

Protecting Indemnity Rights in Arbitration

By David A. Harris September 25, 2018

Through choice or compulsion, sureties often end up in arbitration proceedings involving a claimant and the principal. The principal and surety's joint participation in the arbitration requires precautions to prevent the loss of indemnity rights.

Arbitration will invariably involve some document setting forth the scope and breadth of the proceedings. Often expressed in a consent order or arbitration agreement, default language used between two contractors might say that the parties agree to submit to arbitration "any and all claims or disputes they have against one another" related to the project or contract at issue.

Broad language defining the scope of the arbitration could later haunt the surety when it seeks to enforce its indemnity rights and recoup attorneys' fees and costs involved in the arbitration or even recover losses and expenses incurred on other bonds.

This was the case in *Western Surety Co. v. S3H*, 2:14-CV-2056 JCM (PAL), 2016 WL 4157307 (D. Nev. Aug. 3, 2016). The arbitration agreement provided that the intent of the proceeding was to be "the sole mechanism for resolving all disputes arising from and related to the bond." Further, the parties agreed that each "shall be responsible for and bear the costs of its own attorney's fees and expenses."

The surety and its principal won the arbitration, the principal indemnified the surety for all claims paid, but the surety was forced to sue to recover its substantial attorneys' fees and costs. Apparently giving the surety the temporary benefit of the doubt, the court did not finally decide that the arbitration agreement overrode the indemnity agreement, but it did deny the surety's motion for summary judgment. The surety at best faced further expense and delay in enforcing its rights.

What do sureties need to do to secure their indemnity rights when engaging in an arbitration involving their principals?

The *Western Surety* court advises that, if the surety did not want its indemnity claims to be decided by the arbitration, "it should have executed contractual amendments or other documents clarifying the status of [the principal's] duty to indemnify" the surety.

An additional agreement or contractual amendment can preserve the surety's indemnity rights. However, a better approach is to specifically carve out the issue of indemnity between the surety and principal from the scope of the arbitration proceeding. This can be done directly in the consent order and arbitration agreement, thus negating the need for an additional agreement or amendment.

In a recent arbitration agreement we prepared for a surety client, the scope of the arbitration is limited to

the specific claims made by a subcontractor on a bonded project. The agreement further expressly states that the arbitration proceeding shall not encompass claims between the surety and principal arising under the indemnity agreement. Additionally, the arbitration agreement states that “Any award of fees and expenses shall not constitute a determination of any rights, liabilities or defenses as to any claim of indemnity between Surety and Principal, and both of those parties reserve all rights with respect to any indemnity claim.”

A surety tendering its defense to principal’s counsel in an arbitration proceeding should take extra care to review the arbitration agreement and ensure its indemnity rights are not subject to the award. The indemnity claims cannot be pursued by counsel representing both surety and principal and might be deemed lost after the conclusion of the arbitration.