach of contract and violation of the Massachusetts Consumer Protection Act. For employee dishonesty coverage, the bond required manifest intent to cause the insured a loss and to obtain a financial benefit. There is no mention in the decision of any exclusion from financial benefit for wages, salaries or commissions. The parties filed cross motions for summary judgment. The insured argued both a direct loss from employee dishonesty and misplacement. The insurer argued that money erroneously paid to the former employee was not an employee dishonesty loss.

The court thought that the dishonesty – silence after learning that he was receiving a grossly inflated payment – "simply continued uninterrupted after he left." The court rejected the insurer's argument that each payment or each withdrawal from the account was a separate act and pointed out that in paying the loss for the period before the employee resigned the insurer applied only a single deductible whereas if each payment was a separate loss there would have been five deductibles. The court held that the entire loss was covered as employee dishonesty but rejected the insured's misplacement argument, without reaching its merits, because it was not included in the proof of loss or the complaint and so was not asserted within six months of discovery of the loss. The court also held that the insurer did not act in bad faith. The court granted the insured summary judgment on the breach of contract claim and the insurer summary judgment on the statutory bad faith claim. *FundQuest Inc. v. Travelers Cas. and Sur. Co.*, 2010 WL 2223301 (D.Mass. June 4, 2010).

FSD • 16010 Financial Institution Bond – Knowingly False Answers to Material Questions on Application Justified Rescission of Bond, and Rescission Was Not Barred by Statute Codifying D'Oench Duhme Doctrine

The insured bank had suffered losses, its former employees had been indicted and its prior carrier refused to consider renewal unless the officers of the bank traveled to London for a face-to-face meeting. Nevertheless, the bank responded negatively to three application questions on prior losses, any insurance that had been declined or cancelled and any information that might materially affect the insurance proposal.

The Second Circuit disagreed with the district court and held that the bond was an "asset" within the meaning of 12 U.S.C. §1823(e), the codification of the *D'Oench Duhme* doctrine. The court, however, found that the right to rescind the bond was not a secret agreement the enforcement of which was barred by §1823(e). The grounds for rescission, "misrepresentation, omission, concealment or any incorrect statement of a material fact," were plainly stated on the face of the bond. The court examined the three questions and held that the responses were knowingly false and material to the insurer's decision to accept the risk. The court affirmed the judgment of the district court reported at 2009 WL 387160 (D.Conn. February 13, 2009). *Federal Dep. Ins. Corp. v. Great Am. Ins. Co.*, 607 F.3d 288 (2nd Cir. 2010).

FSD • 16011 Financial Institution Bond – Uncollected Funds Exclusion Barred Claim

A purported cashiers check was deposited in an account at the insured bank. Three days later, before the check cleared, the bank honored the depositor's instructions to wire substantially all of the funds to a bank in China. The cashiers check was counterfeit and was returned by the drawee bank. The insured bank was unable to recover the funds and sued the insurer asserting a claim under Insuring Agreement (D). The insurer moved to dismiss the case for failure to state a claim.

The court held that the uncollected funds exclusion barred the claim and granted the insurer's motion. *Adirondack Trust Co. v. St. Paul Mercury Ins. Co.*, 2010 WL 2425915(N.D.N.Y. June 11, 2010).

FSD • 16012 Fidelity Bond – Officers of Independent Contractor Were Not Covered Under ERISA Plan's Bond

The insured ERISA plans suffered losses as a result of the dishonesty of Capital Consultants, an investment advisor, and the insureds argued that Capital Consultant's officers were "employees" as defined in the policies' ERISA Endorsement. The Endorsement included within "employee" a trustee, officer, employee, administrator or manager of the insured plan, but not an administrator or manager who was an independent contractor. The insureds argued that the words used in the ERISA Endorsement should take their meaning from the Labor Department's ERISA regulations and that under those meanings Capital Consultant's officers were employees or officers of the insured plans. The insureds also argued that if the dishonest persons were administrators or managers, the Endorsement provided illusory coverage and should be construed to cover the losses. Finally, the insureds argued that ERISA required the dishonest persons to be covered because they were handling plan assets therefore the statute should be read into the insurance policies to provide coverage.

The court rejected each argument. The endorsement excluded coverage for administrators or managers who were independent contractors. The insured's argument that the dishonest persons were employees or officers of the plans, even though they clearly were not, was based on a contention that they were not administrators and therefore had to be officers or employees. The court held that even assuming that the ERISA regulations controlled, the dishonest persons were administrators so the predicate of the insured's argument failed. The court also held that the endorsement was not illusory because it excluded independent contractors and that nothing in ERISA required every bond written for a plan to cover all persons who handled plan assets. *Employers-Shopmens Local 516 Pension Trust v. Travelers Cas. and Sur. Co. of Am.*, 2010 WL 2384216 (Ore.App. June 16, 2010).

FSD • 16013 Fidelity Bond – Knowledge of Manager of Risk Analysis for ATM Servicing Department Constituted Knowledge of Prior Dishonesty and Barred Claim

A commercial crime policy covered the theft of money in the custody of armored car companies servicing ATMs pursuant to contracts between the insured and various banks. Such losses occurred as a result of dishonesty by officers of Tri-State Armored Services. The policy covered losses discovered during the policy period and defined discovery as occurring when the insured's risk management department first became aware of facts that would cause a reasonable person to assume that a loss had occurred. The policy also provided that there was no coverage for any loss caused by a wrongdoer after discovery of an actual or potential loss caused by that wrongdoer. The cash included in the proof of loss had been entrusted to Tri-State well after the insured had reimbursed numerous banks for cash shortages caused by Tri-State and after officials in the insured's ATM servicing unit had spoken to the FBI as part of the FBI's investigation of Tri-State.

The court rejected the insured's argument that these officials' knowledge did not constitute discovery of Tri-State's dishonesty because they were not in the risk management department. The court reasoned that discovery of loss in the ATM servicing area was triggered by knowledge of the manager of risk analysis for the ATM servicing operation, even though he was not part

of the risk management department. The court granted the insurer summary judgment on its prior knowledge defense and also rejected the insured's argument that its bad faith claim could exist even if there was no coverage under the policy. The remaining issues were moot, and the court entered judgment for the insurer. *Diebold, Inc. v. Continental Cas. Co.*, 2010 WL 2539333 (D.N.J. June 21, 2010).

FSD • 16014 Financial Institution Bond – Loan Loss Did Not Result From Forgery and Closing Attorney Was Not Employee of Participating Banks, But As To Lead Banks Issues of Fact Existed As to Whether Attorney Was Dishonest, Intended to Cause a Loss, and Intended to Receive an Improper Financial Benefit

Several servicing and numerous participating banks sued their respective insurers for losses when a loan backed by non-existent collateral was not repaid. The banks argued that the closing attorney was an employee of the banks and that he was dishonest because he knew for the last four loans that amended articles of incorporation of an alleged airline had not been filed with the Florida Secretary of State but did not tell the banks even though he told the loan broker. The banks alleged forgery and employee dishonesty coverage.

The court granted summary judgment to the insurers dismissing the employee dishonesty claims of the participating (as opposed to the lead or servicing) banks because the attorney was not an "employee" of the participating banks. As to the lead banks, the court thought that there were genuine issues of fact as to the attorney's alleged dishonesty, intent, and improper financial benefit or personal gain. There was no evidence of an actual intent to cause the banks a loss or of any bribes, kickbacks or improper payments. The court, however, thought that manifest intent could be found based on a loss substantially certain to result from the employee's acts and that the expectation of future work from the loan broker could be an intent to obtain an improper financial gain. The court found issues of fact precluding summary judgment as to the lead banks' employee dishonesty claims. The court granted summary judgment dismissing the forgery claims because the loss did not result from forgery. The court also held that none of the forged documents were the types of documents listed in the bonds' forgery coverages. *Alerus Financial N.A. v. St. Paul Mercury Ins. Co.*, Case No. 27-cv-09-3344 (Minn. Dist. Ct. for Hennepin County, June 28, 2010).

FSD • 16015 Financial Institution Bond – Amount of Judgment Was Amount Insured Paid to Customers Plus Amount Owed Under Claim Expense Rider Minus Recoveries from Other Sources and Deductible

In a prior decision the court granted summary judgment to the insured on liability, and now considered the amount of the judgment.

The court started with the amount the insured paid its customers from whom the employee stole even though that amount included interest the customers failed to earn on the stolen funds. The court then gave the insurer credit for amounts recovered from the dishonest employee, two brokerage firms involved in the dishonest transactions and another insurer. The court added $10,000 for claim preparation expenses pursuant to a rider authorizing such expenses, subtracted the deductible, and awarded prejudgment interest running from the date the proof of loss was filed. The court rejected the insured's argument that the recovery from the brokerage firms should be applied to the deductible amount instead of to reduce the gross loss. *First Defiance Financial Corp. v. Progressive Cas. Ins. Co.*, 2010 WL 2643419 (N.D. Ohio June 30, 2010).

FSD • 16016 Financial Institution Bond – Insurer Granted Summary Judgment Dismissing Insuring Agreement (E) Claim because Loan Guaranty Was Not Forged

The insured bank extended credit in reliance on a guarantee from Underwriters Reinsurance Co. Ltd. After the loan went into default, the bank recovered a judgment against the guarantor but was unable to collect on it. The bank then submitted an Insuring Agreement (E) claim and sued the insurer on its financial institution bond. The insurer argued that the loan guarantee documents were not forged and the bank had merely made a poor credit decision. The bank argued that under Insuring Agreement (E) the requirement that the listed document be forged, lost or altered applied only to the last of the listed documents (statements of uncertificated securities).

The court examined the structure and meaning of the insuring agreement and cases construing it. The court rejected the insured's argument and held that the claim failed because the loan guarantee was not forged. The court granted summary judgment for the insurer. *First Nat. Bank of Davis, Ok. v. Progressive Cas. Ins. Co.*, Case No. 09-cv-546 (W.D.Okla. May 5, 2010).

FSD • 16017 Financial Institution Bond – Court Denied Insurer's Motion to Stay or Dismiss so that Claims by Multiple Insureds Involving Allegedly Dishonest Mortgage Servicer Could be Decided in One Action

The insured alleged that a servicing contractor sold 36 mortgages, converted the proceeds, and made the monthly payments on the mortgages to conceal the transactions. After the scheme was discovered, the president and majority shareholder of the alleged servicing contractor pled guilty to criminal charges and the servicing contractor filed for bankruptcy. The insurer

had filed an action in Wisconsin state court naming as defendants the insured and some twenty other credit unions that did business with the alleged servicing contractor. The insurer asked the court to stay or dismiss the Maryland federal case so that the dispute could be resolved in the Wisconsin case.

The court found that the two actions were not parallel for purposes of applying the *Colorado River* abstention factors because the parties to the cases were not the same. The court also held that even if the actions were parallel, abstention would not be justified. The court denied the insurer's motion to stay or dismiss. *Educational Sys. Federal Credit Union v. Cumis Ins. Soc., Inc.*, 2010 WL 1930582 (D.Md. May 12, 2010).

FSD • 16018 Fidelity Bond – Court Denied Motion to Alter or Amend Judgment That Individual Participant Did Not Have Standing to Sue on Bond Protecting ERISA Plan

In a prior decision reported at 2009 WL 2916824 (N.D.Ill. September 2, 2009), the court held that an individual plan participant did not have standing to sue on the fidelity bonds protecting the plan. The plaintiff moved to alter or amend the judgment.

The court denied the motion and reiterated that an individual participant does not have standing to sue the insurers on bonds issued to the plan. *Peabody v. Davis*, 2010 WL 1416933 (N.D.Ill. April 5, 2010).

FSD • 16019 Fidelity Bond – Insured Alleging that Bernard Madoff Was Trustee of Plan Failed to Comply with Proof of Loss and Cooperation Provisions of Bond

The insured submitted a claim on a fidelity policy protecting its retirement and profit sharing plan on the theory that Bernard Madoff was a trustee of the plan and therefore an employee under the fidelity policy. The insured sought losses allegedly caused by Mr. Madoff's dishonesty. The plan invested in a limited partnership which in turn invested with Madoff Securities LLC. The insured promptly notified the insurer after the Madoff scheme was exposed and submitted an unsigned, unsworn proof of loss. The insurer repeatedly asked for any documents showing a relationship between the plan and Mr. Madoff and particularly any documents naming trustees of the plan. The insured did not provide documents to support its allegations or give the insurer access to the plan's records. The insured argued that Mr. Madoff and Madoff Securities had possession of plan funds and discretion over their investment. The insurer denied the claim based on the limited information provided and the insured's failure to comply with the proof of loss and cooperation provisions of the policy. The insured sued and the insurer filed a motion to dismiss for failure to state a claim.

The court granted the motion on the ground that the insured breached the sworn proof of loss and cooperation conditions of the policy. The insured failed to plead performance of its obligations under the policy. The court dismissed the complaint without leave to amend and did not reach the issue of whether Madoff was a trustee or employee of the plan. *Schupak Group, Inc. v. Travelers Cas. and Sur. Co. of Am.*, 2010 WL 1487737 (S.D.N.Y. April 13, 2010).

FSD • 16020 Fidelity Bond – Employee's Embezzlement Was Single Occurrence Subject to Single Limit

An employee embezzled $424,024 by means of 293 fraudulent checks. The insurer paid the $10,000 per occurrence limit. The insured argued that each check was a separate occurrence. The trial court granted summary judgment for the insurer in a decision reported at 2009 WL 973358 (S.D.W.Va. April 9, 2009), and the insured appealed.

The Court found that the definition of occurrence was unambiguous and rejected the insured's arguments based on continuing tort cases and the number of counts in the criminal complaint to which the employee pled guilty. *Beckley Mechanical, Inc. v. Erie Ins. Co.*, 2010 WL 1452616 (4th Cir. April 13, 2010).

Court Bonds

FSD • 16021 Bail Bond – Reinstatement of Bond Increased Surety's Risk and so Surety Entitled to Remission of Forfeiture Based on Facts Prior to Reinstatement

The criminal defendant failed to appear and his bail bond was forfeited. The following month, he was arrested on a traffic charge in another county. The court converted the bench warrant to a detainer and reinstated the bond without the surety's knowledge or consent. A few days later the defendant was returned and released on the reinstated bond. The defendant again failed to appear, and a judgment was entered on the bond.

The surety appealed, and the Appellate Division recognized that the court could not increase the surety's risk without the surety's consent. Applying basic principles of suretyship law, the Court held that reinstatement of the bond increased the surety's risk. The court remanded the case for remission of the amount forfeited considered as of the date the bond was reinstated. *State v. Giusini*, 2010 WL 2196001 (N.J.Super.A.D. June 2, 2010).

FSD • 16022 Supersedeas Bond – Bond Posted for Appeal in Estate Action Could be Applied to Pay for Damages Awarded to Executrices in Related Case for Conversion of Estate Property

The son of the decedent and the co-executrices of the decedent's estate disputed ownership of certain equipment. In the estate proceeding, the co-executrices filed an inventory and appraisal that included the equipment and valued it at $51,860. The son objected to the inventory. The probate court sustained some of his objections, disallowed others and approved the modified inventory (the Estate case). The son appealed and sold some of the equipment. As part of the appeal, he posted a supersedeas bond in the amount attributed to the disputed items. The co-executrices commenced an action for conversion (the Concealment case) and ultimately prevailed. The court of appeals affirmed the probate court's judgment in the Estate case. The court used the value attributed to the equipment in the inventory as the measure of damages in the concealment case and entered judgment against the son. The court also applied the supersedeas bond to payment of the judgment. The son appealed.

The court held that the supersedeas bond in the Estate case was liable for damages awarded in the concealment case. The bond was set in the amount of the equipment that had been sold and conditioned on payment of all damages awarded against the son upon final determination of the appeal. The majority opinion thought that the cases were really part of the same proceeding, not separate cases as argued by the son. The dissenting Judge thought that there were two separate cases, the estate case appeal in which the bond was posted was closed, and the expired bond could not be applied to damages awarded in the concealment case. *Apergis v. Boccia*, 2010 WL 2557700 (Ohio App. June 25, 2010).

FSD • 16023 Injunction Bond – Trial Court's Order Vacating the Bond, Clerk's Return of Original Bond and Surety's Release of Collateral Prevented Trial Court from Correcting its Error or Reinstating Bond

The surety issued an injunction bond in reliance on 100% cash collateral. The injunction was eventually reversed by the Appellate Division. After remand, the trial court entered an order to vacate the bond although what it apparently meant to do was decrease the amount. In reliance on the order, however, the clerk returned the original bond to the plaintiff's counsel, and it was returned to the surety along with the order. The surety released the cash collateral. The enjoined party sought to recover damages (interest and attorneys fees) resulting from issuance of the injunction.

The trial court recognized its error, but held that since the collateral had been released it could not reinstate the bond or award damages against the surety. Instead, it ordered the plaintiff to post a new bond, which the plaintiff failed to do. On appeal, the Appellate Division affirmed. *Founders Ins. Co. Ltd. v. Everest Nat. Ins. Co.*, 2010 WL 1753197 (N.Y.A.D. May 4, 2010).

FSD • 16024 Trustee Bond – Surety's Liability Could Not Exceed Trustee's Liability, and so Gross Negligence Standard Applied to Bond Claim

A creditor asserted claims against the surety bond posted for bankruptcy trustees in the Northern District of Texas and moved for partial summary judgment as to liability. The court had already found that the trustee failed to act promptly to collect property and administer the estate. The surety argued that the claimant had to establish the trustee's personal liability, and prove gross negligence. The bond was conditioned on the trustee's faithful performance of her official duties, and that language was taken directly from Section 322(a) of the Bankruptcy Code. However, the Fifth Circuit had held that a bankruptcy trustee is personally liable only for gross negligence.

The court rejected the creditor's argument that the surety could be liable on the bond for lack of faithful performance while the trustee was liable only for gross negligence. The court recognized that the surety's liability was limited to the trustee's liability. The court concluded, "Unless the Trustee is grossly negligent, Liberty Mutual is not obligated to answer under the bond." Issues of fact precluded summary judgment under the gross negligence standard. *U.S. ex rel. Lamesa Nat. Bank v. Liberty Mut. Sur. (In re Schooler)*, 2010 WL 1946268 (Bankr.N.D.Tex. May 13, 2010).

FSD • 16025 Injunction Bond – No Exception to Bond Requirement for Non-Profit Organization Dedicated to Protection of Environment

A non-profit organization dedicated to protection of the environment argued that it should not have to comply with the injunction bond requirement of Rule 65(c), Federal Rules of Civil Procedure. The trial court thought otherwise, and the non-profit organization appealed.

The court went into considerable detail analyzing the bond requirement and why it was properly applied in the case. *Habitat Educ. Center v. U. S. Forest Ser.*, 2010 WL 2104277 (7th Cir. May 27, 2010).

FSD • 16026 Probate Bond – Court Dismissed Frivolous Claims against Surety on Executor's Bond

A *pro se* plaintiff sued the executors of his great-grandfather's estate, the surety on the probate bond for the estate, the surety's attorney, and 14 judges who allegedly had made rulings related to the estate.

The court dismissed the case as based on frivolous claims for which the court lacked jurisdiction. *Patterson v. Rodgers*, 2010 WL 1704403 (D.Conn.

April 28, 2010).

FSD • 16027 Injunction Bond – Order Releasing Bond and Return of Original Bond Were in Error, But Surety Relied on Them to Return Collateral so Bond Could Not Be Reinstated

The surety issued an injunction bond in reliance on 100% cash collateral. The injunction was eventually reversed by the Appellate Division. After remand, the trial court entered an order to vacate the bond although what it apparently meant to do was decrease the amount. In reliance on the order, however, the clerk returned the original bond to the plaintiff's counsel, and it was returned to the surety along with the order. The surety released the cash collateral. The enjoined party sought to recover damages (interest and attorneys fees) resulting from issuance of the injunction. The trial court recognized its error, but held that since the collateral had been released it could not reinstate the bond or award damages against the surety. Instead, it ordered the plaintiff to post a new bond, which the plaintiff failed to do. The enjoined party appealed.

The appellate division affirmed. *Founders Ins. Co. Ltd. v. Everest Nat. Ins. Co.*, 2010 WL 1753197 (N.Y.A.D. May 4, 2010).

Miscellaneous Bonds

FSD • 16028 License Bond – Agreements Signed by Licensee Were Adjudicated Violations for Purposes of Bond Forfeiture

The licensee for a sports bar on three occasions signed agreements and waiver of hearings for permitting consumption during prohibited hours. The commission forfeited his bond, which was conditioned on revocation of the license or three adjudicated violations of the alcoholic beverage code or rules. The trial court reversed the commission's decision, and the commission appealed. The licensee argued that there had been no adjudicated violation because he admitted the violations and signed the waivers of hearing.

The court of appeals withdrew its prior decision reported at 2010 WL 1713641 (Tex.App. – Dallas April 28, 2010) and issued a new opinion reaching the same result. The court reversed the trial court and entered judgment for the commission dismissing the licensee's appeal. *Texas Alcoholic Beverage Comm. v. Cabanas*, 2010 WL 2198386 (Tex.App. – Dallas June 3, 2010).

FSD • 16029 Subdivision Bond – Homeowner's Association's Interests Not Adequately Represented by County and Motion to Intervene Granted

The county sued to enforce seven subdivision bonds on a failed residential project. The county sought either payment of the face amount of the bonds or completion of the improvements guaranteed by the bonds. The magistrate judge recommended that the homeowners association for the development be allowed to intervene, *see* 2009 WL 6543659 (W.D.N.C. December 3, 2009). The surety objected to the magistrate's recommendation and argued that the present parties adequately represented the alleged interests of the homeowners association.

The court found that there was an adversity of interests between the county and the homeowners in that the county might not use any bond proceeds solely for the improvements and might settle the claims or allow completion of the work in a way that would increase future maintenance costs of the homeowners association. The court overruled the surety's objections and accepted the magistrate judge's recommendation to allow intervention. The court also directed further briefing on whether a count in the homeowner's proposed complaint addressing use of the funds after they may be recovered from the surety created an adversary relationship between the County and the homeowners that would destroy diversity jurisdiction. *Rutherford County v. Bond Safeguard Ins. Co.*, 2010 WL 2231780 (W.D.N.C. June 1, 2010).

FSD • 16030 Lease Bond – Obligee Named on Two Sureties' Bonds Was Intended to Be Obligee and Fraud In The Inducement Defense Could be Asserted Despite Fraud Waivers in Bonds

In ongoing litigation over bonds issued in connection with fraudulent leases, the identity of the obligee for purposes of two sureties' fraud in the inducement defense was tried to the court. The claimant banks argued that they or an intermediary were intended to be the obligee even though the bonds on their face named Commercial Money Center (CMC), the perpetrator of the fraud. The identity of the obligee was very significant because the bonds guaranteed obligations under fraudulent leases, and the court previously held that very broad fraud waivers in the bonds would bar a defense based on fraud by the principal but not fraud by the obligee.

The court held that CMC was the original obligee of the bonds issued by the two sureties. The court concluded, "As a result, the Sureties may assert defenses based on fraud by CMC." *In re Commercial Money Center, Inc. Equip. Lease Lit.*, 2010 WL 2232799 (N.D.Ohio May 28, 2010).

FSD • 16031 License and Permit Bond – Surety on Real Estate Settlement Agent's Bond Liable to Title Insurer for Loss Caused by Dishonesty of Principal in Real Estate Transaction

A real estate settlement agent stole funds intended

for payment of a prior loan on the property. The title insurance company paid the loss and obtained a consent judgment against the settlement agent. The title insurer settled with the agent's owner and insurer and sued the surety on the agent's bond required under the Virginia Consumer Real Estate Settlement Protection Act (CRESPA). The surety's initial defense was that the claimant title insurance company was not a proper claimant under the bond. In an earlier opinion, reported at 2009 WL 1491418 (E.D.Va. May 27, 2009), the court rejected that argument. The surety then argued that the claimant had prejudiced the surety's subrogation rights, released the principal and was trying to recover for misdeeds of its own agent.

The court rejected each defense. The court thought that the dishonest agent was an agent of the claimant only for issuance of the title policy, not for conducting the real estate settlement. The court held that the settlements with third parties did not prejudice the surety and, in any event, the surety had not and would not make the claimant whole so the surety's subrogation rights would not come into play. The claimant's loss exceeded the bond penalty, and the court entered judgment for the penalty. *First American Title Ins. Co. v. First Alliance Title, Inc.*, 2010 WL 2382896 (E.D.Va. June 14, 2010).

FSD • 16032 Motor Vehicle Dealer Bond – Attorneys Fees Awarded to Successful Claimant Pursuant to Insurance Statute

Successful claimants on a motor vehicle dealer bond sought attorneys fees pursuant to §627.428, Florida Statutes. The trial court denied the claimants' request for fees and the claimants appealed.

The court of appeals held that the surety was subject to an award of attorneys fees pursuant to the statute. The court reasoned that surety is defined in the insurance statutes as a type of insurance, and §627.428 mandates an award of reasonable attorneys fees if an insured or beneficiary recovers a judgment against an insurer. The court reversed the trial court and remanded the case. The court did not address whether the fees could be awarded against the principal on the bond, any indemnity issues, or whether the penal sum was a limit on the recovery including the fee award. *Snow v. Jim Rathman Chevrolet, Inc.*, 2010 WL 2425946 (Fla.App. June 18, 2010).

FSD • 16033 Lease Bond – Reformation of Bond Equitable Issue as to Which There Is No Right to a Jury Trial

Claimant and surety disputed whether the parties intended the obligee on one set of bonds to be someone other than the named obligee. The court viewed this issue as one of reformation and therefore an equitable issue on which there was no right to a jury trial. The claimant involved argued that the legal and equitable issues were so intertwined that the legal issues should be tried first to a jury.

The court agreed with the surety that the identity of the intended obligee was a threshold issue because it would determine whether the surety could present its fraud in the inducement defense. The court directed that a bench trial be scheduled to decide the claimant's contention that it or one of its intermediaries was the actual intended obligee of the bonds rather than Commercial Money Center, the named obligee and perpetrator of the fraud. *In re Commercial Money Center, Inc. Equipment Lease Litigation*, 2010 WL 2465251 (N.D.Ohio June 14, 2010).

FSD • 16034 Transportation Broker Bond – Liability of Surety on Transportation Broker's Bond Limited to Penal Sum in Aggregate Not Penal Sum Per Claimant

The surety on a transportation broker's bond deposited the $10,000 penalty of the bond in court in an interpleader action. Most of the potential claimants did not file a responsive pleading, and the district court divided the deposited amount pro rata among the claimants who appeared. Five of the claimants appealed arguing that the limit of the surety's liability should be construed as $10,000 per claimant not $10,000 in the aggregate.

The court examined the governing statute, regulations and mandatory bond form and held that the surety's liability was limited in the aggregate to the single penal sum. The claimants objected to consideration of the mandatory bond form because the bond in the case was apparently submitted electronically and no actual signed bond was produced. The court held that the bond form BMC 84 was required by the regulations and properly considered. The Court affirmed the district court's judgment. *RLI Ins. Co. v. All Star Transportation, Inc.*, 2010 WL 2487534 (D.C.Cir. June 22, 2010).

FSD • 16035 Certificate of Title Bonds – Counterclaim and Record Included Sufficient Information to State Claim on Bond

The surety issued bonds to secure certificates of title for trucks sold by the principal. The surety filed suit, and one defendant counterclaimed for damages in connection with three trucks it purchased but did not receive. The surety moved to dismiss the counterclaim for failure to include necessary information or allegations.

The court denied the motion either because the allegedly missing information was in the record or was not necessary. *Guarantee Co. of N. Am., USA v. Middleton Brothers, Inc.*, 2010 WL 2553693 (E.D.Mo. June 23, 2010).

FSD • 16036 Motor Vehicle Dealer Bond –

Court Granted Surety's Motion to Reopen Default Judgment against Principal and Determine Claimant's Actual Damages

The claimant bought a used car from the principal and alleged that the principal misrepresented the condition of the car. In federal court, the claimant recovered an $11,000 default judgment for fraud, cheating and misrepresentation against the principal that recited it was for actual monetary damages. However, while the language of the default judgment tracked the condition of the principal's motor vehicle dealer's bond, but in fact the court made no inquiry into the facts and did not determine the amount of damages, if any, suffered by the claimant from the principal's fraud. The claimant then sued the surety in state court using the federal court judgment to establish the surety's liability under the bond. The surety filed a motion in federal court to set aside the default judgment and to determine the amount of monetary damages suffered by the claimant from the principal's fraud.

The court granted the motion and scheduled proceedings to determine the amount of damages. *Osbeck v. Golfside Auto Sales, Inc.*, 2010 WL 2572713 (E.D.Mich. June 23, 2010).

FSD • 16037 Customs Bond – Court Dismissed Suit to Challenge Denial of Protest because Summons and Check Paying Duties Were Mailed on Same Day

Customs liquidated an entry and denied a protest of the liquidation. The surety filed suit in the Court of International Trade to challenge denial of the protest. A jurisdictional prerequisite to such a suit is full payment of the duties. The surety mailed its check for the bond penalty and the Summons for the case on the same day. The payment was effective upon receipt by customs. The summons was effective upon the date of mailing. The United States moved to dismiss the case for lack of jurisdiction because on the date the case was filed (i.e. the date of mailing) the duties had not been paid because the check had not been received.

The court agreed and granted the government's motion to dismiss. *Great Am. Ins. Co. of New York v. United States*, 2010 WL 1816184 (CIT May 6, 2010).

FSD • 16038 Mortgage Broker Bond – Bond Conditioned on Failure to Comply with Laws Regulating Broker, Therefore Allegation that Broker Failed to Pay Judgment Insufficient

A disappointed borrower recovered a judgment against his mortgage broker. He then sued the surety for the mortgage broker on two statutory license bonds conditioned on compliance with laws regulating the mortgage broker. The surety moved to dismiss for failure to state a claim.

The court noted that the bonds were not conditioned on payment of any judgment recovered against the principal. The first count of the complaint alleged failure to pay the judgment, but not failure to comply with any laws regulating the broker. Therefore, the court granted the motion to dismiss as to the first count. The second count, however, alleged that the broker violated the Missouri Merchandising Practices Act. The court thought this allegation gave the surety fair notice of the claim against it and denied the motion to dismiss as to the second count. *Lingo v. Hartford Fire Ins. Co.*, 2010 WL 1837718 (E.D.Mo. May 4, 2010).

FSD • 16039 Subdivision Bonds – County's Alleged Delay in Demanding Completion Did Not Discharge Surety's Obligations and County Granted Summary Judgment

The county sued to enforce payment under subdivision bonds. The principal had not completed the required improvements, and the lender foreclosed on the property. The surety argued that it could not complete the improvements without the consent of the new owner of the property and that this increased its risk. In a prior decision, the court denied the surety's motions to bring the new owner, the bond principal and the CEO of the bond principal into the suit, for a stay of discovery and for a determination that the permit had been extended. The surety moved for reconsideration of that decision and for summary judgment, and the county moved for summary judgment.

The court ruled against the surety and for the county on each issue. The court rejected the surety's arguments, based on contract performance bond cases, that the county's delay in declaring a default deprived the surety of the opportunity to finish the improvements. The court found that there was no unreasonable conduct by the county that prevented the surety from completing the bonded work. The court granted the county summary judgment for the bond penalties (which had been reduced for work previously done) plus pre and post judgment interest. *County of Brunswick v. Lexon Ins. Co.*, 2010 WL 1872551 (E.D.N.C. May 7, 2010).

FSD • 16040 Contractor's License Bond – Bond Penalty Was Inadequate to Pay Two Claimants of Same Class, So The Penalty Should Have Been Pro Rated Rather Than Awarded to First Claimant to Obtain Judgment

Two homeowners filed suit against a contractor and the contractor's license bond surety. RCW 18.27.040(4) established a priority in rights against the bond of (1) laborers, (2) residential homeowners, (3) material suppliers, and (4) taxes. Both claimants were in category (2), and both were owed more than the bond penalty. The trial court awarded the penalty to the first of the two claimants to reduce his claim to

judgment.

The court of appeals reversed and held that the bond penalty should be prorated among claimants of the same class. *Hosea v. Toth*, 2010 WL 2026734 (Wash.App. May 24, 2010).

FSD • 16041 Customs Bond – Court Remanded to Customs Issue of Setting Bond Amount for Continuous Entry Bonds for Importers of Products Subject to Antidumping Duties

Shrimp importers subject to antidumping duties challenged the procedures by which customs set the amount of continuous entry bonds the importers had to maintain. The court reviewed a revised bond rule issued by customs following the court's previous remand and an adverse World Trade Organization decision.

The court held that customs could consider antidumping duties in applying its normal bond amount rule (10% of the importer's prior year duties, taxes and fees). It thought, however, that it was inequitable to apply the rule without considering that many of the covered entries had already been liquidated and the duties paid and held that customs could not on remand increase the amount of bonds that predated the dispute and had never been part of the case. The court again remanded the matter to customs for redetermination in light of the court's opinion and set a schedule for any objections to the redetermination. *National Fisheries Institute, Inc. v. U. S. Bur. of Cust. and Border Prot.*, 2010 WL 2076007 (CIT May 25, 2010).

FSD • 16042 License Bond – Surety Was Prevailing Party as to Plaintiff Who Voluntarily Dismissed Claim on License Bond, and Dismissing Party Was Liable for Surety's Attorneys Fees

Two individuals sued a contractor and later added the contractor's license bond surety. One of the individuals dismissed her claims without prejudice. The other plaintiff proceeded with the case and eventually reached a settlement with the defendants. The license bond statute provided for prevailing party attorneys fees. The trial court awarded fees against the dismissing plaintiff, and she appealed.

The court of appeals held that "the definition of 'prevailing party' under RCW 18.27.040(6) includes a defendant who prevails through voluntary dismissal." The court also held that the fees could be awarded only for defense of the bond, but since it is always necessary to establish the contractor's breach in order to recover from the bond, fees incurred to defend the contractor and surety together can be recovered. Here the court affirmed such fees for work even before the surety was added to the case as long as the work inured to the benefit of the bond. However, the court allowed only fees with respect to the dismissing plaintiff not fees, for instance, for discovery from the other plaintiff. The court recognized that the surety prevailed on the appeal, but it had not filed a brief and so had no appellate fees which could be awarded. *Nichols v. Day*, 2010 WL 1647461 (Wash.App. April 26, 2010).

FSD • 16043 Mechanics Lien Release Bond – Defense of Payment Barred Lien and Therefore Bond Claim

The owner bonded off a mechanics lien filed by a sub-subcontractor. The claimant sued the owner and surety. The bond action was subject to any defenses that could have been asserted in an action to foreclose the lien, and the lien was limited to amounts due or to become due to the contractor as of the date the claimant gave notice of the filing of its subcontract. In this case, that was in July, 2008, but the contractor had failed to pay its obligations and been defaulted in March.

The court found that there was nothing due or to become due to the contractor, and therefore nothing for the lien to seize. The court dismissed the subcontractor's claim against the bond. *Soarmar, Inc. v. Pinnconn, LLC*, 2010 WL 1687655 (Mass.Super. April 22, 2010).

FSD • 16044 License Bond – Waiver of Hearing Acknowledging Violation Was Adjudicated Violation for Purposes of Bond

The licensee for a sports bar on three occasions signed agreements and waiver of hearings on charges of permitting consumption during prohibited hours. The Commission forfeited his bond, which was conditioned on revocation of the license or three adjudicated violations of the Alcoholic Beverage Code or Rules. The trial court reversed the Commission's decision and the Commission appealed.

The licensee argued that there had been no adjudicated violation because he admitted the violations and signed the waivers of hearing. The court of appeals disagreed and reversed the trial court. The Court entered judgment for the commission dismissing the licensee's appeal. *Texas Alcoholic Beverage Commission v. Cabanas*, 2010 WL 1713641 (Tex.App. – Dallas April 28, 2010).

FSD • 16045 Mechanics lien Release Bond – Forum Selection Clause in Subcontract Applied in Mechanics Lien Action to Collect Money Allegedly Owed Under Subcontract

The prime contractor and a subcontractor on a private project asserted claims and counterclaims against each other. The subcontractor also filed a third party claim against the surety on a bond the prime contractor posted to release the subcontractor's mechanics lien. The project was located in Texas, and the subcon-

tractor moved to transfer the case to the Eastern District of Texas.

The court held that a venue selection clause in the subcontract calling for suit in East Baton Rouge, Louisiana was valid and enforceable and denied the motion to transfer. *Group Contractors, LLC v. Kizziah Constr., Inc.*, 2010 WL 1274386 (M.D.La. April 1, 2010).

FSD • 16046 Maintenance Bond – Bond Guaranteed that Principal would Correct Any Defective Workmanship or Material Not That Principal Would Perform

The obligee on a maintenance bond sued the surety. The condition of the bond was that the principal make any repairs that may become necessary because of defective materials or workmanship. The bond also required that the obligee give the surety written notice within 30 days of discovery of such a defect. In January and March, 2009, the obligee's engineer wrote to the principal with lists of work to be performed. On June 18, the obligee wrote the principal stating that the principal had failed to maintain certain improvements and that if the work was not done in ten days the obligee would notify the surety. On July 21, the obligee notified the surety that the principal was in default for not repairing or correcting all of the items in the June 18 letter. The surety denied liability because the obligee did not meet the 30 day notice requirement. The obligee argued that it had to give notice only if the principal failed to make corrections within 10 days of the obligee's demand, therefore the July 21 letter was timely notice.

The court rejected both interpretations of the bond. The court thought the bond was unambiguous and guaranteed against defective materials and workmanship not failure to perform. The court stated, "The phrase in the Bond requires the Developer to have already performed or executed a task in which the Plaintiff must then discover a defect in the Developer's materials or in the quality of Developer's work. A failure to perform is not a defect in workmanship, and the plain terms of the Bond do not insure against a failure to perform." The court granted the surety's motion to dismiss for failure to state a claim. *Lower Salford Township v. Int'l Fid. Ins. Co.*, 2010 WL 1741356 (E.D.Pa. April 27, 2010).

Surety's Rights

FSD • 16047 Surety's Rights – Surety Entitled to Summary Judgment against Principal

The surety sued the principal for indemnity. The court affirmed judgment for the surety. The court found that the defendant signed a bond application in which he agreed to indemnify the surety and that no evidence supported his contention that he did not have an agreement with the surety. *Western Sur. Co. v. Villa*, 77 Mass.App.Ct. 1102, 927 N.E.2d 1040 (table), 2010 WL 2330189 (Mass.App. June 11, 2010).

FSD • 16048 Surety's Rights – Surety Awarded Summary Judgment against Indemnitor

The surety settled a payment bond claim and sued an indemnitor, the ex-wife of the owner of the principal.

The court granted summary judgment to the surety for its loss payment and declared the indemnitor liable for the surety's reasonable attorney's fees. The court rejected the indemnitor's "armada of arguments" including res judicata, estoppel, laches, release, unilateral mistake, disparate bargaining power, negligence and bad faith. *Hartford Cas. Ins. Co. v. Jenkins*, 2010 WL 2348619 (S.D.Ala. June 9, 2010).

FSD • 16049 Surety's Rights – Surety Entitled to Summary Judgment against Indemnitor for Amount of Loss

The surety on a subdivision bond paid losses and sued the indemnitor.

The court granted the surety summary judgment in the amount of the losses. *Developers Sur. and Indem. Co. v. Old Towne Station, LLC*, 2010 WL 2367491 (M.D.Ala. June 11, 2010).

FSD • 16050 FSD No. 74__ Surety's Rights – Surety's Suit to Recover Loss Payment on Union Fringe Benefit Bond Purely State Law Matter and Case Remanded to State Court

The surety on a union fringe benefit bond paid the bond penalty and sued the principal and indemnitors in state court. The surety amended its complaint to add the union benefit plans as defendants and seek recovery of the payment as an alternative remedy. The defendants removed the case to federal court alleging federal question jurisdiction under ERISA.

The court noted that the causes of action in the amended complaint were purely state law claims and that the surety did not have standing under ERISA because it was not a beneficiary, fiduciary or participant of the plans. The court remanded the case to state court. *Nova Cas. Co. v. Tech-Elec Electrical Contr.*, 2010 WL 2541201 (S.D.N.Y. June 7, 2010).

FSD • 16051 Surety's Rights – Subdivision Bond Surety Barred from Recovery against Purchaser of Property by Bankruptcy Court Order Approving Sale of the Property Free and Clear of all Liens, Claims, Encumbrances or Interests

The principal on a subdivision bond filed for bankruptcy leaving work to be completed. The bankruptcy court sold the property free and clear of all liens, claims, encumbrances or interests. The obligee

demanded that the surety complete the improvements covered by the bond, and the surety demanded that the purchaser of the property do so. The purchaser refused, and the surety paid to complete the bonded work. The surety then sued the purchaser as subrogee of the obligee. The purchaser moved to dismiss the suit as an impermissible collateral attack on the bankruptcy court's order approving the sale or as barred by res judicata.

The court agreed with both theories and dismissed the suit for failure to state a claim. The court reasoned that the surety entered its appearance in the bankruptcy proceeding and could have objected to the order. The surety argued that the order did not bar its current claim because the order exempted enforcement of liability to a governmental unit under police and regulatory statutes or regulations. The court held that the underlying permit was a contractual obligation of the principal to the obligee, and the surety bond merely guaranteed that contractual obligation. The order approved the sale free and clear of the obligation, therefore the purchaser did not have to reimburse the surety for the cost to complete the work. The court also held that the surety could have and should have made its objections in the bankruptcy proceeding and the order approving the sale was a final order for purposes of res judicata. *Travelers Cas. and Sur. Co. of Am. v. Morgan Acquisitions, LLC*, 2010 WL 2474631 (E.D.Mich. June 14, 2010).

FSD • 16052 Surety's Rights – Surety Granted Injunction against Third Party Paying Obligation Owed to Principal

The surety paid losses and expenses and sued the principal and indemnitors. The surety brought in a "reach and apply" defendant that owed money to the principal.

The court granted the surety a preliminary injunction barring the reach and apply defendant from paying the principal any amount up to the amount claimed by the surety in the case. *Travelers Cas. and Sur., Co. of Am. v. Cresta Constr., Inc.*, 2010 WL 2509916 (D.Mass. June 16, 2010).

FSD • 16053 Surety's Rights – Surety Granted Leave to Add Indemnitors Who Withdrew from Indemnity Agreement as to Losses on Bonds that Were Written Prior to Their Withdrawal

The surety on a series of bonds for a bankrupt developer sued its indemnitors. Another set of indemnitors had withdrawn from the indemnity agreement in 2005, but some claims were made on bonds that predated their withdrawal. The surety moved to extend dates in the court's scheduling order and for leave to amend its complaint to add that set of indemnitors as to the pre-withdrawal bonds.

The court thought that the surety unduly delayed in seeking to add the new defendants but also recognized that there was no prejudice to them since the surety could sue them in a separate action. The court thought that the interests of justice were to resolve all of the claims in the one suit and granted the surety's motion, vacated the existing scheduling order and directed the parties to appear for a scheduling conference. *Travelers Cas. and Sur. Co. of Am. v. Dunmore*, 2010 WL 2546070 (E.D.Cal. June 23, 2010).

FSD • 16054 Surety's Rights – Court Sustains Objections by Workers Compensation Self Insurance Bond Surety to Allocation of Tort Settlement Between Injured Worker and His Family

The court asked to approve a tort settlement considered the allocation of the settlement amount between an injured worker's claim and his wife's and children's loss of consortium claim. The employer of the injured worker was self insured for workers compensation, and after it became bankrupt its surety paid benefits to the injured worker and had a lien on the proceeds of the injured worker's tort claim but not on his wife and children's claims. The tort plaintiffs proposed to divide the settlement 20% to the injured worker and 80% to his wife and children. The surety objected to the allocation but not to the gross amount of the settlement.

The court rejected the proposed allocation. The court did not have the ability to re-allocate the proposed settlement but indicated it would have approved something over 50% to the loss of consortium plaintiffs. *Janocha v. Wood Mill, LLC*, 2010 WL 2636823 (Mass.Super. June 15, 2010).

FSD • 16055 Surety's Rights – Insurer's Allegations against Former Employee Were Subject to a Conditional Privilege and Not Defamatory

The insured and insurer sued two former employees to recover an employee theft loss. One of the employees and her husband filed a counterclaim for slander and malicious prosecution.

The court granted summary judgment dismissing the counterclaim. The insurer's allegations in the complaint and its attached exhibits were subject to a conditional privilege. The allegations also could be read as stating that the counterclaiming employee negligently facilitated the other employee's theft and so were not defamatory. *Jalou II, Inc. v. Liner*, 2010 WL 2400431 (La.App. June 16, 2010).

FSD • 16056 Surety's Rights – Trust Fund Provision in Indemnity Agreement Was Basis for Holding that Indemnitor Was Guilty of Defalcation While in a Fiduciary Capacity and

So Not Entitled to Discharge of Debt to Surety

The bond application included a trust fund provision, and the debtor was the sole owner, director and officer of the principal as well as an indemnitor. He controlled the principal's handling of payments on the bonded project, and there was no dispute that some payments were not used as provided in the trust fund provision.

The court found that this was defalcation while in a fiduciary capacity and granted the surety summary judgment exempting the surety's claim from discharge. *The Cincinnati Ins. Co. v. Foy (In re Foy)*, 2010 WL 2584193 (Bankr.D.Kan. June 21, 2010).

FSD • 16057 Surety's Rights – Principal and Indemnitors' Motion to Dismiss Denied Even Though Agreement Signed Several Years After Bond Was Issued and After Surety Had Been Sued by Claimant

A subcontractor on a public project sued the prime contractor's payment bond surety, and the surety filed a third party claim against the principal and indemnitors. The principal and indemnitors moved to dismiss the third party claim. The surety's third party claim was based on an indemnity agreement, but the agreement was signed several years after the bond was issued and, in fact, after the subcontractor filed suit. The third party defendants argued that there was no consideration for the indemnity agreement and that the surety failed to disclose the pending suit.

The court held that the indemnity agreement was executed under seal and therefore did not require consideration and that the surety did not have a duty to disclose to the principal or indemnitors that suit had been filed against the bond. The court denied the motion to dismiss. *DeAngelo Brothers, Inc. v. Platte River Ins. Co.*, 2010 WL 2635983 (M.D.Pa. June 29, 2010).

FSD • 16058 Surety's Rights – Letter of Credit Securing Surety Not Part of Bankruptcy Filed by Alleged Owner of Security Given to Bank, and Court Denied Trustee's Request to Stay Surety's Action to Collect on the Letter of Credit

The contract bond surety advanced funds to the principal secured in part by a letter of credit. When the surety sought to draw on the letter of credit, the principal and several other allegedly interested parties filed suit in state court to enjoin the surety from calling the letter of credit. The state court granted a preliminary injunction to stop payment of the letter of credit pending a determination of the amount owed the surety. One of the interested parties, the alleged owner of a certificate of deposit securing the letter of credit, filed for bankruptcy. The trustee in bankruptcy asked the bankruptcy court to stay the state court action.

The court found that the letter of credit was not property of the estate and so not subject to the automatic stay. The court applied the normal balancing of equities for a preliminary injunction and found that the trustee was unlikely to prevail on the merits and the surety would be irreparably harmed if not allowed to draw on the letter of credit. The court recognized the distinction between the letter of credit and the certificate of deposit that secured it. Under the "independence principle" the letter of credit was a matter between the bank and the surety. If the bank sought to enforce its security in the certificate of deposit, the automatic stay would apply and the court would have jurisdiction to decide the bank's claim. The court therefore denied the trustee's motion. *Shields v. RLI Ins. Co. (In re Williams)*, 2010 WL 2670801 (Bankr.N.D.Ala. June 30, 2010).

FSD • 16059 Surety's Rights – Sureties Were Assignees of Contractor and Could Assert Pre-Takeover Agreement Claims

The sureties for a bankrupt contractor took over and successfully completed the work on a federal project and asserted numerous claims for extra costs and time extensions. The government argued that the sureties were not Contract Disputes Act contractors as to pre-takeover agreement claims. As a part of the takeover agreement, however, the contractor had assigned its claims to the sureties. The government accepted the assignment and the bankruptcy court approved it.

The Court of Federal Claims rejected the government's argument that the assignment was ineffective because it did not include the contractor's liabilities. The court pointed out that the documents reserved to the government all its defenses and offsets. The court also rejected the Government's argument that the takeover agreement reservation of the penal sum and limitation of the sureties' recovery to the amount of their loss somehow barred the claims. The sureties presented proof of their expenditures to complete the project. *Fireman's Fund Ins. Co. v. United States*, 92 Fed.Cl. 598 (2010).

FSD • 16060 Surety's Rights – Surety Entitled to Default Judgment But Directed to Submit Support for Amount Claimed

The surety paid losses and expenses of $102,658.26, had pending claims for an additional $171,011.66 and anticipated more claims. The surety sued the indemnitors, who defaulted. The court agreed that the surety was entitled to a default judgment, but the surety's motion sought an order that the defendants deposit $500,000 with the surety.

The court thought there was no basis shown for that relief and directed the surety to submit affidavits and supporting documents to establish its money dam-

ages. *Guarantee Co. of N. Am. v. Gadcon, Inc.* 2010 WL 1382343 (S.D.Ala. April 2, 2010).

FSD • 16061 Surety's Rights – Indemnitor's Fraud in Obtaining Bonds Barred Discharge of Indemnitor's Debt to Surety

The surety wrote bonds for the principal in reliance on an indemnity agreement signed by the two co-owners of the principal and their respective spouses. After losses were paid and the surety sued the indemnitors, one of the co-owners admitted that he forged the signatures of the other co-owner and the two spouses. The surety recovered a consent judgment against the forger, who filed for bankruptcy. The surety sought a determination that its claim was excepted from discharge as a debt for services or credit obtained by fraud. The indemnitor testified that the surety's agent (who had died) told him to forge the other signatures.

The court did not credit that testimony, noted that it was contradicted by other facts, and held that even if true it would not be a defense since the agent would have been acting contrary to the surety's interests and his knowledge, therefore, would not have been imputed to the surety. The court entered judgment for the surety declaring the debt non-dischargeable. *First Nat'l Ins. Co. of Am. v. Kapetanakis (In re Kapetanakis)*, 2010 WL 1463437 (Bankr.S.D.Tex. April 12, 2010).

FSD • 16062 Surety's Rights – Surety Not Entitled to Statutory Trust against Principal's Funds that Indemnitor Paid Bank on Principal's Debt, But Surety Did State Claim for Common Law Conversion

The surety recovered a judgment against the principal and indemnitors and used supplemental proceedings to seek a constructive trust against funds of the principal that one of the indemnitors used to pay his personal debt to a bank. The bank opposed the motion to impose such a trust.

The court found that the surety's allegations failed to show that the indemnitor was a fiduciary of the principal for purposes of Section 5 of the Illinois Fiduciary Obligations Act at the time he made the challenged payments. However, the surety alleged facts to support a common law conversion claim. The principal owed no debt to the bank, and the bank had a duty to exercise due care to determine the indemnitor's authority to use the principal's funds to reduce the indemnitor's personal obligation to the bank. There were issues of fact as to this claim, and the court determined that a contested evidentiary hearing would be necessary to decide it. *West Bend Mut. Ins. Co. v. Belmont State Corp.*, 2010 WL 1611037 (N.D.Ill. April 21, 2010).

FSD • 16063 Surety's Rights – Surety Had Right to Settle Claim Over Objection of Principal and to Attorneys Fees in Defending Settlement

In a dispute over real property that a ward conveyed to his mother-in-law, the mother-in-law posted a bond. The surety and the ward's conservator eventually settled the dispute. The mother-in-law objected to the settlement and appealed various other rulings of the trial court.

The court of appeals noted that the contract between the mother-in-law and the surety entitled the surety to settle claims on the bond and to attorneys fees sustained by reason of the execution of the bond. The court affirmed the trial court and awarded the surety attorneys fees on the appeal. *In re Conservatorship of Montopoli*, 2010 WL 1640978 (Ariz.App. April 22, 2010).

FSD • 16064 Surety's Rights – Surety Asserting Contractor's Mechanics Lien Rights Bound by Waivers the Contractor Signed in Exchange for Progress Payments

The issue was priority between a bank's recorded deed of trust and a contractor's mechanics lien. The contractor's surety had paid job obligations and stood in the shoes of its principal for purposes of claiming any funds due under the lien. North Carolina G.S. 44A-10 gave a mechanics lien priority as of the time the claimant first furnished labor or material at the site (the date of first furnishing). The contractor first worked on April 22, 2005, and the bank's deed of trust was executed on May 19, 2005. However, the contractor also executed lien waivers in exchange for monthly progress payments. The contractor waived all lien rights for work up to May 31, 2005. Thus, the issue was whether the date of first furnishing for priority purposes remained April 22 or was changed by the waivers to at least May 31.

The court held for the bank and found that the deed of trust had priority over the mechanics lien. *Wachovia Bank Nat'l. Assoc. v. Superior Constr. Corp.*, 2010 WL 1655494 (N.C.Super. April 23, 2010).

FSD • 16065 Surety's Rights – Surety Entitled to Common Law Indemnity for Attorneys Fees incurred in Defending Underlying Suit on Bond

After years of litigation, the principals on two motor vehicle dealer bonds paid the judgment entered by the court. The surety, however, had incurred attorneys fees and expenses in the matter and filed a claim against the principals to recover its fees and expenses. The surety produced a bond application signed by one of the principals, and the indemnity obligations of the application included attorneys fees. As to the other principal, the surety relied on common law indemnity.

The court held that if an innocent party is involved in litigation because of the active wrong-doing of another, the innocent party is entitled to indemnification including its attorneys fees and expenses in defending itself in the underlying suit. This right of common law indemnity would not extend to attorneys fees or expenses expended in seeking indemnification. The court also held that the fees had to be reasonable and necessary. The court found that the documents submitted by the surety, together with the court's own knowledge of the case and reasonable rates in the Albuquerque, New Mexico area, established that the fees incurred by the surety were reasonable and necessary. *Pedroza v. Lomas Auto Mall, Inc.*, 2010 WL 2301115 (D.N.M. April 30, 2010).

FSD • 16066 Surety's Rights – Surety for Subcontractor Paid Claim in Good Faith and Became Entitled to Proceeds of Subcontractor's Claim against Prime Contractor's Surety Superior to Competing Claim of Subcontractor's Assignee Bank

The surety for a subcontractor paid a payment bond loss to a sub-subcontractor. The subcontractor, however, settled its claim against the prime contractor's surety for an amount that exceeded the loss. The surety claimed a right to reimbursement out of the settlement by subrogation and under the indemnity agreement. The subcontractor was bankrupt, and it owed an assignee bank more than the settlement amount. The surety sued the subcontractor and the assignee bank asking the court to determine that the surety was entitled to reimbursement from the settlement fund. The defendants apparently conceded that the surety was entitled to the amount the subcontractor owed the sub-subcontractor but not to any additional amount. The defendants alleged that the surety had failed to respond to the sub-subcontractor's claim within the 45 days required by the payment bond and, therefore, had been barred from presenting evidence to contest the claim. The defendants argued that this led the surety to pay more to the sub-subcontractor, but they admitted that the surety acted in good faith. The surety moved for partial summary judgment and to strike the subcontractor and bank's defenses based on the alleged payment in excess of the amount the subcontractor owed.

The court noted that the surety negotiated a substantial reduction in the claim and that the defendants conceded the surety acted in good faith. The indemnity agreement gave the surety the right to settle claims on the bond. The court held that the surety's equitable subrogation rights were for the settlement amount and granted the surety's motion striking the subcontractor and bank's defenses based on the alleged overpayment to the sub-subcontractor. *Fid. & Dep. Co. of Maryland v. Westra Constr., Inc.*, 2010 WL 1904524 (M.D.Pa. May 10, 2010).

FSD • 16067 Surety's Rights – Court Ordered Principal and Indemnitors to Produce Documents Requested by Surety

The surety sued the principal and indemnitors for, among other things, access to the books and records as provided in the indemnity agreement. The defendants failed to make the initial disclosures required by Rule 26 and failed to respond to the surety's request for production of documents. The surety filed a motion to compel, and the defendants did not respond to it.

The court granted the motion to compel and ordered the defendants to produce all responsive documents. *Hartford Fire Ins. Co. v. NBC General Contr. Corp.*, 2010 WL 2034770 (N.D.Cal. May 19, 2010).

FSD • 16068 Surety's Rights – Surety Granted Summary Judgment against Indemnitors

The surety paid losses and expenses and sued indemnitors under a written agreement of indemnity. The surety and two of the indemnitors moved for summary judgment. One indemnitor argued that she received no consideration for signing the indemnity agreement and that she was discharged by changes in personnel at the principal or a later agreement between the surety and some of the indemnitors.

The court pointed out that issuance of the bonds was consideration whether the particular indemnitor benefited or not. The later agreement merely reaffirmed the indemnity agreement, and the personnel changes did not modify the identity of the principal or the obligations of the indemnitor. The court also rejected an argument of another indemnitor, a trust, that the agreement between the surety and some indemnitors was a non-judicial settlement agreement in violation of a Minnesota statute. The court granted the surety summary judgment as to liability and scheduled further proceedings to set the amount of damages. *Safeco Ins. Co. of Am. v. Richard Knutson, Inc.*, 2010 WL 2104542 (D.Minn. May 25, 2010).

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changes did not modify the identity of the principal or the obligations of the indemnitor. The court also rejected an argument of another indemnitor, a trust, that the agreement between the surety and some indemnitors was a non-judicial settlement agreement in violation of a Minnesota statute. The court granted the surety summary judgment as to liability and scheduled further proceedings to set the amount of damages. *Safeco Ins. Co. of Am. v. Richard Knutson, Inc.*, 2010 WL 2104542 (D.Minn. May 25, 2010).

FSD • 16070 Surety's Rights – In Suit by Supplier, Court Looked to Surety Precedents to Hold that Supplier Was Entitled to Contract Funds in Preference to Secured Lender

The owner interpled contract funds. The rival claimants were a supplier to the bankrupt contractor and a factor holding a recorded, perfected security interest in the contractor's accounts receivable. The trial court awarded the disputed fund to the factor (up to the amount of its claim), attorneys fees to the owner and the small remaining balance to the supplier. The supplier appealed relying on cases, including *Pearlman* and *Jacobs v. Northeastern*, involving sureties.

In a 2-1 decision, the Superior court reversed. The Court held that the unpaid supplier had an equitable lien on the contract funds until it was paid in full. Therefore, no payment was due the bankrupt contractor until it paid the supplier. The assignee factor had only an assignment of the contractor's claim to the fund and so was in an inferior position to the supplier's equitable lien. The court awarded the fund to the supplier and disallowed the owner's attorneys fee claim on the grounds that the fees were unnecessary since the owner could have simply paid the supplier. The dissenting judge would have affirmed the trial court. *Trevdan Building Supply v. Toll Brothers, Inc.*, 2010 WL 2142836 (Pa.Super. May 28, 2010).

FSD • 16071 Surety's Rights – Surety Entitled to Judgment against Defaulting Principal, but Amount of Judgment Limited by Allegations in Complaint

The surety sued the principal for indemnity, and the principal defaulted. The surety moved for judgment by default.

The court entered a default judgment for the surety's paid losses and attorneys fees but refused to include amounts for possible future losses or amounts attributable to another bond that it thought was not sufficiently identified in the complaint. *Guarantee Co. of N. Am. USA v. Gadcon, Inc.*, 2010 WL 2202805 (S.D.Ala. May 28, 2010).