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INSIDE

In This Issue

This issue was edited by Dennis Bartlett with the assistance of his associate Catherine McDaugale and covers cases reported between July 1, 2010 and September 30, 2010. As usual, the reported cases present a mixed bag for surety and fidelity claims professionals and lawyers.

In the Performance Bond category, a New Jersey court found that the surety could be liable for consequential damages caused by its principal's default. See *Titan Stone, Tile & Masonry, Inc. v. Hunt Const. Group, Inc.*, FSD — 16072. However, in contrast in *Hartford Fire Ins. Co. v. City Mont Belvieu*, FSD — 16074, the court strictly enforced the applicable statute of limitation in favor of the surety. Also, in *Five Star Lodging, Inc. v. George Constr., LLC,* FSD — 16081, the court found the surety was not bound by a default judgment entered against its principal and the limitation period was strictly enforced in the surety's favor.

In the Payment Bond category, the court, in *Ricky Tittle Constr. Co. v. Safeco Ins. Co. of Am.*, FSD — 16087, held the inventorying of materials, the turning over of keys, and end of the project cleanup were not "contract work" to determine the applicable one year limitation period for suing the surety. In *Artistic Stone Crafters, Inc. v. Safeco Ins. Co. of Am.*, FSD — 16097, the court enforced a contract clause requiring all change orders be in writing and denied that claimant's claim for extra work not covered by a written change order. However, in *Attard Indus., Inc. v. United States Fire Ins. Co.*, FSD — 16098, the court found that a subcontractor's waiver of a right to a jury trial did not extend to the subcontractor's claims against the surety since the surety was not specifically referenced in the waiver. Also, in *United States ex rel. Indus. TurnAround Corp. v. Travelers Cas. & Sur. Co. of Am.*, FSD — 16099, the court found that an arbitration award against the principal was binding on the surety and confirmed the award as to the surety because the surety had notice of the arbitration proceeding, the ability to participate in that proceeding and that the lawyers representing the surety had been actively involved in presenting the principal's case.

In *Tri-State Contractors, Inc. v. Fagnant*, FSD — 16105, the owner's negotiation of value engineered cost savings which led the bidder to submit a revised proposal barred the owner's claim against the bid bond after the principal withdrew from the project. Similarly, in *Jay Dee/Mole Joint Venture v. Mayor of Baltimore*, FSD — 16106, the principal's failure to meet MBE and WBE provisions of the contract did not allow the obligee to forfeit the bid bond.

In *Great Am. Ins. Co. v. AFS/IBEX Fin. Servs., Inc.*, FSD — 16109, the court tackled the interesting question of when is a forgery a forgery. The wrongdoer, Charles McMahon, Jr., the office manager, endorsed converted checks "Charles McMahon Insurance Agency" and deposited them into his personal account. The carrier defended in part on an argument that the checks were forged which argument the court rejected. In *Tooling, Mfg. & Techs. Ass'n v. Hartford Fire Ins. Co.*, FSD — 16112, the court explored what is a direct loss and found property stolen from a noninsured subsidiary was not a direct loss and not covered.

In the Miscellaneous Bond area on a subdivision bond case, the surety was found not obligated to pay for improvements that had not been built for a development in which no lots had been sold or were likely to be sold in the foreseeable future. See *Westchester Fire Ins. Co. v. City of Brooksville*, FSD — 16135. Also, in *City of Yorkville ex rel. Pirtano Constr. Co. v. Ocean Atl. Servs. Corp.*, FSD— 16137, the court held the subdivision bond protected only the named obligee, not claimants who furnished work to construct the improvements.

We hope you enjoy this issue.

Dennis J. Bartlett

Editor-in-Chief

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Contract Bonds

Performance Bonds

FSD • 16072 Performance Bond – Surety Liable for Obligee's damages, Not Just Completion Costs, But Not For Obligee's Attorneys Fees

The prime contractor terminated a subcontractor, and the subcontractor sued for damages. The prime contractor counterclaimed and also sued the subcontractor's surety. The district court found that the termination was justified and awarded damages against the subcontractor and its surety.

On appeal, the Court rejected the surety's argument that it was liable for only the cost to complete the subcontract work. The bond incorporated the subcontract by reference, and they should be read together. The Court held that the surety could be liable for damages caused by the subcontractor's default including delay costs and backcharges supported in the record. The Court also held, however, that although the prime contractor was the prevailing party and entitled to attorneys fees from the subcontractor, the surety was not liable for the fees. The Court noted that under New Jersey law the surety is chargeable only in accordance with the strict terms of its undertaking and stated, "Since the surety bond did not explicitly cover attorneys' fees – and considering New Jersey's strong policy disfavoring the shifting of attorneys' fees – the District Court correctly held that IFIC was not liable to Hunt for attorneys' fees and costs. . . ." *Titan Stone, Tile & Masonry, Inc. v. Hunt Const. Group, Inc.*, 2010 WL 3622944 (3d Cir. Sept. 20, 2010).

FSD • 16073 Performance Bond – Arbitration Award against Principal and Surety Affirmed on Appeal

In a long-running dispute between a public owner, the contractor and the contractor's surety, the parties agreed to resolve their disputes by arbitration. After the arbitrators rendered an award to the public owner and the district court affirmed the award, the contractor and surety appealed.

The Court held that the district court did not abuse its discretion in certifying the judgment as final pursuant to Rule 54(b) without waiting for resolution of the contractor's claims against the City's engineers. The Court also held that the contractor and surety's objections to the way the City presented its case did not amount to "undue means" to justify setting aside the award. It was up to the arbitrators to interpret the contract, and their interpretation was not such that the award exceeded their powers or did not draw its essence from the contract. Finally, pursuant to the AAA Rules the arbitrators were not obligated to provide a "reasoned decision" explaining the damage award because one had not been requested prior to selection of the panel. The Court affirmed the district court judgment confirming the arbitration award but denied the City's request for sanctions against the principal and surety for challenging the award. *MCI Constructors, LLC v. City of Greensboro*, 610 F.3d 849, (4th Cir. July 1, 2010).

FSD • 16074 Performance Bond – Obligee's Claim Barred by One Year Limitation Period and Surety Not Estopped to Assert Limitations Defense

A certificate of occupancy for a public project was issued in mid-2001 and the City took possession. In

July, 2002, the project was open to the public and in operation, but the City and the contractor had various disputes including alleged punch list and warranty work. They agreed to a Change Order that established the "actual completion date" as July 19, 2001, which was identified as the date of Substantial Completion on the cover page of the Change Order. The Change Order also provided that the contractor and surety agreed all warranties remained in force and the contractor would pursue completion of the punch list and warranty items. Pursuant to the Change Order, the City made a substantial payment jointly to the contractor and surety. For several years the City and surety corresponded over the contractor's alleged failure to perform the punch list and warranty work. Finally, in 2007 the surety sued the City for a declaratory judgment that the statute of limitations barred the City's claims, and the City counterclaimed. After a jury trial, the district court entered judgment for the City, and the surety appealed.

The Court reversed the district court and held that the one year statute of limitations of Texas Gov't Code § 2253.078(a) barred the claim. The limitations period was one year from "the date of final completion, abandonment, or termination of the public work project." The City argued that the one year had not started because there was no final completion. The Court held that under Texas law substantial completion was final completion and pursuant to the certifications in the Change Order that was on July 19, 2001. In the alternative, the City argued that the discussions and letters between the City and the surety estopped the surety from asserting the limitations defense. The Court rejected both promissory estoppel and quasi estoppel arguments in part because the surety never made a commitment to pay the claim or said the surety would not assert the limitations defense and in part because the correspondence on which the City relied was almost all after the limitations period had already run, i.e. more than one year from July 19, 2001. *Hartford Fire Ins. Co. v. City of Mont Belvieu*, 611 F.3d 289 (5th Cir. 2010).

FSD • 16075 Performance Bond – Allegations of Amended Complaint Sufficient to Support Obligee's Waiver or Estoppel Arguments as to Performance Bond Limitations Period But Not as to Payment Bond

The obligee sued the surety after expiration of the statute of limitations. In prior opinions the court dismissed the claims as time barred but recognized that failure to respond to the claims in a timely manner could be a ground for waiver or estoppel barring the surety from asserting the limitations defense. The obligee filed an amended complaint alleging details of its interaction with the surety, and also asserted a claim under the payment bond. The surety moved to dismiss the amended complaint.

The court held that allegations in the amended complaint as to the performance bond were sufficient to withstand a motion to dismiss. As to the payment bond, the court found that the facts alleged did not show a factual basis for estoppel or waiver by the surety within the one year limitations period applicable to the payment bond. The court denied the surety's motion as to the performance bond claim but granted it as to the payment bond claim. *Edgewater Beach Apartments Corp. v. Frontier Ins. Co.*, 2010 WL 2926236 (N.D. Ill. July 20, 2010).

FSD • 16076 Performance Bond – Case Removed After Year of Litigation Remanded to State Court

The Michigan Department of Transportation (DOT) filed a state court suit against the owner of a bridge and its surety for specific performance of a contract to build direct connections between the bridge and Michigan's interstate highway system. The owner and surety defended the case in state court. After a year of unsuccessful litigation, the defendants removed the case to federal court, and the DOT filed a motion to remand.

The court rejected the defendants' contentions that the notice of removal was timely because a show cause order added a federal question of impairment of contract. The court remanded the case to state court and awarded the DOT attorneys fees. *Mich. Dep't of Transp. v. Detroit Int'l Bridge Co.*, 2010 WL 3245773 (E.D. Mich. Aug. 17, 2010).

FSD • 16077 Performance Bond – Sureties Did Not File an Affirmative Claim in Bankruptcy Court Sufficient to Waive Right to Jury Trial

The successor to the debtor and another bankrupt entity sued the sureties. The sureties counterclaimed and filed various affirmative defenses seeking a determination that they did not have liability for the claims. The sureties timely demanded a jury trial, and the plaintiffs moved to strike the demand on the ground that the sureties lost any right to a jury trial by seeking affirmative relief in the bankruptcy court.

The court found that the sureties' defenses did not amount to assertion of an affirmative claim whose allowance or disallowance would invoke the equitable jurisdiction of the bankruptcy court. The court denied the motion to strike the sureties' jury demand. *Actrade Liquidation Trust v. Greenwich Ins. Co. (In re Actrade Fin. Techs., Ltd.)*, 2010 WL 3386945 (Bankr. S.D.N.Y. Aug. 23, 2010).

FSD • 16078 Performance Bond – Dual Obligee Rider Did Not Require that Obligee Pay Principal More Than Was Due Under Contract

A subcontractor sued the prime contractor on a private project, and the prime contractor counterclaimed and added the subcontractor's surety as a counterclaim defendant. The surety moved for summary judgment on the ground that a dual obligee rider conditioned the surety's obligation on full payment to the principal and the prime had not paid the full subcontract amount to the subcontractor.

The court pointed out that the rider required only that the prime contractor pay the subcontractor in accordance with the terms of the subcontract, and the subcontract authorized the prime contractor to withhold payment to offset its damages. Since the prime contractor's alleged damages exceeded the unpaid balance of the subcontract price, the court denied the surety's motion. *Quinn Constr., Inc. v. Skanska USA Bldg., Inc.*, 2010 WL 3064347 (E.D. Pa. Aug. 3, 2010).

FSD • 16079 Performance Bond – Obligee's Suit in State Where Subcontract Negotiated and Signed Was Proper, and Court Denied Motion to Transfer or Dismiss

The prime contractor on a private project located in South Carolina sued a subcontractor and its surety in federal court in Tennessee. The subcontractor was from Georgia and had filed a mechanics lien action in state court in South Carolina. The subcontractor, supported by its surety, filed a motion to abstain, to transfer or to dismiss for improper venue or forum non conveniens. The essence of the subcontractor's argument was that the case should be decided in South Carolina and that South Carolina was more convenient for witnesses and would avoid piecemeal litigation.

The court disagreed and denied the motion. The forum where the subcontract was negotiated and signed was proper, and none of the subcontractor's arguments overcame the deference given to the plaintiff's choice of forum or the federal court's obligation to decide cases brought before it. *DBS Corp. v. Reid Constr. Co., Inc.*, 2010 WL 3806415 (E.D. Tenn. Sept. 23, 2010).

FSD • 16080 Performance Bond – Unlicensed Subcontractor and Its Surety Could Not Use Principal's Unlicensed Status as a Defense Even if Obligee Was Aware Principal Did Not Have License

An unlicensed subcontractor performed defective work and the prime contractor recovered a judgment. The subcontractor and its surety appealed arguing the trial court erred by granting partial summary judgment precluding a defense that the prime contractor knew the subcontractor was unlicensed, and therefore the subcontract was unenforceable by the prime contractor.

Fla. Stat. § 489.128 was amended prior to the contract involved to provide that a contract with an unlicensed contractor is unenforceable only by the unlicensed contractor. The Court held that the trial court correctly followed the amended statute and affirmed the judgment. *Earth Trades, Inc. v. T & G Corp.*, 42 So. 3d 929 (Fla. Dist. Ct. App. 2010).

FSD • 16081 Performance Bond – Obligee Bound by Limitation Provision in Bond and Default Judgment against Principal Did Not Bind Surety

The contract performance bond required suit within two years of the earlier of completion or occupancy. The contract was completed and occupied in 2000. The obligee, however, was dissatisfied with some of the work and commenced correspondence with the contractor and the surety through its agent. The obligee eventually sued the contractor, but not the surety, in 2002, but the suit was placed in abeyance pending arbitration. Eventually, in 2007 the obligee recovered a default judgment against the contractor and sought to amend its complaint to add the surety as a defendant. The surety asserted that the action was barred by the two year suit limitation of the bond and moved for summary judgment. The obligee argued that it was not a party to the bond, and so not bound by the limitation provision, and that its default judgment against the principal was res judicata binding the surety.

The Court held that even a third party beneficiary is bound by the terms of the contract upon which it seeks to sue and pointed out that if the obligee was dissatisfied with the limitation provision it could have rejected the bond and required the contractor to provide one without such a provision. The Court also held that the default judgment was not *res judicata* as to the surety. The surety was not a party to the suit and the default judgment was not a judgment on the merits. There was no basis for estoppel against the surety, which had not misled the obligee in any way. The Court affirmed summary judgment for the surety. *Five Star Lodging, Inc. v. George Constr., LLC*, 2010 WL 2976524 (Ky. Ct. App. July 30, 2010).

FSD • 16082 Performance Bond – County in which Obligee Filed Third Party Claim against Surety Was a Venue Issue That Did Not Affect the Court's Jurisdiction over the Third Party Claim

The principal sued the obligee in Saratoga County, and the court transferred the case to Albany County. The obligee wanted to file a third party complaint against the surety. The case file was still in Saratoga County, and the obligee filed its third party complaint there rather than wait until after the file was transferred. After the file was transferred, the surety moved to dismiss the third party complaint for lack of

jurisdiction because when it was filed the court where it was filed no longer had jurisdiction. The trial court denied the motion, and the surety appealed.

The Appellate Division affirmed because the county court in which to file was a venue question that did not affect the court's jurisdiction. *Pike Co. v. County of Albany*, 905 N.Y.S.2d 371 (N.Y. App. Div. 2010).

FSD • 16083 Performance Bond – Two Year Limitation Provision in Bond Barred Obligee's Claim

The owner and contractor on a private project had numerous disputes. The owner eventually terminated the contract, and it was undisputed that the contractor performed no work after April 5, 2004. The owner promptly contacted the surety, and in June, 2004 the surety wrote the owner explaining the numerous disputes, the contractor's willingness to finish its version of the remaining work, the arbitration clause in the contract, the owner's breaches, and the surety's belief that the project lender was the obligee of the bond. The surety reserved all of its or its principal's rights and stated the its obligations "have not arisen." The owner and contractor engaged in arbitration, in which the surety declined to participate. The contractor eventually defaulted, and an award was entered for the owner. The owner then sued the surety more than two years after the admitted last date the principal worked on the job. The bond included a limitations provision requiring suit within two years of the date the principal ceased work. The trial court granted a directed verdict to the surety at the close of the owner's case because the two year limitation provision barred the claim, and the owner appealed.

The Court of Appeals refused to consider the owner's argument that the arbitration award was binding on the surety because it was not properly designated in the notice of appeal. On the limitations issues, the Court held that the two year provision was reasonable and enforceable and that the surety's June letter was not a waiver of the limitations defense. The dissenting judge thought that the waiver issue was a question of fact that should have been decided by the jury, not by the trial court in a directed verdict. *Monreal Funeral Home, Inc. v. Ohio Farmers Ins. Co.*, 937 N.E.2d 159 (Ohio Ct. App. 2010).

Payment Bonds

FSD • 16084 Payment Bond – Case Stayed Pending Arbitration Between Claimant and Principal

A subcontractor sued under the Miller Act and the principal counterclaimed. The principal and surety moved to stay pending arbitration between the principal and subcontractor pursuant to a provision in the subcontract. The claimant sought to dismiss the principal and proceed against only the surety.

The court denied the claimant's motion and stayed the entire case pending arbitration. *United States ex rel. Western Indus., Inc. v. Western Surety Co.*, 2010 WL 3338532 (D. Alaska Aug. 25, 2010).

FSD • 16085 Payment Bond – Suit for Prevailing Wages Met Requirements for Diversity Jurisdiction, and Court Denied Claimants' Motion to Remand

Two employees sued the principal and surety alleging failure to pay prevailing wages, overtime wages, and wages for missed meal and rest breaks as well as failure to pay wages timely and unfair business practices. The plaintiffs were California citizens, the principal a citizen of Minnesota, and the surety of Massachusetts. The principal and surety removed the case to U.S. district court, and the plaintiffs filed a motion to remand.

The court found that there was complete diversity and that the amount in controversy as to at least one of the individual plaintiffs exceeded $75,000. Even if one or more of the other plaintiffs' claims involved less than the jurisdictional amount, the court could exercise supplemental jurisdiction over them. The court denied the motion to remand. *Carey v. S.J. Louis Constr. Inc.*, 2010 WL 3853348 (E.D. Cal. Sept. 30, 2010).

FSD • 16086 Payment Bond – Claimant Could Claim for Equipment it Leased From Owner and for Attorneys Fees Pursuant to Rental Agreement With Subcontractor

The claimant rented equipment to a first tier subcontractor on a Miller Act project. The prime contractor and its surety moved for partial summary judgment to dismiss three components of the claim. First, they argued that some of the equipment furnished did not belong to the claimant (the claimant rented the equipment and then re-rented it to the subcontractor) and so the claimant could not furnish it under the Miller Act. Second, the defendants argued that the claimant could not recover attorneys fees pursuant to an attorneys fee provision in its rental agreement with the subcontractor. Third, they argued that the claimant was not entitled to prejudgment interest.

The court rejected the first argument. The claimant was in lawful possession of the equipment and furnished it for use on the job. As to attorneys fees, the court recognized that federal law controlled attorneys fees in Miller Act cases but held that under Miller Act precedents the courts enforced attorneys fee clauses in agreements between first tier subcontractors and their suppliers on the theory that the attorneys fees were part of the sum justly due for the rented equipment. As to prejudgment interest, the court distinguished between the 1.5% service charge

in the rental agreement and prejudgment interest. Since the claimant sought only the contractual 1.5%, and did not seek prejudgment interest on top of it, the court granted the motion as to prejudgment interest and denied it as to the other two issues. *United States ex rel. Ramona Equip. Rentals, Inc. v. Carolina Cas. Ins. Co.*, 2010 WL 3489348 (S.D. Cal. Sept. 3, 2010).

FSD • 16087 Payment Bond – Inventory of Material, Turn Over of Keys and Clean Up Were Not Contract Work for Purposes of One Year Limitation in Miller Act

The claimant subcontractor on a Miller Act project sued more than one year after it was terminated from the job but within one year after it went to the job to inventory material, turn over keys and clean up. The surety moved for judgment on the pleadings.

The court held that these activities were analogous to repair work, removal of equipment or final inspections, all of which have been held not to qualify as contract work for purposes of the one year limitations provision. The court granted the surety's motion. *Ricky Tittle Constr. Co. v. Safeco Ins. Co. of Am.*, 2010 WL 2690572 (M.D. Ga. July 6, 2010).

FSD • 16088 Payment Bond – Judgment for Principal Barred Claim against Surety

The claimant subcontractor litigated its delay damages claim against the bond principal in state court and lost. Its federal court suit against the surety had been stayed. After the state court judgment was affirmed on appeal, the claimant argued that it could re-litigate its claims in the suit against the surety.

The court held that the surety's liability was measured by that of the principal and since the principal was not liable, neither was the surety. The court granted the surety's motion for summary judgment. *Lexicon, Inc. v. Safeco Ins. Co. of Am.*, 2010 WL 3294448 (E.D. Ky. Aug. 20, 2010).

FSD • 16089 Payment Bond – Motion to Dismiss Denied Because Factual Basis for Surety's Arguments Was Not Set Out in the Complaint

A second tier subcontractor on a municipal project sued the prime contractor and its surety. The complaint alleged that the claimant had fulfilled all conditions precedent and had not been paid in full for its work on the project. The surety moved to dismiss the complaint. The surety argued that the complaint should have been brought in the name of the United States for the use of the claimant even though the project was not for the federal government. The surety argued that the claimant did not give notice of its claim and was paid in full, but these alleged facts did not appear on the face of the complaint. The surety argued that the claimant was not entitled to lost profits, but no lost profits were alleged in the complaint.

The court refused to consider the surety's allegations that contradicted the complaint and denied the surety's motion to dismiss. *F.F. Heating & Cooling, Inc. v. Lewis Mech. Servs., LLC*, 2010 WL 3323854 (E.D. Mo. Aug. 20, 2010).

FSD • 16090 Payment Bond – Affidavit that Claimant Was a Co-Subcontractor Was Sufficient to Establish Issue of Fact as to His Status and Prevent Summary Judgment for Surety

The claimant performed electrical work on a Miller Act project. He did not give the 90 day notice required of a sub-subcontractor or an employee of a subcontractor. The prime contractor and its surety moved to dismiss the complaint, which the court treated as a motion for summary judgment.

The claimant, however, filed an affidavit that he was a "co-subcontractor" working directly for the bond principal. The documents suggested that the claimant was either a sub-subcontractor or an employee of the subcontractor, but the court thought that the affidavit was sufficient to establish an issue as to a material fact and denied the motion. *United States ex rel. Burke v. S&M Assocs., Inc.*, 2010 WL 3122798 (S.D. Miss. Aug. 4, 2010).

FSD • 16091 Payment Bond – Issues of Fact Precluded Summary Judgment for Claimant on Most of Surety's defenses and Setoffs, But Court Granted Claimant Summary Judgment as to Right to Sue on Bond and a Setoff for a Redesign Saving

A subcontractor on a project in New York City sued the surety for the prime contractor. The surety asserted numerous defenses and setoffs, and the claimant moved for summary judgment on most of them.

The court granted the motion in part. The court rejected the surety's argument that the claimant could not sue on the bond and disallowed a setoff for a cost saving redesign credit. Otherwise, the court denied the motion because there were issues of fact as to the offsets and defenses asserted by the surety. *Underpinning & Found. Skanska, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 3735786 (E.D.N.Y. Sept. 20, 2010).

FSD • 16092 Payment Bond – Record on Partial Summary Judgment Motion Did Not Support Certain of Surety's Backcharges against Claimant

The claimant sub-subcontractor alleged that it was owed a balance of $1,117,050 and the surety for the subcontractor asserted its principal's backcharges of

$1,151,761. The claimant moved for partial summary judgment asking the court to disallow certain of the alleged backcharges. There was no dispute that the surety could, as a matter of law, assert its principal's backcharges. The issues raised by the motion were whether some categories of backcharges were supported in the record.

The court disallowed some of the backcharges and held that the claimant was due a net of $184,488.78 even if the surety prevailed on the remaining issues. *Underpinning & Found. Skanska, Inc. v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 2899786 (S.D.N.Y. July 23, 2010).

FSD • 16093 Payment Bond – Court Refused to Consider Notice Defense In Connection With Surety's Motion to Dismiss Because Defense Was First Raised in Reply Brief

A fourth tier subcontractor on a federal project sued the second tier subcontractor and its surety. The surety moved to dismiss the Complaint.

The court dismissed the claimant's quasi-contract and indemnity claims but denied the motion to dismiss the claimant's bond claim. The court recognized that the Miller Act did not apply to the bond claim. The principal and surety argued that the claimant did not allege compliance with the bond's notice requirements, but they first made the argument in their reply, and the court refused to consider it. *CLP Res., Inc. v. Ky. Bluegrass Contracting, LLC*, 2010 WL 2690404 (W.D. Okla. July 2, 2010).

FSD • 16094 Payment Bond – Court Severed Cases by Subcontractor Because Different Sureties on Two Jobs Disagreed on Strategy and Settlement

The prime contractor on three federal jobs, and its sureties, were sued by a subcontractor. One of the jobs was in Texas, and two were in Oklahoma. The Texas jobs had one surety and the Oklahoma jobs had another. The subcontractor's Texas suit was transferred to Oklahoma and consolidated with the Oklahoma suit. The surety on the two Oklahoma jobs did not agree with the surety on the Texas job as to strategy or settlement and moved to sever the cases.

The court granted the motion. *United States ex rel. Southern Rock, Inc. v. Precision Impact Recovery, LLC*, 2010 WL 3749391 (W.D. Okla. Sept. 21, 2010).

FSD • 16095 Payment Bond – Case Severed From Case Brought Against Principal and Another Surety Re-transferred to District Where It Was Originally Filed

The surety on a job in Texas moved to re-transfer the case against it back to the Northern District of Texas, where the job was located and where the suit had originally been filed.

The court held that in light of its decision reported at 2010 WL 3749391 (W.D. Okla. Sept. 21, 2010) severing the case from a case involving the same claimant and prime contractor on two Oklahoma jobs, the case should be sent back to Texas. The court reasoned that Texas law would control and some witnesses were located in Texas and might not be available if the case remained in Oklahoma. *United States ex rel. Southern Rock, Inc. v. Precision Impact Recovery, LLC*, 2010 WL 3808689 (W.D. Okla. Sept. 23, 2010).

FSD • 16096 Payment Bond – Miller Act Suit Stayed Pending Arbitration Between Claimant and Principal Pursuant to Arbitration Clause Incorporated by Reference Into Sub-subcontract

A second tier subcontractor sued the prime contractor and its Miller Act payment bond surety on a project at the U.S .Consulate in Ciudad Juarez, Mexico. The prime contractor and surety moved to stay the case pending arbitration pursuant to a clause in the first tier subcontract. They argued that the second tier subcontract incorporated the first tier subcontract and its arbitration clause by reference.

The court agreed and granted the stay. *Proyecto Electromecanico S.A. De C.V. v. Caddell Constr. Co.*, 2010 WL 2838040 (W.D. Tex. July 14, 2010).

FSD • 16097 Payment Bond – Claimant's Release and Requirement for Written Change Order Barred Claims Based on Alleged Oral Promises of Payment for Extra Work

A subcontractor on a Miller Act project was paid the adjusted subcontract amount but claimed to have performed additional work in reliance on oral promises from the prime contractor. The subcontract required that any extra work be authorized by written change order, and after completing its work the subcontractor executed a release and lien waiver in return for payment of the remaining subcontract balance. The prime contractor and surety moved for summary judgment.

The court held that the release barred the claim and that the subcontract requirement of a written change order had not been waived by the conduct of the parties. The court entered summary judgment for the principal and surety. *Artistic Stone Crafters, Inc. v. Safeco Ins. Co. of Am.*, 2010 WL 2977894 (E.D. Va. July 27, 2010).

FSD • 16098 Payment Bond – Claimant's Waiver of Right to Jury Trial against Principal Did Not Extend to Suit against Surety

A sub-subcontractor sued the payment bond surety for the subcontractor. The sub-subcontract contained a waiver of any right to trial by jury of all disputes arising out of the sub-subcontract. There was no reference directly to a payment bond claim, and there was no

jury trial waiver in the bond itself or in the subcontract that was incorporated into the bond. The surety moved to strike the claimant's jury trial demand based on the waiver in the sub-subcontract. The surety argued that sureties could enforce arbitration clauses in the claimant's agreement with the principal, and that arbitration necessarily involved waiver of a right to a jury trial.

The court recognized a split of authorities from other jurisdictions and that the surety stood in the shoes of the principal to assert the principal's defenses to the claim. The court reasoned that a major factor in the arbitration cases was the strong federal policy in favor of arbitration while here there was a strong federal policy requiring that any waiver of the Constitutional right to a jury trial be clear and explicit. The court thought that the waiver in the sub-subcontract, which did not refer to a surety bond and was not repeated in the bond itself, did not qualify under that test and held that the surety could not enforce the waiver. The court denied the surety's motion to strike the claimants jury trial demand. *Attard Indus., Inc. v. United States Fire Ins. Co.*, 2010 WL 3069799 (E.D. Va. Aug. 5, 2010).

FSD • 16099 Payment Bond – Court Affirmed Arbitration Award as to Surety in Miller Act Suit Even Though Principal Was Not a Party to Suit, Surety Did Not Participate in Arbitration and Principal Had Filed a Separate Action to Vacate Award

A subcontractor on a federal project sued the surety for the prime contractor. The surety successfully moved to stay the suit pending arbitration between the claimant and the principal. On the eve of the arbitration hearing, the surety unsuccessfully moved to stay the arbitration because the United States was not a party and could not be made a party. The arbitrator made an award to the claimant, and in doing so held that the contractor waived strict compliance with various subcontract provisions including a no damage for delay clause. The principal filed a separate suit in State court to vacate the award, and the claimant moved in the Miller Act case to confirm it as to the surety. The surety moved to vacate the award.

The arbitration clause proved for judicial review of issues of law and findings not supported by substantial evidence. The court interpreted this to track the review standards of the Federal Arbitration Act and a comparable Virginia statute. The court found that the arbitrator did not exceed his powers either in reviewing the acceptability of work or finding a waiver of the no damage for delay provision. The court also held that even though the surety was not a party to the arbitration and the principal had filed an action to vacate the award, the court could confirm the award in the Miller Act suit. The court noted that the surety had notice of the arbitration proceeding and the ability to participate and that, in fact, the lawyers representing the surety had been actively involved in presenting the prime contractor's defense. The court also relied on the fact that the surety in the Miller Act suit had invoked the arbitration clause and later sought a stay of the arbitration. The arbitration clause provided for confirmation of an award by any court with jurisdiction, and the Miller Act gave the court jurisdiction. The claim arose out of the subcontract and was within the scope of the arbitration clause. The court granted the claimant's motion, affirmed the award as to the surety, and denied the surety's motion to vacate the award. *United States ex rel. Indus. TurnAround Corp. v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 3190749 (E.D. Va. Aug. 11, 2010).

FSD • 16100 Payment Bond – Claim Barred by Second Tier Claimant's Failure to Give Notice Required by the Prime Contractor's Bond and by Defense of Payment Available Under Virginia Mechanics Lien Statute

A supplier to a first tier supplier on a "privitazation" military housing project sued the prime contractor and its surety. The prime contractor had paid the first tier supplier in full, but the first tier supplier filed for bankruptcy owing the claimant. The claimant sued under the Miller Act, but the bond was on an AIA A312 form rather than the federal standard form. The court did not resolve whether the Miller Act applied and treated the claimant as if it were a second tier subcontractor instead of a supplier to a supplier.

The court granted summary judgment to the prime contractor and its surety on the ground that the 90 day notice required from a second tier claimant by both the Miller Act and the AIA bond form was not timely provided. The court also incorrectly thought that the prime's payment of the first tier supplier barred the claim of the second tier claimant. The court applied the defense of payment available for a Virginia mechanics lien and stated, "Because Clark paid Smitty's [the bankrupt first tier supplier] for all material supplied, Smitty's could not have obtained a mechanics lien . . . Accordingly, Capitol likewise would have no right to a mechanics lien and correspondingly no right to claim under the Payment Bond for the materials at issue." *United States ex rel. Capitol Bldg. Supply, Inc. v. Clark Realty, LLC*, 2010 WL 3767853 (E.D. Va. Sept. 15, 2010).

FSD • 16101 Payment Bond – Whether Settlement Agreement Between Claimant and Subcontractor Was a Novation Discharging Bond Claim Depended on Intent of Parties, and

Court Affirmed Trial Court's Rejection of Novation Argument

A supplier to a subcontractor on an Alabama public project sued the prime contractor and its surety. The claimant settled with the subcontractor and the subcontractor's president on his personal guaranty. The settlement was reduced to writing and called for periodic payments and a consent judgment to be entered if the payments were not made. It also allocated most of the first payment to another job and the rest to the bonded job and set an amount agreed to be due on the bonded job. The prime contractor and surety moved for summary judgment on the ground that the settlement agreement was a novation that substituted a new agreement for the one to supply material on the bonded job and extinguished the original obligation and, therefore, the payment bond claim.

The Court held that the intent of the parties to the settlement agreement controlled whether a novation had occurred that would extinguish the old obligation and substitute a new one. In light of the language of the settlement agreement, and particularly a provision that disclaimed any intent to benefit third parties, and the intent of the Alabama Little Miller Act to protect suppliers, the Court affirmed the trial court's finding that there was no intent to discharge the bond claim. The Court also affirmed rejection of arguments based on the claimant's continuing to supply material after not receiving payments and alleged lack of proof that some of the material was delivered to the job site. The Court affirmed award of attorneys fees to the claimant. *Safeco Ins. Co. of Am. v. Graybar Elec. Co.*, 2010 WL 3835723 (Ala. Sept. 30, 2010).

FSD • 16102 Payment Bond – Surety on Prime Contractor's Payment Bond Liable to Second Tier Subcontractor Even If First Tier Subcontractor Had Not Been Paid But Bond Principal Not Liable Because It Was Not in Privity With Claimant

A sub-subcontractor on a public project sued the prime contractor and its sureties. The claimant did not sue the first tier subcontractor. In addition to a claim on the payment bond, the sub-subcontractor alleged violation of Chapter 93A, intentional interference with contract, defamation and concerted action claims against the prime contractor. The defendants filed a motion to dismiss. The defendants argued that the sub-subcontract had a pay if paid clause and the intervening subcontractor had not been paid therefore there was no debt due to the sub-subcontractor.

The court rejected this argument and held that the promise in the payment bond to pay claimants, which included sub-subcontractors, was not limited to claimants who could prove a debt from the intervening subcontractor. The court then went even further and held that the bond principal, since it was not in privity with the claimant, had no obligation to the claimant and dismissed the payment bond count as to the principal. The court stated, "The bond is a promise made to Riley by the sureties not by the principal. Riley therefore has no claim against URS under the bond, and Count I must be dismissed with respect to URS." The court rejected the prime contractor's argument that the economic loss rule barred the various bad faith or business tort claims. Thus, the court denied the motion to dismiss in its entirety except for the erroneous holding that the principal was not liable on the bond. *P.J. Riley & Co. v. URS Corp. – New York*, 2010 WL 3934643 (Mass. Super. Ct. Aug. 24, 2010).

FSD • 16103 Payment Bond – Third Tier Subcontractor Proper Claimant Under First Tier Subcontractor's Bond, Rejection of Joint Check Offer Did Not Estop Third Tier Subcontractor From Asserting Claim, And Interest Provision in Claimant's Subcontract Applied

A third tier subcontractor sued the first tier subcontractor and its payment bond surety. The defendants argued that lack of privity barred the claim, that the claimant failed to mitigate its damages by rejecting a joint check offer, and that the trial court should not have awarded prejudgment interest at the 18% rate called for in the claimant's agreement with the second tier subcontractor.

The Court found that the payment bond defined "claimant" to include those in privity with the principal's subcontractors; therefore, the plaintiff was a proper claimant. The Court also found no basis to estop the claimant from pursuing the bond even if it did reject joint checks and that the interest rate set out in the agreement under which the material was furnished was binding on the defendants. The Court affirmed the trial court's judgment. *Boatwright Distrib. & Supply, Inc. v. North State Mech. Inc.*, 2010 WL 3464837 (N.C. Ct. App. Sept. 7, 2010).

FSD • 16104 Payment Bond – On Record, Pay-if-Paid Clause Barred Claim

A subcontractor sued the prime contractor and its payment bond surety. The trial court granted summary judgment to the subcontractor, and the principal and surety appealed. The appellants argued several points including that a pay-if-paid clause in the subcontract barred the claim.

The Court held that the payment provision of the subcontract was a clear pay-if-paid clause that succeeded in making the owner's payment to the contractor an enforceable, express condition precedent to the contractor's obligation to pay the subcontractor. There was no evidence that the owner had paid the contractor for the subcontractor's work, therefore the Court reversed summary judgment for the subcontractor and

remanded the case. *FaulknerUSA, LP v. Alaron Supply Co.*, 322 S.W.3d 357 (Tex. App. – 2010).

Bid Bonds

FSD • 16105 Bid Bond – Rejection of Bid Followed by Negotiation of Cost Reductions and New Agreement Barred Forfeiture of Bid Bond

The low bidder on a public project submitted a bid bond in the form of a certified check. The bid, however, exceeded the owner's budget, and the owner did not accept the bid. Instead, it negotiated various value engineering cost savings, and the bidder submitted a revised proposal that the owner accepted. The bidder discovered various conditions on the site that would increase costs and withdrew from the contract. The owner sought to retain the bid bond.

The Court held that under the Wyoming bid bond statute the bid bond could be forfeited only if the bid was accepted and the bidder failed to enter into the contract within 30 days or failed to proceed with performance. Here, the value engineering negotiations were a counterproposal that effectively rejected the bid. The bidder had a property interest in the bid bond, and the owner's refusal to return the bond deprived the bidder of its property without due process of law. The case was on an interlocutory appeal by individual members of the owner's governing body contesting the trial court's denial of their motions to dismiss based on qualified immunity. The Tenth Circuit affirmed the trial court, noted that the bid bond had already been returned, and remanded for consideration of the bidder's claims for attorneys fees and punitive damages. *Tri-State Contractors, Inc. v. Fagnant*, 2010 WL 3422587 (10th Cir. Sept. 1, 2010).

FSD • 16106 Bid Bond – Bid Bond Penalty Not Forfeited by Post Award Failure to Meet MBE/WBE Requirements

The bid bond provided for forfeiture of the penal amount, $817,125.18, as liquidated damages in the event of a default. The principal's low bid identified two proposed subcontractors that the bidder would use to comply with the MBE and WBE provisions of the contract. After award, the principal signed the contract, furnished the performance bond, and did some preconstruction work but was not issued a notice to proceed. The principal could not reach agreement with its two proposed MBE/WBE subcontractors and requested permission to substitute others. The City investigated and doubted the good faith of the principal's original MBE/WBE submission. The City annulled the contract for non-compliance with the MBE/WBE requirements. The principal sued the City and the City counterclaimed. After discovery, the parties filed cross motions for summary judgment.

The court held that the principal breached the contract and awarded the City nominal damages of $1. The court rejected the City's liquidated damages claim for the bid bond amount. The court found that the conditions of the bid bond were performed. The principal executed the contract, furnished the performance bond, and performed its post-award, pre-formal contract duties created by acceptance of the bid. Once the principal performed these obligations, the bid bond conditions were satisfied, and the City's protection was the performance bond. *Jay Dee/Mole Joint Venture v. Mayor of Baltimore*, 725 F. Supp. 2d 513 (D. Md. 2010).

FSD • 16107 Bid Bond – Bond That Did Not Meet Statutory Requirements Made Bid Nonresponsive, and it Should Have Been Rejected, Therefore Obligee Could Not Seek Damages from Bond

A bidder submitted a bid bond that did not comply with Louisiana law because the surety was not authorized to write bonds in Louisiana and did not meet the requirements of the Louisiana Public Works Act. Nevertheless, the public entity awarded the contract to the bidder, but when the bidder failed to provide an acceptable performance bond the public owner sought damages from the bidder and surety on the bid bond including the cost to re-bid the project, the difference between the bid and the price ultimately accepted, and delay costs.

The Court held that the bid was non-responsive because the bid bond surety did not meet the statutory requirements. As such, the bid had to be rejected and was "null and void" pursuant to the statute and not susceptible of acceptance. Therefore, the principal and surety were not liable on the bid bond, and the complaint failed to state a cause of action. *State v. Infinity Sur. Agency, L.L.C.*, 47 So.3d 647 (La. Ct. App. (2010).

FSD • 16108 Bid Bond – Surety's Consent Form Held to Be Unconditional Because It Committed Surety to Final Bonds Either Alone or With Co-Sureties

The low bidder's certificate of surety stated that the surety agreed, "to execute the final bond as required by specifications or to become co-sureties with others in the full amount of the contract price for the faithful performance of the contract." Another bidder protested and argued that this was not the required unconditional consent. The trial court disagreed and permitted the City to award the contract.

The Appellate Division affirmed. The Court reviewed precedent on what is necessary in the consent of surety, including the recent *Nova Crete v. City of Elizabeth* decision, and concluded that the surety's promise was unconditional. *Blue Diamond Disposal,*

Inc. v. City of Vineland, 2010 WL 3419192 (N. J. Super. Ct. App. Div. Aug. 24, 2010).

Fidelity Bonds

FSD • 16109 Fidelity Bond – Checks Obtained by Fraudulent Scheme and Endorsed by Office Manager of Payee Were Forged Even Though Office Manager Was Authorized to Endorse Legitimate Checks and Name of Payee Agency Was Partly His Own Name

The insured made premium finance loans for insurance policies. It was fraudulently induced to issue 127 checks payable to Charles McMahon Insurance Agency to finance premiums on non-existent insurance policies. There was a Charles McMahon Insurance Agency owned by Charles McMahon, Sr. His son, Charles McMahon, Jr., was the office manager and the perpetrator of the fraud. The son endorsed the checks "Charles McMahon Insurance Agency" and deposited them in his personal account. The premium finance company claimed a loss resulting from forged endorsements on the checks. The insurer denied that the checks were forged. The trial court granted the insured summary judgment and, after trial, added statutory prejudgment interest until the date of judgment, attorneys fees, and consequential damages for the insured's expenses in suing the wrongdoer. The district court denied the insured's claim for bad faith. The insurer appealed and the insured cross appealed.

The Court of Appeals rejected the insurer's arguments that there was no forgery because the son was the insurance agency's office manager authorized to endorse checks. The Court thought that under the definition of forgery in the policy the question was whether he was authorized to endorse these specific checks and concluded that he was not. The Court also rejected the argument that there was no forgery because the agency's name and the son's name both included "Charles McMahon." The point was that the son was signing the agency's name not his own name. The Court borrowed from the district court in reasoning that if Bob Jones signed Bob Smith's name it was still a forgery even though they were both named Bob. The Court reversed the award of consequential damages in the form of attorneys fees to sue the wrongdoer since they were not the consequence of the insurer's denial of liability and, in fact, were incurred prior to the denial. On the insured's cross appeal, the Court affirmed the stopping of 18% statutory penalty interest on the date of judgment in the district court. On the bad faith issue, the district court had correctly held that the insured alleged no damages from the supposed bad faith denial of liability separate from its damages for breach of contract. Therefore, on the situation before it, the district court was correct, but now the Court had held the consequential damages (attorneys fees to sue the wrongdoer) were not recoverable as breach of contract damages, so the insured had extra-contractual damages to claim. The district court had not reached the merits of the insured's extra-contractual claim and so made no finding on the insurer's good faith or on compliance with the Texas Insurance Code. Since the insured could now allege damages separate from breach of contract, the Court remanded the bad faith claim to the district court. *Great Am. Ins. Co. v. AFS/IBEX Fin. Servs., Inc.*, 612 F.3d 800 (5th Cir. 2010).

FSD • 16110 Financial Institution Bond – Closing Attorney Was Retained by Insured and Within Definition of Employee But Issues of Fact Existed as to His Alleged Dishonesty and Receipt of Financial Benefit

Lots were sold in a residential development to purchasers who were told that the developer would lease the lots back from them and they would not have to make payments. The insured made loans to 90 of the purchasers and sued for losses on those loans. The insured alleged that it did not know of the ponzi-like scheme and that the closing documents falsely indicated substantial down payments from each borrower. The claim was based on dishonesty by the closing attorney who stated in the HUD-1 form that the purchasers made the down payments. The bond defined Employee to include "an attorney retained by the ASSURED and an employee of such attorney while either of them is performing legal services for the ASSURED." There was no dispute that the attorney performed legal services for the insured, but the parties disputed whether he was retained by the insured, whether he was dishonest, and whether he received an improper financial benefit. The parties filed cross motions for summary judgment.

The court held that given its plain meaning "retained" meant "to engage the services of an attorney or counselor to manage a specific matter or action" and that the attorney, as the bank's sole representative at the closing, met this definition as a matter of law. The court also held that there were genuine issues of fact as to whether the attorney was dishonest and whether he received any improper financial benefit from the transactions. The court granted the insured's motion for partial summary judgment as to the attorney's status and the insurer's motion for summary judgment dismissing the insured's bad faith claim. The court denied summary judgment on the dishonest acts and improper financial gain issues. *Fed. Ins. Co. v. United Cmty. Banks, Inc.*, 2010 WL 3842359 (N.D. Ga. Sept. 27, 2010).

FSD • 16111 Fidelity Bond – Insured's Naming In-state Agent in Suit Was Not Fraudulent Joinder, so Case Remanded to State Court

The insured hired an employee with knowledge that the employee had been convicted of fraud. The insured had a series of policies in force during the period the employee embezzled funds by issuing checks to a phony vendor. The insurer denied the claim based on the automatic termination provisions of the policies, and the insured sued the insurer and the agent who placed the last policy. The insured and the agent were citizens of the same state, but the insurer removed the case on the basis of diversity jurisdiction. The insured moved to remand, and the issue was whether the agent was fraudulently joined. The insurer argued that the claims against the agent were barred by the statute of limitations and that the insured could not establish a cause of action against the agent for either breach of fiduciary duty or negligent misrepresentation. The court disagreed and found that there was a reasonable possibility the claims were not time barred and that the insured had stated a claim for breach of fiduciary duty. Therefore, there was no improper joinder and the court did not need to reach the negligent misrepresentation claim. The court granted the motion to remand. *Allied Bldg. Stores, Inc. v. Cont'l Cas. Co.*, 2010 WL 3896502 (W.D. La. Sept. 29, 2010).

FSD • 16112 Fidelity Bond – Property Stolen from Noninsured Subsidiary Was Not a Direct Loss

The insured trade association had several entities added as insureds under its policy, but did not add TMTA Insurance Agency LLC. The Agency was a licensed insurance producer formed to collect brokerage fees on insurance sold to members of the trade association. An employee diverted such commissions. The policy covered direct loss from employee theft and excluded indirect loss which was defined to include the inability to realize income that the insured would have realized had there been no loss.

The court held that the diverted brokerage commissions were an indirect loss. If the Agency had been an insured, there would have been coverage, but it was not an insured and the diverted commissions were owed to it not to the insured. The insured argued that it would have received the money as the owner of the Agency, but the court thought that the inability to realize that income was an indirect loss excluded by the policy. The court granted the insurer summary judgment. *Tooling, Mfg. & Techs. Ass'n v. Hartford Fire Ins. Co.*, 2010 WL 3464329 (E.D. Mich. Aug. 30, 2010).

FSD • 16113 Fidelity Bond – Transfers Between Insured's Accounts Was Not a Loss, and Loss from Transfers to President's Personal Account Was Barred by Officer-Shareholder Exclusion

The insured's president and part owner transferred funds from trust accounts into the insured's operating account and then further transferred part of the funds to his personal account. The Policy excluded loss caused by the dishonest acts of any Officer-Shareholder. The insured claimed the entire amount transferred from the trust accounts as a loss. The insured also asserted a vexatious refusal to pay claim. The insurer moved for summary judgment.

The court held that transfers between accounts were a theoretical or booking loss and not within the meaning of loss in the policy. The amounts transferred to the president's personal account were a loss but were not covered because of the Officer-Shareholder exclusion for loss resulting from dishonest acts of any Officer-Shareholder "whether acting alone or in collusion with others." The insured admitted that the former president was within the definition of Officer-Shareholder but argued the transfers were covered because another employee aided or helped conceal his misdeeds. The court found that the exclusion still applied because the Officer-Shareholder was a participant in the entire theft and the exclusion explicitly contemplated that an Officer-Shareholder could act in collusion with others including other employees. Finally, the court held that the insured's vexatious refusal to pay claim failed because the insurer's denial of liability was correct. The court granted the insurer's motion for summary judgment and dismissed the suit. *Tactical Stop-Loss LLC v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 2802203 (W.D. Mo. July 14, 2010).

FSD • 16114 Financial Institution Bond — Suit by Insured Was Not Parallel to Insurer's Suit against Insured and Other Institutions with Similar Claims Because Insured Was Contesting Jurisdiction, Therefore Prerequisite of Abstention Did Not Exist and Motion Was Denied Without Prejudice

An insured credit union sued its insurer for losses allegedly caused by a mortgage servicer that fraudulently sold mortgages and stole the proceeds. The insurer filed suit in Wisconsin against all 26 credit unions that suffered such losses. The insurer moved to dismiss or stay the credit union's New Jersey suit.

The court rejected several procedural objections advanced by the credit union but held that because the credit union had filed an objection to personal jurisdiction in the Wisconsin court there was no parallel proceeding. The prerequisite of federal law on abstention is the existence of a parallel proceeding. Until the Wisconsin court decided that it had jurisdiction over the insured, there was no parallel proceeding and

therefore no basis for a motion to stay. The court denied the insurer's motion without prejudice it its renewal if the Wisconsin court exercised jurisdiction over the credit union and the insurer chose to renew its motion. *Sperry Assocs. Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 2010 WL 2925924 (D.N.J. July 21, 2010).

FSD • 16115 Financial Institution Bond – Suit by Insured Was Parallel to Insurer's Suit against Insured and Other Institutions with Similar Claims, But Abstention Was Not Justified under Facts of the Case

An alleged servicing contractor, CU National Mortgage, LLC, sold 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. The insurer had filed an action in Wisconsin state court naming as defendants the insured and a number of other credit unions that did business with the alleged servicing contractor. After the Wisconsin suit was filed, the insured filed suit in New York federal court seeking to recover its losses. The insurer asked the court to stay or dismiss the New York case so that the dispute could be resolved in the Wisconsin case.

The court found that the two actions were parallel for purposes of applying the *Colorado River* abstention factors, but after analyzing the application of the factors the court concluded that abstention was not justified. The court denied the insurer's motion to stay or dismiss the case. *Suffolk Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 2010 WL 2925492 (E.D.N.Y. July 22, 2010).

FSD • 16116 Fraud Safeguard Provision of Homeowners Policy – Plaintiffs Received More Than They Invested in Madoff Scheme and So Had No Loss

Individual victims of Bernard Madoff Investment Securities (BMIS) sued their homeowners insurer pursuant to a Fraud Safeguard provision of the policy. The plaintiffs sued on their own behalf and on behalf of all others similarly situated. The plaintiffs, however, had received $225,000 more back from BMIS than they invested. The Fraud Safeguard coverage insured against direct loss and excluded indirect losses including the inability to realize potential income.

The court found that the plaintiffs did not suffer a loss. The court rejected arguments that the insureds possessed the amount shown in their final statement from BMIS because they could have withdrawn it at any time up to the date the fraud was revealed and therefore "lost" that amount. The court also rejected arguments based on (1) the plaintiffs' expectation of earnings computed on an implied interest rate or reasonable growth assumptions, (2) inflation adjustments, (3) non-recoverable tax payments, and (4) alleged legitimate investment growth before the Ponzi scheme commenced. Since there was no loss, the plaintiffs failed to state claims for breach of contract, bad faith, unjust enrichment or declaratory relief. The court granted the insurer's motion to dismiss. *Horowitz v. Am. Int'l Grp., Inc.*, 2010 WL 3825737 (S.D.N.Y. Sept. 30, 2010).

FSD • 16117 Financial Institution Bond – Insurer's Counterclaim to Rescind Partial Payment Stated a Claim Upon Which Relief Could Be Granted Based on Mutual Mistake of Fact But Not Based on Fraudulent Misrepresentation

The SIPA trustee liquidating the insured sued on the insured's financial institution bond and the insurer counterclaimed to recover a partial payment made under a reservation of rights agreement. The insurer argued that additional facts showed the person whose dishonesty caused the loss was not an Employee under the terms of the bond. The trustee moved to dismiss the counterclaim for failure to state a claim arguing that the counterclaim was barred by res judicata, or was untimely, or was barred by SIPA. The insurer argued for rescission because the partial payment was based on mutual mistake of fact or fraudulent misrepresentation as to the dishonest person's status as an Employee.

The court found that pursuant to the facts alleged by the insurer and which the court could otherwise consider in deciding the Rule 12(b)(6) motion, the insurer stated a claim for rescission based on mutual mistake but not based on fraudulent misrepresentation. The court denied the motion to dismiss the insurer's counterclaim except as to the fraudulent misrepresentation claim. *Zaremba v. Fed. Ins. Co. (In re Cont'l Capital Inv. Servs., Inc.)*, 2010 WL 3860715 (Bankr. N.D. Ohio Sept. 30, 2010).

FSD • 16118 Financial Institution Bond – Issues of Fact as to Discovery, Notice and Faithful Performance Precluded Summary Judgment for Either Party, But Court Held that Loss Occurred When Loans Were Made, Payments Received Reduced the Loss, and Accrued But Unpaid Interest on Loans was Not Part of Loss

Two employees made loans for construction of houses that the borrowers did not intend to occupy. Loans for such "spec" houses allegedly were against the insured's lending policies. The insured also claimed that other policies were not followed for some of the loans. The insured gave late notice of the claim. The parties each moved for summary judgment.

The court held that there were issues of fact as to when the loss was discovered, whether the insurer was prejudiced by the late notice, what loan policies were in place and enforced at the time the loans were made, and whether the acts of the employees were within the policy's definition of "failure to faithfully perform his/her trust." The court held that coverage was only for a direct loss and that any loss occurred when the loans were made not when the real estate market collapsed. The amount of the loss would be the amount loaned less any receipts or recoveries. The insured was not entitled to claim accrued but unpaid interest on the loans but could claim prejudgment interest against the insurer if it prevailed on the merits of the claim. The court granted in part and denied in part the parties' respective motions for summary judgment. *Transwest Credit Union v. Cumis Ins. Soc'y, Inc.*, 2010 WL 3791310 (D. Utah Sept. 21, 2010).

FSD • 16119 Fidelity Bond – Insurer's Motion to Dismiss Granted Because Re-Purchase of Loans by Insured Was Not a Direct Loss and Was Excluded from Coverage

The insured was a mortgage lender that packaged its mortgages and sold them to investors. The insured warranted to the investors that the underlying mortgages met Fannie Mae's requirements, including that the borrowers had themselves made certain minimum down payments. One of the insured's office managers in Florida conspired with a mortgage broker to make loans that did not meet the down payment requirement. After defaults exposed this defect, the insured was obligated to re-purchase the mortgages from the investors. The insured sought to recover its resulting loss from the insurer on its fidelity bond, which insured against direct loss from employee dishonesty but excluded loss from repurchasing a real estate loan from an investor. The insurer moved to dismiss the suit for failure to state a claim upon which relief could be granted.

The court held that under Wisconsin law direct means direct and the loss from repurchasing the mortgages was not direct. The existence of the loss depended on the borrowers defaulting and the investors demanding that the insured repurchase the loans. The court found that there was no direct loss and no loss resulting directly from the employee's dishonesty. The court also held that the exclusion barred the claim and rejected the insured's argument that its loss resulted from advancing loan funds to unqualified borrowers. The insured sold the loans and suffered no loss until called upon to repurchase them from the investors. The court also dismissed the insured's claims for statutory failure to pay and bad faith since the insurer had facts to establish that its liability was, at the very least, "fairly debatable." *Universal Mortg. Corp. v. Wurttembergische Versigherung, AG*, 2010 WL 3060655 (E.D. Wis. July 30, 2010).

FSD • 16120 Fidelity Bond – Computer Crime Coverage Not Limited to Hacking and Issues of Fact Precluded Summary Judgment for Insurer on Whether Computer Use Was Proximate Cause of Loss And Claim for Alleged Bad Faith Denial of Claim

The insured law firm was retained to collect an alleged debt owed to an alleged Chinese company. The alleged debtor sent the firm an "official check" purportedly from Wachovia Bank, and the law firm wired the amount of the check less a small fee to an account in South Korea designated by the purported client. The "official check" was a fraud, and the law firm was out the money it wired. The law firm claimed under the Computer Crime coverage of its policy on the theory that its communications with the scammer were via E-mail and the fraudulent check was most likely created by use of a computer. The insurer denied the claim, and the law firm sued and added a claim for breach of the duty of good faith and fair dealing. The insurer moved for summary judgment.

The court rejected the insurer's argument that there was no coverage because there had been no computer hacking or manipulation of computer data. The court thought there were genuine issues of fact as to whether the loss resulted directly from use of the computer. The court interpreted direct loss to require only proximate cause and rejected the insurer's argument that the cause of the loss was the insured's wiring money out of its account. The court also rejected the insurer's arguments based on exclusions for loss from acceptance of money orders or counterfeit checks and from surrendering money in a purchase or exchange. The court found that issues of fact precluded summary judgment on the good faith and fair dealing claim and denied the insurer's motion as to both counts of the complaint. *Owens, Schine & Nicola, P.C. v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 4226958 (Conn. Super. Ct. Sept. 20, 2010).

FSD • 16121 Financial Institution Bond – Suit for Breach of Bond Was an Action at Law and Transferred to Superior Court from Chancery Court

The insured life insurance company sued its primary and excess fidelity bond insurers and D&O carriers in Delaware Chancery Court. The defendants did not object to the Court's jurisdiction, but the Court raised the issue itself.

The Chancery Court decided that the suit was really an action at law for breach of contract, not an equitable action for apportionment of defense costs, and transferred it to the Delaware Superior Court. *Mass. Mut. Life Ins. Co. v. Certain Underwriters at Lloyd's of London*, 2010 WL 3724745 (Del. Ch. Sept. 24, 2010).

FSD • 16122 Financial Institution Bond – Court Denied Motion to Dismiss Claims of Insured That Lost Its or Its Customers' Money in Madoff Scam

The insured plaintiffs were a life insurance company and its affiliates, or entities it or its affiliates managed, which invested over $3 billion with Bernard Madoff. The defendants were a primary fidelity bond carrier and several excess fidelity carriers and a primary Directors and Officers insurer and several excess D & O insurers. The plaintiffs alleged both direct losses and suits against plaintiff entities by investors whose money was lost. The fidelity insurers moved to dismiss the complaint for failure to state a claim upon which relief could be granted. Numerous provisions of the primary fidelity policy varied from the comparable provisions of the 1986 S.F. No. 24 including the definition of employee, an Independent Broker Exclusion Rider, the definition of "Assured," the definition of Property, the Ownership provision, a Court Costs and Attorneys Fees provision, and the On Premises Insuring Agreement.

One set of claimants were hedge funds which invested with Madoff. The court thought that Madoff stole the hedge funds' money directly and rejected the argument that the Trading Loss exclusion applied and that the stolen funds were not the property of an Assured. The other set of claimants managed the hedge funds and were sued by investors ("feeder fund" suits, for example) and sought coverage for the cost to defend and any liability in those underlying suits. The insurers argued that any such costs or losses could not result directly from a covered cause. The court rejected the insurers' categorical position that a third party claim can never be a direct loss and stated, "Because the Bond Underwriters' categorical no-coverage position is incorrect, I deny the motion to dismiss. This is not to suggest that all or even many of the claims in the Underlying Actions are covered." The court extensively discussed the applicable provisions of the primary bond and denied the fidelity insurers' motion to dismiss because it thought that on the record before it the complaint was adequate to state claims on the primary bond. *Mass. Mut. Life Ins. Co. v. Certain Underwriters at Lloyd's of London*, 2010 WL 2929552 (Del. Ch. July 23, 2010).

Court Bonds

FSD • 16123 Probate Bond – Disgruntled Heir's Suit Barred Because All Claims Had Been Asserted and Rejected in Prior Suits

A disgruntled heir sued the surety on an executor's bond repeating claims she had made in several previous suits.

The Court held that New Jersey's Entire Controversy Doctrine barred the claims because they were asserted and decided in prior litigation. The Court also noted that the plaintiff's claims might also be barred by the statute of limitations. *Wisniewski v. Travelers Cas. & Sur. Co.*, 2010 WL 2893610 (3d Cir. July 26, 2010).

FSD • 16124 Supersedeas Bond – Court Approved Bond Based on Obvious Ability of Principal and Surety to Pay Judgment

The judgment creditor objected to the supersedeas bond filed by the debtor.

The court approved the bond based on the obvious financial ability of the principal (DuPont) and the surety (F&D) to pay the judgment even though the bond did not contain language from a Local Rule that in the event of a default the surety consented to summary jurisdiction of the court. *Adams v. United States*, 2010 WL 3038089 (D. Idaho Aug. 2, 2010).

FSD • 16125 Probate Bond – Surety Failed to State a Claim against Estate's Former Attorneys

A probate bond surety paid the Estate and sued the Estate's former attorney and her law firm to recover the loss and expenses. The surety's complaint asserted claims for non-contractual indemnity, contribution, and professional negligence. The defendants moved to dismiss the complaint.

The court found that for non-contractual indemnity the obligation discharged by the plaintiff must be the same as the obligation owed by the defendants. Here the obligations were different, and the court dismissed the surety's non-contractual indemnity claim. For contribution, the parties must share a common liability, and here they did not. The court dismissed the contribution claim. The surety was not the defendants' client, therefore under Missouri law it could sue for professional negligence only by showing that the defendants were retained by the Estate with the specific intent to benefit the surety. The court found no allegation or evidence of such a specific intent and dismissed the professional negligence claim. According to the court, the surety first asserted equitable subrogation in its opposition to the motion to dismiss, but the court nevertheless considered it. The court thought that under Missouri law subrogation was a drastic remedy to be allowed only in extreme cases bordering on fraud. The surety did not allege fraud or anything bordering on fraud, and the court concluded, "Because Merchants has not stated a plausible claim for equitable subrogation, Defendants' motion must be granted." *Merchants Bonding Co. v. Noland*, 2010 WL 3584017 (W.D. Mo. Sept. 7, 2010).

FSD • 16126 Supersedeas Bond – Bond Released if Result Reversed on Appeal But Remains Liable if Liability Affirmed and Case Remanded Only for Determination of Amount of Damages

A law firm sued to recover $244,371 in allegedly unpaid attorneys fees. The court awarded $27,849 but then added $210,364 for attorneys fees and costs in the litigation pursuant to a prevailing party provision in the retainer agreement. The defendant appealed and posted a supersedeas bond for $306,000 conditioned on his prosecution of the appeal with effect. While the appeal was pending, the trial court awarded the plaintiff another $38,403 of attorneys fees and costs incurred after the first award. The Court of Appeals affirmed the underlying $27,849 judgment but vacated and remanded the $210,364 for attorneys fees and costs. On remand the trial court reinstated its award of the $210,364, and the defendant appealed. The plaintiff sought payment of out of the bond and a declaration that the unpaid amount of the bond be reserved for payment of the appealed attorneys fee award. The trial court awarded what the plaintiff asked, and the surety appealed.

The Court of Appeals held that the bond was liable for the underlying $27,849 (which was not in dispute), was not liable for the $38,403 of additional attorneys fees awarded after the defendant had taken the appeal for which the bond was given, and ordered that the bond would be liable for the $210,364 of attorneys fees included in the original judgment if that amount was ultimately affirmed. The Court reasoned that if the appeal results in a reversal of the defendant's liability, the bond is discharged, but if it results only in the amount of damages being set aside and a remand to determine amount, the bond remains in place and liable for the amount ultimately determined. The Court emphasized that a bond must be enforced according to its terms and the surety's liability cannot be extended beyond its undertaking. *Holt Goup, L.L.C. v. Kellum*, 2010 WL 3035728 (Colo. App. Aug. 5, 2010).

FSD • 16127 Probate Bond – Statutory Procedure for Notice by Publication Was Constitutional, and Heir's Claim against Principal and Surety Were Barred

The ward died and the conservator filed a final accounting and request that she and her surety be discharged. Because the conservator was also the executor of the ward's estate, the court appointed a guardian ad litem. The guardian ad litem reviewed the accounting and consented to its approval. Notice was published in a proper newspaper. The court approved the final accounting and discharged the conservator and her surety. A year and a half later, an heir of the deceased ward challenged the proceeding on the grounds that she did not receive notice and the statute on notice was unconstitutional.

The Court rejected her contentions. She did not have a sufficient direct interest in the conservatorship proceeding to require more than notice by publication. *Ray v. Stewart*, 700 S.E.2d 367 (Ga. Sept. 2010).

FSD • 16128 Injunction Bond – Party Wrongfully Enjoined Entitled to Opportunity to Prove Damages Suffered as a Result of Injunction

The trial court discharged an injunction bond, and the party enjoined appealed.

The Court held that it was error to discharge the bond without giving the party enjoined an opportunity to present evidence of damages suffered during the period the injunction was in place. *Kinzler v. Pope*, 2010 WL 3503453 (Iowa Ct. App. Sept. 9, 2010).

FSD • 16129 Supersedeas Bond – Trial Court Retained Jurisdiction over Bond and Petitioner Did Not Meet Stringent Requirements for Mandamus

A litigant appealed denial of his petition for writ of mandamus to require, among other things, release of his supersedeas bond.

The Court held that the trial court retained jurisdiction over the bond and the petitioner's allegations did not meet the stringent requirements for mandamus. The Court affirmed the order of the Court of Appeals denying the requested relief. *Seaman v. Isaacs*, 2010 WL 3377726 (Ky. Aug. 26, 2010).

FSD • 16130 Probate Bond – Approval of Principal's Final Accounting, From Which No Appeal Was Taken, Barred Suit against Surety

The probate court approved the final accounting of an estate administrator. A dissatisfied heir, who had opposed every pleading filed by the administrator, did not appeal the approval and discharge but filed a separate suit against the administrator and his surety objecting to his handling of the estate.

The Court held that the order approving the final accounting and discharging the administrator was res judicata and barred the claims and that the surety's liability had to be premised on a breach by the principal. The Court stated, "Because the probate court concluded that Eckstein was not negligent in performing his duties, a surcharge action against Fidelity could not have accrued." *Rothschild v. Eckstein*, 2010 WL 3528996 (Ohio Ct. App. Sept. 13, 2010).

FSD • 16131 Supersedeas Bond – Courts Had Authority to Modify Judgment and Assess Bond for Unpaid Rent Accrued During Appeal Period

A tenant appealed a judgment for his landlord and remained in possession of the apartment by posting a

supersedeas bond with his parents as sureties. After the judgment was affirmed and review by the Texas Supreme Court denied, the Court of Appeals modified its judgment and mandate to add the unpaid rent accrued during the appeal and attorneys fees. The Court directed the trial court to determine the amounts and to enter judgment against the sureties up to the penal sum of the bond. The trial court followed instructions, and the tenant appealed.

The Court held that it and the trial court had the authority to modify the judgments and mandate and to include the sureties in the revised judgments. This decision replaces the Court's earlier opinion reaching the same result and reported at 2010 WL 547536 (Tex. App. Feb. 18, 2010). *Whitmire v. Greenridge Place Apartments*, 2010 WL 3294280 (Tex. App. Aug. 19, 2010).

FSD • 16132 Injunction Bond – Trial Court Abused Discretion by Not Releasing Bond When Case Was Non-Suited and No Claim for Damages Filed

A utility obtained Temporary Restraining Orders to permit it to go on the property of three owners and conduct a survey. The trial court granted the TROs but conditioned them on bonds of $25,000 for each property owner. The petitioner used the TROs to survey the defendants' properties, had no need for further relief, and filed non-suits. The property owners did not move to dissolve the TROs or file any damage claims prior to the non-suits, although they did file counterclaims a month and a half later. The trial court, however, refused to order return of the bonds and the utility company appealed.

The Court of Appeals held that it was an abuse of discretion not to have returned the bonds. *Energy Transfer Fuel, L.P. v. Bryan*, 322 S.W.3d 409 (Tex. App. Aug. 31, 2010), *Energy Transfer Fuel, L.P. v. Black*, 2010 WL 3419216 (Tex. App. Aug. 31, 2010), and *Energy Transfer Fuel, L.P. v. Trammell*, 2010 WL 3419221 (Tex. App. Aug. 31, 2010).

Miscellaneous Bonds

FSD • 16133 Customs Bond – Customs Claim Was Barred by Its Failure to Request Return of Merchandise Within 30 Days of Receipt of Samples, and Surety's Collateral Claim against Principal Was Moot, but Surety Awarded Only Attorneys Fees that Were Not Tainted by Attorney's Conflict of Interest

Customs requested samples of material from two entries. The importer submitted the samples, and a Customs staffer at the port involved wrote acknowledging their receipt and purporting to extend the period of time within which Customs could request redelivery of the merchandise. After testing the samples, Customs requested redelivery and sued the importer and surety for liquidated damages when the importer was not able to return the merchandise. The importer and surety argued that the conditional release period started when Customs requested the samples and ended when the samples were delivered, and that Customs had only 30 days from delivery of the samples to request redelivery of the merchandise. Since the request for redelivery was made substantially more than 30 days after the samples were delivered, the importer and surety moved to dismiss the action. The surety also filed a cross claim against the importer. The surety sought deposit of collateral in the amount of the Government's claim and attorneys fees pursuant to an indemnity agreement.

The court held that the regulations and consistent guidance from Customs Headquarters were that redelivery had to be requested within the 30 day period and the Customs staffer could not extend that period. The court held, "The government has no colorable claim here. This is an action that should never have been brought; and the motions to dismiss it now must be granted." The court found that the surety's collateral request was moot because the underlying claim was dismissed. The attorneys initially retained by the surety had also represented the importer in connection with Custom's claim. The court held that they were disqualified by conflicts of interest from also representing the surety in the matter and disallowed their fees and the fees of the surety's successor lawyers to consult with them. The court also disallowed an expedited filing fee and fees for work on other matters and awarded the surety only the successor lawyer's remaining fees for work on the case before it. *United States v. Pressman-Gutman Co.*,721 F. Supp. 2d 1333 (Ct. Int'l Trade 2010).

FSD • 16134 Notary Bond – California Joint Tortfeasor Statute Would Not Protect Settling Notary or Surety, Therefore Settlement Conditioned on Full Release Not Approved

Two defendants in an action by a disappointed mortgage re-financer filed cross claims against the notary involved and her surety. The notary and surety reached a settlement with one of the cross claimants conditioned on its also barring claims by anyone else. The notary and surety then moved for a determination by the court that the settlement was in good faith under Cal. Civ. Proc. Code § 877.6 (a joint tortfeasor statute).

The court denied the motion. The statute protects a tortfeasor entering into a good faith settlement from contribution or indemnity claims if the settling claimant recovers from a joint tortfeasor, it would not protect against independent claims of another

defendant found liable to the plaintiff. Since the settlement was conditioned on full protection from other claims, it could not be approved. *Jette v. Orange Country Fin., Inc.*, 2010 WL 3341561 (E.D. Cal. Aug. 11, 2010).

FSD • 16135 Subdivision Bond – Surety Not Obligated to Pay for Improvements that Had Not Been Built for Development in Which No Lots Had Been Sold or Were Likely to Be Sold in the Foreseeable Future

Two subdivision bonds were issued for infrastructure improvements in Phase II of a development. Before starting Phase II, the developer filed for bankruptcy. The property was sold, and as part of the sale the Obligee agreed to construct the infrastructure improvements if, but only if, it collected the cost from the surety. No lots or homes had been sold in Phase II, and there was no dispute that the improvements would cost more than the lots were worth on the open market or that any home construction was years away.

The court read the bond and the Obligee's ordinance together to require that the improvements actually be constructed and thought that to forfeit the bond would be a windfall to the Obligee and not achieve the purpose of the bond to assure the ability of homeowners to connect to City utilities. The court found that the bond was an indemnity obligation and that the Obligee had no damages for which it needed indemnity since it had no obligation to construct the improvements. The court refused to force the surety to pay the Obligee for the possible future benefit of the purchaser of the property. *Westchester Fire Ins. Co. v. City of Brooksville*, 2010 WL 3043917 (M.D. Fla. July 30, 2010).

FSD • 16136 Subdivision Bond – Naming Developer as Defendant Was Not Fraudulent Joinder, Even Though Individuals Affiliated With Developer Controlled Plaintiff Homeowners Association, Developer Would Not Be Realigned as Plaintiff, and Case Remanded to State Court

A homeowner's association and club sued the developer and its surety. The surety filed a notice of removal, but the developer did not join in the notice. The surety argued that the developer controlled the two plaintiffs and that its joinder was fraudulent or that it should be re-aligned as a plaintiff. The surety relied on the fact that the developer still owned a significant percentage of the lots, although less than a majority, and that the majority of the officers and directors of the plaintiffs were individuals associated with the developer. The plaintiffs pointed out that the developer was the principal on the bonds and the surety's liability could not exceed the principal's.

The Magistrate Judge refused to re-align the developer or to disregard it as fraudulently joined and accordingly recommended remanding the case to state court. The Judge also found, however, that the surety's position was not objectively unreasonable and recommended denial of the plaintiff's request for attorneys fees. *Club at Hokuli'a, Inc. v. Am. Motorists Ins. Co.*, 2010 WL 3465278 (D. Haw. Sept. 3, 2010).

FSD • 16137 Subdivision Bond – Bonds Protected Only Obligee Not Claimants Who Allegedly Worked to Construct the Improvements

Three claimants on subdivision bonds sued the principal and surety. The obligee was not a party to the action. The defendants moved to dismiss on the grounds that the bonds did not protect the claimants. The claimants had each filed mechanics liens, and one of the events of default under the bonds was the developer permitting liens against the improvements. The developer wrote the City stating that it would be unable to complete the work and recommending that the City call the bonds. The City clerk wrote the surety requesting payment. To date the surety had not paid.

The court rejected the claimants' argument that they were third party beneficiaries of promises in the bonds and held that they did not have standing to bring a direct suit against the surety. The court construed the bonds as purely performance bonds designed to protect the City. *City of Yorkville ex rel. Pirtano Constr. Co. v. Ocean Atl. Servs. Corp.*, 2010 WL 3385461 (N.D. Ill. Aug. 24, 2010).

FSD • 16138 Public Official Bond – Surety's Failure to Pay Admitted Amount, Conditioning Partial Payment on Release of Claim, and Request for Information after Admitting Debt Were Unfair Trade Practices

An employee covered by a public official bond embezzled funds over a period of several years. The School District claimed the bond penalty for each year. The court's interpretation of the correspondence between the parties was that the insurance company first acknowledged liability for a single bond penalty but conditioned payment on submission of a proof of loss that would have waived the School District's claim for additional amounts. Several years later, the insurance company asked for additional information and took the position that it had defenses to the claim. The obligee School District asserted a statutory unfair trade practices claim pursuant to Mass. Gen. Laws ch. 93A. After the court entered summary judgment on the bond claim, 2008 WL 5650854 (D. Mass. Sept. 16, 2008), the insurance company paid the entire amount claimed plus interest leaving only the Chapter 93A claim.

The court found that merely taking the position that only one bond penalty was owed was not a violation but that the insurance company did violate Chapter 93A by conditioning payment on waiver of any claim for additional amounts, requesting information several years after admitting liability, and not paying the admitted amount. The court found that the first set of violations were barred by the applicable four year statute of limitations and that the violations were not willful or knowing (which would have allowed multiple damages) and awarded the School District attorneys fees and costs. *S. Worcester Cnty. Reg'l Vocational Sch. Dist. v. Utica Mut. Ins. Co.*, 2010 WL 3222015 (D. Mass. Aug. 13, 2010).

FSD • 16139 Certificate of Title Bond – Counterclaim by Judgment Creditor of Principal Stated a Claim on Bond

The surety issued bonds to secure certificates of title for trucks sold by the principal. The surety filed suit against the principal and others. One of the other defendants (Manasseh) had recovered a judgment against the principal for selling trucks that belonged to Manasseh and filed a counterclaim against the surety for the amount of the bonds related to those trucks. The surety moved to dismiss the counterclaim or for a more definite statement.

The court thought that the allegations of the counterclaim were sufficient to state a claim on the bonds and denied the surety's motion. *Guarantee Co. of N. Am., USA v. Middleton Bros., Inc.*, 2010 WL 2801879 (E.D. Mo. July 15, 2010).

FSD • 16140 Lease Bond – Court Refused to Exclude Expert Witnesses Proposed by Banks and Broker But Did Limit the Scope of Their Proposed Testimony

In a consolidated multidistrict litigation involving fraudulent leases and related surety bonds, several sureties moved to exclude testimony of expert witnesses proposed by some of the claimant banks or, in the alternative, to limit the witnesses' testimony.

The court refused to exclude the witnesses but did substantially limit their testimony. The court held that the expert witnesses would not be allowed to testify contrary to findings the court had already made (for example, that in certain of the cases CMC rather than the bank was the intended obligee), or to ultimate facts, the intent of the parties or legal conclusions including the meaning of contracts. One expert proffered by a broker would be permitted to testify as to custom and practice in the surety industry related to broker compensation and brokers' standard of care. *In re Commercial Money Ctr., Inc.*, 2010 WL 2991526 (N.D. Ohio July 27, 2010).

FSD • 16141 Mortgage Broker Bond – Surety Bound by Amount of Judgment against Principal, Including Attorneys Fees, Up to Penal Sum of Bond

A homeowner recovered a judgment against a mortgage broker, and the judgment was affirmed on appeal. The judgment included $65,070.65 under the Ohio Mortgage Brokers Act consisting of $2,125 in compensatory damages, $52,532.50 in attorneys fees, $4,038.15 of court costs and $6,375 of punitive damages. The homeowner submitted a claim on the mortgage broker's $60,000 bond required by the Act. The surety paid $15,000 consisting of the compensatory damages and $12,825 of attorneys fees. The homeowner sued the surety for the balance of the bond amount plus prejudgment interest and costs.

The court found that the surety was bound by the state court judgment because it was in privity with the bond principal and had notice of the suit prior to judgment (but well after the suit was filed). The court awarded the homeowner the $45,000 unpaid balance of the bond. The court also awarded prejudgment interest at 10% from the date the judgment against the principal became final and attorneys fees in the federal court action against the surety on the theory that the surety's refusal to pay once the court of appeals affirmed the judgment against the principal was "obdurate conduct." *Swayne v. Capitol Indem. Corp.*, 2010 WL 2663209 (S.D. Ohio July 1, 2010).

FSD • 16142 Property Broker Bond – Surety Discharged in Interpleader Action Upon Payment of Amount Owed to Two Claimants Who Filed Answers

The surety on a Property Broker Bond received claims that exceeded the bond penalty. The surety filed an interpleader action, and only two of the claimants filed responsive pleadings. The bond amount was sufficient to pay those two claimants in full.

The Magistrate Judge recommended, and the district court ordered, that upon payment into court of the amount of the two claims the surety was released and discharged from further liability under the bond. *Ohio Cas. Ins. Co. v. C&C Trucking of Duncan SC, Inc.*, 2010 WL 3075270 (S.D. Ohio June 24, 2010) and 3092908 (S.D. Ohio Aug. 6, 2010).

FSD • 16143 Mechanics Lien Bond – Statutory Lien Bond Protected Owner and Property from Lien Claim and Owner Dismissed from Action to Enforce Lien

A subcontractor filed its notice of contract to assert a mechanics lien against a private project well after the contractor and its surety filed a statutory lien bond. The subcontractor sued the prime and surety on the bond but also sued the owner of the property. The

owner moved to dismiss the claims against it on the ground that by statute once the lien bond was filed it and its property were not subject to the lien.

The court agreed and dismissed the claims against the owner. *Gen. Mech. Contractors, Inc. v. C.E. Floyd Co.*, 2010 WL 3191799 (Mass. Super. Ct. June 29, 2010).

FSD • 16144 Mechanics Lien Release Bond – Claimant Entitled to Reform Lien Release to Correct Date, and Other Defenses Foreclosed by Prior Judgment

A supplier to a subcontractor filed a lien. The prime contractor contacted the supplier, and they agreed on a settlement. The prime contractor delivered a check and a lien release, which the supplier signed. In a prior appeal, the Court held that the supplier was entitled to a trial on its claim that the date through which it released its lien rights was a mistake and it was entitled to reform the release. There was no prior appeal of the judgment for the claimant for the period after the date stated in the lien release. After remand, the trial court entered judgment for the claimant, and the prime contractor and surety appealed.

The Court found that substantial evidence supported reforming the lien release on both mutual mistake and unilateral mistake grounds and that the prior judgment barred the prime contractor from raising other defenses to the lien. The Court also awarded attorneys fees to the claimant not limited by the bond amount. *N. Coast Elec. Co. v. Ariz. Elec. Serv., Inc.*, 2010 WL 3298857 (Wash. Ct. App. Aug. 23, 2010).

Surety's Rights

FSD • 16145 Surety's Rights – Surety Did Not Have Standing to Intervene in Contract Appeals Board Proceeding on Principal's Claims

An ongoing proceeding before the Armed Services Contract Appeals Board (ASBCA) involved appeals by the contractor of the government's denial of affirmative claims. The surety paid payment bond losses on the two contracts involved, recovered a judgment against the principal and indemnitors, and sought to intervene in the ASBCA proceeding as both the subrogee and assignee of the contractor.

The ASBCA denied permission to intervene and reiterated its position that in the absence of a takeover agreement the surety is not subject to the Contract Disputes Act or the Disputes clause in the contract and has no standing before the Board. *Appeals of Thorington Elec. & Constr. Co.*, ASBCA No. 56895, 2010 WL 2899030 (July 16, 2010).

FSD • 16146 Surety's Rights – Surety Entitled to Summary Judgment against Indemnitor

The surety sued the principal and indemnitors. One indemnitor filed for bankruptcy, and after trial the surety recovered a judgment against the other defendants. The surety then obtained relief from the automatic stay and moved for summary judgment against the bankrupt indemnitor.

The court granted the motion based on a statement of uncontested facts. *Am. Contractor's Indem. Co. v. A.C.I. Contracting, Inc.*, 2010 WL 3522438 (W.D. Ark. Sept. 1, 2010).

FSD • 16147 Surety's Rights – Subdivision Bond Surety Granted Judgment by Default against Principal and Indemnitor

The surety on a subdivision bond sued the principal and an indemnitor. The defendants defaulted, and the surety moved for entry of judgment by default.

The court granted the surety's motion and entered judgment by default against the principal and indemnitor. *Developers Surety & Indem. Co. v. Old Towne Station, LLC*, 2010 WL 2951214 (M.D. Ala. July 22, 2010).

FSD • 16148 Surety's Rights – Surety Entitled to Add Attorneys Fees, Costs and Prejudgment Interest to Earlier Judgment for Losses

In an earlier decision reported at 2010 WL 2367491 (M.D. Ala. June 11, 2010), the court granted the surety summary judgment for its losses. The surety sought to add attorneys fees, costs and prejudgment interest.

The court agreed and granted the surety its attorneys fees, costs and prejudgment interest. *Developers Sur. & Indem. Co. v. Old Towne Station, LLC*, 2010 WL 3258617 (M.D. Ala. Aug. 16, 2010).

FSD • 16149 Surety's Rights – Surety's Complaint Stated Claims for Breach of Contract and Conversion against Bank that Signed Set Aside Agreement

The surety issued a subdivision bond in reliance on a set aside agreement from the defendant bank. After the principal defaulted, the bank refused to pay over the balance of the set aside fund for use in completing the bonded work. The surety settled with the obligee and sued the bank for breach of contract and conversion. The bank moved to dismiss the complaint for failure to state a claim. The bank argued that the set aside agreement was not a binding contract because neither the surety not the principal signed it.

The court noted that the bank signed the agreement and the surety and principal could signify acceptance by their actions, including issuance of the bond. Similarly, for the conversion count the complaint alleged an adequate property right in the fund based on the contract. The court denied the bank's motion to dismiss. *Lincoln Gen. Ins. Co. v. Tri*

Counties Bank, 2010 WL 3069874 (E.D. Cal. Aug. 5, 2010).

FSD • 16150 Surety's Rights – Surety Entitled to Attorneys Fees Pursuant to a Prevailing Party Attorneys Fee Provision in Bonded Subcontract, Which Was Incorporated Into the Bond by Reference

The bond incorporated the subcontract, and the subcontract contained a prevailing party attorneys fee clause. After the Court of Appeals affirmed a judgment for the subcontractor's sureties based on the obligee's failure to perform conditions precedent in the bond, the sureties moved in the district court for an award of attorneys fees and costs as provided in the subcontract. The obligee argued that it should not have to pay fees incurred to defend the principal since the principal was not a prevailing party. The sureties responded that defending the principal was a part of defending the sureties, but they took the issue into account by requesting only 50% of the fees actually paid from the time the sureties were added to the case until the time the case was stayed pending appeal of the judgment for the sureties.

The court agreed that the 50% allocation was a reasonable estimate and granted the motion but made several other minor reductions in the requested fees. *Hunt Constr. Grp., Inc. v. Nat'l Wrecking Corp.*, Case No. 1:05-cv-165 (D.D.C. July 19, 2010).

FSD • 16151 Surety's Rights – Indemnitors Ordered to Deposit Collateral Despite Bankruptcy Filing of Principal and Other Indemnitors

The principal and several indemnitors filed for bankruptcy. The surety sought to compel the non-bankrupt indemnitors to comply with the collateral deposit and access to books and records sections of the indemnity agreement.

The court granted the surety's motion to the extent of an order directing the defendants to deposit $3.5 million with the clerk to be held as collateral for the surety. *Kearney Constr. Co. v. Travelers Cas. & Sur. Co. of Am.*, 2010 WL 2803971 (M.D. Fla. July 15, 2010).

FSD • 16152 Surety's Rights – Completing Surety Stated Claim against Obligee for Payment of Contract Funds Earned by Surety's Completion Work

The obligee on a Florida public project delayed for many months before finally terminating the principal and demanding that the surety complete the work. The obligee refused to enter into a takeover agreement and demanded that the surety simply perform the work. After the surety completed the disputed phase of the work, the obligee refused to pay the surety and claimed that liquidated damages exceeded the remaining contract funds. The surety sued, and the obligee filed a motion to dismiss. The obligee asserted that sovereign immunity barred the surety's suit because there was no written contract between it and the surety. The obligee also argued that the surety's claims were barred by the provision of the bond that no right of action accrued to anyone other than the obligee or its successors or assigns and that it was only a beneficiary of the bond, did not sign it, and had no obligations under it. The obligee argued that the surety was a mere volunteer and so not entitled to assert any claims and relied on alleged inconsistencies between the surety's allegations and enforcement of the surety's rights under the bond or rights implied into the bond and contract. Finally, the obligee argued that its set off for liquidated damages exceeded the contract balance. The surety, however, alleged in its Complaint that the delays in project completion were caused by the obligee's own mismanagement of the contract.

The Magistrate Judge recommended denial of the owner's motion. The court held that the bond incorporated the contract and created contractual obligations between the owner and the surety sufficient to meet Florida's requirements for waiver of sovereign immunity. The court also agreed with the surety that sovereign immunity did not bar the surety's equitable subrogation claim to the rights of the contractor and owner. By virtue of completing the work, the surety was subrogated to the rights of the contractor and owner and could sue for the contract funds earned by its performance. The court noted that the bond provision limiting who could sue on the bond to the obligee and its successors would not have prevented the contractor from suing to enforce the contract and held that by completing the work the surety stood in the shoes of the contractor and also could sue for money owed under the contract. The court rejected the owner's argument as contrary to mutuality of contract under Florida law and contrary to the surety's rights upon completion of the work. The court rejected the owner's volunteer argument and pointed out that the School Board itself demanded performance and the surety obviously acted to protect its interests not as a volunteer. The court also rejected the set off argument. For purposes of the motion to dismiss, the surety's allegations had to be taken as true, and the School Board's set off claims would be determined on their merits later in the proceedings. *Great Am. Ins. Co. v. Sch. Bd. of Broward Cnty.*, 2010 WL 4366865 (S.D. Fla. July 30, 2010) [No objections were filed to the Magistrate's recommendation, and it was adopted by the District Court on September 27, 2010.]

FSD • 16153 Surety's Rights – Surety Could Not Use Collateral Pending Resolution of Its and Bank's Conflicting Claims

The surety sued an indemnitor and sought deposit of collateral. The same indemnitor had guaranteed a bank loan to the principal, and the bank intervened in the surety's suit. In a prior decision, the court ordered the indemnitor to deposit collateral with the surety but ordered the surety not to use the collateral pending authority from the court. The surety sought that authority and the bank objected arguing that the record did not show the amount and source of any collateral deposited with the surety, that the surety had not shown a security interest in the indemnitor's assets, and that it was entitled to discovery as to the claims made on the surety's bonds.

The court recognized that under Illinois law the indemnity agreement's collateral deposit provision was enforceable, but nevertheless denied the surety's motion to use the collateral. The court agreed that the bank was entitled to know the source of any collateral to see if it claimed a prior interest in it and ordered the surety to provide that information to the bank. The court declined to rule on the surety's and bank's conflicting claims to priority in whatever was deposited and denied the bank's request for discovery as to the bond claims against the surety. *Travelers Cas. and Sur., Co. of Am. v. Paderta*, 2010 WL 2732243 (N.D. Ill. July 8, 2010).

FSD • 16154 Surety's Rights – Court Denied Principal and Indemnitors' Motion to Dismiss

The surety sued the principal and indemnitors to recover its losses and expenses. The defendants filed a motion to dismiss. The defendants' arguments were based on a change in the surety's name, the alleged failure to plead the specific cause of the losses, and the surety's failure to seek indemnity by means of a cross claim in the obligee's suit against the principal and surety.

The court rejected each argument. An amended complaint explained the name change, the losses and expenses were incurred by reason of the execution of the bonds as provided in the indemnity agreement, and there was no identity of action between the obligee's suit and the surety's suit for indemnity, so res judicata did not apply. *Pa. Gen. Ins. Co. v. Hunter Alliance Corp.*, 2010 WL 3516008 (N.D. Ill. Aug. 31, 2010).

FSD • 16155 Surety's Rights – Surety Not Responsible for Alleged Fraud by Agent and Entitled to Summary Judgment against Indemnitors, as Limited in Amount by Rider to Agreement, and Upon Disposition of All Claims Involving Surety Case Dismissed as to Other Parties for Lack of Diversity Jurisdiction

Contract bonds were obtained in part by a false financial statement and in part by indemnity from persons who were not owners of the principal. These persons also lent money to the principal to provide working capital for the bonded job. They alleged that the agent placing the business knew the financial statement was false. The surety paid losses and sued on the indemnity agreement. The principal and individual indemnitors related to the principal defaulted, but the individual indemnitors who were not owners defended and argued that the agent was the surety's agent and induced their participation by means of the false financial statement. There were also various cross claims and third party claims against the agent and the accountant who prepared the financial statement as well as between indemnitors.

The court granted summary judgment to the surety on its indemnity claims. The agent did not have actual or apparent authority to act for the surety in representing the financial condition of the principal, and even if he had, any reliance by the indemnitors would not have been reasonable. The surety was not responsible for any fraud by the agent. The court also granted summary judgment limiting the amount of the indemnity obligations pursuant to a rider to the indemnity agreement. This disposed of all claims in the case to which the surety was a party. There was no diversity among the remaining parties, and the court declined to exercise supplemental jurisdiction over their remaining disputes. The court dismissed the remaining claims for lack of jurisdiction. *Travelers Cas. & Sur. Co. of Am. v. Young Constr. & Paving, LLC*, 2010 WL 3341569 (N.D. Ill. Aug. 18, 2010).

FSD • 16156 Surety's Rights – Surety Stated Claim against Principal and Indemnitors

The surety sued the principal and indemnitors to recover its losses and expenses. The defendants filed a motion to dismiss. The defendants asserted arguments based on a change in the surety's name, the alleged failure to plead the specific cause of the losses, and the surety's failure to seek indemnity by means of a cross claim in the obligee's suit against the principal and surety.

The court denied the motion. An amended complaint explained the name change, the losses and expenses were incurred by reason of the execution of the bonds as provided in the indemnity agreement, and there was no identity of action between the obligee's suit and the surety's suit for indemnity, so res judicata did not apply. *Pa. Gen. Ins. Co. v. Hunter Alliance Corp.*, 2010 WL 3516008 (N.D. Ill. Aug. 31, 2010).

FSD • 16157 Surety's Rights – Probate Bond Surety Recovered Default Judgment against Executor and Others Based on Discovery Abuse in Fraudulent Conveyance Suit

The surety for the executor of a California probate estate sued the executor, another individual and an LLC to recover funds diverted from the estate and fraudulently conveyed to the LLC to purchase real property in Kansas. The defendants defaulted and failed to comply with discovery requests in spite of numerous warnings, second chances and promises.

The magistrate judge recommended, and the district court entered, a default judgment against two of the defendants as sanctions for their discovery abuse. *Am. Contractors Indem. Co. v. Atamian*, 2010 WL 3862034 (D. Kan. Aug. 6, 2010) and 2010 WL 3843642 (D. Kan. Sept. 27, 2010).

FSD • 16158 Surety's Rights – Judgment for Surety Would be Premature Unless Settlement Agreement Breached

The surety sought entry of a final money judgment even though there was a settlement agreement that was in the process of performance. The payments and other obligations had been performed to date, but other obligations remained to be performed in the future. The surety argued that it could use the money judgment if the settlement agreement were breached and that all of the defendants were not parties to the agreement even though all would be released if or when it was fully performed.

The court thought that the surety's motion was premature unless there was an actual breach of the settlement agreement and denied the motion. *Frontier Ins. Co. v. MC Mgmt., Inc.*, 2010 WL 3276430 (W.D. Ky. Aug. 17, 2010).

FSD • 16159 Surety's Rights – Surety's Claims against Obligee Must be Decided by Arbitration Under the Broad Arbitration Clause in the Bonded Subcontract

The surety for a subcontractor paid losses and sued the obligee alleging that the obligee concealed the fact that its estimate of the cost of the subcontract work substantially exceeded the subcontract amount and initially divided the work into two subcontracts to avoid the surety performing an independent estimate of the cost. The surety further alleged that the obligee concealed problems with the work to induce the surety to consent to an increase in the amount of the bonds and then terminated the second subcontract and added its scope to the first subcontract. The surety pled causes of action to void the bonds and to recover damages for fraud in the inducement, fraud/intentional misrepresentation, negligent misrepresentation, fraudulent concealment, unjust enrichment, equitable estoppel, and unfair and deceptive trade practices. The subcontract contained an arbitration clause and stated that the subcontractor's insurers and sureties would be obligated to participate in and be bound by the arbitration. The obligee moved to dismiss the suit and the surety moved to stay the arbitration.

The court found that the arbitration clause was "broad" and, combined with the presumption of arbitrability, empowered the arbitrators to decide the surety's claims including its fraud claims. The court denied the surety's motion to stay the arbitration and reserved judgment on the obligee's motion to dismiss. It appears that the court thought the litigation should be stayed pending completion of the arbitration, but no one had yet requested that relief. *First Sealord Sur., Inc. v. TLT Constr. Corp.*, 2010 WL 3810856 (D. Mass. Sept. 27, 2010).

FSD • 16160 Surety's Rights – Deposit Agreement Between Insured and Bank Barred Subrogation Claim by Insurer

The insured (Schultz Foods) issued a check for $153,856.46. The check was stolen and the payee changed by "washing" to an individual who endorsed and deposited it. The money was promptly wired overseas. When Schultz Foods discovered what had happened, it asked its bank (Wachovia) to re-credit its account. When Wachovia refused, Schultz Food recovered from its insurer and the insurer sued Wachovia as subrogee. The parties recognized that the check was not properly payable and that under the U.C.C. the loss fell on Wachovia. The U.C.C., however, allows this result to be varied by agreement as long as the agreement does not absolve the bank from lack of good faith or the failure to exercise ordinary care. The deposit agreement between Schultz Foods and Wachovia recited several precautions that a customer could take and several fraud prevention services that Wachovia offered to its customers and provided that the customer would be precluded from recovering against Wachovia if it failed to implement any of the services or failed to follow any of the precautions. Among the services offered was Positive Pay in which the customer informs the bank of certain information about each check as it is issued and the bank contacts the customer before paying any check that varies from the information provided. The court accepted that Positive Pay would have included the identity of the payee of the check and would have prevented the loss.

The court rejected the insurer's arguments that: (1) the deposit agreement released Wachovia only if the depositor took none of the precautions and used none of the services; (2) a bank and its customer cannot contract out of the strict liability imposed by the U.C.C.; (3) the very broad provision was unenforceable because it purported to absolve Wachovia of liability for its own lack of good faith or failure to exercise ordinary care even though there was no allegation of either in this case; (4) Positive Pay was an unreasonable requirement because Schultz Foods incorrectly believed that it would be very costly to implement; and (5) Wachovia's payment of three prior check

frauds suffered by Schultz Foods without invoking the deposit agreement was a waiver of its right to invoke the deposit agreement in this instance. The court interpreted the agreement to apply if the customer either did not take precautions or did not purchase services. The U.C.C. clearly allowed variation of the bank's responsibility within limits. The agreement would be judged based on the facts of the case, and just because it might not be enforceable under other circumstances was irrelevant. The reasonableness of Positive Pay was an objective question to be decided on the facts not on Schultz Foods' mistaken belief as to its cost. And, the deposit agreement contained an explicit anti-waiver provision that Wachovia could enforce the agreement even if it had chosen not to in past cases. The court granted summary judgment to Wachovia and dismissed the case. *Cincinnati Ins. Co. v. Wachovia Bank, N.A.*, 2010 WL 2777478 (D. Minn. July 14, 2010).

FSD • 16161 Surety's Rights – Issues of Fact Precluded Summary Judgment on Subrogated Insurer's Claims against Interstate Shipping Group

The dishonest shipping manager of the insured perpetrated a kickback scheme in which the insured overpaid for shipping. The insurer paid the loss and sued the other parties to the scheme as well as the employee. The insurer recovered judgments against the shipping manager, the local trucking company involved, and the local company's dishonest employee, but the remaining defendant, a shipping group used by the local company for interstate shipments, was originally dismissed based on a limitations clause in the bills of lading. The Eighth Circuit reversed, *see* 562 F.3d 943 (8th Cir. 2009), and following remand the insurer and the remaining defendant filed cross motions for summary judgment on many of the insurer's claims.

The court largely denied the motions because there were issues of fact as to the agency relationship between the remaining defendant and the local trucking company and its dishonest employee. The court was sympathetic to the insurer's argument that the remaining defendant was unjustly enriched by its percentage of the overcharges and stated that it would not be surprised if the jury forced their return. The court rejected the insurer's argument that the remaining defendant was bound by the unopposed summary judgment entered against the dishonest employee of the local shipping company because he was the remaining defendant's subagent. *Hartford Fire Ins. Co. v. Clark*, 2010 WL 2925050 (D. Minn. July 21, 2010).

FSD • 16162 Surety's Rights – Dishonest Employee's Debt Not Discharged to the Extent of Her Net Theft But Proof Was Insufficient to Deny Dischargeability of Her Husband's Debt

An employee stole $314,327.49 from the insured. The policy had a limit of liability of $150,000, and the insurer paid that amount to the insured. The employee and her husband filed for bankruptcy, and the insurer and insured filed a complaint objecting to the dischargeability of the debt arising out of the theft. The issues were the amount to be excepted from discharge and whether the discharge exception should also apply to the husband.

The court subtracted from the amount the employee stole various items of recovery and restitution and the amount of $84,123.45 for which the employer had issued a Form 1099 to the employee. That left $135,392.64, and the court entered judgment declaring that amount nondischargeable as to the employee. The court credited the husband's testimony that he did not know of his wife's activities and did not pay attention to the family finances. The court stated, "While Darren's ambivalence to the family finances was likely reckless, there are insufficient facts to conclude that Darren's actions rise to the level of willful and maliciousness or that he conspired with Lisa." The court, therefore, excepted from discharge only the debt of the employee herself. *Acuity v. Rodenbaugh (In re Rodenbaugh)*, 431 B.R. 473 (Bankr. E.D. Mo. 2010).

FSD • 16163 Surety's Rights – Bankruptcy Court Held that Mortgage Broker Bond Surety's Indemnity or Contribution Claim against Appraiser Was Barred by Joint Tortfeasor Statute

The surety on a mortgage broker bond filed a third party complaint seeking indemnity or contribution from other persons involved in the mortgage transaction that gave rise to the plaintiff's damages. One of the third party defendants, an appraiser, settled with the claimant and moved to dismiss the surety's third party complaint on the ground that a Missouri statute barred contribution or indemnity from a settling tortfeasor. The surety tried to explain suretyship and subrogation to the Bankruptcy Judge, but he was determined that the principal was the "insured" and the surety was subrogated to the principal's rights not to the rights of the claimant.

The court held that the joint tortfeasor statute applied and the surety's third party complaint was barred. The court granted the appraiser's motion. *McClelland v. N. Am. Specialty Ins. Co. (In re McClelland)*, 2010 WL 3245315 (Bankr. W.D. Mo. Aug. 16, 2010).

FSD • 16164 Surety's Rights – Surety Entitled to Summary Judgment against Indemnitor and to Seek Additional Expenses in the Future

The surety moved for summary judgment against an indemnitor for the surety's losses paid to date and

for future expenses incurred in defending a suit by the obligee.

The court granted the surety's motion including leave to seek an award of additional expenses in the future. *Travelers Cas. & Sur. Co. of Am. v. Power Tech Servs., Inc.*, 2010 WL 2802387 (D.N.J. July 15, 2010).

FSD • 16165 Surety's Rights – Surety Entitled to Judgment Pursuant to Settlement Agreement Breached by Indemnitors

The surety and indemnitors agreed to a settlement by which the indemnitors were to make periodic payments and the surety accepted less than the full amount owed if the payments were made. If the payments were not made, the indemnitors consented to a judgment in the full amount owed plus interest less any payments made. The indemnitors made payments for several months before defaulting. The surety moved to enforce the settlement agreement and enter judgment in the full amount still owed. One indemnitor opposed the motion and filed a cross motion to set aside the agreement. He argued that he should not be bound by the agreement because his attorney did not inform him of the settlement terms. The facts, including his making payments under the agreement, showed otherwise.

The court granted the surety's motion, denied the indemnitor's cross motion, and entered judgment for the surety. *RLI Ins. Co. v. Vintage Contracting Co.*, 2010 WL 4062862 (D.N.J. Aug. 25, 2010).

FSD • 16166 Surety's Rights – Public Official Bond Surety Failed to State Claim against Entities That Paid Bribes to County Executive

The surety on public official bonds for a former county executive settled with the county for losses stemming from the principal's giving contracts in exchange for bribes. The surety then sued three related entities that paid some of the bribes and profited from the contracts. The three entities filed for bankruptcy, and the surety filed adversary proceedings to determine the debt and declare that it was nondischargable. The surety's complaints relied on subrogation, common law indemnity and disgorgement. The defendants moved to dismiss the complaints.

The Bankruptcy Court held that the surety did not show that any of its payments to the county were for debts for which the county could have recovered from the defendants and so subrogation did not apply. The court also held that the defendants and the surety were not joint tortfeasors, so there could be no common law indemnity, and that while the county could have sued for disgorgement of the profits from the fraudulently obtained contracts the surety could not assert that cause of action. The court dismissed the surety's action for failure to state a claim. *W. Sur. Co. v. Sandoval*, 2010 WL 3745895 (Bankr. D.N.J. Sept. 17, 2010).

FSD • 16167 Surety's Rights – Court Dismissed Surety's Additional Insured Claims against Subcontractors' CGL Carriers Based on Policy Defenses Asserted by Carriers

The prime contractor's surety was assigned the prime contractor's rights and sued three CGL carriers for a subcontractor alleging that the prime contractor was an additional insured under the policies. This was one aspect of a long running dispute over repair of terrazzo floors on the project. In a prior decision the court found issues of fact as to prejudice from alleged late notice to the three insurers. The insurers moved for summary judgment on other grounds.

The court noted the split of authority in other jurisdictions over whether faulty workmanship can be covered under a liability policy and that the New Jersey Supreme Court had not decided the issue. The court did not need to reach that question because each insurer was entitled to summary judgment on other grounds. For one, the additional insured endorsement required that a certificate of insurance be issued, and it was not. For another, the defective work was known to the additional insured prior to inception of the policy and so was excluded by a Known Injury amendment. For the third policy, several business risk exclusions combined to bar coverage. The court granted the insurers' motions for summary judgment and dismissed them from the case. *Travelers Cas. & Sur. Co. v. Dormitory Auth.-State of New York*, 2010 WL 3001729 (S.D.N.Y. July 20, 2010).

FSD • 16168 Surety's Rights – Court Granted Summary Judgment Rejecting Surety's Third Party Beneficiary, Functional Equivalent of Privity and Litigation with Third Party Theories to Overcome Lack of Privity with Architect and CM

The surety for a co-prime contractor on a public project sued, among others, the project architect and construction manager (CM) alleging increased costs to perform the work as a result of the architect and CM's multiple failures. The architect and CM moved for summary judgment. The surety was the subrogee and assignee of its principal, but the principal was not in privity of contract with these defendants. The surety sought to overcome this lack of privity by arguing that the principal was a third party beneficiary of the contracts between the owner and the architect and CM, or that the principal's relationships to the architect and CM were the functional equivalent of privity under New York law, or that the surety incurred attorneys fees and expenses in defending suits by subcontractors and others as a result of the wrongful acts of the architect and CM.

The court rejected each argument and granted summary judgment to the architect and CM dismissing the

surety's claims. The court found that the facts of record after extensive discovery showed that the principal was not an intended third party beneficiary of the owner's contracts with the architect and CM. Since the principal was simply one among many potential bidders, it was not "known" for purposes of the functional equivalent of privity test at the time of the alleged misrepresentations by the architect and CM. Since there was no duty owed to the principal there was no basis to apply the New York rule allowing attorneys fees as a component of damages when a wrongful act involved the claimant in litigation with others. *Travelers Cas. & Sur. Co. v. Dormitory Auth.-State of New York*, 2010 WL 3199861 (S.D.N.Y. Aug. 11, 2010).

FSD • 16169 Surety's Rights – Court Granted Summary Judgment Dismissing Surety's Claims against Owner, Other Than for Money Due Under the Contract, and Dismissing the Owner's Counterclaims, Other Than by Subrogation to Payment Bond Claims of Subcontractors Owner Paid

The surety financed completion of the project and sued the owner for money due under the contract, for delay damages the contractor suffered, for various impact pass through claims of subcontractors, and for the surety's own costs in defending various payment bond suits allegedly caused by the owner's breaches. The owner counterclaimed for the contractor's breach of contract and the surety's breach of both the performance and payment bonds. The owner sought summary judgment on each of the surety's claims, except money owed under the contract, and the surety moved for summary judgment on each of the owner's counterclaims.

The court held that the no damage for delay clause barred the delay damage claims. Some of the pass through claims were not subject to a liquidating agreement that complied with New York law, and those that were failed because of either the no damage for delay clauses or the claimant's failure to give required notice of the conditions alleged to have caused increased costs. The surety's claim for costs to defend payment bond suits was barred by the provision in the payment bond that "The owner shall not be liable for the payment of any costs or expenses of any such suit." The court also granted the surety summary judgment on all but one of the owner's counterclaims. The contractor had completed the work, albeit with financing from the surety, and there was no termination for default. The court held that the surety did not assume the contractor's obligations and that the owner's attempted alter ego argument was not pled and came far too late. The owner never performed the conditions precedent to make a performance bond claim. The owner had paid some subcontractors, however, and could make a payment bond claim for those payments by subrogation to the rights of the subcontractors it paid. *Travelers Cas. & Sur. Co. v. Dormitory Auth.-State of New York*, 2010 WL 3419196 (S.D.N.Y. Aug. 26, 2010).

FSD • 16170 Surety's Rights – Surety Entitled to Default Judgment in Amount of Its Losses and Expenses Plus Prejudgment Interest

The surety paid the obligee union benefit fund and sued the principal and indemnitors. Following the defendants' default, the surety moved for entry of judgment by default.

The Magistrate Judge recommended a default judgment for the surety for the amount the surety paid the obligee plus expenses plus prejudgment interest pursuant to New York law. *Great Am. Ins. Co. v. Gateway Acoustics Corp.*, 2010 WL 3522813 (E.D.N.Y. July 26, 2010).

FSD • 16171 Surety's Rights – Surety Entitled to Default Judgment against Principal and Indemnitors

The surety sued the principal and indemnitors and moved for by default.

The Magistrate Judge recommended a default judgment for the surety against the principal and indemnitors for the amount the surety paid the obligee (a union benefit fund) plus expenses plus prejudgment interest pursuant to New York law. *Great Am. Ins. Co. v. Gateway Acoustics Corp.*, 2010 WL 3522813 (E.D.N.Y. July 26, 2010).

FSD • 16172 Surety's Rights – Subdivision Bond Surety That Had Not performed or Paid Under Its Bonds Did Not Have Standing to Seek Contribution from New Owner of Property That Would Benefit from the Improvements

A developer failed after selling some lots, and the unsold portion of the property was sold in foreclosure. The County demanded that the surety on two bonds guarantying completion of improvements either complete the work or pay the costs to complete. The County recovered a judgment against the surety, and the surety appealed. In this case, the surety sued the entities that owned the land as a result of the foreclosure. The surety sought a declaratory judgment that the defendants should contribute pro rata to the costs of the improvements or payments demanded by the County. The surety argued that the defendants would be unjustly enriched if the surety made or paid for the improvements.

The court dismissed the case as not meeting the case or controversy and standing requirements of the federal courts. The surety had done no work and paid for no improvements. The defendants had not been

enriched, unjustly or otherwise, because the improvements had not been made. The surety could not show an injury in fact because it had not performed. The court dismissed the complaint because the surety did not have Article III standing. *Lexon Ins. Co. v. BMR Funding, LLC*, 2010 WL 2816786 (E.D.N.C. July 14, 2010).

FSD • 16173 Surety's Rights – Dilatory Defendants Denied Extension of Discovery Deadline

The surety paid losses and expenses and sued the principal and indemnitors in 2008. The original discovery deadline of December 1, 2009, was extended to June 1, 2010. The defendants served written discovery requests on the last business day before the deadline and moved for another extension.

The court found that no excuse was offered to justify not making the discovery requests in a timely manner and denied the motion. *Cincinnati Ins. Co. v. Savarino Constr. Corp*., 2010 WL 3001937 (S.D. Ohio July 28, 2010).

FSD • 16174 Surety's Rights – Court Denied Principal and Indemnitors' Belated Motion to Transfer Action as Not in the Interests of the Parties or the Public

The surety sued the principal and indemnitors in the federal court in Pennsylvania. After discovery was completed and summary judgment motions filed, the defendants moved to transfer the case to Tennessee, where they were apparently located.

The court noted the defendants' delay and that the surety's predecessor was located in Pennsylvania and substantial events leading to the suit occurred in Pennsylvania. The court thought that the Eastern District of Pennsylvania was a permissible venue and that the balance of the interests of the parties and the public favored retaining the case rather than transferring it. The court denied the defendants' motion. *Fid. & Deposit Co. of Md. v. Price & Price Mech., Inc.*, 2010 WL 3431858 (E.D. Pa. Aug. 31, 2010).

FSD • 16175 Surety's Rights – Court Denied Indemnitors' Motion to Transfer Suit

The surety sued the principal and indemnitors in the federal court in Pennsylvania. After discovery was completed and summary judgment motions filed, the defendants moved to transfer the case to Tennessee, where they were apparently located.

The court noted the defendants' delay and the fact that the surety's predecessor was located in Pennsylvania and substantial events leading to the suit occurred in Pennsylvania. The court thought that the Eastern District of Pennsylvania was a permissible venue and that the balance of the interests of the parties and the public favored retaining the case rather than transferring it. The court denied the defendants' motion. *Fid. & Deposit Co. of Md. v. Price & Price Mech. Inc.*, 2010 WL 3431858 (E.D. Pa. Aug. 31, 2010).

FSD • 16176 Surety's Rights – Surety Granted Summary Judgment against Principal and Indemnitors

The surety settled with the obligee, sued the principal and indemnitors, and moved for summary judgment. The defendants did not oppose the motion.

The court reviewed the surety's support for the motion, enforced the indemnity and prima facie evidence provisions of the indemnity agreement, and entered summary judgment for the surety. *United States Fid. & Guar. Co. v. Hato Tejas Constr., S.E.*, 2010 WL 2900372 (D.P.R. July 21, 2010).

FSD • 16177 Surety's Rights – Surety Entitled to Summary Judgment as to Indemnitor's Liability, But Surety's Motion to Set Aside Transfer of Assets Was Premature

The surety sued the principal and indemnitors and moved for summary judgment. One indemnitor argued that the indemnity agreement was a contract of adhesion, unconscionable, against public policy, and induced by fraud. She also argued that she was not kept informed about claims or settlements.

The court found that the indemnitor did not read the agreement and could not now complain about its terms, that her then husband was not the surety's agent, and that the surety did not have an obligation, contractual or fiduciary, to keep her informed about claims and payments. The court granted the surety summary judgment as to liability and directed it to submit updated information on the amount of its losses and expenses. The court denied as premature the surety's motion for summary judgment to set aside the indemnitor's transfer of assets to a partnership and trust. Documents relevant to the transfers had recently been produced, and the court allowed renewed motions after they were considered. The court rejected the surety's "reverse piercing" argument that the partnership and trust should be considered alter egos liable for the debts of the indemnitor and granted the indemnitor summary judgment on that issue. *Hartford Fire Ins. Co. v. CMC Constr. Co.*, 2010 WL 3338581 (E.D. Tenn. Aug. 24, 2010).

FSD • 16178 Surety's Rights – In a Suit to Determine Responsibility for Completion Costs to Correct Defects in the Original Contractor's Work, the Court Delineated the Owner's Duty to Disclose Information and Remanded the Case for Determination of Responsibility for Certain Costs

A completion contractor had to perform substantial work beyond that contemplated in the completion contract because of defects in the original contractor's work that were not revealed in the owner's punch lists or other documents. The trial court held for the owner, the Court of Appeal reversed, and the Supreme Court accepted the case to resolve conflicting decisions by the Courts of Appeal and decide the circumstances under which a public owner would be liable for a contractor's increased costs if the public owner knew, but failed to disclose, material facts that would affect the contractor's bid or performance.

The Court rejected the owner's argument that the contractor had to prove active intent to conceal or mislead. Instead, the Court held that relief for nondisclosure is appropriate when "(1) the contractor submitted its bid or undertook to perform without material information that affected performance costs; (2) the public entity was in possession of the information and was aware the contractor had no knowledge of, nor any reason to obtain, such information; (3) any contract specifications or other information furnished by the public entity to the contractor misled the contractor or did not put it on notice to inquire; and (4) the public entity failed to provide the relevant information." The Court agreed with the result in the Court of Appeals reversing the trial court judgment for the owner. The Court remanded the case to determine responsibility for increased costs to correct latent defects in the work of the original contractor. *Los Angeles Unified Sch. Dist. v. Great Am. Ins. Co.*, 234 P.3d 490 (Cal. 2010).

FSD • 16179 Surety's Rights – Surety Entitled to Summary Judgment against Principal and Indemnitors

The trial court granted the surety summary judgment against the principal and indemnitors, and the defendants appealed.

The court relied on the indemnity agreement and held that the issue was not whether the principal was in default but whether the obligee had declared it to be in default. The affidavit of the surety's employee as to losses and expenses was prima facie evidence of the amount owed, and the indemnitor's conclusory affidavit that it should have cost less did not create an issue of fact. The Court rejected the defendants' argument that the one year limitation period for suits on a payment bond applied. The Court held that the indemnity agreement was a contract under seal subject to a 20 year limitation period, although the regular six year statute of limitations for breach of a written contract would not have barred the action, and that the limitation period for payment bond suits was irrelevant. *Cagle Constr., LLC v. Travelers Indem. Co.*, 700 S.E.2d 658 (Ga. Ct. App. 2010).

FSD • 16180 Surety's Rights – Surety That Completed Contract and Paid Payment Bond Obligations Entitled to Contract Funds and, Therefore, Owner's Breach of Settlement Agreement by Paying Surety Instead of Filing Interpleader Did Not Harm other Claimants

The obligee on a public project held a contract balance. The surety completed the project, paid claimants under the payment bond, and claimed the contract funds. The contractor, lender and guarantor of the lender also claimed the funds. The owner agreed to a settlement in which it would pay the funds into court in an interpleader, but the owner instead paid the surety. The court held that failure to pay the fund into court was a breach of the settlement agreement, but that the other parties suffered no damages because the surety was entitled to the fund. *Century Ins. Co. v. Guerrero Bros., Inc.*, 2010 WL 3515810 (N. Mar. I. Sept. 9, 2010).

FSD • 16181 Surety's Rights – Surety's Failure to Act Promptly Barred Trial Court From Reconsidering Judgment for Indemnitor

An alleged indemnitor filed a declaratory judgment action against the surety alleging, among other things, that he did not sign the indemnity agreement. The surety counterclaimed for its losses on a bond for unpaid taxes. The indemnitor filed a motion for summary judgment on the surety's counterclaim. The court thought that the surety had not responded and granted the motion. The indemnitor then nonsuited his other claims, and the court signed the order of nonsuit on October 22, 2009. On January 11, 2010, the surety filed an unsworn motion for reconsideration of the summary judgment and pointed out that it had timely mailed an opposition to the motion. The court granted the surety's motion, and upon reconsideration denied the indemnitor's summary judgment motion. The court rejected the indemnitor's argument that the order of nonsuit made the original summary judgment a final judgment and the surety's motion for reconsideration came too late. The indemnitor sought mandamus.

The Court of Appeals held that the judgment was final and the trial court did not have jurisdiction to reconsider its original summary judgment. *In re Jamea*, 2010 WL 2968044 (Tex. App. July 29, 2010).