RECENT DEVELOPMENTS IN FIDELITY AND SURETY LAW

Carleton R. Burch, Lee M. Brewer, Jonathan M. Bryan, Shannon J. Briglia, Adam D. Cornett, Carla Crapster, Evan B. Gatewood, David A. Harris, Heather M. Jonczak, James A. Knox, Jr., Mark J. Krone, Paul H. Mandal, Christopher R. Scifres, and Jessica Wynn

Carleton R. Burch (crb@amclaw.com) is a senior partner in the Los Angeles office of Anderson, McPharlin & Conners, LLP. Lee M. Brewer (lbrewer@bryanandbrewer.com) and Jonathan M. Bryan (jbryan@bryanandbrewer.com) are partners with Bryan & Brewer, LLC in Columbus, Ohio. Shannon J. Briglia (sbriglia@briglialaw.com) is a partner with the Vienna, Virginia, office of Briglia McLaughlin LLP. Adam D. Cornett (acornett@abais.com) is a senior attorney with ABA Insurance Services in Mayfield Heights, Ohio. Carla Crapster (carla.crapster@strasburger.com) is an associate with Strasburger & Price, LLP in Dallas. Evan B. Gatewood (egatewood@hmglawyers.com) is a partner at Hayes, Magrini & Gatewood in Oklahoma City. David A. Harris (dah@boviskyle.com) is an associate with Bovis, Kyle, Burch & Melin LLC in Atlanta. Heather M. Jonczak (hjonczak@carltonfields.com) is an associate with Carlton, Fields, Jorden, Burt PA in Miami, Florida. James A. Knox, Jr. (jknox@christensenlaw.com) is a senior counsel with the Chicago firm of Christensen Ehret, LLP. Mark J. Krone (mjk@amclaw.com) is an attorney with Anderson, McPharlin & Conners LLP in Los Angeles. Paul H. Mandal is a partner with Dreifuss Bonacci & Parker, PC, in Florham Park, New Jersey. Christopher R. Scifres (cscifres@weinrad.com) is an associate with Weinstein Radcliff Pipkin, LLC in Dallas. Jessica L. Wynn (jwynn@albercrafton.com) is an attorney with Alber Crafton PSC in Troy, Michigan.

I. SURETY LAW

A. *Performance Bonds*

1. Conditions Precedent

In *International Fidelity Insurance Co. v. Americaribe-Moriarty JV*,[1] the court granted summary judgment in favor of the surety, finding that the obligee failed to satisfy the conditions precedent of the performance bond. The obligee contended that the performance bond incorporated the subcontract, which authorized the obligee to undertake completion of the work under the subcontract if the subcontractor failed to cure its default within three days of the date that written notice was delivered or mailed, or to terminate the subcontract upon an additional three-day notice.[2] The court concluded that incorporation of the subcontract did not overrule the performance bond's notice requirements.[3] Because the obligee failed to provide appropriate notice to the surety, Florida law relieved the surety of its obligations under the bond.

In *JMR Construction Corp. v. Environmental Assessment & Remediation Management, Inc.*,[4] the California Court of Appeal affirmed the trial court's judgment against the performance bond surety, finding that a declaration of default or notice of default to surety were not conditions precedent to recovery under the performance bonds. While the project was ongoing, the general contractor notified the subcontractor of alleged delays and improper work. After the project was completed, the general contractor filed suit against the subcontractor and its surety. The surety contended that it had no obligations under the performance bonds because the obligee failed to declare the principal to be in default or notify the surety of any such default. The court found that there were no specific notice provisions in the performance bonds and that the default provisions in the subcontracts required only notice to the subcontractor, not the surety.[5]

In *Milton Regional Sewer Authority v. Travelers Casualty & Surety Co. of America*,[6] the U.S. District Court for the Middle District of Pennsylvania dismissed the obligee's performance bond claim, finding that it failed to follow the right-to-cure provision of the bonded contract.[7] Soon after work began, the obligee became dissatisfied with the principal's work. The obligee terminated the contract, hired another construction firm, and asserted a claim against the surety for the additional costs incurred,

1. No. 15-24183-CIV, 2016 WL 3647668 (S.D. Fla. June 22, 2016).
2. *Id.* at *5.
3. *Id.*
4. 198 Cal. Rptr. 3d 47 (Ct. App. 2015), *as modified on denial of reh'g* (Jan. 28, 2016).
5. *Id.* at 68.
6. 648 F. App'x 215 (3d Cir. 2016).
7. *Id.* at 216.

despite the fact that the principal offered to correct the deficiencies.[8] The bonded contract contained a right-to-cure provision granting the principal thirty days to cure before its rights under the contract could be terminated. On appeal, the court held that the obligee, without any valid reason, failed to comply with the right-to-cure provision.[9] As a result, the surety's obligations under the bond were not triggered and the claims against surety were properly dismissed.[10]

2. Bad Faith

In *KISAQ-RQ 8A 2JV v. Bankers Insurance Co.*,[11] the court granted the performance bond surety's motion to dismiss the obligee's claims of bad faith and unfair and deceptive trade practices under North Carolina law. The principal failed to complete its subcontract and filed Chapter 11. The obligee demanded the surety complete its principal's work. The surety refused to perform, citing the automatic stay under the Bankruptcy Code. The obligee obtained relief from the automatic stay and notified the surety that it was in default under the bond and that the obligee would complete the work to mitigate damages. The obligee filed suit, alleging breach of performance bond, breach of the implied duty of good faith and fair dealing, and unfair and deceptive trade practices.[12] The court found that North Carolina law did not recognize a claim by an obligee against a surety for breach of the implied duty of good faith and fair dealing.[13] The court also found that there were no aggravating circumstances to support an unfair and deceptive trade practice claim.[14]

3. Release

In *Coleman v. Commonwealth*,[15] the claimant alleged damages as the result of the principal's mining activities and challenged a state administrative agency's decision to release a performance bond related to a mining company's reclamation efforts. Kentucky law provides that when reviewing an administrative agency's decision, "the court shall not substitute its judgment for that of the agency"[16] and "[i]f the agency's decision is supported by substantial evidence, the reviewing court is limited to determining whether the agency applied the correct rule of law."[17] Stating that it

8. *Id.*
9. *Id.* at 218.
10. *Id.*
11. No. 4:15-CV-155-BO, 2016 WL 649529 (E.D.N.C. Feb. 17, 2016).
12. *Id.* at *1.
13. *Id* at *2.
14. *Id.*
15. No. 2013-CA-001856-MR, 2016 WL 675822 (Ky. Ct. App. Feb. 19, 2016).
16. *Id.* at *2 (citation omitted).
17. *Id.* (citation omitted).

had thoroughly reviewed the record, the court held that substantial evidence supported the agency's decision and affirmed the agency's decision to release the bond.[18]

B. *Payment Bonds*

1. Bad Faith

In *S & S Paving & Construction, Inc. v. Berkley Regional Insurance Co.*,[19] the trial court dismissed a subcontractor's claims for breach of contract and bad faith against a surety after concluding that the breach of contract claim was barred by the statute of limitations and that there was no contractual or special relationship to survive.[20] Attorney fees were awarded to the surety. The Arizona Court of Appeals found that a "common law bad faith remedy would be inconsistent with the legislature's defined liability for Act sureties"[21] and held that "a surety on a payment bond issued under Arizona's 'Little Miller Act' may not be sued for bad faith."[22] In distinguishing this case from the holding in *Dodge v. Fidelity & Deposit Co. of Maryland*,[23] the appellate court stated that

> [t]he most fundamental distinction between *Dodge* and this case is that the former did not involve a statute, let alone a carefully crafted statutory scheme that seeks to balance the competing interests inherent in public works projects. And unlike *Dodge*, where the court found that the surety lacked incentive to address the homeowners' claim, a surety under the Act has a strong pecuniary motive to pay valid claims without litigation.[24]

2. Notice Requirements

In *N-Tek Construction Services, Inc. v. Hartford Fire Insurance Co.*,[25] the Massachusetts Appeals Court affirmed judgment in favor of the surety, finding that a second-tier claimant had not provided written notice to the general contractor advising, either expressly or impliedly, that the claimant was looking to the general contractor for payment.[26] The claimant sent an email to the general contractor advising him that his invoices had not been paid and attaching copies of those unpaid invoices.[27] The claimant argued that the statutory notice did not have to include an express statement that the claimant was seeking payment from the general

18. *Id.* at *2–3.
19. 372 P.3d 1036 (Ariz. Ct. App. 2016).
20. *Id.* at 1038.
21. *Id.* at 1039.
22. *Id.* at 1037.
23. 778 P.2d 1240 (Ariz. 1989).
24. *S & S Paving*, 372 P.3d at 1040.
25. 47 N.E.3d 435 (Mass. App. Ct. 2016).
26. *Id.* at 442.
27. *Id.* at 438.

contractor.[28] In rejecting this argument, the court noted that the statutory notice requirements were for the protection of the general contractor, and the claimant's failure to state explicitly or implicitly that the second-tier claimant was making a claim for services rendered on the project was required in order to enforce a claim.[29]

In *Dudley Construction, Ltd. v. Act Pipe & Supply, Inc.*,[30] the Texas Court of Appeals ruled that "substantial compliance" with the bond's notice requirements is sufficient to satisfy the conditions precedent to filing suit under the payment bond.[31] The court defined substantial compliance as "when actual notice of the claims are provided."[32] The appellate court found that the lower court's record demonstrated that the claimant sent several notices to the surety and the principal, which was named "RM Dudley Construction, Ltd." but later changed its name to "Dudley Construction, Ltd." The court also found that the majority of the claimant's notices included sworn statements of account, which were verified and supported with invoices. On these facts, the court affirmed that notice to the surety was sufficient and substantially complied with the preconditions of filing a bond claim.[33]

In *Pierce Foundations, Inc. v. JaRoy Construction, Inc.*,[34] the Louisiana Supreme Court overturned the appellate decision in favor of the surety where the payment bond claimant failed to comply with the notice and recordation provisions of the Louisiana Public Works Act.[35] Before the owner accepted the work, the claimant sued the principal and the surety to recover amounts due under the subcontract.[36] The subcontractor's failure to comply with the notice and recordation requirements of the statute governing claims for money owed on public contract did not affect its rights to proceed directly against the general contractor and surety.[37]

In *Wyandotte Electric Supply Co. v. Electrical Technology Systems, Inc.*,[38] the Michigan Supreme Court addressed "several facets of the public works bond act (PWBA), MCL 129.201 *et seq.*"[39] The court held that a supplier was able to recover on its bond claim even though the prime contractor never received the statutory thirty days' notice from the supplier.[40]

28. *Id.* at 441.
29. *Id.* at 441–42.
30. No. 06-15-00045-CV, 2016 WL 3917211(Tex. App. July 14, 2016).
31. *Id.* at *9.
32. *Id.*
33. *Id.* at *10.
34. 190 So. 3d 298 (La. 2016).
35. *Id.* at 299–300.
36. *Id.* at 300.
37. *Id.* at 304.
38. 881 N.W.2d 95 (Mich. 2016).
39. *Id.* at 97.
40. *Id.* at 101.

The court reasoned that the supplier complied with this provision by mailing the notice to the prime contractor via certified mail, regardless of whether the prime contractor actually received the notice.[41]

3. Limitations

In *Tutor Perini Corp. v. Montgomery Kone, Inc.*,[42] the court held that the period of limitations provided that claims against the surety had to be brought within two years of the date that final payment fell due, not when the last payment to the subcontractor was actually made or when the obligee decided it would not make another payment to the subcontractor.[43] The principal completed its work on a project in 2004 and received its final payment in 2005.[44] There were multiple delays on the project, and the parties disputed responsibility for the delays.[45] In 2009, the chief engineer on the project issued a decision that attributed the project's delays to the general contractor, and the next year the owner assessed liquidated damages against the obligee.[46] In 2013, the obligee contractor brought a breach of contract action against the subcontractor and its surety.[47] The court also found that collateral estoppel did not apply to the chief engineer's decision because the court was not clear on the chief engineer's word choice, nor was it sure whether the parties understood the chief engineer's decision to be final.[48]

4. Principal's Defenses

In *JSI Communications v. Travelers Casualty & Surety Co. of America*,[49] the Fifth Circuit reversed summary judgment for a surety, finding that the judgment in an interpleader action that discharged a contractor's liability did not discharge the contractor's surety. The principal, the general contractor on a public works project, received a notice of garnishment against funds due its subcontractor, filed an interpleader action, and deposited the remaining subcontract balances into the court.[50] A judgment discharged the principal from any further liability pertaining to the named defendants, including its subcontractor.[51] Several months later, a second-tier subcontractor that was not named in the interpleader asserted a claim

41. *Id.*
42. No. 2013-0763-BLS1, 2016 WL 3184420 (Mass. Super. Ct. May 16, 2016).
43. *Id.* at *5.
44. *Id.* at *1, *3.
45. *Id.* at *2.
46. *Id.*
47. *Id.*
48. Tutor Perini Corp. v. Montgomery Kone, Inc., No. 2013-0763-BLS1, 2016 WL 3184420, at *7, *9 (Mass. Super. Ct. May 16, 2016).
49. 807 F.3d 725 (5th Cir. 2015).
50. *Id.* at 726.
51. *Id.*

against the payment bond.[52] The contractor amended its interpleader complaint to include the second-tier subcontractor and was granted an amended judgment extending the release of liability to "any claim made by any other claimant made a party to this action for sums due and owing from [subcontractor] for materials, supplies and/or labor provided to [subcontractor] on the [project]."[53] Because the claim against its principal had been discharged, the surety denied the claim.[54] The appellate court rejected the arguments of the contractor's surety that because the contractor was discharged from its contractual liability with its first tier subcontractor, the surety had no obligation to the second-tier subcontractor.[55] The fact that the contractor may be obligated to indemnify the surety if the second-tier subcontractor recovers against the surety is not contrary to the discharge of liability in the interpleader because the indemnity obligation is a private contractual agreement between the contractor and the surety.[56]

In *Ground Service Technology, Inc. v. Triton Structural Concrete, Inc.*,[57] the trial court concluded that the principal violated the prompt payment statute by failing to timely remit payment to its subcontractor and that it unreasonably withheld payment.[58] The principal and surety argued that the principal could not be liable for breach of contract or prompt payment penalties because the prevailing wage provisions required the principal to withhold payment.[59] The subcontract also "expressly allowed" the principal to withhold payment for failing to "comply with all applicable laws and regulations."[60] The appellate court reversed, concluding that because the subcontractor breached its obligation to comply with prevailing wage laws, the principal was allowed to withhold payment. "More fundamentally, the subcontract allowed [the principal] to reject [the subcontractor's] payment applications based on [the subcontractor's] failure to comply with prevailing wage law statutes and regulations."[61]

In *United States ex rel. Metric Electric, Inc. v. CCB, Inc.*,[62] a subcontractor sued the bond principal and the surety for terminating its subcontract "without cause," alleging breach of contract, quantum meruit, violation

52. *Id.*
53. *Id.*
54. *Id.* at 727.
55. JSI Commc'ns v. Travelers Cas. & Sur. Co. of Am., 807 F.3d 725, 727–28 (5th Cir. 2015).
56. *Id.*
57. No. D067349, 2016 WL 3448626 (Cal. Ct. App. June 16, 2016).
58. *Id.* at *1.
59. *Id.* at *4.
60. *Id.* at *5.
61. *Id.* at *6.
62. No. 15-11934-RGS, 2016 WL 4491831 (D. Mass. Aug. 25, 2016).

of the Miller Act, and violation of the Massachusetts Unfair Business Practices Act.[63] The court found that the subcontractor's failure to pay its employees under federal and state law constituted a material breach of the subcontract as a matter of law.[64] The subcontractor's breach relieved the prime contractor of any further duty to perform under the subcontract. The breach also relieved the prime contractor of any duty to continue making progress payments to the subcontractor.[65]

In *Ursa Major Underground, Inc. v. Liberty Mutual Insurance Co.*,[66] the surety issued a payment bond on behalf of the general contractor for a pipeline project. The contractor terminated its contract with the project owner for breach of its payment obligations.[67] The contractor then terminated its subcontracts on grounds of convenience and refused to pay subcontractors, citing defective work and the fact the owner had not paid the contractor.[68] The magistrate judge recommended that the court grant, in part, the subcontractors' motion for summary judgment, finding that the subcontractors were entitled to payment from the surety for their work, despite the fact that the contractor had commenced a separate lawsuit against the owner for any money due on the project.[69] The magistrate found that the subcontracts contained "pay-when-paid" and not "pay-if-paid" provisions, stating that the subcontracts obligated the contractor to pay within a certain number of days after receipt of payment from the owner and did not establish that payment to the contractor was a condition precedent to payment of the subcontractors.[70]

In *United States ex rel. Jack Daniels Construction, Inc. v. Liberty Mutual Insurance Co.*,[71] the U.S. District Court for the Middle District of Florida addressed summary judgment motions of a second-tier subcontractor and the prime contractor's surety in a Miller Act case. The subcontractor previously sued the prime contractor seeking contract balances owed.[72] The subcontractor attempted to "pass through" the second-tier subcontractor's claims, but the court declined to rule on the second-tier subcontractor's damages because they were the subject of the present action.[73]

63. *Id.* at *1, *2.
64. *Id.* at *2.
65. *Id.*
66. No. 1:14-CV-00162-DBH, 2015 WL 9596001 (D. Me. Nov. 19, 2015), *report and recommendation adopted sub nom.* Ursa Major Underground, LLC v. Liberty Mut. Ins. Co., No. 1:14-CV-162-DBH, 2016 WL 50372 (D. Me. Jan. 4, 2016).
67. *Id.* at *3.
68. *Id.*
69. *Id.* at *6.
70. *Id.* at *6-7.
71. No. 8:12-cv-2921-T-24TBM, 2015 WL 9460115 (M.D. Fla. Dec. 28, 2015).
72. *Id.* at *3.
73. *Id.*

The court granted the surety's motion in part and denied it in part.[74] The court granted the surety's motion as to the second-tier subcontractor's claim for attorney fees.[75] Citing *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co., Inc.*,[76] the court reasoned that in the absence of statutory or contractual guidance, the commercial aspect of Miller Act cases should not allow an exception to the American Rule that parties must pay their own legal costs.[77] Based on issues of fact, the court denied the surety's motion on the remaining issues: (1) whether the second-tier subcontractor's claim was for lost profits, (2) whether portions of the claim were for delay damages barred by the sub-subcontract, (3) whether portions of the claim were for costs actually expended, and (4) whether the second-tier subcontractor waived or released portions of the claim.[78] The court also denied the second-tier subcontractor's motion for summary judgment as to its claims for breach of contract and dismissal of several of the surety's affirmative defenses due to issues of fact.[79]

In *United States ex rel. Agate Steel, Inc. v. Jaynes Corp.*,[80] a sub-subcontractor on a Miller Act payment bond sought a judgment against the prime contractor and its surety pursuant to Federal Rule of Civil Procedure 54(b), following an order granting summary judgment. The prime contractor and its surety argued that judicial efficiency weighed against entry of a judgment because an appeal of the judgment might become moot after the resolution of their claims against the subcontractor and its surety.[81] The court entered a judgment under Rule 54(b), finding that the prime contractor and surety's liability to the sub-subcontractor was legally and factually separate from the issue of indemnification.[82] The sub-subcontractor that had awaited payment for several years should not be forced to continue "to wait for resolution of a dispute in which it has no participation."[83]

5. Waiver of Penal Sum

In *Deluxe Building Systems, Inc. v. Constructamax, Inc.*,[84] a subcontractor sought recovery under a combined performance and payment bond despite the fact that the surety had exceeded its penal sum in completing

74. *Id.* at *11.
75. *Id.* at *7.
76. 417 U.S. 116, 128–31 (1974).
77. United States *ex rel.* Jack Daniels Const., Inc. v. Liberty Mut. Inc. Co., No. 8:12-cv-2921-T-24TBM, 2015 WL 9460115, at *7 (M.D. Fla. Dec. 28, 2015).
78. *Id.* at *4–6.
79. *Id.* at *7–10.
80. No. 2:13-CV-01907-APG-NJK, 2016 WL 4203863 (D. Nev. July 21, 2016).
81. *Id.* at *1.
82. *Id.*
83. *Id.* at *2.
84. No. CV 06-2996, 2016 WL 4150746 (D.N.J. Aug. 1, 2016).

the project and paying labor and material suppliers.[85] The subcontractor argued that under the law of the case the surety's obligations were not limited to its penal sum.[86] The U.S. District Court of New Jersey disagreed, observing that the court's prior rulings pertaining to the penal sum arose out of a takeover agreement and not the bond.[87] The court granted the surety summary judgment, holding that the "Bond explicitly limits liability under it to the penal sum" and the penal sum had been exhausted.[88]

6. Implicit Guaranty or Contract Formation

In *Berger Enterprises v. Zurich American Insurance Co.*,[89] the dispute arose out of a previous lawsuit where a plaintiff/subcontractor pursued its claims against the general contractor and its surety under the payment bond. The parties resolved their dispute and entered into a settlement agreement, which included provisions for payment by the general contractor to the subcontractor and the subcontractor to pursue pass-through claims directly to the federal government.[90] The general contractor filed for bankruptcy.[91] The subcontractor's claim to the federal government "was rejected on the grounds that it was not properly sponsored or presented in the name of [the general contractor]."[92] In granting the surety's motion to dismiss the present suit, the court held there was no "express suretyship undertaking" and "it would be implausible to construe a contract negotiated between sophisticated parties as implying one."[93] The court noted that the plaintiff wisely did not argue that its claim was predicated upon the payment bond because the plaintiff was well beyond the one-year statute of limitations under the Miller Act.[94]

In *Aggregate Industries-Northeast Region, Inc. v. Hugo Key & Sons, Inc.*,[95] a subcontractor sought quantum meruit damages against the general contractor and surety under Massachusetts General Law Chapter 149, § 29 and Chapter 93A.[96] The trial court concluded that the subcontractor was entitled to "the fair and reasonable sum of $7,125 on its quantum meruit claim,"[97] but denied recovery, finding that "[f]airness would be

85. *Id.* at *2.
86. *Id.* at *4.
87. *Id.* at *2.
88. *Id.* at *5-6.
89. No. 15-CV-13879, 2016 WL 4011262 (E.D. Mich. July 27, 2016).
90. *Id.* at *4.
91. *Id.*
92. *Id.* at *1.
93. *Id.* at *3.
94. *Id.*
95. 57 N.E.3d 1027 (Mass. App. Ct. 2016).
96. *Id.* at 1028.
97. *Id.* at 1030.

the victim if this court permitted [the subcontractor] to recover under the bond, with its right to attorneys' fees, on a quantum meruit claim that [the general contractor] was ready, willing and able to resolve at the fair and reasonable value of the services provided at or about the time this action was commenced."[98] The Massachusetts Appeals Court overturned the trial court decision, reasoning that the statute did not require the subcontractor to be reasonable or even have a strong case. The appellate court remanded it back to the trial court for it to enter judgment for the $7,125, plus prejudgment and post judgment interest and an award of reasonable attorney fees and costs.[99]

7. Waiver of Claim Rights

In *Cell-Crete Corp. v. Safeco Insurance Co. of America*,[100] "a 'sub-subcontractor' was entitled to collect its fee for materials and labor from a payment bond on a public works project, despite its execution of unconditional waivers prior to the performance of its work."[101] The California Court of Appeal found pivotal that "[w]aiver always rests upon intent" in upholding the lower court's ruling, finding that there was substantial evidence that Cell-Crete did not intend to waive its statutory rights by executing the unconditional lien waivers.[102]

8. Attorney Fees

In *Hypower, Inc. v. National Union Fire Insurance Co. of Pittsburgh, PA*,[103] the U.S. District Court of Kansas affirmed an arbitrator's finding that "prevailing" by obtaining an award in an arbitration does not necessarily warrant an award of attorney fees pursuant to the subcontract's "prevailing party" attorney fees provision.[104] The arbitrator determined that the plaintiff was not entitled to attorney fees because the plaintiff was not a "prevailing party" as the subcontract required. The court agreed with the arbitrator's determination that the plaintiff did not "succeed or prevail" as a whole, since the arbitrator's award to the plaintiff was less than 18 percent of the nearly $3,000,000 in damages sought in its initial arbitration demand and only 31 percent of the $1,694,335.56 that it made in its final demand for damages.[105]

98. *Id.*
99. *Id.* at 1032–33.
100. No. G051112, 2015 WL 8678624 (Cal. Ct. App. Dec. 11, 2015).
101. *Id.* at *1.
102. *Id.* at *5 (citing DRG/Beverly Hills, Ltd. v. Chopstix Dim Sum Café & Takeout III, Ltd., 35 Cal. Rptr. 2d 515, 518 (Ct. App. 1994)).
103. No. 13-CV-2326-DDC-TJJ, 2015 WL 7451171 (D. Kan. Nov. 23, 2015).
104. *Id.* at *4.
105. *Id.*

9. First to File Rule

In *United States ex rel. Paquin v. Insurance Co. of the State of Pennsylvania*,[106] the U.S. District Court for the Western District of Louisiana resolved whether a surety being assigned its principal's rights pursuant to the indemnity agreement and bond may assert its principal's rights in a second law suit. The court rejected prudential standing and "first to file" arguments asserted against the surety. The court ruled that a surety has "its own legal right to assert claims on behalf of [its principal]."[107] Moreover, the court found no authority supporting the proposition that the surety loses the right to assert the same claim when the principal asserts a claim. Rather, the court found that the principal and the surety may jointly assert counterclaims and third-party demands.[108] The court also stated that a district court applying the "first to file" rule does not *dismiss* a related action, but rather *transfers* it to the court or judge presiding over the first action. The court handling the first action then determines whether the subsequently filed action should proceed. Given that the related cases had already been transferred and consolidated, the court held that the "first to file" rule was not applicable.[109]

C. *Other Bonds*

1. Bid Bond

J. Smentkowski, Inc. v. Lacey Township[110] involved a bid protest where the plaintiff alleged that the bid bond and conditional consent of surety were material defects in the low bid. The original bid solicitation called for an eighteen-month contract, but the term was increased to nineteen months in a revised bid package. The bond submitted by the low bidder referenced the eighteen-month term. The Superior Court of New Jersey, Appellate Division, held that the bond did not create a material defect in the bid because the surety "remained fully bound by the bond already issued," despite the reference to the wrong contract term.[111] The consent of surety conditioned the bond on acceptance of the bid and a "timely awarded and executed" contract.[112] Despite the fact that a conditional consent of surety was a material defect, the court held that the consent of surety provided by the low bidder was not a material defect because the bid specifications required a contract to be awarded, if at all, within sixty days.[113]

106. No. 5:15-CV-1744 (MEMBER), 2016 WL 1322479 (W.D. La. Apr. 1, 2016).
107. *Id.* at *5.
108. *Id.*
109. *Id.*
110. No. A-5930-13T1, 2015 WL 6511656 (N.J. Super. Ct. App. Div. Oct. 29, 2015).
111. *Id.* at *1.
112. *Id.*
113. *Id.*

2. Fringe Benefit Bonds

In *Board of Trustees, Roofers Local No. 30 Combined Welfare Fund v. International Fidelity Insurance Co.*,[114] the trust funds filed a lawsuit against the principals seeking to recover unpaid monthly contributions. The case was settled by an agreement that required the principals to fund the unpaid contributions over time and continue to pay current contributions. The surety bonds required that the funds notify the surety within one year of "actual knowledge of default" by the principal.[115] When the principals again breached their obligations to the funds, the funds notified the surety. The surety then denied the liability on the bases that the notices of default were not timely, the funds did not "exercise their discretion reasonably and in good faith," and the funds modified the surety bonds by entering into settlement agreements with the principals.[116] The trial court held that the surety breached its obligations under the surety bonds.[117] The appellate court affirmed, holding that the bonds granted the funds sole and exclusion discretion to determine whether the principals were in default and, once they did so, the surety was timely notified.[118] The court further rejected the surety's argument that the funds acted in bad faith when they settled with the principal and did not notify the surety.[119]

3. Motor Vehicle Bond

In *McCoolidge v. Oyvetsky*,[120] the plaintiff purchased a vehicle through an online auction from an out-of-state seller. The plaintiff received the vehicle and the title, but was unable to register the vehicle in Nebraska.[121] The plaintiff filed suit against the car dealer, dealership, and the surety that issued the bond to the seller, alleging breach of warranty of title and seeking damages for, *inter alia*, storage costs and loss of use.[122] The district court determined that the sellers breached the warranty of title by failing to deliver a registrable certificate of title to the plaintiff. The court, however, concluded that although the defendants initially breached the warranty of title and the seller's involvement in the transaction triggered the protection of the bond, the plaintiff failed to establish damages attributable to the breach.[123] The Supreme Court of Nebraska affirmed,

114. 644 F. App'x 133 (3d Cir. 2016).
115. *Id.* at 135.
116. *Id.* at 135–37.
117. *Id.* at 135.
118. *Id.* at 136.
119. *Id.* at 137.
120. 874 N.W.2d 892 (Neb. 2016).
121. *Id.* at 896.
122. *Id.* at 898.
123. *Id.* at 898–99.

holding that because the plaintiff failed to establish damages, the court did not need to decide whether any shadow remained on the title.[124]

4. Probate Bond

In *In re Estate of Ibarra*,[125] the fiduciary, who was also an heir of the estate, diverted estate funds. The trial court awarded a judgment against the principal and his surety for the amount diverted from the second heir, the amount necessary to pay income taxes, court costs, and attorney and administrator fees relating to the estate.[126] The trial court also held that Iowa law provides a procedure for the successor to enforce a claim against the bond within the administration of the estate and that the procedure should have been followed by the successor.[127] On cross-appeal, the surety claimed that its liability could not exceed the total amount the principal diverted from the estate.[128] The appellate court affirmed the trial court opinion. It agreed that the award against the principal was properly reduced by the principal's share of the estate under equitable principles.[129] It further agreed that the trial court granted a reasonable value on the extraordinary service fees incurred by the successor and his counsel.[130] The successor and his counsel were not entitled to recover all service fees because they failed to pursue the administrative procedure set forth in Iowa Code § 633.186(2).

5. Public Official Bond

In *State ex rel. Whitaker v. Rinehart*,[131] the plaintiffs sought to recover a wrongful death award against the sheriff's public official bond, alleging that a prisoner died from a drug overdose because the sheriff failed to discharge his duties. Liability under the bond was conditioned on a finding that the sheriff failed to faithfully perform his duties.[132] The surety sought to be dismissed or, in the alternative, sought a stay of the claims against it pending a determination as to whether the sheriff was liable.[133] The court denied the request for dismissal, but granted the stay, holding that although the plaintiffs pled a cognizable claim against a public official bond

124. *Id.* at 903–05.
125. 873 N.W.2d 775 (table), 2015 WL 8462090 (Iowa Ct. App. 2015).
126. *Id.* at *4.
127. *Id.* at *3–4.
128. *Id.* *11.
129. *Id.* at *9.
130. *Id.* at *10.
131. No. 1:15-cv-00077-GHD-DAS, 2016 WL 744599 (N.D. Miss. Feb. 23, 2016).
132. *Id.* at *3.
133. *Id.* at *2.

for the faithful performance of a sheriff, the claim had to be stayed until liability was established against the sheriff.[134]

6. Release of Lien Bond

In *Hiller v. Phoenix Associates of South Florida, Inc.*,[135] a homeowner posted a transfer bond to remove a mechanics' lien and filed a notice of contest triggering a sixty-day window within which the lien claimant was required to file a lawsuit to enforce its lien rights.[136] The lien claimant commenced suit against the surety after the sixty-day period expired.[137] The trial court declined to find that the notice of contest shortened the limitations period. The court of appeals disagreed, however.[138] The contractor's failure to bring an action within the sixty-day period extinguished its right to make a claim on the bond.[139]

In *Stock Building Supply, Inc. v. Platte River Insurance Co.*,[140] a lien claimant filed suit against the surety that issued the release of lien bond seeking to recover its labor and materials costs as well as overhead, profit, and insurance costs.[141] In its defense, the surety argued that the subcontractor was estopped from enforcing its lien because it failed to list the lien as an asset in its bankruptcy proceeding.[142] Both parties filed motions for summary judgment. The surety's motion was denied.

The Georgia Court of Appeals found that because the lien claimant included a provision to preserve any causes of action in its bankruptcy petition, it was not estopped from pursuing its lien claim.[143] The court also found that, pursuant to the lien statute in effect when the lien was filed, as opposed to the amended statute, the plaintiff's recovery was limited to the costs for materials and work that actually went into the structure.[144] The surety's full payment defense failed because the surety did not establish that the payments made by the owner to the general contractor were properly appropriated to the subcontractor.[145]

134. *Id.* at *4.
135. 189 So. 3d 272 (Fla. Dist. Ct. App.), *review denied*, SC16-711, 2016 WL 3522783 (Fla. June 28, 2016).
136. *Id.* at 273–74.
137. *Id.* at 274.
138. *Id.* at 274–75.
139. *Id.* at 275.
140. 783 S.E.2d 708 (Ga. Ct. App. 2016).
141. *Id.* at 710.
142. *Id.*
143. *Id.* at 711–12.
144. *Id.* at 713.
145. *Id.* at 715.

In *Wagner Interior Supply of Wichita, Inc. v. Dynamic Drywall, Inc.*,[146] a supplier filed a lien in which it incorrectly identified the general contractor and the owner.[147] The general contractor subsequently filed a release of lien bond and the supplier filed a petition to recover under the bond.[148] The lien claimant argued that "it was not required to perfect the lien because [the general contractor] filed a release of lien bond which substituted for and discharged the lien."[149] The trial court held that the lien claimant's failure to "timely perfect its mechanic's lien prevented it from collecting under the bond."[150] The lien claimant appealed.

The appellate court, interpreting the amended Kansas Statute § 60-1110, held that "when the bond is filed the statutory requirements of the lien, such as the filing of a lien statement, need not be complied with and are waived."[151] Accordingly, when the general contractor chose to file a release of lien bond rather than to challenge the supplier's lien as unperfected, the supplier's lien was discharged because the parties did not dispute the facts establishing the validity of the supplier's claim under the bond.[152] The appellate court reversed and remanded the trial court's ruling with directions to grant summary judgment in favor of the supplier.[153]

7. Subdivision Bond

In *Camino Properties, LLC v. Insurance Company of the West*,[154] the plaintiff sought to enforce its assignment rights against the performance bond for a subdivision development agreement. The principal filed a bankruptcy petition and abandoned the work.[155] The plaintiff, after it acquired the property, demanded that the city compel the surety to complete the work. After the city refused to do so, the plaintiff, without assuming responsibility for the principal's scope of work, began completing the work. The plaintiff discovered that the sewer system the principal installed was deficient. The plaintiff therefore demanded that the surety correct the deficiencies and complete the remaining work, but the surety refused.[156] Thereafter, the city assigned its rights under the bond to the plaintiff, which again demanded that the surety complete the work and

146. 356 P.3d 1077 (table), 2015 WL 5750465 (Kan. Ct. App. 2015), *review granted* (June 21, 2016).
147. *Id.* at *1.
148. *Id.* at *2.
149. *Id.*
150. *Id.*
151. *Id.* at *6 (quoting Bob Eldridge Constr. Co. v. Pioneer Materials, Inc., 684 P.2d 355, 360 (Kan. 1984)).
152. *Id.* at *6–7.
153. *Id.* at *7.
154. No. 2:13-CV-02262-APG-CWH, 2016 WL 1213224 (D. Nev. Mar. 23, 2016).
155. *Id.* at *1.
156. *Id.* at *3–4.

correct the deficiencies. While the surety was conducting its investigation, the plaintiff performed the principal's outstanding work and repaired the sewer system. The plaintiff then filed the lawsuit asserting breach of contract, breach of the covenant of good faith and fair dealing, and breach of the city's municipal code.[157]

The court held that the plaintiff, as assignee of the city's rights under the bond, had a legal right to demand completion and/or correction of the any of the bonded work that was not completed in accordance with the subdivision development agreement or to receive proceeds from the performance bond to pay for the work and that the surety materially breached its obligations under the performance bond by not curing the principal's breach or tendering proceeds of the bond to cover the cost to complete the work.[158] In finding that the surety did not breach the implied covenant of good faith and fair dealing, the court noted that the surety was entitled to conduct its claim investigation before issuing payment under the performance bond. Prior to the lawsuit, the plaintiff failed to provide sufficient responses to the surety's requests for information.[159]

Stonecrest Properties, LLC v. City of Eugene[160] involved a subdivision bond and the question of the successor developer's standing to assert claims against that bond. The development agreement stated that the city did not intend to "bestow a benefit on individual third parties but rather to protect the public interest by obtaining compliance with the laws . . . governing the development of real property within the city."[161] The plaintiff was the successor developer.[162]

The plaintiff filed claims against both the city and the surety, alleging that the city was obligated to either enforce the bond against the surety or perform the unfinished improvements. The plaintiff alleged that it was entitled to enforce a claim against the surety bond. The surety responded that the plaintiff lacked standing to enforce a claim against the bond as a third-party beneficiary or under a covenant that runs with the land.[163] The surety brought two counterclaims: one seeking a declaration that it had no obligation to the plaintiff under the bond and a second seeking attorney fees.[164] The trial court granted the surety summary judgment on both claims. The court awarded attorney fees to the surety.[165]

157. *Id.* at *4–6.
158. *Id.* at *5.
159. *Id.*
160. 382 P.3d 539 (Or. Ct. App. 2016).
161. *Id.* at 541.
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.* at 542.

On appeal, the Court of Appeals of Oregon rejected the plaintiff's claim that it was a third-party or donee beneficiary under the bond. The court noted that the development agreement expressly provided that the city was not seeking to confer a benefit on any third party.[166] As to the plaintiff's claim that the city was obligated to require that the surety complete the unfinished work or do so itself, the appellate court appeared to agree that the trial court's grant of summary judgment to the surety was in error because the surety was not named in that claim. However, because the plaintiff conveyed its interests in the property after filing the appeal, the assignment of error was moot. The appellate court further noted that the city also was granted summary judgment on this issue. The plaintiff appealed the summary judgment ruling, but this court upheld the ruling on summary judgment.[167]

8. Supersedeas Bond

In *Rudolph Technologies, Inc. v. Camtek Ltd.*,[168] a supersedeas bond was issued pursuant to Federal Rule of Civil Procedure 62(d) to stay execution of a judgment in a patent infringement action. Judgment and a permanent injunction were entered in the plaintiff's favor following a jury trial finding infringement on the part of defendant. The Federal Circuit later determined that the court erred in its claim construction, vacated the decision, and remanded the case for further proceedings. Summary judgment was entered in the plaintiff's favor on the issue of infringement, and the court entered a final judgment and permanent injunction. The defendant again appealed the judgment to the Federal Circuit, and the judgment was affirmed.[169] Because the judgment was finally stayed and the defendant had not made any payments to satisfy the judgment, the magistrate judge recommended that a motion to enforce the supersedeas bond be granted.[170]

In *Snyder v. First Tennessee Bank, N.A.*,[171] the Tennessee Court of Appeals reversed the trial court's award of litigation costs, including attorney fees, against the surety upon the granting of the defendant's motion to dismiss.[172] Citing a specific subsection of a Tennessee statute, the court held that language included in its cost bond limited the surety's liability to "court costs and taxes" as defined in the statute.[173] The appellate

166. Stonecrest Props., LLC v. City of Eugene, 382 P.3d 539, 543 (Or. Ct. App. 2016).
167. *Id.*
168. No. 05-1396 (JRT/FLN), 2016 WL 3976349 (D. Minn. June 24, 2016).
169. *Id.* at *1.
170. *Id.* at *2.
171. No. E2015-00530-COA-R3-CV, 2016 WL 423806 (Tenn. Ct. App. Feb. 3, 2016).
172. *Id.* at *11.
173. *Id* at *10.

court otherwise affirmed the trial court's judgment against the principal and remanded the case for enforcement of that judgment.[174]

D. *Rights of Surety*

1. Indemnity

In *Developers Surety & Indemnity Co. v. Barlow*,[175] two indemnitors claimed that they had no liability on bonds issued after they had sold their interest in the principal and severed ties with the company. The indemnitors argued that they had no interest in the bonds, there was a lack of consideration, and Developers Surety had notice that they were no longer interested in the bonds. The court rejected each argument.[176] First, the text of the indemnity agreement warranted that they were "specifically and beneficially interested in obtaining each [b]ond."[177] Next, as consideration, Developers Surety suffered a detriment by issuing the bond that resulted in a loss.[178] There was also no lack of consideration because Developers did exactly as it promised that it would by issuing the bonds.[179] Finally, the indemnity agreement specifically described exactly how the indemnitors could cancel their liability on future bonds by providing written notice. Since the indemnitors failed to provide proper notice, they did not terminate their liability.[180]

In *Great American Insurance Co. v. Fountain Engineering, Inc.*,[181] the court denied the surety's motion for issuance of a preliminary injunction, finding that violation of a collateral security provision in an indemnity agreement did not constitute irreparable harm. The court held that the defendants' failure to deposit collateral in accordance with the provision did not mandate the issuance of a preliminary injunction without evidence of an immediate and imminent threat to the surety's ability to recover on a judgment.[182] For the preliminary injunction to be issued, the surety needed to demonstrate "(1) a substantial likelihood of success on the merits, (2) that irreparable injury will be suffered if the relief is not granted, (3) that the threatened injury outweighs the harm the relief would inflict on the non-movant, and (4) that the entry of relief would serve the public interest."[183]

174. *Id.* at *10, *11.
175. 628 F. App'x 980 (10th Cir. 2015).
176. *Id.* at 982.
177. *Id.* at 983.
178. *Id.*
179. *Id.* at 983–84.
180. *Id.* at 984.
181. No. 15-CIV-10068-JLK, 2015 WL 6395283 (S.D. Fla. Oct. 22, 2015).
182. *Id.* at *3–4.
183. *Id.* at *2 (citations omitted).

As to the first prerequisite, the surety argued it clearly established a substantial likelihood of success on the merits because the contractual language mandated issuance of preliminary injunction and specific performance of "this kind of collateral security clause is routine."[184] The court disagreed, finding that the surety did not carry its burden of persuasion as to this first requirement because it failed to set forth factual support, other than citing to the agreement itself. Moreover, the surety did not respond to the defendants' defenses and denials as to the agreement's validity. The court explained that "[t]he legal truism that sureties are routinely entitled to the specific performance of validly executed collateral security clauses does not impact upon whether the provision in the instant case is substantially likely to be valid."[185]

As for the second requirement, the surety's alleged injury was "the lack of collateralization posted while claims are pending, and that nothing can remedy that injury after the fact."[186] The surety argued that the numerous claims asserted against the bonds were proof that the indemnitors could not pay those claims and that it would suffer irreparable harm.[187] The court disagreed, finding that the evidence failed to prove the defendants were unable to pay any monetary judgment, which is necessary for a finding of irreparable harm. The court also found that the surety's four-month "delay" in filing its motion for preliminary injunction diminished its argument that it would suffer an irreparable injury.[188]

In *Ohio Casualty Insurance Co. v. Campbell's Siding & Windows*,[189] the court denied the surety's motion for issuance of a preliminary injunction requiring the deposit of collateral as provided in the indemnity agreement. Even though the defendants did not oppose the motion, the court denied the motion on the ground that the surety did not establish "irreparable harm."[190] The court reasoned that the alleged harm was economic because the surety would have to pay the bond claims before receiving collateral, and an economic injury "does not establish irreparable injury that cannot be remedied later."[191]

In *United Fire & Casualty Co. v. AMS, Inc.*,[192] the contractor requested that the surety defend the project owner's claim against the bid bond, but failed to deposit any collateral with the surety as required by their indem-

184. *Id.*
185. *Id.* at *3.
186. *Id.*
187. Great Am. Ins. Co. v. Fountain Eng'g, Inc., No. 15-CIV-10068-JLK, 2015 WL 6395283, at *3 (S.D. Fla. Oct. 22, 2015).
188. *Id.* at *4.
189. No. 1:15-CV-00255-EJL, 2015 WL 6758137 (D. Idaho Nov. 4, 2015).
190. *Id.* at *3.
191. *Id.*
192. No. 1:15-CV-515, 2016 WL 3542449 (S.D. Ohio June 29, 2016).

nity agreement.[193] The surety settled the claim and then filed suit to enforce its rights under the indemnity agreement.[194] The defendants denied liability and countersued for breach of contract, bad faith performance of the surety agreement, and breach of fiduciary duty.[195] The defendants argued they had valid defenses to the owner's claim against the bid bond and had claims against the owner for wrongful termination of the contract.[196] The court concluded that the surety had no contractual duty to defend the claim, even if the contractor had valid defenses. In finding for the surety on summary judgment, the court held that the parties' "indemnity agreement gave the surety the right to settle claims against the bonds and required the contractor to post collateral satisfactory to the surety in order to trigger the surety's duty to defend claims against the bonds."[197]

In *Western Surety Co. v. S3H*,[198] the surety sought to recover costs it incurred in an arbitration proceeding. The bonded contracts required that the principal and obligee submit their disputes to arbitration. Disputes arose and the parties, including the surety on the subcontractor performance and payments bonds, entered into an amended arbitration panel agreement (AAPA), which provided that each party "shall be responsible for and bear the costs of its own attorney's fees and expenses and an equal portion of the panel's costs and expenses."[199] After arbitration was complete, the surety initiated suit to recover its attorney fees and related arbitration expenses pursuant to the terms of the general agreement of indemnity.[200] The court denied the surety's motion for summary judgment, finding that the surety failed to set forth sufficient evidence to demonstrate that it did not intend to alter the indemnity obligations when it entered into the arbitration agreement.[201] The court explained that if surety wanted the indemnity agreement "to alter or override the obligations set forth in the AAPA, it should have executed contractual amendments or other documents clarifying the status of the defendants' duty to indemnify plaintiff."[202]

In *Payne v. American Contractors Indemnity Co.*,[203] the surety settled a claim brought by a homeowner alleging that the contractor-principal im-

193. *Id.* at *3.
194. *Id.* at *1.
195. *Id.*
196. *Id.* at *2.
197. *Id.* at *4.
198. No. 2:14-CV-2056 JCM (PAL), 2016 WL 4157307 (D. Nev. Aug. 3, 2016).
199. *Id.* at *1.
200. *Id.*
201. *Id.* at *4.
202. *Id.* at *3.
203. No. C072674, 2016 WL 476454 (Cal. Ct. App. Feb. 8, 2016).

properly installed windows at her home.[204] The principal failed to reimburse the surety. Thereafter, the surety refused to issue the contractor a new bond and put the state licensing board on notice of the events.[205] The state suspended the principal's license and cited him for the improper work.[206] The principal sued the surety for breach of contract, breach of the implied covenant of good faith and fair dealing, and declaratory relief.[207] The trial court sustained the surety's demurrers with leave to amend on each of the contractor's causes of action.[208] The contractor appealed.[209]

The California Court of Appeal found that the trial court erred in sustaining the surety's demurrer to the contractor's cause of action for declaratory relief because an actual controversy existed concerning the rights and duties of the surety and the contractor, and this controversy was sufficient to maintain an action for declaratory relief.[210] The appellate court found, however, that the trial court properly sustained the surety's demurrers to the contractor's breach of contract and good faith and fair dealing causes of action.[211] The court concluded that the surety's payment to the homeowner did not constitute a breach of the indemnity agreement regardless of whether the surety was liable for the claim.[212] The court further concluded that even if the contractor were able to establish that he properly installed the windows, it did not follow that the surety acted in bad faith in settling the homeowner's claim or seeking reimbursement from the contractor.[213]

2. Subrogation

In *Bond Safeguard Insurance Co. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,[214] the Eleventh Circuit affirmed the lower court's order granting the insurer summary judgment where, due to an exclusion in the insurance policy, the insurer had no duty to indemnify an indemnitor for the value of his settlement with the surety.[215]

In *Insurance Co. of the West v. United Security Bank*,[216] the California Court of Appeal affirmed the lower court's order granting the bank's mo-

204. *Id.* at *2.
205. *Id.*
206. *Id.*
207. *Id.* at *1.
208. *Id.*
209. Payne v. Am. Contractors Indem. Co., No. C072674, 2016 WL 476454, at *1 (Cal. Ct. App. Feb. 8, 2016).
210. *Id.* at *5.
211. *Id.* at *7, *10.
212. *Id.* at *6.
213. *Id.* at *9.
214. 628 F. App'x 648 (11th Cir. 2015).
215. *Id.* at 649, 655.
216. No. F068649, 2016 WL 1091318 (Cal. Ct. App. Mar. 21, 2016).

tion for summary judgment where the bank issued a set-aside letter to the surety stating that the bank would allocate a portion of the principal's loan funds to pay the costs of work covered by the surety's performance bond in the event the principal failed to complete or pay for the bonded work. The set-aside letter also included a provision stating that the bank's obligations under the letter would expire and terminate upon loan maturity.[217] The principal did not complete its work, and the surety demanded that the bank honor its obligations under the set-aside letter.[218] When the bank did not pay the surety, the surety sued the bank for breach of contract and conversion.[219] The lower court granted summary judgment to the bank on the breach of contract and conversion claims, reasoning that the loan matured before the surety made its claim under the set-aside letter.[220] In affirming the lower court's ruling, the appellate court stated that the plain terms of the set-aside letter terminated the bank's obligation to the surety two years before the surety made its claim.[221] Additionally, the appellate court affirmed the lower court's ruling on the conversion issue because the surety had no right to the funds until it made a claim, and by the time the surety made a claim, the set-aside letter had terminated by its own terms.[222]

The appellate court also addressed the bank's cross appeal of the lower court's denial of its attorney fees claim.[223] The construction loan between the bank and the principal contained an attorney fee provision, which entitled the bank to fees for enforcing the principal's obligations.[224] Because the basis for the surety's claims was the set-aside letter, not the construction loan, the court affirmed the lower court's ruling denying attorney fees to the bank.[225]

In *Village of Montgomery v. Fidelity & Deposit Co. of Maryland*,[226] the Illinois Appellate Court reversed the lower court's order dismissing a surety's complaint for failure to state a claim. A village and a developer entered into an annexation agreement under which the village annexed certain property to the developer.[227] The annexation agreement applied to the developer and its successors and assigns.[228] The surety issued a sub-

217. *Id.* at *1.
218. *Id.*
219. *Id.* at *2.
220. *Id.*
221. *Id.* at *6.
222. Ins. Co. of the W. v. United Sec. Bank, No. F068649, 2016 WL 1091318, at *11 (Cal. Ct. App. Mar. 21, 2016).
223. *Id.* at *18.
224. *Id.*
225. *Id.* at *19.
226. No. 2-15-0571, 2016 WL 1621971 (Ill. App. Ct. Apr. 21, 2016).
227. *Id.* at *1.
228. *Id.* at *2.

division bond to the developer.[229] The developer subsequently filed for bankruptcy, and a successor developer purchased the developer's remaining property.[230] The village sued the surety, seeking a determination on the surety's obligations under the bond.[231] The surety filed a third-party complaint against the successor developer under the theory that the annexation agreement rendered the successor developer a successor owner of the property with primary responsibility to complete the subdivision improvements and furnish security to the village.[232] The lower court dismissed the surety's third-party complaint for failure to state a claim.[233] The appellate court reversed, however, reasoning that the annexation agreement's successor-owner provision clearly reflected the contracting parties' intent that the agreement be connected to the land.[234] Further, the appellate court reasoned that while the original developer had not been released under the annexation agreement because no new bond or letter of credit had been posted for the successor developer, the original developer and the successor developer were jointly primarily liable to the village for completion of the project.[235] The surety was secondarily liable to the developers.[236]

3. Preliminary Relief/Collateral

In *Western Surety Co. v. Futurenet Group, Inc.*,[237] the court held that a surety's loss of its secured position does in fact constitute an irreparable injury. In finding that the surety was likely to suffer irreparable harm in the absence of a preliminary injunction, the court explained that the surety specifically bargained for the collateral-security clause so that it "would not be placed in a situation in which its only hope of obtaining indemnification is a final judgment against the possibly judgment-proof Indemnitors."[238] The longer the surety "has to wait for the enforcement of the collateral-security clause, the less likely it becomes that the clause will be effective and that [the surety] will be able to obtain the benefit of its bargain."[239] There was evidence that the indemnitors were facing serious financial problems that further indicated to the court that the surety would suffer irreparable harm if action was not taken to protect its inter-

229. *Id.*
230. *Id.*
231. *Id.* at *3.
232. Vill. of Montgomery v. Fid. & Deposit Co. of Md., No. 2-15-0571, 2016 WL 1621971, at *3 (Ill. App. Ct. Apr. 21, 2016).
233. *Id.*
234. *Id.* at *6.
235. *Id.* at *7.
236. *Id.*
237. No. 16-CV-11055, 2016 WL 3180188 (E.D. Mich. June 8, 2016).
238. *Id.* at *6.
239. *Id.*

ests. Rather than order specific performance of the collateral security clause per se, the court fashioned its own remedy and ordered a freeze of the indemnitors' assets.[240]

II. FIDELITY LAW

A. *Employee Theft*

Two recent cases discuss the meaning of "taking" in the commercial crime policy's definition of employee theft. In *Tesoro Refining & Marketing Co. LLC v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,[241] the insured, Tesoro, sold fuel to Enmex on credit. Tesoro's employee, Cal Leavell, forged letters of credit to make it appear that Enmex could afford to buy more fuel than it could.[242] When Enmex became unable to pay for all the fuel it purchased, Tesoro suffered a loss. Tesoro contended Leavell's forgeries were employee "theft," which the policy defined as "an unlawful taking to the deprivation of the insured."[243] The court held that a "taking" requires the actor to "exert control over the article such that possession or control is transferred,"[244] which Leavell had not done. Leavell induced Tesoro to keep selling fuel to Enmex on credit, but these misrepresentations "did not exert control over the fuel such that possession or control of the fuel was transferred *by virtue of the misrepresentations themselves*."[245] By inducing sales rather than exerting control over the fuel himself, Leavell had not "taken" the fuel. The Fifth Circuit affirmed, noting that "Tesoro failed to offer any evidence that it would have acted differently had it known the Enmex account was actually not secured."[246]

In *Frazier Industrial Co. v. Navigators Insurance Co.*,[247] the insured, Frazier Industrial Co., suffered a loss when its employee knowingly approved a vendor's inflated bids.[248] The vendor paid the employee under the table in return. Frazier claimed that this was employee theft. The relevant policy defined "employee theft" as "the unlawful taking of property to the deprivation of the Insured."[249] The court found that there was no coverage because the policy was designed "to protect [Frazier] from employee theft, not against a less favorable deal from a deceitful contractor."[250] The court

240. *Id.* at *10.
241. 96 F. Supp. 3d 638 (W.D. Tex. 2015).
242. *Id.* at 642.
243. *Id.* at 645.
244. *Id.* at 647.
245. *Id.* at 650.
246. 833 F.3d 470, 479 (5th Cir. 2016).
247. 149 F. Supp. 3d 512 (D.N.J. 2015).
248. *Id.* at 515.
249. *Id.* at 514.
250. *Id.* at 518.

did rule, however, that the kickbacks were covered under the policy. Frazier had "intended to pay only its independent contractor for work performed, and had not authorized a payment to [the employee]."[251] The indirect loss exclusion did not apply because that exclusion barred "inability to realize income that [the insured] would have realized had there been no loss of or damage to 'money.'" Frazier was not seeking income, such as interest, that it would have realized on the funds the employee had taken.[252]

B. *Who Is an Employee?*

1. Multiple Capacities

In *Telamon Corp. v. Charter Oak Fire Insurance Co.*,[253] the insured's vice president, Juanita Berry, used an entity she identified as an independent contractor in a consulting agreement with the insured to purportedly resell the insured's old AT&T equipment for the insured. In fact, she sold the equipment for herself and concealed this fact with false accounting.[254] The court held there was no coverage under Travelers' crime policy because neither Berry nor her entity was acting as an employee.[255] Berry's entity also did not qualify as a labor leasing firm within any of the policy's definitions of employee.[256] As for Berry, the consulting agreement defined her as an independent contractor and thus an independent contractor exclusion applied.[257]

2. Broker Exclusion

In *United States Fire Insurance Co. v. Nine Thirty FEF Investments, LLC*,[258] U.S. Fire issued financial institution bonds to the insureds that excluded acts of outside brokers and investment advisors.[259] The insureds suffered a loss of funds invested with Bernard L. Madoff Investment Securities LLC.[260] The court held the loss was not covered. Madoff, who pleaded guilty to investment advisor fraud, was not the insured's employee.[261] Coverage for Madoff Securities was also excluded because it was a registered broker-dealer. It did not matter whether Madoff or Madoff Securities was actually acting as a broker.[262]

251. *Id.*
252. *Id.* at 520.
253. No. 1:13-cv-00382, 2015 WL 10738615 (S.D. Ind. Dec. 10, 2015).
254. *Id.* at *3.
255. *Id.* at *9.
256. *Id.*
257. *Id.* at *8–9.
258. 17 N.Y.S.3d 118 (App. Div. 2015).
259. *Id.* at 119.
260. *Id.*
261. *Id.* at 120.
262. *Id.*

3. Alter Ego

In *Cedar Lake Homeowners Association v. Northwest Empire Community Management, Inc.*,[263] Northwest managed funds for two homeowners associations (HOA). The HOAs obtained a judgment against Northwest for theft by a Northwest employee and garnished Northwest's fidelity insurer. The policy covered "loss of money or securities resulting 'directly' from dishonest acts committed by the insured's employee with the 'manifest intent' to cause the insured to sustain loss and to obtain a financial benefit."[264]

The court found that there was coverage under these circumstances. Contractually, Northwest was a bailee of the HOAs' funds. It both held the funds and was legally liable for them. The funds thus met the policy's definition of "covered property."[265] Northwest lost this property as a direct result of its employee's theft.[266] In deciding whether the employee had "manifest intent" to cause the loss, the court found that term was ambiguous because courts had differed on what it meant.[267] Adopting the most liberal construction, the court held that the employee had manifest intent to cause a direct loss to Northwest because Northwest's liability to the HOAs was a natural and probable consequence of the employee's theft of their funds.[268] Therefore, the loss was covered to the extent the employee stole the funds during the policy period.[269]

In *Dillon v. Continental Casualty Co.*,[270] the insured's owners stole Internal Revenue Code § 1031 exchange funds from customers.[271] The insured's receiver sought to recover on behalf of those customers under a fidelity bond. The district court entered summary judgment for the insurer on the basis that California Insurance Code § 533, which prevents an insured from recovering for its own "wilful act," applied.[272] The Ninth Circuit reversed. Section 533 expresses as public policy that "insurance coverage should not 'directly or indirectly exempt anyone from personal responsibility for his own wilful injury to another.'"[273] Here, the policy granted subrogation rights to the insurer as surety against the insured to recover any amounts paid under the policy.[274] Thus, the policy

263. No. 3:14-cv-00599-PK, 2015 WL 9690846 (D. Or. Nov. 13, 2015), *adopted*, 2016 WL 126738 (D. Or. Jan. 11, 2016).
264. *Id.* at *1.
265. *Id.* at *3–4.
266. *Id.* at *5.
267. *Id.* at *5–6.
268. *Id.* at *6.
269. Cedar Lake Homeowners Ass'n v. Nw. Empire Cmty. Mgmt., Inc., No. 3:14-cv-00599-PK, 2015 WL 9690846, at *8 (D. Or. Nov. 13, 2015).
270. 649 F. App'x 417 (9th Cir. 2016).
271. *Id.* at 418.
272. *Id.*
273. *Id.* (quoting Aetna Cas. & Sur. Co. v. Sheft, 989 F.2d 1105, 1107 (9th Cir. 1993)).
274. *Id.*

created a surety relationship and was not exempt from Section 533 because the principal would not escape responsibility.[275]

C. *Computer Fraud/Funds Transfer Fraud*

1. Hacking Requirement

A hot coverage issue is whether a crime policy's "computer fraud" coverage extends only to hacking or also covers a "social engineering" type of loss that tangentially involves the use of a computer. In *Kraft Chemical Co., Inc. v. Federal Insurance Co.*,[276] fraudsters, pretending to be an existing vendor, sent emails to Kraft. The emails requested Kraft change the bank account information it had for the vendor, and Kraft complied. Kraft's payments thus went to the fraudster instead of the vendor.[277] Coverage turned on whether Kraft sustained "an unauthorized (A) entry into or deletion of Data from a Computer System; (B) change of Data elements or program logic of a Computer System . . . or (C) introduction of instructions, programmatic or otherwise, which propagate themselves through a Computer System."[278] The court found that Kraft was not covered under the policy. Kraft's receipt of an email did not qualify as an unauthorized entry or change to a computer system.[279] Some "actual or threatened interference with the computer's functioning" is required.[280] Moreover, the court determined that the insured knowingly effectuated the transfers so the loss did not result directly from the fraudulent emails under the "direct means direct" standard of causation.[281]

Similarly, in *Apache Corp. v. Great American Insurance Co.*,[282] a fraudster posing as a vendor phoned and asked Apache's employee to change the vendor's bank account for future payments. As instructed, the fraudster emailed a formal request on the vendor's letterhead. The email domain address resembled, but was not, the vendor's genuine address. Persuaded that the request was authentic, Apache changed the account and sent funds to the account in payment of genuine invoices.[283] After learning of the fraud, Apache sought coverage for loss "resulting directly from the use of any computer to fraudulently cause a transfer" of funds under Great American's crime protection policy.[284] Reversing the district court, the Fifth Circuit found that Apache had no coverage under the crime protection policy.

275. *Id.*
276. No. 13 M2 002568, 2016 Ill. Cir. LEXIS 1 (Ill. Cir. Ct. Jan. 5, 2016).
277. *Id.* at *10–11.
278. *Id.* at *8.
279. *Id.* at *15.
280. *Id.* at *16.
281. *Id.* at *23–27.
282. No. 15-20499, 2016 WL 6090901 (5th Cir. Oct. 18, 2016).
283. *Id.* at *1.
284. *Id.* at *2.

Reviewing *Pestmaster Services, Inc. v. Travelers Casualty & Surety Co.*[285] and other cases, the court found "cross-jurisdictional uniformity in declining to extend coverage when the fraudulent transfer was the result of other events and not directly by the computer use."[286] The mere use of email did not establish coverage because electronic communications are ubiquitous. Moreover, Apache's loss was not caused by computer use. The loss was caused by Apache's telephone conduct and its failure to investigate the account change request properly.[287] Additionally, Apache transferred funds to pay legitimate invoices, not fraudulent ones. "Regrettably, it sent the payments to the wrong bank account."[288] The court held that no computer directly and fraudulently caused Apache to make that error.

2. Exclusions and Concurrent Causation

In *State Bank of Bellingham v. BancInsure, Inc.*,[289] the insured bank failed to implement security procedures, including running updated antivirus software, on the computer used to complete FedLine wire transfers, and the computer became infected with malware.[290] The loss occurred when an employee left an infected computer running overnight without logging off or removing the tokens.[291] In finding that there was computer fraud coverage under BancInsure's financial institution bond, the court applied Minnesota's concurrent causation doctrine to overcome exclusions for (1) employee-caused loss, (2) the theft of confidential information exclusion, and (3) the mechanical breakdown or deterioration of a computer system.[292] The doctrine of concurrent causation allows an insured to recover when the overriding cause of the loss is not excluded even though an excluded cause may also have contributed to the loss.[293] The court found that the bond did not impose a higher standard. The parties did not contract for the concurrent causation doctrine not to apply.[294]

3. Authorized User or Transfer Exclusion

In *Pestmaster Services, Inc. v. Travelers Casualty & Surety Co. of America*,[295] the insured authorized its payroll service, Priority 1, to make ACH transfers from Pestmaster's account to Priority 1's account and process the

285. 656 F. App'x 332 (9th Cir. 2016).
286. *Apache Corp.*, 2016 WL 6090901, at *4, *6.
287. *Id.* at *6.
288. *Id.* at *7.
289. 823 F.3d 456 (8th Cir. 2016).
290. *Id.* at 457–59.
291. *Id.* at 457.
292. *Id.* at 458.
293. *Id.* at 459.
294. *Id.* at 460.
295. 656 F. App'x 332 (9th Cir. 2016).

payroll, including taxes.[296] It turned out that Priority 1 was not paying the taxes.[297] The Ninth Circuit affirmed the ruling of the district court that there was no funds transfer coverage because the transfers were expressly authorized.[298] There was also no computer crime coverage because the policy covered only loss "directly caused by the use of a computer to fraudulently cause a transfer of funds."[299] No such loss occurred. The court explained:

> We interpret the phrase "fraudulently cause a transfer" to require an unauthorized transfer of funds. When Priority 1 transferred funds pursuant to authorization from Pestmaster, the transfer was not fraudulently caused. Because computers are used in almost every business transaction, reading this provision to cover all transfers that involve both a computer and fraud at some point in the transaction would convert this Crime Policy into a "General Fraud" Policy.[300]

In *Southern California Counseling Center v. Great American Insurance Co.*,[301] the insured regularly made ACH transfers to its payroll service, Ben Franklin Payroll Service, for payment of payroll taxes.[302] Rather than pay the taxes, Franklin converted the funds.[303] The Ninth Circuit affirmed the ruling of the district court that there was no coverage. The policy excluded loss caused by the dishonest acts of "authorized representatives."[304] Franklin was the insured's "authorized representative" within the plain meaning of that term.[305] The purpose of this provision was to put the risk of loss as a result of the conduct of anyone the insured appointed to such a position on the insured.[306] That Franklin was not an incorporated or registered business did not matter to the court's ruling because the insured had entered into the agreements with Franklin, which had been performing the payroll service, at least partially for a time.[307]

296. Pestmaster Servs. Inc. v. Travelers Cas. & Sur. Co. of Am., No. CV 13-5039-JFW (MRWx), 2014 WL 3844627, at *1–2 (C.D. Cal. July 17, 2014).
297. *Id.* at *2.
298. *Pestmaster*, 656 F. App'x at 333.
299. *Id.*
300. *Id.* The Ninth Circuit did reverse in part, with respect to whether a couple of unauthorized transfers were covered, but these were small. *Id.*
301. No. 14-56169, 2016 WL 3545350 (9th Cir. June 28, 2016), *aff'g*, 162 F. Supp. 3d 1045 (C.D. Cal. 2014).
302. *S. Cal. Counseling Ctr.*, 162 F. Supp. 3d at 1048-49.
303. *Id.* at 1049.
304. *S. Cal. Counseling Ctr.*, 2016 WL 3545350, at *1.
305. *Id.*
306. *Id.*
307. *Id.*

In *Aqua Star (USA) Corp. v Travelers Casualty & Surety Co. of America*,[308] a hacker sent email to Aqua Star that "spoofed" the vendor's authentic email, inducing Aqua Star to change the bank account information for future payments to the vendor.[309] After discovering its payments went to the hacker's account, Aqua Star sought coverage under its crime policy. The court applied Exclusion G, which barred coverage for "loss resulting directly or indirectly from the input of Electronic Data by a natural person having the authority to enter the Insured's Computer System."[310] Here, an authorized user entered electronic data into Aqua Star's system and Aqua Star used that data to transfer funds to the hacker instead of the vendor.[311] "Because an indirect cause of the loss was the entry of Electronic Data into Aqua Star's Computer System by someone with authority to enter the system, Exclusion G applies."[312] Aqua Star has appealed to the Ninth Circuit.

D. *Discovery of Loss*

In *Construction Contractors Employer Group, LLC v. Federal Insurance Co.*,[313] the insured purchased an employee theft policy after discovering an embezzlement by an employee. The policy included a "loss discovered" exclusion for any loss that the insured was aware of before the inception date of the policy.[314] After policy inception, the insured discovered that the same employee had embezzled additional sums.[315] The U.S. District Court of the Northern District of Ohio entered summary judgment for the insurer. The policy defined all loss caused by a single employee as a single loss. The insured thus was aware of its loss prior to the policy's inception date and the "loss discovered" exclusion applied.[316] On appeal, the Sixth Circuit affirmed.[317] Discovery of loss does not occur until the insured discovers facts showing that dishonest acts occurred and appreciates the significance of those facts.[318] Nevertheless, the same employee committed both the initial theft and the additional theft. Both thefts thus were a single loss under the policy that had been discovered before the policy went into effect.[319] The single loss provision expressly referred

308. No. C14-1368RSL, 2016 WL 3655265 (W.D. Wash. July 8, 2016), *appeal filed*, No. 16-35614 (9th Cir. Aug. 1, 2016).
309. *Id.* at *1.
310. *Id.* at *2.
311. *Id.* at *2–3.
312. *Id.* at *3.
313. No. 3:14 CV 1468, 2015 WL 6964584 (N.D. Ohio Nov. 10, 2015).
314. *Id.* at *3.
315. *Id.* at *4.
316. *Id.* at *5.
317. 829 F.3d 449 (6th Cir. 2016).
318. *Id.* at 453–54.
319. *Id.* at 454.

to the prior loss coverage, which did not apply to loss discovered before the policy period.[320]

E. *Prior Insurance*

In *Emcor Group, Inc. v. Great American Insurance Co.*,[321] the insured's employee committed fraud from 1999 to 2003. Great American issued separate crime policies to the insured from 2002 to 2005, although a different insurer issued the earlier policies.[322] Great American's 2004 policy covered loss sustained "during the period of any prior insurance," if the prior insurance would have covered the loss had it been discovered at the time and only if "this insurance became effective at the time of cancellation or termination of the prior insurance."[323] The district court found that the 2004 policy covered only loss from acts occurring during the 2004 policy period and the immediately preceding 2003 policy period.[324] The insured appealed, contending "any prior insurance" unambiguously referred to all prior commercial crime policies, including those issued by other insurers, as long as commercial crime coverage was maintained continuously.[325] The Fourth Circuit disagreed, finding the clause unambiguously limited any coverage of events occurring before the 2004 period to the 2003 period.[326] The clause's reference to "this insurance" referred only to the 2004 policy.[327]

F. *Termination as to Employee*

National Credit Union v. Cumis Insurance Society, Inc.[328] examined whether the directors or officers of the insured credit union discovered an employee's dishonesty before the bond incepted such that coverage as to that employee never became effective. The employee both falsified loan applications and manipulated the loan delinquency rate.[329] He reported *no* loans were delinquent; this was far from true. The court did not agree that the directors and officers had to be aware not just of the fact of dishonesty, but also appreciate its significance.[330] That the employee suddenly began reporting zero delinquencies could not be ignored.[331] One director admitted that the board never got a straight answer when it questioned

320. *Id.* at 454–55.
321. 636 F. App'x 189 (4th Cir. 2016).
322. *Id.* at 190.
323. *Id.* at 191.
324. *Id.* at 191–92.
325. *Id.* at 192.
326. *Id.* at 192–93.
327. Emcor Group, Inc. v. Great Am. Ins. Co., 636 F. App'x 189, 193 (4th Cir. 2016).
328. No. 1:11 CV 1739, 2016 WL 165379 (N.D. Ohio Jan. 14, 2016).
329. *Id.* at *4.
330. *Id.* at *16.
331. *Id.*

the employee about such a remarkable turnaround.[332] The court concluded that there was no coverage because a director or officer of the insured learned of the employee's dishonesty before the bond incepted.

G. *Owned or Covered Property Requirement*

In *Cooper Industries, Ltd. v. National Union Fire Insurance Co. of Pittsburgh, Pa.*,[333] two people posing as securities fund managers induced the insured to invest $175 million in a Ponzi scheme. Cooper claimed National Union's commercial crime policy covered its resulting loss of principal, interest, and earnings on the invested funds. The court found that the perpetrators and their investment company were "employees."[334] The trading loss exclusion therefore did not bar coverage, as the losses were caused by theft, not market forces.[335] To the extent Cooper suffered a loss of legitimate earnings, the policy would even have covered that.[336] Cooper's late proof of loss did not prejudice National Union so as to bar recovery either.[337] Nevertheless, the court held in favor of National Union because Cooper did not "own" the lost funds, as the policy expressly required.[338] Cooper had not invested directly in the Ponzi scheme. Cooper had loaned its funds to a broker dealer affiliate, which, in turn, invested the funds.[339] The insured relinquished its ownership of the funds in exchange for the notes.[340] The court rejected Cooper's argument that ERISA and the beneficial ownership doctrine expanded the meaning of "own" as used by the policy.[341]

In *Pfeiffer v. American Alternative Insurance Corp.*,[342] the fire district's insurance policy covered loss caused by the "[f]ailure of any 'employee' to faithfully perform his or her duties as prescribed by law, when such failure has as its direct and immediate result a loss of your covered property."[343] The fire district's tax collector overvalued a property by more than $2 million. To cover her error, she secretly reduced the tax bill for that property by $800,000 without correcting the tax rolls. This caused the fire district to suffer a shortfall in anticipated revenue. The court ruled that the shortfall was a direct loss of "covered property" under

332. *Id.* at *15.
333. No. 4:12-CV-01591, 2016 WL 3405295 (S.D. Tex. June 21, 2016).
334. *Id.* at *6–7.
335. *Id.* at *7.
336. *Id.* at *8–9.
337. *Id.* at *9–10.
338. *Id.* at *6.
339. Cooper Indus., Ltd. v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., No. 4:12-CV-01591, 2016 WL 3405295, at *12 (S.D. Tex. June 21, 2016).
340. *Id.*
341. *Id.* at *13.
342. No. 14-521L, 2016 WL 614663 (D.R.I. Feb. 16, 2016).
343. *Id.* at *1.

the policy.[344] The fire district had a legal obligation to collect the money it needed to fund its budget. The tax collector's failure to fulfill her duty prevented the district from fulfilling its duty.[345]

H. *Number of Losses or Occurrences*

In *Dataflow, Inc. v. Peerless Insurance Co.*,[346] three related insureds sought coverage of an employee's $1.2 million embezzlement under two successive policies issued by the same insurer. The court denied the insurer's motion for reconsideration as to whether the court should use New York's "unfortunate events" test to determine the number of occurrences.[347] This test examines "whether there is a close temporal and spatial relation between the incidents giving rise to injury or loss, and whether the incidents can be viewed as part of the same causal continuum, without intervening agents or factors."[348] The policies defined "occurrence" as a "series of related acts."[349] The "unfortunate events" test was appropriate as "a framework for determining whether separate acts causing the harm are sufficiently related such that they would be considered one occurrence."[350]

I. *Rescission for Material Misrepresentation in Application*

In *Everest National Insurance Co. v. Tri-State Bancshares, Inc.*,[351] Everest sought rescission of the fidelity policy it issued to Tri-State on the basis of misrepresentations in consecutive policy applications prepared and signed by the insured's dishonest employee, Jim Scott. Scott made material misrepresentations in the policy application to conceal his embezzlement of nearly $2 million from the insured.[352] Under the adverse interest exception, however, these were not imputed to Tri-State. "[I]f an agent is acting adversely to his principal and is acting solely for his own benefit or the benefit of another, then the agent's knowledge is not imputed to the principal."[353] "Scott's embezzlement was for his own benefit and was adverse to the interests of Tri-State."[354] The "sole control" exception to this did not apply because Scott did not have sole control; although he held

344. *Id.* at *2.
345. Id.
346. No. 3:11-CV-1127 (LEK/DEP), 2015 WL 6023675 (N.D.N.Y. Oct. 15, 2015), *denying reconsideration of* 2014 WL 4881534 (N.D.N.Y. Sept. 30, 2014).
347. *Id.* at *2–5.
348. *Id.* at *2 (citing Appalachian Ins. Co. v. Gen. Elec. Co., 863 N.E.2d 994, 999 (N.Y. 2007)).
349. *Id.*
350. *Id.* at *5.
351. No. 15-1491, 2016 U.S. Dist. LEXIS 104534 (W.D. La. Aug. 2, 2016).
352. *Id.*
353. *Id.* at *24.
354. *Id.* at *29.

the bank's top position, he was not its alter ego.[355] Everest did not qualify as an innocent third party that should not bear the risk of Scott acting adversely to Tri-State either because the adverse interest exception does not apply in favor of fidelity insurers.[356] Everest also argued that Tri-State was bound by another officer's signatures on the false applications. This officer did not read the application before he signed, but the court found that insufficient to infer the required intent to deceive. There was also no showing that he knew they contained misrepresentations.[357] Everest was not entitled to a summary judgment for rescission.[358]

In *Kurtz v. Liberty Mutual Insurance Co.*,[359] the Ninth Circuit held that the insurer was entitled to rescind its crime policy due to a misrepresentation in the application.[360] The insured, NFE, had falsely responded to the question: "Are proceeds from 1031 transactions held in bank accounts segregated from those of your operating funds?"[361] NFE argued that the question was ambiguous. The Ninth Circuit held, however, that there was only one reasonable interpretation: "[W]hether NFE holds 'proceeds from 1031 transactions' in separate bank accounts from NFE's bank account holding its operating funds."[362] Because the insured's false answer to the question was not obvious from the application itself, the insurer maintained its misrepresentation defenses.[363]

In *Georgia Casualty & Surety Co. v. Valley Wood, Inc.*,[364] the insured made misrepresentations in its application regarding whether the insured was audited by a CPA and required countersignatures on checks.[365] The underwriter testified that if he had known the truth, he would not have issued the policy. The fact that an independent insurance agent had prepared the application, its employees had never seen the questions, and it trusted the agent to fill out the application did not excuse Valley Wood.[366] Accurately completing the application was squarely within the agency relationship between the Valley Wood and the agent.[367] The agent's misrepresentations therefore were imputed to Valley Wood.

355. *Id.* at *34–36.
356. *Id.* at *36–39.
357. Everest Nat'l Ins. Co. v. Tri-State Bancshares, Inc., No. 15-1491, 2016 U.S. Dist. LEXIS 104534, at *39-41 (W.D. La. Aug. 2, 2016).
358. *Id.* at *41–42.
359. No. 14-55931, 2016 WL 4547366 (9th Cir. Aug. 30, 2016).
360. *Id.* at *1.
361. *Id.*
362. *Id.*
363. *Id.* at *2.
364. 783 S.E.2d 441 (Ga. Ct. App. 2016).
365. *Id.* at 796.
366. *Id.* at 443-44.
367. *Id.* at 444.

J. *Claim Handling/Bad Faith*

In *Nilson v. Softmart, Inc.*,[368] Softmart sued its crime insurer, Twin City Fire Insurance Co., for breach of contract and bad faith after Twin City denied Softmart's employee theft claim. On Twin City's motion, the court dismissed the bad faith claims.[369] Twin City conducted a thorough investigation, reviewed many documents, and relied on the recommendation of outside counsel in denying coverage.[370] The court determined that the insurer's coverage determinations were reasonable.[371] Also, given the volume of Softmart's documents and Softmart's delays in furnishing them, the eleven-month investigation was reasonable.[372] Moreover, Twin City also did not act in bad faith in refusing to enter into a tolling agreement because it had no duty to do.[373]

In *Bryant v. Colonial Surety Co.*,[374] the insured's fiduciary defrauded the insured by wire transfer while an ERISA bond was in force.[375] After the bond expired, Colonial reviewed an audit report that disclosed the wire transfer and chose not to renew the bond when it learned a claim would be made.[376] Colonial denied the claim as well, and the insured filed suit.[377] In support of its motion to add a claim for punitive damages, the insured contended that it was unreasonable for Colonial not to renew the bond.[378] The insured also alleged that Colonial's investigation was inadequate.[379] The court denied the insured's motion to add a claim for punitive damages.[380] The bond had already expired when Colonial received the audit report disclosing the wire transfer. Colonial's knowledge did not place it under an obligation to renew the bond.[381] Moreover, evidence that Colonial had the "requisite malice" was lacking.[382] Thus, there was no evidence that Colonial's denial of the claim without further investigation was such an extreme deviation from reasonable claim handling procedures as to warrant a claim of punitive damages.[383]

368. No. 14-2287, 2015 WL 12516792 (E.D. Pa. Oct. 1, 2015).
369. *Id.* at *1.
370. *Id.* at *4.
371. *Id.*
372. *Id.* at *4–5.
373. *Id.* at *5.
374. No. 1:13-cv-298-BLW, 2016 WL 707339 (D. Idaho Feb. 22, 2016).
375. *Id.* at *2.
376. *Id.*
377. *Id.*
378. *Id.* at *2–3.
379. *Id.* at *3.
380. Bryant v. Colonial Sur. Co., No. 1:13-cv-298-BLW, 2016 WL 707339, at *3 (D. Idaho Feb. 22, 2016).
381. *Id.* at *4.
382. *Id.* at *6.
383. *Id.* at *5.