RECENT DEVELOPMENTS IN FIDELITY AND SURETY LAW

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I. SURETY LAW

A. *Performance Bonds*

1. Conditions Precedent

In *Forest Manor, LLC v. Travelers Casualty & Surety Co.*,[1] the Superior Court of Connecticut granted a construction contract surety's motion for summary judgment only in part.[2] The surety argued it was discharged from any obligations under its performance bond because the obligee failed to comply with the conditions precedent of notice, declaration of default, termination, and tender of contract balance, as set forth in paragraph 3.[3] The surety explained the need for these conditions—to give the surety an opportunity to select from the performance options set forth in paragraphs 4, 5, and 6. The court rejected the surety's argument. It found a supposedly

1. Forest Manor, LLC v. Travelers Cas. & Sur. Co., No. UWY-CV-15-6029923-S, 2018 WL 1137580 (Conn. Super. Ct. Jan. 30, 2018).
2. *Id.* at *9.
3. *Id.* at *5.

separate and independent obligation under paragraph 1, which provided that the surety was jointly and severally obligated with the principal to perform the bonded contract. The court concluded that the surety's obligations under paragraph 1 were not subject to the conditions in paragraph 3.[4] The surety thus was liable if the principal was liable, but because principal's liability remained a question of fact, summary judgment as to that issue was denied.[5]

In *Developers Surety & Indemnity Company v. Archer Western Contractors, LLC*,[6] the general contractor defaulted the subcontractor for performance issues and hired a third party to perform corrective work. The general contractor then submitted a claim under the subcontractor's performance bond.[7] The surety denied the claim and asserted that the bond was discharged by the general contractor's retaining the third party before the surety had an opportunity to perform under the bond.[8]

The surety filed a declaratory judgment action seeking a determination that the performance bond had been discharged and the surety had no obligation under the bond.[9] The court found that general contractor's preliminary negotiations with the third party were permissible and the general contractor did not breach its implied duty of good faith and fair dealing by failing to provide documentation of the subcontractor's default.[10] The court granted the general contractor's motion for summary judgment, concluding that the surety breached the bond by not taking one of the required actions under the bond in response to the general contractor's notice of default.[11] Additionally, because the bond states that the surety shall be liable for the cost of remedying the subcontractor's defective work, the surety was liable to the general contractor for both the cost to correct the subcontractor's work and the cost to complete its work.[12]

2. Arbitration

In *Developers Surety and Indemnity Co. v. Carothers Construction, Inc.*,[13] the surety executed performance and payment bonds on behalf of a subcontractor and in favor of a prime contractor as obligee for construction

4. *Id.* at *8–9.
5. *Id.*
6. Developers Sur. & Indem. Co. v. Archer W. Contractors, LLC, No. 6:16-cv-1875-Orl-40KRS, 2018 WL 2100032 (M.D. Fla. May 7, 2018).
7. *Id.* *1–2.
8. *Id.*
9. *Id.* at *1.
10. *Id.* at *8.
11. *Id.* at *9.
12. *Id.*
13. Developers Sur. & Indem. Co. v. Carothers Constr., Inc., No. 17-22292-JWL, 2017 WL 3674975 (D. Kan. Aug. 24, 2017).

projects in Kansas, Georgia, South Carolina, and Connecticut.[14] After the principal defaulted, the prime contractor initiated arbitration against the surety pursuant to a provision in the subcontract.[15] The surety sought a declaratory judgment and injunction against the arbitration.[16]

The bonds did not contain an arbitration provision.[17] However, the obligee argued the bonds incorporated the subcontract and thus the arbitration provision.[18] The court disagreed. Even if the surety agreed to incorporation of the arbitration provision into its bonds, the language of that provision applied only to disputes between the obligee and principal, not disputes with the surety.[19] The court also rejected the obligee's estoppel theories.[20]

3. Attorney Fees Provision

In *Fidelity & Deposit Co. of Maryland v. Big Town Mechanical, LLC*,[21] the United States District Court for the District of Nevada denied a motion by a subcontractor and its surety for partial summary judgment against enforcement of a unilateral attorney fees provision.[22] The project owner contracted with the general contractor, who obtained performance and payment bonds naming the owner as obligee.[23] The general contractor subcontracted with a subcontractor, which provided performance and payment bonds naming the general contractor as obligee.[24] The subcontract between the general contractor and the subcontractor allowed the general contractor to recover attorney fees from the subcontractor, but expressly forbade the subcontractor from recovering attorney fees from the general contractor.[25] Upon default by the contractor and subcontractor, their sureties stepped in. The subcontractor's surety sought to have the court declare the unilateral attorney fees provision void for lack of mutuality of obligation.[26] The court refused to do so; it found that Nevada law allows unilateral attorney fees provisions.[27]

14. *Id.* at *1.
15. *Id.* at *6.
16. *Id.* at *1–2.
17. *Id.* at *9.
18. *Id.*
19. *Id.*
20. *Id.* at *16–17.
21. Fid. & Deposit Co. of Md. v. Big Town Mech., LLC, No. 2:13-cv-00380-JAD-GWF, 2017 WL 5165044 (D. Nev. Nov. 7, 2017).
22. *Id.* at *5.
23. *Id.* at *1.
24. *Id.*
25. *Id.*
26. *Id.* In denying the motion, the court noted that the subcontractor's surety conflated mutuality of obligation with mutuality of remedy and that neither concept entitled it to the declaratory relief it requested. *Id.* at *2.
27. *Id.* at *4.

4. Limitations

In *New Riegel Local School District v. Buehrer Group Architecture & Engineering, Inc.*,[28] the appellate court reversed the dismissal of a suit in favor of a contractor and its surety on the basis of a statute of repose.[29] The owner sued the general contractor, its surety, and its subcontractor more than ten years after completion of the project.[30] The court held that the statute of repose does not apply to breach of contract claims.[31] Neither the general contractor nor its surety was entitled to dismissal.[32] This decision has been appealed to the Ohio Supreme Court.

5. Fraud Claims

In *Hanover Insurance Co. v. United States*,[33] the owner terminated the bonded contractor for default and agreed to the tender of a completing contractor by the bonded contractor's surety. The surety agreed to pay the amount due the completing contractor in excess of the original contract's remaining balance.[34] The bonded contractor contested the termination. After the contractor moved for leave to file an amended complaint, the owner moved for leave to add an affirmative defense and three counterclaims based on fraud.[35] In granting the owner's motion, the court considered the impact any fraud committed by the contractor would have on the surety's subrogation claim, finding that if the owner can assert counterclaims against the contractor, it can also assert them against the surety, at least to the extent the surety asserts subrogation rights.[36] The court also found that the surety could not be liable for any fraud penalties incurred by the contractor.[37] However, because the owner was not able to settle claims under the Contract Disputes Act, to the extent the tender and release agreement between the owner and surety insulated the surety from liability for fraud, whether committed by the contractor or the surety, such release was ineffective.[38]

6. Bad Faith and Liability for Agent's Actions

In *Associated Construction/AP Construction, LLP v. Hanover Insurance Co.*,[39] the surety's agent authorized three separate performance bonds for different

28. New Riegel Local Sch. Dist. v. Buehrer Grp. Architecture & Eng'g, Inc., No. 13-17-03, No. 13-17-06, 2017 WL 5256358 (Ohio Ct. App. Nov. 13, 2017) (consolidated opinion).
29. *Id.* at *4.
30. *Id.* at *1.
31. *Id.* at *3.
32. *Id.* at *4.
33. Hanover Ins. Co. v. United States, 134 Fed. Cl. 51 (2017).
34. *Id.* at 56.
35. *Id.* at 59.
36. *Id.* at 68.
37. *Id.* at 69–70.
38. *Id.* at 70.
39. Associated Constr./AP Constr., LLP v. Hanover Ins. Co., No. 3:15-cv-1600 (MPS), 2018 WL 3998972 (D. Conn. Aug. 21, 2018).

portions of a subcontract agreement in an aggregate amount that exceeded the agent's authority.[40] The agent responded to issues after performance commenced without the surety's knowledge and allegedly made certain representations that the obligee deemed to be false.[41] Claims were brought by the obligee for violations of the state's unfair practices laws, breach of contract, and bad faith.[42] On summary judgment, the court found that the surety's liability was limited to the penal sum of each bond for that bond's portion of the project and that the obligee could not sustain claims against the surety for violations of state unfair practices laws, breach of contract, or bad faith for failing to perform prior to the principal's termination. The principal's termination was a condition precedent to any liability of the surety.[43]

However, the court denied the surety's motion for summary judgment against claims for violation of state unfair practices laws and breach of contract after the termination of the principal. An issue of fact existed as to whether the surety performed in full merely by paying the obligee's replacement subcontractors.[44] The court also rejected the surety's argument that there was no evidence of any actual malice on its part as needed to show bad faith. The surety knew of the agent's history, which it described as a "willingness to play fast and loose with its accounts," yet the surety did not terminate the agent because his business was profitable to the surety.[45]

B. *Payment Bonds*

1. Jurisdiction and Arbitration

In *United States ex rel. Red Hawk Contracting, Inc. v. MSK Construction, Inc.*,[46] a subcontractor brought suit against a prime contractor and its payment bond surety.[47] The prime contractor, citing the arbitration clause in the subcontract, moved to stay the action pursuant to the Federal Arbitration Act ("FAA").[48] In opposition to the prime contractor's motion, the subcontractor argued that the underlying contract did not involve interstate commerce and the arbitration clause was void under a North Carolina forum-selection statute.[49] In the alternative, the subcontractor argued that the arbitration clause was void on equitable grounds because the surety

40. *Id.* at *3–6.
41. *Id.* at *7–8.
42. *Id.* at *14–15.
43. *Id.* at *18–21, *45.
44. *Id.* at *18–21, *21–25, *46–48.
45. *Id.* at *40–46.
46. United States *ex rel.* Red Hawk Contracting, Inc. v. MSK Constr., Inc., No. 1:16CV1183, 2018 WL 2121625 (M.D.N.C. May 8, 2018).
47. *Id.* at *1–2.
48. *Id.* at *1, *3–5.
49. *Id.* at *6–7.

was not a party to the subcontract. Requiring separate actions against the prime contractor and its surety would inconvenience the subcontractor.[50] The court determined that the subcontract was governed by the FAA. The prime contractor's business had a "multistate nature" because it required the prime contractor, a South Carolina corporation, to make payments to the subcontractor, a North Carolina corporation, at the subcontractor's location in North Carolina.[51] The court then determined that the FAA preempted the North Carolina forum-selection statute, which was not intended to apply to arbitration agreements governed by the FAA.[52] The court lastly determined that, although the subcontractor's inconvenience was insufficient to void the arbitration clause, considerations of judicial economy were sufficient to stay the entire proceeding, including the subcontractor's claim against the surety.[53] As a result, the court granted the prime contractor's motion to stay the action pending arbitration under the subcontract.[54]

2. Procedural Disputes

In *Johnson Marcraft, Inc. v. Western Surety Co.*,[55] a dispute arose between a subcontractor and its supplier regarding performance under a purchase order.[56] The supplier brought suit against the subcontractor's payment bond surety, which then asserted a third-party indemnity claim against the subcontractor.[57] The supplier first moved to sanction the surety by barring it from asserting a choice-of-law defense because the surety had failed to disclose that defense in response to an interrogatory and court order.[58] The supplier next moved to enforce a settlement agreement between it and the subcontractor, arguing that mutual asset was evidenced by correspondence from the subcontractor's attorney agreeing to proposed language preserving the supplier's claims against the surety.[59] The supplier lastly moved for partial summary judgment on the existence of the purchase order, arguing that submittals signed by the subcontractor constituted an enforceable contract.[60] In opposition to the supplier's motions, the surety argued that sanctions were inappropriate because its failure to disclose the

50. *Id.* at *7.
51. *Id.* at *9–10.
52. *Id.* at *10–11 (citing N.C. Gen. Stat. § 22B-2).
53. *Id.* at *11–14.
54. *Id.* at *12, *14–15.
55. Johnson Marcraft, Inc. v. W. Sur. Co., No. 3:15-1482, 2018 WL 1089685 (M.D. Tenn. Feb. 28, 2018), *adopted by* 2018 WL 3491219 (M.D. Tenn. July 19, 2018).
56. *Id.* at *3.
57. *Id.* at *12, *32–33.
58. *Id.* at *4–5.
59. *Id.* at *2, *12, *17–18.
60. *Id.* at *23–25, *28.

choice-of-law defense was not prejudicial to the supplier, whereas the subcontractor disputed whether correspondence between it and the supplier was sufficient to evidence mutual asset, particularly when the proposed language would subject it to additional liability.[61] The court granted the supplier's motion for sanctions. The surety had violated the court's "clear and unambiguous" instruction and otherwise prejudiced the supplier by raising a choice-of-law defense after discovery had closed.[62] The court next granted the supplier's motion to enforce the settlement agreement, explaining that the correspondence between the supplier and subcontractor evidenced "unequivocal acceptance" sufficient to form a contract.[63] The court rejected the subcontractor's liability argument, emphasizing that mistake of law was insufficient to rescind a contract.[64] The court lastly granted the supplier's motion for summary judgment, explaining that the surety had failed to file a response and could not rely on the subcontractor's opposition, which had been resolved under the settlement agreement.[65]

3. Venue

In *Consolidated Pipe & Supply Co., v. Ohio Casualty Insurance Co.*,[66] a supplier petitioned the Alabama Supreme Court for a writ of mandamus vacating a trial court order transferring venue.[67] The supplier argued the forum-selection clause of the bonded contract required the action remain in the original forum.[68] In opposition, the prime contractor and its surety argued that the forum-selection clause was irrelevant because the contract's definition of "claimant" did not include the supplier; it could not "assert a materialman's or mechanic's lien" as the contract required.[69] The court rejected this interpretation. The bonded contract's definition of claimant was not intended to prevent suppliers from asserting claims.[70] The court granted a writ of mandamus directing the trial court to vacate its order transferring venue.[71]

In *Long Painting Co. v. General Electric Co.*,[72] a subcontractor brought suit against a prime contractor in federal district court pursuant to the

61. *Id.* at *7–8, *18–22.
62. *Id.* at *8–11.
63. *Id.* at *18–19.
64. *Id.* at *20, *22–23.
65. *Id.* at *26–27, *29, *31–32.
66. Consol. Pipe & Supply Co., v. Ohio Cas. Ins. Co., No. 1170050, 2018 WL 3083719 (Ala. June 22, 2018).
67. *Id.* at *1, *4.
68. *Id.* at *8–9.
69. *Id.* at *9–10.
70. *Id.* at *11.
71. *Id.* at *13.
72. Long Painting Co. v. Gen. Elec. Co., No. 17-cv-9975 (KBF), 2018 U.S. Dist. LEXIS 128171 (S.D.N.Y. July 31, 2018).

subcontract's forum-selection clause.[73] The subcontractor moved for leave to file an amended complaint adding the prime contractor's payment bond surety as a party.[74] The court denied the motion as futile. Washington law required the subcontractor to sue the surety "in the county where the lien was filed."[75] The subcontract's forum-selection clause did not waive this because the surety was not a party to that contract.[76]

4. Notice

In *Bear Industries, Inc., v. Hanover Insurance Co.*,[77] a supplier filed suit against the subcontractor, general contractor, and surety under the Louisiana Private Works Act (the "Act").[78] The Act has specific notice provisions and grants certain rights to enumerated persons to facilitate recovery of the costs of their work from an owner with whom they lack privity of contract.[79] The appellate court concluded that the supplier had substantially complied with the form of the notice and no "actual prejudice [was caused] by a claimant or other person acquiring rights in the immovable [property]."[80] Thus, the supplier's statement of claims and privileges was timely filed because the notice of contract was timely filed.[81] Moreover, the appellate court held that the Act did not require the supplier to provide notice of nonpayment to the property owner at least ten days before filing statement of claim because the construction project was for commercial purposes rather than residential.[82] In addition, the court found that the principal's "pay if paid" defense was unavailable to the surety. Allowing the surety to assert this would render the protections afforded to suppliers in the Act meaningless.[83] The court also ruled that the surety was not entitled to assert a provision in the underlying contracts stating that the supplier's failure to notify the general contractor of the subcontractor's failure to pay an invoice within 60 days would constitute waiver of any liens, rights, or rights of collection against the general contractor.[84]

5. Limitations

In *Valley View School District 365-U ex rel. IBEW Local 176 Health, Welfare, Pension, Vacation & Training Trust Fund Trustees v. Hartford Fire Insurance*

73. *Id.* at *1–2.
74. *Id.*
75. *Id.* at *3 (citing RCW § 60.28.030).
76. *Id.*
77. Bear Indus, Inc., v. Hanover Ins. Co., 241 So.3d 1159 (La. Ct. App. 2018).
78. *Id.* at 1161–62.
79. *Id.* at 1162.
80. *Id.* at 1164.
81. *Id.*
82. *Id.* at 1165.
83. *Id.*
84. *Id.*

Co.,[85] the surety issued performance and payment bonds on behalf of a subcontractor in connection with three school renovation projects.[86] The payment bond included a one-year period of limitations, and the performance bond included a two-year period of limitations.[87] Nearly two years after the last work was performed on the projects, the school district sued the surety on both bonds, on behalf of an electricians' union. The school district alleged the subcontractor failed to make certain payments on behalf of union members working for it.[88] The surety argued the payment bond claim was time-barred and the school district lacked standing to sue on behalf of the union against the performance bond.[89] The trial court granted summary judgment to the school district on the basis it did have standing to sue for the union on the performance bond.[90] The surety appealed.[91]

The appellate court found that remittances to the union were properly characterized as "performance" under the subcontract, so the school district's suit was timely under the performance bond's two-year period of limitations.[92] The court also found that the school district, as an express obligee, had standing to enforce the subcontractor's performance obligation to pay the union.[93] Finally, the court found that the school district sufficiently established its damages by affidavit.[94]

In *Trustees of the New York City District Council of Carpenters Pension Fund v. Arch Insurance Co.*,[95] employee organizations brought suit on behalf of individual member subcontractors against a prime contractor's payment bond surety in New York.[96] The employee organizations moved for summary judgment.[97] In opposition, the surety argued that most of the claims were untimely, because the statute of limitations began to run on each member subcontractor's claims when he or she last worked on the bonded project.[98] The surety also argued that the employee organizations' reliance on certified payroll records was insufficient to demonstrate that

85. Valley View School District 365-U *ex rel.* IBEW Local 176 Health, Welfare, Pension, Vacation & Training Trust Fund Trs. v. Hartford Fire Ins. Co., No. 3-15-0477, 2018 WL 3031614, at *2 (Ill. Ct. App. June 18, 2018).
86. *Id.* at *2.
87. *Id.* at *3–4.
88. *Id.* at *4–5.
89. *Id.* at *5.
90. *Id.* at *6.
91. *Id.* at *7.
92. *Id.* at *13.
93. *Id.* at *15.
94. *Id.* at *19.
95. Trs. of the New York City Dist.Council of Carpenters Pension Fund v. Arch Ins. Co., No. 162642, 2018 N.Y. Misc. LEXIS 1128, 2018 NY Slip Op 30578(U) (Sup. Ct. Apr. 2, 2018).
96. *Id.* at *1–2.
97. *Id.* at *1.
98. *Id.* at *1–2 (citing N.Y. Lab. Law § 220-g).

their member subcontractors actually worked on the bonded project.[99] The court rejected the surety's arguments, explaining that the employee organizations' claims were not untimely. The statute of limitations began to run when the organization as a whole last worked on the bonded project.[100] The court further explained that certified payroll records were sufficient to establish that the employee organizations' member subcontractors worked on the bonded project. Such records "are subject to the penalties of perjury and are required in New York."[101]

In *Fisk Electric Co. v. DQSI, L.L.C.*,[102] an electrical subcontractor sought to recover damages due to a 464-day delay on a United States Army Corps of Engineers ("Corps") project. The subcontractor contended its contract authorized such damages.[103] In reviewing the unsigned bilateral modifications between the contractor and the Corps and the contractor's Request for Equitable Adjustment ("REA"), the subcontractor observed that the adjustment granted to the contractor contained a provision stating that the approved adjustment constituted settlement in full of all claims, including those of the contractor's subcontractors and suppliers.[104] The subcontractor believed it was foreclosed from seeking compensation from the Corps; however, in subsequent negotiations, the contractor allegedly represented that the subcontractor's claims were still viable with the Corps.[105] The general contractor and subcontractor then reached a settlement under which the contractor agreed to submit the subcontractor's REA to the Corps and the subcontractor agreed to release the contractor of all claims.[106] Thereafter, the Corps rejected the subcontractor's REA stating that it settled all claims with the contractor.[107]

The subcontractor filed suit alleging that the contractor fraudulently induced it into releasing its Miller Act claims.[108] The trial court granted summary judgment in favor of the general contractor, concluding that the subcontractor could not prove a necessary element of a state law based fraudulent-inducement claim, i.e., justifiable reliance.[109] On appeal, the Fifth Circuit concluded that federal contract law applied, and that "fraudulent inducement does not require active investigation to demonstrate justifiable

99. *Id.* at *3–4.
100. *Id.* at *2 (citing N.Y. Lab. Law § 220-g).
101. *Id.* at *4 (citing N.Y. Lab. Law § 220(3-a)(a)(iii)).
102. Fisk Elec. Co. v. DQSI, L.L.C., 894 F.3d 645 (5th Cir. 2018).
103. *Id.* at 647.
104. *Id.*
105. *Id.*
106. *Id.*
107. *Id.* at 649.
108. *Id.* at 647.
109. *Id.* at 650.

reliance."[110] The court held that, although the subcontractor might have ascertained the falsity of the representation had it made an investigation, federal law, nevertheless, dictated that justifiable reliance does not impose a duty of active investigation on a plaintiff.[111] Thus, there was a genuine issue of material fact as to justifiable reliance.[112] Even though the subcontractor could have investigated whether the unsigned contract modifications represented finalized, binding documents, the subcontractor could have been entitled to justifiably rely on the representations made by the general contractor that settlement negotiations were ongoing with the Corps.[113]

6. Proper Claimant

In *BT Granite Run, LP v. Bondex Insurance Co.*,[114] an owner contracted with a contractor for the demolition of a shopping mall.[115] The surety executed performance and payment bonds on behalf of the contractor. After the contractor defaulted, the owner sued the contractor and surety.[116] The owner asserted claims against the surety for breach of the bonds.[117] The surety moved for summary judgment on the claim against the payment bond because the owner was not a permissible claimant under the terms of that bond.[118] The court noted that although by the terms of the payment bond the owner was not a claimant, an exception existed "for payments actually made to claimants which were compelled by the filing of mechanic's liens."[119] Because the owner submitted evidence showing that it made payments to subcontractors as a result of mechanic's liens, the court denied the surety's motion for summary judgment.[120]

7. Principal's Defenses

In *United States ex rel. American Combustion Industries, Inc. v. Hartford Accident & Indemnity Co.*,[121] a subcontractor filed suit against the contractor's surety on a Miller Act payment bond issued on a project for the United

110. *Id.* at 652.
111. *Id.*
112. *Id.* at 654.
113. *Id.* at 653–54.
114. BT Granite Run, LP v. Bondex Ins. Co., No. 17-1584, 2017 WL 4642090 (E.D. Pa. Oct. 17, 2017).
115. *Id.* at *1.
116. *Id.*
117. *Id.*
118. *Id.* at *2.
119. *Id.* at *3.
120. *Id.*
121. United States *ex rel.* Am. Combustion Indus., Inc. v. Hartford Accident & Indem. Co., No. 3:13-CV-0865, 2017 WL 5971833 (M.D. Pa. Dec. 1, 2017).

States Army Corps of Engineers.[122] The subcontractor's claims related to change order work the Corps refused to pay for.[123] The contractor filed a notice of appeal with the Armed Services Board of Contract Appeals ("ABSCA").[124] The surety moved to stay the payment bond suit pending a decision by ABSCA.[125] The court subjected the motion to a four-factor test: "(1) the length of the requested stay; (2) the hardship or inequity that the movant would face in going forward with the litigation; (3) the injury that a stay would inflict upon the non-movant; and (4) whether a stay would simplify issues and promote judicial economy."[126] The court found that the stay sought by the surety was for an indefinite duration, which is disfavored.[127] Second, a substantial portion of the subcontractor's claims were not limited to the claims on appeal to ABSCA.[128] Third, a stay would likely injure the subcontractor because the claims related to events that occurred six or seven years ago; further delays could be prejudicial.[129] Finally, while there may be some judicial economy by allowing the ABSCA to proceed first, that benefit was minimal because a substantial portion of the change orders at issue in the suit were not subject to the ABSCA process.[130] The court concluded: "Subcontractors need not await the completion of the dispute resolution proceedings between the Government and the Prime Contractor before the Subcontractor can show an amount due under the Miller Act, and accordingly, it would be inappropriate to enter another stay in this case."[131]

In *JSI Communications v. Travelers Casualty & Surety Co. of America*,[132] a second-tier subcontractor asserted claims against the prime contractor principal and its surety under their payment bond. The surety denied the claim on the basis its principal had been released in an interpleader action.[133] The subcontractor sued the surety on the bond and for bad faith.[134] The trial court granted summary judgment in favor of the surety. This was reversed on appeal. The release of the general contractor had "no

122. *Id.* at *1.
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* at *2.
127. *Id.*
128. *Id.*
129. *Id.* at *3.
130. *Id.*
131. *Id.* (citing United States ex rel. Kitchens to Go v. John C. Grimberg Co., Inc., 283 F.Supp.3d 476, 488 (E.D. Va. 2017)).
132. JSI Commc'ns v. Travelers Cas. & Sur. Co. of Am., 717 F. App'x 382, 384 (5th Cir. 2017).
133. *Id.*
134. *Id.* at 385.

effect on [the subcontractor's] ability to recover under the Bond" and any "funds relating to the general contractor's bond obligation (and that of [the surety]) were clearly not included in the interpleader action."[135] However, the appellate court upheld dismissal of the bad faith claim. Mississippi law had not yet addressed the effects of an interpleader action that released a principal and arguably therefore also its surety from liability.[136]

In *Pinnacle Crushing & Construction LLC v. Hartford Fire Insurance Co.*,[137] the United States Army Corps of Engineers terminated the prime contractor.[138] The prime contractor disputed the termination and submitted its claims under the Contracts Dispute Act, which included the claims of its subcontractors.[139] The subcontractors filed suit against the prime contractor and the surety under the Miller Act for nonpayment.[140] The general contractor and surety moved to dismiss or stay the subcontractors' claims pending a determination of the pending claims arguing that the sub-tier claims were not ripe.[141]

The court found that the subcontractors' claims were ripe because they alleged a specific injury in fact—the subcontractors were owed money for completed work on the project.[142] The court also held that the subcontractors did not waive their Miller Act rights because such rights can only be waived by a sufficiently clear or explicit writing signed by the parties after the subcontractor has furnished labor or material.[143] The contractor and surety also argued that pursuant to the subcontracts any Miller Act remedies were stayed until disputes between the general contractor and the Corps were resolved.[144] The court rejected this argument and reasoned that, even though the disputes would undoubtedly result in some duplication, the "risk of inconsistent results between that process and this litigation is a risk that the prime contractor must bear—transferring the risk of nonpayment for work performed from the subcontractor to the prime contractor is one of the purposes of the Miller Act."[145] Moreover, the court held that staying the subcontractors' claims, particularly where the respective subcontracts purport to bind the subcontractors to

135. *Id.*
136. *Id.* at 388.
137. Pinnacle Crushing & Constr. LLC v. Hartford Fire Ins. Co., No. C17-1908JLR, 2018 WL 1907569 (W.D. Wash. Apr. 23, 2018).
138. *Id.* at *2.
139. *Id.*
140. *Id.*
141. *Id.*
142. *Id.* at *3.
143. *Id.*
144. *Id.* at *5.
145. *Id.*

the outcome between the general contractor and the Corps—would be prejudicial.[146]

8. Damages

In *United States ex rel. Kitchens To Go, LLC v. John C. Grimberg Co.*,[147] the principal, as prime contractor, entered into a contract with the United States Department of the Navy to construct improvements at the FBI Academy.[148] The principal entered into a subcontract with an entity to supply temporary kitchen facilities.[149] The subcontract included a no-damages-for-delay clause, under which the principal was not liable for delays beyond its control and the subcontractor was "entitled only to reimbursement for any damages for delay actually recovered from the Owner."[150] Because of start delays and other extensions, the subcontractor was required to remain at the project for approximately fifteen months longer than originally required.[151]

The subcontractor submitted to the principal an application for payment that included $607,221 for extended rental of the kitchen facilities.[152] After the application for payment was rejected, the subcontractor sued the principal and its surety.[153] The subcontractor moved for summary judgment against the surety on the extended rental claims.[154] The surety argued that the no-damages-for-delay provision of the subcontract precluded the subcontractor's entitlement to recovery. The court found that the no-damages-for-delay clause "contravenes the text and purpose of the Miller Act because, like pay-when-paid or pay-if-paid clauses, [the] no-damages-for-delay clause affects both the timing and the right of recovery."[155] Therefore, "the Surety may not rely on the no-damages-for-delay clause in the Subcontract as a defense to Miller Act liability on the payment bond[.]"[156]

In *Boneso Brothers Construction, Inc. v. Sauer, Inc.*,[157] the subcontractor entered into a subcontract with a subsidiary corporation of the prime

146. *Id.* at *6.
147. United States *ex rel.* Kitchens to Go, LLC v. John C. Grimberg Co., 283 F.Supp.3d 476 (E.D. Va. 2017).
148. *Id.* at 478–79.
149. *Id.*
150. *Id.* at 479.
151. *Id.*
152. *Id.* at 480.
153. *Id.*
154. *Id.*.
155. *Id.* at 485.
156. *Id.*
157. Boneso Bros. Constr., Inc. v. Sauer, Inc., No. 17-CV-02608-LHK, 2018 WL 2387833 (N.D. Cal. May 25, 2018).

contractor to perform plumbing and HVAC services.[158] The subsidiary defaulted and the subcontractor filed suit against the prime contractor's surety.[159] The subcontractor argued that "pursuant to the Payment Bond, [the surety] and [the subsidiary corporation] are jointly and severally liable for the damages sustained by [the subcontractor]."[160] The subcontractor also asserted that the Miller Act payment bond incorporated by reference the subcontract.[161] The court disagreed; "at the very most, the payment bond's joint and several liability clause [made the surety] jointly and severally liable for damages caused by [the prime contractor]—the entity that is listed as the 'Principal' in the payment bond—and not for damages caused by [the prime contractor's subsidiary corporation]."[162] Further, the court found that the language in the payment bond only made the surety potentially liable to "all persons having a direct relationship" with the prime contractor, and only for any "unpaid labor or material furnished by those persons" for the project.[163] Because of the express language contained in the payment bond, the surety was not liable for any damages beyond those that stem from unpaid labor or material.[164]

9. Material Alteration

In *T. Mina Supply, Inc. v. Clemente Brothers Contracting Corp.*,[165] the surety executed two payment bonds on behalf of its principal, for the benefit of an owner obligee.[166] The principal had entered into two requirements contracts with the obligee.[167] The duration of each contract was one year, but the obligee extended the duration of each contract without the consent of the surety.[168]

A subcontractor of the principal filed suit and moved for summary judgment on its payment bond claim against the surety.[169] The court denied the motion, finding that the obligee and principal "materially altered the terms of [the contracts] by substantially increasing the scope of the work to be performed."[170] The court also found that "a surety is not liable on a

158. *Id.* at *2.
159. *Id.* at *4.
160. *Id.* (citations omitted).
161. *Id.*
162. *Id.* at *5.
163. *Id.*
164. *Id.*
165. T. Mina Supply, Inc. v. Clemente Bros. Contracting Corp., 139 A.D.3d 1040 (N.Y. App. Div. 2016).
166. *Id.* at 1041.
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*

payment bond where the underlying contract has been materially altered without the surety's consent."[171]

C. *Other Bonds*

1. Probate Bond

In *Estate of Gladstone*,[172] the court reversed an award of punitive damages against the surety on a conservator's bond. The surety did not contest the payment of its penal sum because of the principal's unauthorized use of funds. The sole issue before the court was the surety's additional exposure to punitive damages, for which the probate court had found the surety and principal jointly and severally liable. The court held that a probate bond surety is not liable for punitive damages for the acts of its principal because the bond only covers the loss of bonded assets caused by the principal's breach of its fiduciary duty. The court reasoned that because the bond is based on the value of the estate's property, the legislature intended to cover only actual damages and punitive damages are not available against the surety. If the legislature intended the surety to be jointly liable for punitive damages, the statute must expressly say so, which it did not.

In *Cain v. Panitch*,[173] beneficiaries of a decedent's estate brought claims for fraud and conversion against the executor and her surety nine and a half years after the final account had been approved and the estate file closed.[174] The court found that the four-year statute of limitations barred the claims against the executor.[175] The beneficiaries argued that the ten-year statute of limitations on the statutory bond applied to the surety.[176] The court held that the surety's liability is no greater than the principal's, and the surety is entitled to plead defenses available to the principal.[177] Since the principal was not liable under the statute of limitations for fraud and conversion, the surety was not liable.[178]

2. Subdivision Bond

In *Lexon Ins. Co. v. City of Cape Coral*,[179] the principal defaulted on a contract to construct a subdivision. Three years later, the city made a claim on the surety under its subdivision bond but failed to provide the surety with any information supporting its claim.[180] Two years after that, the city filed a

171. *Id.*
172. Estate of Gladstone, 814 S.E.2d 1 (Ga. 2018).
173. Cain v. Panitch, No. 16AP-758, 2018 WL 1953116 (Ohio Ct. App. Apr. 24, 2018).
174. *Id.* ¶¶10, 13.
175. *Id.* ¶¶47–50.
176. *Id.* ¶52.
177. *Id.* ¶54.
178. *Id.* ¶56.
179. Lexon Ins. Co. v. City of Cape Coral, 238 So.3d 356 (Fla. Dist. Ct. App. 2017).
180. *Id.* at 357–58.

lawsuit against the surety and then assigned its claim to a new developer.[181] The surety defended on the grounds that the claim was barred by the five-year statute of limitations.[182] The new developer argued that the cause of action accrued when the city made the demand and the surety did not pay the claim.[183] The court of appeals held the suit was time-barred. Unlike insurance, the cause of action on a surety bond accrues when the principal breaches its duty, not when the obligee makes its claim or the surety denies it.[184]

3. Mechanics Lien Release

In *Gray Construction, Inc. v. Envirotech Construction Corp.*,[185] a prime contractor terminated a subcontract for default, withheld payment, and completed the subcontractor's work itself.[186] The subcontractor liened the project but the prime contractor released that lien by recording a lien-release bond.[187] The prime contractor then brought suit against the subcontractor for breach of contract and declaratory relief.[188] The subcontractor asserted counterclaims and a third-party complaint against the lien-release bond surety and the owner.[189] The court denied the subcontractor's motion for leave to file the third-party complaint. The relief that complaint sought did not satisfy Federal Rule of Civil Procedure 14(a) because it failed to transfer liability "for all or part" of the prime contractor's claim against the subcontractor.[190]

4. Supersedeas Bond

In *McFadin v. Broadway Coffeehouse, LLC*,[191] judgment was entered against a trustee, who filed an appeal. The appeal failed, and the trustee paid the money damages that had been awarded in the trial court. The trial court nevertheless also ordered the trustee's supersedeas bond surety to surrender the entire amount of the bond.[192] The trustee and surety appealed, claiming that the plaintiff had not suffered damages from the appeal and the bond should not be surrendered. The court of appeals dismissed the

181. *Id.* at 358.
182. *Id.*
183. *Id.* at 359.
184. *Id.* at 359–60.
185. Gray Constr., Inc. v. Envirotech Constr. Corp., No. 5:17-484-DCR, 2018 WL 1875478 (E.D. Ky. Apr. 19, 2018).
186. *Id.* at *2.
187. *Id.*
188. *Id.* at *2–3.
189. *Id.* at *3.
190. *Id.* at *4–5.
191. McFadin v. Broadway Coffeehouse, LLC, 539 S.W.3d 278 (Tex. 2018).
192. *Id.* at 281.

appeal for lack of a final appealable order.[193] The supreme court reversed, holding that although typically an order to pay on a supersedeas bond is not a final appealable order, when the order to pay goes outside the provisions of the judgment, it does become final and appealable. Moreover, since the order to pay went outside the provisions of the judgment, the surety was not liable.[194]

5. Trustee's Bond

In *Martinec v. Smith (In re IFS Finance. Corp.)*,[195] the Chapter 7 trustee was removed and a claim was brought against his surety for misappropriated funds.[196] The surety defended on the basis that the two-year statute of limitations had elapsed.[197] The court found that the statute of limitations had not elapsed because the statute did not begin to run until the trustee was "discharged," which was not the same as "removed."[198] In a second decision,[199] the court addressed the fact that the surety had issued a series of bonds. The court held that the surety was only liable on the bond issued for the year in which the breach of duty occurred.[200] Also, the last bond, unlike the earlier bonds, did not contain a limit per case but rather an aggregate limit.[201] The surety could be liable up to the amount of that limit.[202]

D. *Rights of Surety*

1. Indemnity

The surety in *In re Todd*,[203] objected to the debtor's claim under New York Civil Practice Law and Rules § 5205(c) that the proceeds from an IRA she inherited from her mother was exempt from judgment.[204] The court held that the inherited IRA was not exempt.[205] Moreover, the inherited IRA did not qualify for exemption under 26 USCS § 408. The term "qualified" under § 408 "should be read in a manner consistent with the statute's purpose—to include only accounts which receive the same tax treatment as

193. *Id.* at 282.
194. *Id.* at 284–85.
195. Martinec v. Smith (*In re* IFS Fin. Corp.), 580 B.R. 483 (S.D. Tex. 2017).
196. *Id.* at 484.
197. *Id.*
198. *Id.* at 486–87.
199. Martinec v. Smith (*In re* IFS Fin. Corp.), No. 02-39553, 2018 WL 3201746 (S.D. Tex. 2018).
200. *Id.* at *8–12.
201. *Id.* at *12.
202. *Id.* at *13–14.
203. *In re* Todd, 585 B.R. 297 (Bankr. N.D.N.Y 2018).
204. *Id.*
205. *Id.* at 301.

accounts established by individuals for their retirement, rendering inherited IRAs not exempt."[206]

In re Ikhana, LLC,[207] was an appeal by the principal of a contracting officer's decision to default and terminate a contract. The government and the surety opposed the principal on grounds that the surety, through the assignment granted to it in the indemnity agreement, was the real party in interest. The surety unsuccessfully sought declaratory relief in district court and then tried to intervene in the Armed Services Board of Contract Appeals and dismiss the appeal as it had agreed to do when settling with the government. The Board, however, ruled that Congress, in the Contract Disputes Act, intended that the contractor's right to review of a contracting officer's decision would be "unwaivable." Whether by assignment or any other means, the Board held that the contractor cannot be stripped of the right to a decision on its appeal. In so holding, the Board relied heavily on *Burnside-Ott Aviation Training Center v. Dalton*,[208] which held even the contractor cannot waive its own right to appeal.

The bankruptcy court in *In re Kappa Development & General Contracting, Inc.*[209] addressed whether contract funds, after receipt by the principal, became property of the estate. The court expressly deferred to later proceedings the surety's priority to the funds under equitable subrogation. Restricting *Pearlman v. Reliance Insurance Co.*[210] and distinguishing cases applying it to all contract funds, the court found that only those funds held by the obligee will belong to the surety without going through the estate. Contract funds paid to the principal (or its attorney's trust account) are property of the estate.[211]

Davis v. Persons Service Co., LLC[212] addresses unique state law provisions impacting the surety's indemnity rights in North Dakota. The federal courts in North Dakota have construed the statutory and case law of that state as barring a surety from recovering attorney fees under an indemnity agreement. A state statute forbids recovery of attorney fees if the basis is a provision in "evidences of debt," and the state supreme court has held that statute applies to contract surety indemnity agreements.[213] In this case, the magistrate judge recommended default judgment against the indemni-

206. *Id.* at 305.
207. *In re* Ikhana, LLC, Appeal No. 60462, 17-1 BCA P 36871 (ASBCA Oct. 18, 2017).
208. Burnside-Ott Aviation Training Ctr. v. Dalton, 107 F.3d 854 (Fed. Cir. 1997).
209. In re Kappa Development & General Contracting, Inc., 589 B.R. 302 (Bankr. S.D. Miss. Oct. 31, 2017).
210. Pearlman v. Reliance Ins. Co., 371 U.S. 132 (1962).
211. This result is similar to that in *In re Glenbrook Group, Inc.*, 552 B.R. 735 (Bankr. N.D. Ill. 2016).
212. Davis v. Persons Serv. Co., LLC, No. 4-12-cv-153, 2017 WL 6030535 (D.N.D. Nov. 17, 2017), *adopted*, 2017 WL 6029590 (D.N.D. Dec. 5, 2017).
213. Hartford Acc. & Indem. Co. v. Anderson, 155 N.W.2d 728 (N.D. 1968).

tors but, because the surety's evidence did not distinguish between loss and expenses (including attorney fees), further proceedings were required to determine the amount of the surety's recovery.[214]

In *Liberty Mutual Insurance Co. v. Milender White Construction Co.*,[215] the question boiled down to whether the indemnity agreement requires indemnity for costs of defending a bad-faith claim based on the surety's own conduct, as contrasted with a claim based on the principal's liability. The court determined that because the indemnity agreement did not specifically state that it applied to expenses incurred due to allegations of tortious bad-faith claims handling that the surety was not entitled to indemnity.

In *American Contractors Indemnity Co. v. Decal Construction, LLC*,[216] the surety filed its indemnity action in Los Angeles County Superior Court pursuant to the forum selection clause contained in the indemnity agreement.[217] The defendants removed the case to the federal district court citing diversity jurisdiction.[218] The surety sought remand, which was granted.[219] The court reasoned that the forum selection clause required remand and should be enforced as the parties to the agreement are "barred from 'objecting' to Plaintiff's choice of venue by filing a Notice of Removal."[220] The court noted that the party challenging a forum selection clause must show that its enforcement would be "unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching," which defendants failed to do.[221]

2. Subrogation

In *United States ex rel. Wesco Distribution, Inc. v. Greenleaf Construction Co., Inc.*,[222] the surety assumed the obligations of its prime contractor principal to complete a federal construction project after the principal was terminated.[223] The surety entered into an agreement with the principal's electrical subcontractor to continue electrical work for the project.[224] The subcon-

214. *See also* Cincinnati Ins. Co. v. B&B Paving, Inc., No. 1-16-cv-340, 2018 WL 504400 (D.N.D. Jan. 22, 2018), *cert. denied*, 2018 WL 1629859 (D.N.D. Apr. 4, 2018).

215. Liberty Mut. Ins. Co. v. Milender White Constr. Co., No. 17-cv-02102-NYW, 2017 WL 6361418 (D. Colo. Dec. 13, 2017).

216. Am. Contractors Indem. Co. v. Decal Constr., LLC, No. CV 18-6381 PSG (SSx), 2018 WL 4350063 (C.D. Cal. Sep. 11, 2018).

217. *Id.* at *2.

218. *Id.*

219. *Id.* at *7.

220. *Id.* at *6.

221. *Id.* (citing Murphy v. Schneider Nat'l, Inc., 362 F.3d 1133, 1140 (9th Cir. 2004) (quoting M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 12 (1972))).

222. United States *ex rel.* Wesco Distrib., Inc. v. Greenleaf Constr. Co., Inc., No. 4:14-cv-00315-RGE-CFB (S.D. Iowa Feb. 15, 2018).

223. *Id.* at *1.

224. *Id.*

tractor was terminated from the project and filed for bankruptcy protection.[225] The surety asserted claims against the bankrupt subcontractor's performance bond.[226]

One of the bankrupt subcontractor's subcontractors filed a lawsuit pursuant to the Miller Act against the principal, the bankrupt subcontractor, and their respective sureties.[227] The two sureties asserted cross-claims against one another, and the bankrupt subcontractor's surety moved for partial summary judgment on the prime contractor's surety's claims against the subcontractor's surety.[228] The court determined that there was one broad issue for purposes of the motion for summary judgment: whether the prime contractor's surety was entitled to assert claims against the bankrupt subcontractor's performance bond.[229] The court found that by satisfying the prime contractor principal's obligations on the project, its surety became subrogated to the prime contractor principal's rights through equitable subrogation.[230] Therefore, the prime contractor surety was entitled to exercise all remedies that the prime contractor principal possessed against the bankrupt subcontractor and its surety.[231] The court also found that the prime contractor's surety was its principal's "successor" for purposes of the subcontract performance bond, allowing the prime contractor's surety to assert claims against the subcontract performance bond.[232]

In *Fidelity & Deposit Co. of Maryland v. Ohio Department of Transportation*,[233] the surety executed payment and performance bonds.[234] After the contractor began experiencing financial difficulties, the surety undertook to finance, perform the work and pay labor and material suppliers.[235] The public owner, the Ohio Department of Transportation ("ODOT"), did not default the principal or assign the remaining contract funds to the surety until several months after the surety first undertook to assist the principal.[236] Meanwhile, the IRS had filed its tax liens and served Notices of Levy to ODOT. After it received the Notices of Levy, ODOT withheld payment from the surety. [237]

225. *Id.*
226. *Id.*
227. *Id.* at 5.
228. *Id.*
229. *Id.* at 2.
230. *Id.* at 12.
231. *Id.*
232. *Id.* at 16–17.
233. Fid. & Deposit Co. of Md. v. Ohio Dep't of Transp., No. 1:16-cv-284, 2017 WL 5622832 (S.D. Ohio Nov. 22, 2017).
234. *Id.* at *3.
235. *Id.* at *4–7.
236. *Id.* at *11.
237. *Id.*

The court found that despite the fact that the principal had not been declared to be in default, the principal had no right to the contract funds by reason of the surety's having paid labor and material claims and performed the work, thereby recognizing the surety's equitable right of subrogation, and holding that there is no distinction between its rights before and after the declaration of default.[238]

In *Travelers Casualty & Surety Co. of America v. Paderta*,[239] the principal's bank swept the principal's bank account, including contract proceeds from bonded projects.[240] When it swept the funds, the bank knew of the principal's relationship with its surety.[241] The surety filed a lawsuit against the bank seeking to recover the swept funds from the bonded projects.[242] The bank defended on the basis that it was a holder in due course;[243] that it had a right to take electronic funds;[244] that any statutes establishing trusts for those funds do not apply to lenders;[245] and, that it had a right to setoff.[246] The Court rejected each of the bank's defenses and found in favor of the surety.[247]

In *Walsh Construction Co. II, LLC v. United States Surety Co.*,[248] the obligee and surety each claimed that the other was the first party in material breach of the performance bond.[249] The obligee filed a motion seeking to dismiss all counts contained in the surety's counter-claim. The surety sought to recover funds it spent during the financing period, citing to paragraph 8 of the bond that provided that if the obligee was not justified in defaulting the principal, the obligee would pay to the surety its losses, costs and expenses, inclusive of attorney's fees the surety incurred while performing under the bond.[250]

In its motion to dismiss the surety's Paragraph 8 claim, Walsh argued that pursuant to Paragraph 4 the surety was barred from recovery by reason of its having financed the principal.[251] The Court rejected Walsh's reasoning. Paragraph 4 specifically governed when Walsh would have to reimburse the surety.[252] Walsh further sought dismissal arguing that its duty to pay the

238. *Id.* at *25–27.
239. Travelers Cas. & Sur. Co. of Am. v. Paderta, 315 F. Supp. 3d 1096 (N.D. Ill. 2018).
240. *Id.* at 1098.
241. *Id.* at 1098–99.
242. *Id.* at 1100.
243. *Id.* at 1100–02.
244. *Id.* at 1102.
245. *Id.* at 1102–03.
246. *Id.* at 1104–06.
247. *Id.* at 1106–07.
248. Walsh Constr. Co. II, LLC v. U.S. Sur. Co., 334 F. Supp.3d 282 (2018).
249. *Id.*
250. *Id.* at *8.
251. *Id.* at *10.
252. *Id.* at *11.

principal never matured by reason of a "pay when paid" clause. Thus the surety's claim that Walsh's declaration of default was unjustified by reason of its failure to pay the principal had no merit. The Court rejected this argument, finding a question of fact as to whether the obligee "wrongfully delayed seeking payment from the Owner."[253] The obligee also argued that the surety was barred from presenting its claims under the anti-assignment clause under the subcontract. The court rejected this. The clause was intended to prohibit the principal from assigning funds or work to another subcontractor without the prime contractor's approval.[254]

In *Ohio Casualty Insurance Co. v. R3F General Contractors, LLC*,[255] the surety sought to recover its losses from its principal and indemnitors under the indemnity agreement. The individual defendants appeared in the action; however, the principal did not appear.[256] The surety sought a default judgment against the bond principal, which the magistrate recommended be denied without prejudice. It remarked that a "default judgment should not be entered against one defendant in multi-defendant cases when it is alleged that the defendants are jointly liable 'until the matter has been adjudicated with regard to all defendants, or all defendants have defaulted.'"[257]

The surety raised three objections: (1) *Frow v. De La Vega* is inapplicable because individual defendants were discharged in bankruptcy; (2) the principal does not share a common defense with the individual indemnitors; and (3) the court should join with other circuits and cease applying the *Frow* rule. The court rejected the second objection, stating that the test under *Frow* is not whether the defendants share a common or closely related defense, but rather whether the defendants are alleged to be jointly and severally liable.[258] The court rejected the third objection, finding that it was bound to follow *Frow*.[259] As to the surety's first objection, the court agreed that since the individual indemnitors were discharged in bankruptcy, the potential liabilities are severable and the surety's motion for default judgment against the principal should be granted.

253. *Id.* at *14.
254. *Id.* at *24 (citing Handex of Md., Inc. v. Waste Mgmt. Disposal Servs. of Md., Inc., 458 F. Supp. 2d 266 (D. Md. 2006)).
255. Ohio Cas. Ins. Co. v. R3F Gen. Contractors, LLC, No. 17-637 MV/SCY, 2018 WL 4215003 (D.N.M. Sept. 5, 2018).
256. *Id.* at *3.
257. *Id.* (citing Frow v. De La Vega, 82 U.S. 552 (10th Cir. 1872)).
258. *Id.* at *5.
259. *Id.* at *6.

II. FIDELITY LAW

A. *Fidelity Discovery Disputes*

Spear v. Westfield Insurance Co.[260] involved a dispute over three categories of documents the insurance company was seeking from the plaintiff (its insured). Those categories were: "(1) unredacted copies of all documents filed under seal in [a related] Liability Action; (2) all documents produced to the Plaintiffs in the Liability Action; and (3) the Settlement Agreement that concluded the Liability Action."[261] The court agreed with the insurer that these documents were relevant and had to be produced. The court noted that the plaintiff had destroyed some of those documents because, so it claimed, it had to do so to comply with a protective order in place in the Liability Action. The court found this assertion "preposterous," primarily because the defendant insurance company had already requested the documents in the coverage lawsuit before the plaintiffs destroyed the documents. The court believed the plaintiff would have an opportunity to recover the "destroyed" documents and ordered it to do so. The court also quickly shrugged off the argument that the plaintiff could not produce the settlement agreement that concluded the Liability Action because to do so would require obtaining consent from other parties. The court simply instructed the plaintiff to obtain whatever consent was necessary and produce the document.[262] The court also chastised the plaintiff for generally asserting that the attorney-client privilege protected certain documents without providing a privilege log. The court noted that it *could* have penalized this failure with a holding that the privilege had been waived, but the court found that "wholesale waiver" would be "unnecessarily harsh."[263] It therefore held instead that it would merely overrule the "existing, generalized claims of privilege."[264]

In *National Retail Systems v. Markel Insurance Co.*,[265] the insurer sought to compel the production of documents that it believed would prove that an officer of the insured knew that an employee now accused of theft had previously been charged with "theft of company time." The insurer wanted the insured to (1) answer interrogatories on this topic, (2) produce the personnel file of the officer who purportedly knew of the dishonest employee's previous theft of time, and (3) produce payroll documents that would clarify whether there had been a theft of company time. The court granted the

260. Spear v. Westfield Ins. Co., No. 2:15-cv-00582-RAL, 2017 U.S. Dist. LEXIS 188193 (E.D. Pa. Nov. 14, 2017).
261. *Id.* at *6.
262. *Id.* at *15.
263. *Id.* at *18.
264. *Id.*
265. Nat'l Retail Sys. v. Markel Ins. Co., No. 17-672, 2018 U.S. Dist. LEXIS 69891 (E.D. Pa. Apr. 25, 2018).

motion to compel in part and denied it in part. It held that the scope of the interrogatories and document requests had to be more narrowly tailored to reference the relevant time frame.

B. *The Loss of Investment Gains and the Ownership Provision*

In the case of *Cooper Industries Ltd. v. National Union Fire Insurance Co.*,[266] the insured was seeking to recover lost investment gains. The insured's pension plan had invested money with an investment company that also turned out to be running a Ponzi scheme. There was a chain of companies between the insured and the entity that actually had the investment gains. Miraculously, the insured was able to recover its lost principal. But it wanted to recover the amount it would have earned had the money been properly invested. The insurance company denied this claim on the grounds that under the "ownership provision," the lost funds did not truly belong to the insured and were thus not covered. The district court agreed.[267] The district court also, for some reason, went on to consider other defenses, and it sided with the insured on some of them. This part of the opinion was all dicta, however, as the ruling on the ownership provision was dispositive.

The parties cross appealed—the insurer because it had lost some of the issues the court went on to consider in dicta. The Fifth Circuit first dismissed the cross appeal because the insurer had *prevailed* in the lower court.[268] The court then went on to affirm the award of summary judgment to the insurer. It held that the insured relinquished ownership of the funds when it loaned them to an investment company.[269] All the insured held was a promissory note. It no longer owned the funds themselves. The court also sided with the insurer in disagreeing that a loss occurred the moment the insured loaned funds to the dishonest investment company—this was a particularly difficult argument for the insured to make given that it had *recovered* all of its principal.[270] In short, the court agreed that the insured relinquished title to the money when it loaned it to an investment company, and that the ownership provision therefore precluded coverage.

Another recent case, *Posco Daewoo America Corp. v. Allnex USA, Inc.*,[271] also touched on the meaning of the "ownership provision"—surprisingly, in the context of a case arising under a Computer Fraud insuring agreement. The plaintiff in *Posco Daewoo* was a corporation that imported and

266. Cooper Indus. Ltd. v. Nat'l Union Fire Ins. Co., 876 F.3d 119 (5th Cir. 2017).
267. Cooper Indus. v. Nat'l Union Fire Ins. Co., No. 4:12-CV-01591, 2016 U.S. Dist. LEXIS 80342 (S.D. Tex. June 21, 2016).
268. *Cooper Indus.*, 876 F.3d at 126–27.
269. *Id.* at 129–30.
270. *Id.* at 130–31.
271. Posco Daewoo Am. Corp. v. Allnex USA, Inc., No. 17-483, 2017 U.S. Dist. LEXIS 180069, at *1–3 (D.N.J. Oct. 31, 2017).

exported chemicals—often, it sold chemicals to a company called Allnex. An employee of Allnex received an email that appeared to be from an employee that worked in the plaintiff's accounts payable department.[272] The email requested wire transfers to be made to an account at Wells Fargo. The payments that Allnex made went to a bogus account, but they were for amounts that Allnex legitimately owed the insured. The insured argued that it was entitled to receive the remaining amounts from Allnex, but Allnex refused to provide them, arguing it had already paid the fraudster once and would not pay again. The insured sought to recover the amount Allnex refused to pay under a Computer Fraud insuring agreement. Rather than wading into whether the Computer Fraud insuring agreement applied, the court held that the loss was not covered because the insured did not "own" the money that Allnex had refused to pay. The court held that the insured owned the legal right to collect money from Allnex, but not the actual stolen funds themselves, which were in an account it had no right to access.[273]

C. *Insuring Agreement (D) and (E) Issues*

In *Hudson Heritage Federal Credit Union v. Cumis Insurance Society, Inc.*,[274] the insured was a credit union that suffered a loss due to a scheme in which members of the credit union obtained car loans using false documents. Three separate times, "a member of [a] credit union applied for a loan to purchase an automobile using a falsified New York State Department of Motor Vehicles title, which misrepresented the owner/seller of the automobile to be purchased with the loaned funds."[275] The insured sought to recover its loss resulting from nonpayment on the loans under an insuring agreement covering forgery or alteration of an instrument, including a "document of title." The insurance company pointed out that the insured's pleading did not allege that there had been alterations to the original document of title—only to a photocopy or electronic version of the title. The plaintiff amended its pleading to state that "on information and belief," the original DMV titles were falsified.[276] But the plaintiff had admitted that it had only received photocopies of the altered titles. The court held it was improper under these circumstances for the insured to allege "on information and belief" that the *originals* had been altered.[277] The court refused to allow the plaintiff to take discovery to prove alteration of the originals. The court dismissed the claims for breach of contract and a declaratory

272. *Id.* at *2.
273. *Id.* at *15–16.
274. Hudson Heritage Fed. Credit Union v. Cumis Ins. Soc., Inc., No. 17 CV 2930, 2018 U.S. Dist. LEXIS 9823 (S.D.N.Y. Jan. 22, 2018).
275. *Id.* at *2–3.
276. *Id.* at *5–6.
277. *Id.* at *6.

judgment that coverage applied. But the court did not dismiss a claim of negligence, which was based on the argument that the insurance company should have advised the insured that it needed different coverage than it was purchasing.[278] The court noted that the insurer and insured had a long-standing relationship and that the insured often looked to the insurer for advice on what coverage was needed. The court felt this was enough to survive a motion to dismiss the claim of negligence.

D. *Computer Fraud*

The problem of insureds attempting to seek coverage for social-engineering losses under a hacking policy has still not faded away. There were a few helpful cases decided on this issue recently. But unfortunately, there are two harmful cases as well. The first case was *Medidata Solutions, Inc. v. Federal Insurance Co.*[279] The fraud involved an unsolicited email to one of Medidata's employees that purported to be from Medidata's president, advising that a "lawyer" would be calling about an acquisition. The "lawyer" called the employee and requested that Medidata perform a wire transfer in connection with the supposed transaction. The employee informed the fraudster that she needed an email from Medidata's president. She and other employees then received an email that purported to be from the president instructing them to go through with the wire transfer. The fraudster was able to exploit Medidata's email system by use of a computer script that caused the email to appear to come from Medidata's president and presented it with the photo that typically accompanied the president's emails.[280] The employee proceeded to arrange the wire transfer, and two account managers reviewed and approved the wire transfer without speaking to Medidata's president to confirm his authorization. Ultimately, $4.7 million was transferred to the fraudster's bank account.[281] The following month, the "lawyer" contacted the account employee again to arrange another wire transfer. The account employee followed the same procedure, but this time one of the account managers noted that the "reply to" address in the email looked suspicious. The suspicion led to an investigation which uncovered the fraud.[282]

Medidata sought coverage under its computer fraud insuring agreement, which protected against "direct loss of Money" resulting from "Computer Fraud." "Computer Fraud" was defined as "the unlawful taking or the fraudulently induced transfer of Money . . . resulting from a Computer Violation." A "Computer Violation" was defined as "the fraudulent:

278. *Id.* at *9–10.
279. Medidata Sols., Inc. v. Fed. Ins. Co., 268 F. Supp. 3d 471 (S.D.N.Y. 2017).
280. *Id.* at 473.
281. *Id.*
282. *Id.*

(a) entry of Data into . . . a Computer System; [and] (b) change to Data elements or program logic of a Computer System, which is kept in machine readable format . . . ." "Data" included any "representation or information." "Computer System" was "a computer and all input, output, processing, storage, off-line media library and communication facilities which are connected to such computer" used by Medidata.[283] The court held that the mere email spoofing was the type of "deceitful and dishonest access" to a computer system that computer fraud insurance was intended to cover.[284] It rejected the insurer's argument that the fraudster did not enter any computer system of Medidata because the email system was run by Google and it ignored precedent requiring that the loss to the insured result directly or immediately from the use of a computer.

On appeal, the Second Circuit affirmed *Medidata*.[285] In a short opinion, the court concluded: "While Medidata concedes that no hacking occurred, the fraudsters nonetheless crafted a computer-based attack that manipulated Medidata's email system."[286] The court was also persuaded that, in New York, "direct" equates to "proximate cause."[287]

The next case was initially decided correctly by the Eastern District of Michigan, then overturned by the Sixth Circuit. In *American Tooling Center, Inc. v. Travelers Casualty & Surety Co. of America*,[288] the court faced the by-now-familiar scenario of an insured that received an email from an entity purporting to be its vendor, asking the insured to change the bank account information for the vendor for purposes of all future invoices. The insured fell for it and ended up transferring $800,000 to the new account without taking any steps to verify the request.[289] The insured sought to recover its loss under a Computer Fraud insuring agreement that covered loss resulting from the use of any computer to fraudulently cause a transfer. The district court made quick work of this case, stating: "There was no infiltration or 'hacking' of [the insured's] computer system. The emails themselves did not directly cause the transfer of funds; rather, [the insured] authorized the transfer based upon the information received in the emails."[290] The court cited the recent Fifth Circuit case of *Apache Corp. v. Great American Insurance Co.*,[291] as support, as well as a handful of other recent opinions on Computer Fraud. The court noted that the case of *Owens, Schine &*

283. *Id.* at 474.
284. *Id.* at 477.
285. Medidata Sols. Inc. v. Fed. Ins. Co., 729 F. App'x 117 (2d Cir. 2018).
286. *Id.* at 118.
287. *Id.* at 119.
288. Am. Tooling Ctr., Inc. v. Travelers Cas. & Sur. Co. of Am., No. 16-12108, 2017 U.S. Dist. LEXIS 120473 (E.D. Mich. Aug. 1, 2017).
289. *Id.* at *2–3.
290. *Id.* at *7.
291. Apache Corp. v. Great Am. Ins. Co., 662 F. App'x 252 (5th Cir. 2016).

Nicola, P.C. v. Travelers Casualty & Surety Co.,[292] was not persuasive as it was a vacated opinion, and it was in any event distinguishable because the Sixth Circuit followed a narrower definition of "direct" than Connecticut did. Finally, the district court noted that the *Medidata* opinion discussed above was distinguishable because it did not include the words "direct" and "directly caused by Computer Fraud" that the policy before the court included.

Unfortunately, the Sixth Circuit recently overturned the *American Tooling* decision.[293] The court was not persuaded by the insurer's argument that there was no loss until the insured made the decision to pay the actual vendor. The court held instead that the insured "immediately lost its money when it transferred the approximately $834,000 to the impersonator; there was no intervening event."[294] The court next considered whether the Computer Fraud insuring agreement was meant to cover only hacking. Construing the policy in favor of the insured, the court held that the policy was not express enough on this point, and that if the insurer had intended the coverage to be limited to hacking, it should have made it clearer. The court then analyzed several exclusions intended to limit the Computer Fraud insuring agreement to hacking, but rejected their application as well.[295] This opinion is simply not well reasoned, and it is fortunately in the minority. But it is important for practitioners to be aware that insureds will rely on it heavily.

There has been one positive case in this area over the last year, however. In *Aqua Star (USA) Corp. v. Travelers Casualty & Surety Co. of America*,[296] the insured was a seafood importer. It purchased frozen shrimp from a vendor known as Longwei. In the summer of 2013, Longwei's computer system was hacked. The hacker apparently monitored email exchanges between an Aqua Star employee and a Longwei employee before intercepting those email exchanges and sending fraudulent emails using "spoofed" email domains that appeared similar to the employees' actual emails. In these fraudulent emails, the hacker directed the Aqua Star employee to change the bank account information for Longwei for future wire transfers. Aqua Star employees made the changes as directed and were ultimately defrauded of $713,890 by the hacker.

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292. Owens, Schine & Nicola, P.C. v. Travelers Cas. & Sur. Co., 2010 Conn. Super. LEXIS 2386, 2010 WL 4226958 (Sept. 20, 2010).

293. Am. Tooling Ctr., Inc. v. Travelers Cas. & Sur. Co. of Am., 895 F.3d 455 (6th Cir. 2018).

294. *Id.* at 460.

295. *Id.* at 463–65.

296. Aqua Star (USA) Corp. v. Travelers Cas. & Sur. Co. of Am., 719 F. App'x 701 (9th Cir. 2018).

The question before the court was whether Aqua Star's losses were covered by a crime policy issued by Travelers. The policy, in a Computer Fraud insuring agreement, covered "direct loss of, or direct loss from damage to, Money, Securities, and Other Property directly caused by Computer Fraud."[297] Travelers denied coverage, relying on an exclusion that excluded loss resulting directly or indirectly from the input of electronic data by a person having authority to enter data into the insured's computer system. The district court agreed with Travelers that the exclusion applied.[298] It found that an employee of the insured voluntarily entered data into a spreadsheet on the insured's computer system. The data entered into that spreadsheet was the data used to bring about the wire transfers. The court held that the entry of data into the spreadsheet was an intervening act by someone with authority. The court granted summary judgment in favor of the insurer with respect to the breach of contract claim and a claim of bad faith. On appeal, the Ninth Circuit agreed, focusing only on the application of the exclusion.[299] The court held that the exclusion applied "squarely."[300] It rejected the insured's argument that the efficient proximate cause doctrine barred application of the exclusion. That rule, it reasoned, applies only when there are two competing causes or perils in play. Here, the *only* peril in play was Computer Fraud.

E. *The Meaning of "Direct"*

As *American Tooling* hints, the meaning of "direct" in fidelity bonds is often critical. Several recent cases shed light on this perennially relevant issue. In *Federal Deposit Insurance Corp. v. Arch Insurance Co.*,[301] the insured was Washington Mutual ("WaMu"), a bank that purchased mortgages and later discovered that the paperwork regarding those mortgages contained false statements of the borrowers' incomes. The loan originators created a scheme to steal from WaMu for their own financial benefit.[302] The insurance company argued "that WaMu's losses were not directly caused by the loan originators' fraud, but rather by its contractual obligations to repurchase faulty loans sold to third parties."[303] The court explained that WaMu sold the loans it purchased from the fraudulent loan originator to third parties and was obligated to repurchase them when the misrepresentations

297. Aqua Star (USA) Corp. v. Travelers Cas. & Sur. Co. of Am., No. C14-1368RSL, 2016 U.S. Dist. LEXIS 88985 (W.D. Wash. July 8, 2016).
298. *Id.* at *6–9.
299. Merrick v. Ryan, 719 F. App'x at 702 (9th Cir. 2018).
300. *Id.*
301. Fed. Deposit Ins. Corp. v. Arch Ins. Co., No. C14-0545RSL, 2017 U.S. Dist. LEXIS 187222 (W.D. Wash. Nov. 13, 2017).
302. *Id.* at *13.
303. *Id.* at *12.

came to light. The insurer argued that it was the repurchase agreement that caused the loss, and not the underlying fraud. The court did not agree, reasoning that the "common sense understanding of the policy and the relationships between the entities involved shows that WaMu suffered a loss the moment it delivered funds to [the fraudulent loan originator] and received worthless paperwork in return."[304] The court did not commit to whether it was adopting the "direct means direct" approach, but it concluded that, even if it did follow that approach, the loss occurred "immediately and without intervening cause from the loan originators' fraudulent acts."[305]

In *Wilbanks Securities v. National Union Fire Insurance Co.*,[306] Stevens was an investment advisor for the insured, Wilbanks. In early 2012, Stevens advised a husband and wife to invest $1.5 million in an oil and gas company, Aztec Oil & Gas ("Aztec"). The investors were hesitant to put so much money into one company, but were eventually persuaded to invest when Stevens reassured them, going so far as to promise they would not lose their investment. The investment performed for approximately two years. In May 2014, however, the investors expressed dissatisfaction with the investment. And shortly thereafter, it became clear that Aztec was in serious trouble and that the investors' money was lost.

Wilbanks claimed that Stevens engaged in fraudulent and dishonest acts by essentially guaranteeing performance of the investment. In fact, Stevens should not have been encouraging the investors to make this investment at all, because Stevens was not licensed to sell this type of investment.[307] He failed his exam to obtain the necessary license shortly before the investors made this investment. The investors also alleged that there were forged signatures on a disclosure form that asked the investors to acknowledge information about the investment, including that it was a very risky investment.[308] They claim that they never saw or signed this document. The loss the insured sought to recover was an amount it had to pay the investors in a FINRA arbitration.

The insured sought coverage under Insuring Agreements (A) and (D). The court held that neither provision provided coverage. The insurer argued that, with respect to Insuring Agreement (A), there was no evidence of the requisite manifest intent to either cause the insured a loss or obtain a financial benefit for the employee.[309] The insurer further argued that

304. *Id.*
305. *Id.*
306. Wilbanks Sec. v. Nat'l Union Fire Ins. Co., No. CIV-16-294-R, 2018 U.S. Dist. LEXIS 19278 (W.D. Okla. Feb. 6, 2018).
307. *Id.* at *3–4.
308. *Id.* at *4–6.
309. *Id.* at *10.

even if the manifest intent were present, the loss to the insured resulted indirectly from Stevens' dishonest conduct.[310] The court also agreed with the argument that the "resulting directly from" language is satisfied only if there is an immediate connection between the dishonest conduct and the loss.[311] Here, the loss was liability to a third party (the investors). As to the forgery claim, the court held that the agreement alleged to have been forged was not a document of the type listed in Insuring Agreement (D) as it did not have inherent value.[312]

Another recent case involving the meaning of "directly," *CP Food & Beverage, Inc. v. United States Fire Insurance Co.*,[313] was decided in favor of the insurer. This case involved a club in Vegas where topless dancers performed. The insured was the owner of the club, and it suffered a loss when certain employees of the club began overcharging customers' credit cards. Sometimes, the employees would charge the customer for the same bill twice, other times they would charge the customers for alcohol that they never received.[314] The patrons of the club could buy "funny money" to pay the dancers or tip the waitresses.[315] Part of the scheme was that the employees would charge the customers for funny money that was never actually paid for, and the employee would then redeem the funny money for cash, keeping it for themselves.[316] The insured sought coverage under an insuring agreement covering loss resulting directly from theft committed by an employee.[317] The insurer argued that there was no coverage because the loss did not result *directly* from employee theft. The dishonest employees stole from customers, and the loss ultimately fell on the insured only because, once the customers (or their credit card companies) caught wise to the overcharges, the insured was held responsible for its employees' actions.[318]

The court agreed with the insurance company. It predicted that Nevada would follow the "direct means direct" rule and hold that the policy does not cover third-party losses. The court stated: "If proximate cause were sufficient, that would render the word 'directly' superfluous."[319] The court also noted that the policy at issue covered only property that the insured owned or held for others. "The policy thus contemplates a loss when the insured is deprived of property (either its own property it holds as trustee

310. *Id.* at *10–11.
311. *Id.* at *10–14.
312. *Id.* at *16–17.
313. CP Food & Beverage, Inc. v. U.S. Fire Ins. Co., 324 F. Supp. 3d 1172 (D. Nev. 2018).
314. *Id.* at 1174.
315. *Id.*
316. *Id.*
317. *Id.*
318. *Id.* at 1176.
319. *Id.* at 1177.

or bailee), not when a third party is deprived of property and the third party later sues the insured or requires repayment under a contractual provision."[320] The court granted summary judgment in favor of the insurer.

F. *Issues Related to Layers of Insurance and Multiple Policies or Occurrences*

In *Wescott Electric Co. v. Cincinnati Insurance Co.*,[321] the Pennsylvania court analyzed whether the reasonable expectations doctrine could transform a discovery policy into a loss-sustained policy. The court rejected such contention. The insured in that case had an employee that stole almost $3 million from it over a period of approximately ten years. The insured had four policies in place over the ten-year period, including several multi-year policies. The theft was discovered in mid-2013, which was during the policy period of the last policy the insurer had issued. The policy in place provided coverage of $100,000 for each occurrence of employee theft, and the insurer paid that amount. But the insured sought to also recover under a previous policy and alleged that there had been more than one "occurrence." The policy at issue provided, however, that discovery had to occur during the policy period and discovery had obviously occurred only once—during the last policy period. In addition, the policy at issue defined "occurrence" as the "combined total of all separate acts whether or not related; or a series of acts whether or not related; committed by an employee." Here, because all the thefts had been committed by a single employee, it was clear there had been only one occurrence. The insured argued that this language should not be enforced because earlier policies the insured had purchased from this insurer were loss-sustained policies, with a one-year discovery period, citing the reasonable expectations doctrine.[322] The insured asked the court to reform the later policies to match this earlier language. The court agreed with the insured that Pennsylvania generally follows the reasonable expectations doctrine, but refused to apply it here for three reasons. First, the language was clear and conspicuous, which barred the insured from arguing that it had not read or understood the relevant language. Second, the insured had not requested the type of coverage it was now asking the court to reform the policy to reflect. Third, the court noted that the insured had been given a copy of the change in policy language more than two years before it took effect. The court agreed with the insurer that there had been only one "occurrence" and that the discovery nature of the policy could not be undone by the reasonable expectations doctrine.[323]

320. *Id.*
321. Wescott Elec. Co. v. Cincinnati Ins. Co., No. 17-4718, 2018 U.S. Dist. LEXIS 37938 (E.D. Pa. Mar. 8, 2018).
322. *Id.* at 525–56.
323. *Id.* at 526–28.

In *Tennessee Clutch & Supply, Inc. v. Auto Owners Mutual Insurance Co.*,[324] the court also refused to allow an insured to recover more than once under back-to-back policies. There, the insured had an employee that stole approximately $48,000 during 2014, and approximately $50,000 during 2015.[325] The policy in place provided $15,000 per occurrence of employee theft. The insurance company paid $15,000, but the insured argued that another $15,000 was owed because there had been multiple occurrences.[326] The policies at issue included a Non-Cumulation provision stating that the policy limits did not stack from year to year.[327] The court was also persuaded by the body of case law holding that when only one employee's theft is implicated, there is only one "occurrence." The court reversed the lower court's award of summary judgment to the insured and instructed that judgment should instead be entered in favor of the insurance company.[328]

The recent case of *Lioness Holdings, LLC v. Sentinel Insurance Co.*[329] also involved an insured seeking coverage for multiple occurrences. The opinion, however, feels incomplete, as it merely assumes knowledge of the facts at issue and rules on the legal arguments presented by the parties without explaining them. Nevertheless, it seems clear that there was a loss caused by an employee, Mr. Reeves. The insurance company apparently argued that coverage would be limited by the per-occurrence limit, but the court held, without explanation: "the Plaintiff will be allowed to present evidence as to all of the locations in question and present the case on its theory that there were 10 occurrences."[330] The court did, however, grant the insurance company summary judgment on the grounds that breach of the covenant of good faith and fair dealing was not a "stand alone claim" under Oregon law.[331] Ultimately, the case should have limited precedential value given its terse holdings.

In *Dan Tait, Inc. v. Farm Family Casualty Insurance Co.*,[332] the insured also tried to characterize its loss as resulting from multiple occurrences. The insured's former bookkeeper stole half a million dollars using three methods: "(1) making unauthorized purchases with company credit cards; (2) making unauthorized withdrawals from the company's line of credit;

324. Tenn. Clutch & Supply, Inc. v. Auto Owners Mut. Ins. Co., No. M2016-02195-COA-R3-CV, 2017 Tenn. App. LEXIS 761 (Tenn. Ct. App. Nov. 22, 2017).
325. *Id.* at *3.
326. *Id.* at *3–4.
327. *Id.* at *16–17.
328. *Id.* at *17.
329. Lioness Holdings, LLC v. Sentinel Ins. Co., No. 3:17-cv-01238-JE, 2018 U.S. Dist. LEXIS 102890 (D. Or. June 20, 2018).
330. *Id.* at *6.
331. *Id.* at *5.
332. Dan Tait, Inc. v. Farm Family Cas. Ins. Co., 79 N.Y.S.3d 514 (July 2, 2018).

and (3) taking company inventory for personal use."[333] These schemes had lasted approximately five years. The insured sought coverage under an employee dishonesty policy that had a $15,000 limit for each occurrence of employee dishonesty. The insured sought coverage for multiple occurrences. The policy stated that all loss caused by one or more persons involving a single act or series of acts was considered one occurrence. But the insured argued that this language was ambiguous and therefore had to be construed in the insured's favor.[334] The court rejected the insured's reliance on an "unfortunate event" test, asking "whether there is a close temporal and spatial relationship 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."[335] The court held that the problem with this test is that it ignored that courts "must 'first look to the language of the policy.'"[336] The court reasoned that here, the policy language was clear and unambiguous in referring to all acts committed by a single employee. The court concluded that while the acts "committed by Young involved several different methods of theft . . . the clear and unambiguous language of the Policy requires these thefts to be aggregated into one 'occurrence.'"[337] The insured next went on to argue that even if there was one occurrence, the insured could recover under multiple of the back-to-back policies it had in place over the five-year period the thefts occurred.[338] The court rejected this argument, as well, citing the policy's anti-stacking clause. The court granted the insurance company's motion for summary judgment and held that the insured was entitled to recover only one policy limit of $15,000.

G. *Statutory Bond Arguments*

In *Renasant Bank v. St. Paul Mercury Insurance Co.*,[339] the insured was a bank that alleged that one of its loan officers engaged in lending transactions with her customers that resulted in losses to the bank. St. Paul denied the claim, arguing that the bank did not prove that the loan officer received an improper financial benefit, as required by the bond. The bond was a statutory bond under Mississippi law, as it was furnished to comply with the statute that required employees of state chartered banks to be bonded (Miss. Code. Ann. 81-5-15). The insured argued that the requirement of a showing of a financial benefit to the dishonest employee was inconsistent

333. *Id.* at 516.
334. *Id.* at 517.
335. *Id.* at 518.
336. *Id.* (quoting Consol. Edison Co. of NY v. Allstate Ins. Co., 98 N.E.2d 687 (N.Y. 2002)).
337. *Id.* at 519.
338. *Id.* at 521.
339. Renasant Bank v. St. Paul Mercury Ins. Co., 882 F.3d 203 (5th Cir. 2018).

with the Mississippi statute. In retort, the insurer argued that the "improper financial benefit" requirement was consistent with the intent of the statute as it requires the bond to cover losses caused by "dishonesty," and "dishonesty" inherently incorporates an element of intent. Thus, provisions setting the parameters of intentional conduct, such as the improper financial benefit requirement, are consistent with the statute's intent. The bank's sole argument that the loan officer received an improper financial benefit was that she received commissions on the allegedly fraudulent loans. However, the bond expressly excluded commissions from the definition of financial benefit. Further, the "majority rule" is that receipt of a commission was not receipt of an improper financial benefit.[340] The district court sided with the insurance company, and on appeal, the Fifth Circuit affirmed. The appellate court did not actually analyze whether the bond at issue was a "statutory bond" because it agreed with the insurance company that even if it was, the requirement of a showing of an improper financial benefit to the dishonest employee was consistent with the statute. The court reasoned that the purpose of this requirement was to allow the insurance company to avoid covering cases of simple bad business judgment.[341] This was consistent with the Mississippi statute that required financial institutions to obtain coverage for employee dishonesty.

340. *Id.* at 210.
341. *Id.* at 207.