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SURETIES ARE NOT FIDUCIARIES

By Gregory R. Veal February 1, 2019

Sureties are not fiduciaries. This bedrock concept should be as solid as "suretyship is a tri-partite relationship" and "the surety's duties can be no greater than its principal's."

A fiduciary must elevate its beneficiary's interests above anyone else's, including its own. How can a surety be a fiduciary when it necessarily owes duties to principal and to obligee/claimants, whose interests clearly conflict?

Often indemnitors will insist on defending, and even claiming, against sureties based on alleged breach of fiduciary duty. The theory crops up especially when a surety exercises its right, under the general indemnity agreement, to settle its principal's affirmative claims.

Efforts to apply fiduciary duties to sureties continue to fail almost everywhere, including – just nine days ago - the Louisiana federal court. *United States Specialty Ins. Co. v. Strategic Planning Assocs., LLC*, No. 18-7741, 2019 WL 296864 (E.D. La. Jan. 23, 2019). District Judge Martin Feldman granted U.S. Specialty's motion to dismiss four of the indemnitors' six counterclaim counts in the surety's indemnity action, including all allegations of bad faith or breach of fiduciary duty.

The basis of the decision, as explained below, was that the indemnity agreement imposes performance duties on the indemnitors but not the surety. Therefore, a surety may act in its own self-interest when exercising its rights under the indemnity agreement, including the right-to-settle provision.

The surety was embroiled in litigation with the general contractor over claims on a subcontractor performance bond, while the principal was arbitrating against the general contractor over alleged breach of the subcontract. The surety negotiated a global settlement, over the principal's objection, that compromised the bond claim and waived the principal's affirmative claim.

The arbitrator ruled that the surety had the right to settle the principal's claim, and that award was upheld through two levels of appeal. Nevertheless, the indemnitors sought to recover damages from the surety for alleged bad faith and breach of fiduciary duty.

To breach a duty, one first must owe a duty. While the surety generally owes a duty to act in good faith, that is not the same as a duty to perform some task in favor of the principal or indemnitors. Where the indemnity agreement grants the surety the sole discretion to settle its principal's claims, that right is for the benefit of the surety, not the indemnitors. As the court noted, "this provision does not require USSIC to undertake any performance."

A fiduciary acts to benefit the beneficiary of the relationship; indemnitors are not beneficiaries of any

obligations under the indemnity agreement. Instead, the surety is the beneficiary of the indemnity agreement, which imposes duties exclusively on the indemnitors in favor of the surety.

The language of the right-to-settle and power-of-attorney clauses belies the idea that the surety must put the indemnitors' interests ahead of its own. As is usually the case, the indemnity agreement gave the surety "the right, in its sole and absolute discretion, to . . . settle . . . any claim, demand, suit, award, assessment, or judgment in connection with any Bond, Bonded Contract, or Contract." Likewise, the surety was entitled to do what was "deemed necessary and proper by the Surety in order to give full effect to the Surety under all other provisions of this Agreement." The court held these express rights to be totally incompatible with any fiduciary duty.

This recent decision is far from the only one debunking fiduciary duties imposed on sureties. *See Reginella Construction Co., Ltd. v. Travelers Casualty and Surety Company of America,* 949 F. Supp. 2d 599 (W.D. Pa. 2013) (surety not an insurer, owes duties to obligee and claimants that may conflict with principal's interests); *Insurance Co. of the West v. Gibson Tile Co., Inc.*, 134 P.3d 698 (Nev. 2006) (surety not an insurer or fiduciary); *Associated Indemnity Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276 (Tex. 1998) (despite duty of good faith and reasonableness, surety not fiduciary). Simply put: sureties are not fiduciaries.