Current Issues Under the Indemnity Agreement

By David A. Harris March 23, 2018

The issue arising under the indemnity agreement in the last few years that has likely received the most inconsistent treatment by courts is the surety's claim for preliminary injunctive relief on collateral demands.

To obtain a preliminary injunction a surety must establish:

1. Substantial likelihood of success on the merits;
2. Irreparable harm absent injunctive relief;
3. That the threatened harm outweighs any harm that will result if the injunction is granted; and
4. If issued, the injunction will not be adverse to the public interest.

Courts that deny these injunctions usually get hung up on the surety's claim of irreparable harm and whether the harm claimed by the surety outweighs the harm the indemnitors claim they will incur if the injunction is granted.

For example, one court held that, because the surety presented no evidence it would be unable to obtain a monetary judgment without a preliminary injunction, it had not established irreparable harm. Ignoring the surety's particular relationship and obligations, the court declared that "to find that irreparable harm exists in this instance would set a precedent for irreparable harm in any breach of contract case where a plaintiff may potentially have a right to a defendant's assets." *Western Sur. Co. v. Rock Branch Mech., Inc.*, 5:16-CV-09550, 2016 WL 6462100 (S.D. W. Va. Oct. 31, 2016).

In another case, where the surety showed the indemnitors were transferring assets, the court still denied the motion for preliminary injunction. The court accepted the indemnitors' argument that because the transfers were to a trustee "for the benefit of its creditors" there was no evidence the transfers risked dissipation of assets. According to the court, the surety did not meet its burden of showing irreparable harm or that monetary relief later, in the form of a final judgment, was inadequate. *Westchester Fire Ins. Co. v. DeNovo Constructors, Inc.*, 177 F. Supp. 3d 810, 811 (S.D.N.Y. 2016).

One court denied the surety's request for collateral and instead fashioned its own relief by freezing the indemnitors' assets (subject to some exceptions). The court got there by reasoning that the alternative relief would better balance the equities. The court was also influenced by the principal's argument that it would be forced to close its doors and lay off 200 employees if ordered to post the collateral security demanded by the surety. The court found that as a result the public interest justified a change in relief to save the business. *Western Sur. Co. v. Futurenet Grp., Inc.,* No. 16-CV-11055, 2016 WL 3180188 (E.D. Mich. June 8, 2016).

Is all hope lost? Can the surety ever prevail on a preliminary injunction and obtain an order requiring the indemnitors to post collateral security as agreed and as required in the indemnity agreement?

There is good news. Sureties can and should prevail.

Sureties do not fail in every effort to obtain injunctive relief. The strongest argument? Insist there is no other adequate remedy at law to satisfy the surety's right under the indemnity agreement to face current and future losses with collateral security already in hand. If the court enters no preliminary injunction, the surety will forever lose this valuable, bargained-for right. The indemnitors have no superior equities because they agreed to hold the surety harmless in the first instance. The very nature of collateral security balances the equities in favor of the surety, which must hold the collateral in trust only to pay claims and expenses that the indemnitors owe. The need for the collateral arises from the bonds furnished by the surety in reliance in part on the indemnitors promise to furnish collateral security upon demand.

As one recent court summarized: "Merely awarding money damages post-judgment would deny [the surety] its contractual right to immediate payment of collateral, and accordingly, [the surety] would forever lose its right to immediate exoneration and would be irreparably injured. This is not simply an issue of a possible monetary loss, but rather is an issue of impairing a surety's expectation and requiring it to suffer any loss, even if only temporary, associated with the performance of a primary obligor's duty." *Hartford Fire Ins. Co. v. 3i Constr., LLC*, No. 3:16-CV-00992-M, 2017 WL 3209522 at *4 (N.D. Tex. May 18, 2017). *See also Travelers Cas. & Sur. Co. of Am. v. C.R. Calderon Constr., Inc*., CV TDC-17-0282, 2017 WL 2256600 (D. Md. May 22, 2017); *Int'l Fid. Ins. Co. v. Talbot Constr., Inc.*, No. 1:15-CV-3969-LMM, 2016 WL 8814367 (N.D. Ga. Apr. 13, 2016).

The key to obtaining the injunction is to lay the foundation: what the indemnitors agreed, the claims they and the surety face, their failure to hold the surety harmless, the existence of other creditors who will compete for recovery, any aggravating circumstances (such as fraudulent conveyances), the obligation of the surety to investigate, pay, and perform, and the right of the surety to be secured. A bank would not issue a secured loan without taking its security up front; a surety is more generous, waiting to take its security until it encounters the conditions agreed in the indemnity agreement. In both cases, though, the parties' arrangement requires collateral, and the timing of the demand does not make the surety's rights any weaker than the bank's.