

## Privilege: No Blanket Rule and a Heavy Lift

CAVAN S. BOYLE

Fundamental to all litigation is the disclosure of information through the discovery process. So, too, is the mastery of strategies for protection of privileged material from such disclosure. In the surety context, certain privilege claims are common. For example, where the surety and principal work together against an obligee to pursue or defend a claim, it can give rise to a common interest/joint defense privilege. Likewise, the customary involvement of consultants adds to the privilege picture, both in their role in the investigation of claims, and as experts. A recent performance bond case out of the Southern District of New York emphasizes the significant burden faced to successfully assert these privileges.<sup>1</sup>

In *Higgins v. Dobco*, the principal (“Higgins”) and its surety sought guidance for privilege protection of their communications, the investigative files generated by the surety during its bond claim investigation, and communications between Higgins and the surety with various consultants. The decision is a reminder of the potential privilege pitfalls inherent in the claims investigation process.

### Common Interest Doctrine:

Communications among different parties, and with other parties’ attorneys, are ordinarily subject to discovery. However, where the parties have undertaken a “joint defense effort” in furtherance of common legal strategies, they can be protected under the common interest doctrine, an extension of the attorney-client privilege.

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## Court: Business Records Foundation Required for Surety Summary Judgment

NELL M. HURLEY

Surety counsel and claims professionals alike may be surprised by the recent ruling of a Kings County, New York trial court. The court denied a surety’s summary judgment motion for breach of an indemnity agreement but not for the reason you might expect, like an issue of fact. Instead, the court held that because the surety failed to lay the foundation for the admissibility of the business records submitted in support of its motion, the records were not admissible, requiring denial of the surety’s motion.<sup>1</sup> Typically such summary judgment motions are made, and granted, based upon the affidavit of a surety claims professional with personal knowledge of the underlying surety payments and expenses, just as the surety did here.

The matter arose from a 2011 standard industry indemnity agreement executed to secure bonds for construction projects, requiring the indemnitors to pay for losses, expenses, and attorneys’ fees the surety incurred under the bonds. By 2022, the surety had incurred all three and sought recourse under the indemnity agreement against the indemnitors by filing suit for over \$400,000.

A year later, the surety moved for summary judgment in the customary fashion: The affidavit of the surety claims professional explained the claim and attached supporting documentation,<sup>2</sup> based upon personal knowledge and review of the surety’s files.<sup>3</sup> In response, the indemnitors made a conclusory argument regarding an alleged statute of limitations defense, but also argued that the documents provided through the surety claims professional’s affidavit were inadmissible since they failed to meet the foundational “business records” requirements as an exception to the hearsay rule under New York’s civil practice rules.<sup>4</sup>

The surety maintained that the business records exception was inapplicable where, as here, the person submitting the evidence has personal knowledge of the facts stated in, and the documents attached to, the affidavit. Moreover, argued the surety, governing appellate law has specifically rejected the applicability of that business records rule to a surety’s summary judgment motion on an indemnity agreement because of a prima facie evidence clause it contained, which was identical to the one in this case. The clause states:

...the vouchers or other evidence of any such payments made by the [s]urety shall be prima facie evidence of the fact and amount of the [indemnitors’] liability to the [s]urety.

That appellate court concluded:

“...the...surety’s submission of the documentation demonstrating its payment on behalf of the [indemnitors], as well as an itemized list of expenses paid in connection therewith and the affidavit of personal knowledge by the [surety’s] Senior Managing Claims Counsel, was sufficient admissible evidence to demonstrate the [surety’s] prima facie entitlement to judgment as a matter of law [for contractual indemnification]...”<sup>5</sup>

Nonetheless, the motion court was unpersuaded by the surety’s arguments, concluding that the claims professional’s affidavit “fails to lay the proper foundation for admissibility for the business records relied upon” by the surety, citing to a mortgage foreclosure case,

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## Indemnity Agreement Signed Without Actual Authority Held Enforceable

NELL M. HURLEY

An interesting case out of a North Carolina federal district court shows that the execution of a general agreement of indemnity by a person who lacked authority to bind the principal/indemnitor does not necessarily prevent its enforcement. The court ordered the defaulted principal/indemnitor to deposit collateral, furnish the surety with full access to its books and records, and granted summary judgment on liability to the surety for the indemnitor's contractual obligation to exonerate and indemnify the surety for all loss under the agreement.<sup>1</sup>

The relationship started in the usual manner in 2018, with the underwriting, approval, and extension of bonding by the surety to the indemnitor/principal ("Principal"). The Principal, a limited liability company, was comprised of two trusts, each holding a fifty percent ownership. Each trust had a sole trustee, and those two individuals were the co-managers of the Principal. An industry standard indemnity agreement was executed electronically on behalf of the Principal by the sister of the two co-managers, signing the name of one of them. Neither co-manager executed, reviewed or received a link for signature to the indemnity agreement at the time of its execution by the sister.

Despite this, the issue of the validity of the indemnity agreement did not come to light until a few years later, deep into numerous defaulted projects, significant

payments by the surety for bonded obligations, surety extension of financing to the Principal, ignored demands for collateral and access to books and records and, finally, the surety's motion for a preliminary injunction for performance on and breach of the indemnity agreement.

At that point, the Principal asserted that the indemnity agreement was invalid and unenforceable since it had not been signed by both co-managers, as required by the Principal's operating agreement (which was allegedly provided to the surety during underwriting), and therefore lacked mutual assent. In analyzing the issue, the court was guided by North Carolina case law that a principal is bound to contracts made by its agents in three situations:

1. When the agent acts within the scope of his or her actual authority;
2. When the agent acts within the scope of his or her apparent authority, and the third person is without notice that the agent is exceeding actual authority; and
3. When a contract, although unauthorized, has been ratified by the principal.

Concluding that the sister lacked actual authority to execute the indemnity agreement, the court looked to facts regarding the sister's apparent authority, notice to the surety of exceeding actual authority, and whether the principal had ratified the agreement by its conduct. In finding in

the surety's favor on each of these issues, the court cited the following:

1. The Principal regularly held the sister out to others as a manager and as having authority to bind the Principal to contracts, including: naming her as corporate secretary and the only company official in its LLC annual report, her signature on Letters of Intent, her execution of bonds on behalf of the Principal listing her title as "manager," sometimes doing so in front of the Principal's co-managers.
2. The Principal's co-managers had full knowledge of the indemnity agreement executed by the sister, yet never disaffirmed it, or questioned its execution, until filing its opposition to the surety's motion for preliminary injunction.
3. The Principal received the benefit of over \$54 million in bonding over 3 years, allowing it to secure and perform numerous construction contracts.

Thus, decided the court, even if the alleged provision of the Principal's operating agreement (which the surety disputed) was a "notice" of limitation on the sister's actual authority, the Principal clearly received the benefit of the indemnity agreement, and thus ratified its execution despite the technical defect. In addition to granting the surety summary judgment on liability for breach of the indemnity agreement, along with specific performance for collateral deposit and books and records access, the court dismissed the Principal's counterclaims for unfair and deceptive trade practices, tortious interference with contract, and defamation.

While certainly a just result for the surety in this instance, the case highlights that best practices for the surety should include methods for identification and confirmation of the individuals with actual authority to execute the indemnity agreement and other documents binding on the corporate principal. **E&D**



Brian Streicher attended the 2023 Gilbane Upstate New York Annual Charity Golf Tournament in September, held at Bellevue Country Club in Syracuse. Shown here are Brian (L) and Nick Schuler of Schuler-Haas Electric Corp. E&D was a Hole Sponsor.

<sup>1</sup> *Frankenmuth Mut. Ins. Co. v. Nat'l Bridge Builders, LLC*, 2023 WL 5340919 (W.D.N.C. Aug.18, 2023).

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and leaving the issue of the prima facie clause unaddressed.

So where does this leave the surety and its counsel when seeking summary judgment in this situation? It may be that the pro forma referencing of the claims professional's personal knowledge *and* the review of the surety's files draws attention to the documents' submission for the truth of their contents, potentially implicating the business records rule. Thus, if raised by the indemnitor, the admissibility of the records could be vulnerable, as they were here, despite the personal knowledge of the affiant, the

prima facie clause and cases favorable to the surety on the issue. In any event, the safest course is to add a few paragraphs to the claims professional's affidavit that ensure that the documents attached are authenticated, and the proper foundation laid for each type of business record, so as to comply with the jurisdictional requirements for admissibility. Not a very heavy lift, even if arguably unnecessary. Better safe than sorry. **END**

1 *Liberty Mut. Ins. Co. v. Active Fire Sprinkler NYC LLC*, 2023 WL 6444621 (Sup Ct, Kings County 2023).

- 2 Included were the indemnity agreement, the applicable bonds, documents of payments made and credits received, and a settlement agreement reached with other indemnitors.
- 3 An attorney affirmation and Memorandum of Law in support were also submitted.
- 4 NY CPLR R. 4518 (a) requiring that: (1) the record be made in the regular course of business, reflect a routine business activity and be needed in the performance of the business, (2) it is the regular course of the business to make the record; and (3) the record was made at or about the time of the event being recorded.
- 5 *Int'l Fid. Ins. Co. v. Kulka Constr. Corp.*, 100 AD3d 967, 968 (2d Dep't 2012).

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Higgins and the surety sought to shield all their communications under the common interest doctrine. The court explained that there is no such blanket application, noting that the issue must be determined based upon a fact-specific analysis, with the party seeking protection bearing the burden to demonstrate the doctrine applies. "[T]he common interest privilege," the court said, "does not transform an otherwise non-privileged communication...into a protected one simply because it was exchanged between a principal and its surety."<sup>2</sup> Among other things, the court required detailed information as to how and when the common interest arose and to which specific communications the doctrine applies.

**Work-Product Doctrine:** To determine whether the surety's files from its performance bond claim investigation are privileged, the *Higgins* court analogized the work-product doctrine applicable to sureties to that applicable to insurers. Both have a duty to investigate claims and can deny liability, reasoned the court, and documents created after that denial are more likely to be work product prepared in anticipation of litigation. Nonetheless, the court required additional information for fact-specific determinations, with a focus on the timing of the default notice and claim denial, and the purpose of each file for which privilege is asserted.

**Consulting Expert Privilege:** Higgins and the surety also sought protection from disclosure for all communications they had with "consultant experts." The court noted that the rule protecting non-testifying expert disclosure is designed to allow litigants to consult experts for claim evaluation without fear of disclosing this information later, but cautioned that the rule will not "conceal communications with professionals engaged in the ordinary course of business by transforming them into non-testifying experts." In other words, protection typically depends on the purpose of the retention of the consultant and the work performed – was it "ordinary course of business" work or was it done "in anticipation of litigation" for the purpose of furthering a legal strategy? The court directed the parties to provide

additional information, this time focusing on when, by whom, and for what purpose the experts were retained.

The *Higgins* court did not render a result on these privilege issues but made this essential point: facts detailing the timing, nature, and purpose of alleged privileged communications are paramount. With that in mind, from the very outset of a claim situation, the surety should strive to document its files in a way that protects against the inadvertent disclosure of confidential information, including following document protocols. Whenever a consultant (or attorney, for that matter) is retained, the scope and purpose of its work should be clearly defined, especially planned use for legal guidance or claim analysis in preparation for anticipated litigation. Timing of retention will likely factor heavily for consultants, as the surety is in the business of investigating claims. But be advised that "ordinary course of business" communications and reports will not be privileged, regardless of who prepares them or when. Labeling can help identify potentially privileged information ("prepared in anticipation of litigation"), but a court will still look to the facts.<sup>3</sup> Regardless of the surety's protective measures, however, the surety should expect that most of its investigative files will be discoverable.

Similarly, where a surety and principal determine that they share a common interest in a legal matter, in most circumstances a written joint defense agreement should be prepared early on. This will permit the surety (and the principal) to better protect otherwise discoverable, sensitive information from disclosure. **END**

1 *U.S. ex rel. M. Frank Higgins & Co. v. Dobco Inc.*, 2023 WL 5302371 (S.D.N.Y. Aug. 17, 2023).

2 It is assumed that there was also some manner of attorney involvement or else the doctrine would not be applicable.

3 This is also true for attorney-client privilege, where copying outside counsel does not necessarily make the document privileged.



925 Clinton Square  
Rochester, New York 14604

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## FIRM NEWS

Todd Braggins will be a panelist at the January, 2024 ABA/TIPS Fidelity & Surety Law Committee Midwinter Conference in New Orleans. He will speak regarding select surety claims handling considerations related to varying contract delivery methods. Brian Streicher will also attend.

Brian Streicher will present on the topic of "Contracts, Cost, and Compliance Buyout" on March 6, 2024 for the Junior Builders Exchange's *JBX Breaking Ground: Perspectives on Project Teamwork* series in Rochester, NY.

Brian Streicher attended the National Bond Claims Association 2023 Annual meeting at Horseshoe Bay Resort in Texas in October.

Kevin Peartree authored updates to the ConsensusDocs Handbook for the 2024 Cumulative Supplement, including the addition of Chapter 22, ConsensusDocs 755: Standard Master Subcontract Agreement between Constructor and Subcontractor and ConsensusDocs 756: Standard Work Project Order (pursuant to Master Subcontract Agreement).

Cavan Boyle was admitted to the New York Bar on November 8, 2023. Cavan is also licensed to practice in Massachusetts and New Hampshire, since 2013.

Kevin Peartree recently became Chair of the Board of Trustees for Our Lady of Mercy School for Young Women in Rochester, NY.

Clara Onderdonk participated in the national Association of Legal Administrators Executive Leadership Summit, September 28-30, 2023 in San Diego, CA.