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$5 Million in Attorneys' Fees Held Reasonable

MATTHEW D. HOLMES

The continuing saga out of the United States District Court, Eastern District of New York that is *Safeco Insurance Company of America v M.E.S. Inc.* has finally concluded with the court awarding Safeco $5,570,500.62 in attorneys' fees.[1] The court's award was primarily based on the indemnity agreements, which plainly entitled Safeco to attorneys' fees.Significantly, the court found the fees reasonable because the long, protracted litigation was fueled in large measure by the indemnitors' tactics and recalcitrance.

The matter began in 2009 when Safeco sought to recover losses arising from its issuance of performance and payment bonds for three government contracts with the Army Corps of Engineers (the "Corps") in New Jersey. M.E.S., Inc. and M.C.E.S. Inc. ("MES") were bond principals for two of the projects, and the third was a joint venture between MES and an engineering firm. Safeco issued bonds in the amounts of $10,628,832.00 for a Pyrotechnics Research Technology Facility

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Surety v. Broker: No Liability Despite Broker's Breach of Agency Agreement

NELL M. HURLEY

A surety that incurred significant bond losses would likely expect an action against a broker that clearly violated its agency agreement to result in a finding in the surety's favor. In this case, alas, the surety would be wrong. A recent New York appellate court found in favor of the broker, ruling that the broker's breach was not the cause of the surety's losses.[1]

In the case, the surety, Frontier Insurance Company ("Frontier"), entered into an agency agreement in 1994 with its broker, Merritt & McKenzie, Inc. ("Merritt"). In 1995, Merritt submitted two applications for payment and performance bonds on hotel construction projects to be performed by Norwest Contracting, Inc. ("Norwest"). Frontier subsequently authorized the execution of the bonds. The next year, after suffering bond losses in connection with both projects, Frontier sued Merritt on numerous legal theories based upon the failure of Merritt to provide financial background information for Norwest's corporate vice-president of business development. After a bench trial, the court dismissed all of Frontier's claims. Frontier appealed.

First, the appellate court ruled that Frontier's negligence and breach of fiduciary duty claims were duplicative of its claim for breach of contract, since no duty independent of the contract itself had been violated by Merritt and all claims were based upon the same facts and sought the same damages. Thus, all Frontier's claims except for breach of contract were dismissed.

More importantly, the court then found that Frontier failed to prove that Merritt's conduct in omitting the financial information was the direct and proximate cause of Frontier's bond losses. Frontier argued that Merritt's failure to provide any financial background on the principal's corporate officer prevented Frontier from learning that he had prior surety losses, a prior bankruptcy and was involved in pending litigation, information that presumably would have prevented the issuance of the bonds by Frontier. Instead, the court said, it was Frontier's own actions that caused its bond losses.

While it was undisputed that Merritt failed to gather information required of it under the agency agreement, Frontier's underwriting department was solely responsible for authorizing the execution of the bonds, despite the omission, ruled the court. One of Frontier's underwriter's acknowledged that he authorized the bonds' execution knowing that those financials were missing and a later internal Frontier audit showed that the bonds should not have been authorized, the court noted.

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The court relied on the testimony of the Frontier underwriter that no written policy was provided to guide underwriters, that to the extent a policy existed it was constantly changing, and that the underwriting process permitted individualized determinations by the underwriter, including the authority to override Frontier's policy. Indeed, the underwriter considered only the corporation's financial documents and the fact that a larger contractor had taken Norwest on as a mentee, and gave no credit to any personal financial statements. Under those circumstances, reasoned the court, it simply cannot be said that Merritt's conduct was the cause of Frontier's losses.

The case sets forth a cautionary tale for sureties and their counsel alike to ensure that written underwriting policy is maintained and required of any surety underwriting team, as well as enforced by the surety under any agency agreement. F&D

1 Frontier Ins. Co. v. Merritt & McKenzie, Inc., 159 AD3d 1156 (3d Dept. 2018).

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project, $8,253,975.00 for an Explosives Research and Development Loading Facility project, and $16,549,000.00 for a High Energy Propellant Formulation Facility project (collectively, the "Projects"). As consideration and inducement for Safeco to issue the bonds, the bonded principals and individual indemnitors ("Defendants") executed one or both of two virtually identical Indemnity Agreements (collectively "the Agreements").

In the Agreements, Defendants (i) agreed to fully indemnify Safeco for all loss and expense, of any kind or nature whatsoever, incurred in connection with the bonds; and (ii) agreed to a number of additional terms designed to protect Safeco's interests and to insulate it from loss. More specifically, the Agreements provided that the Defendants agreed to pay to Safeco its reasonable attorneys' fees incurred by it on account of any default under the Agreement by any Defendant and for Safeco to incur such expenses, including reasonable attorneys' fees, as deemed necessary or advisable in the investigation, defense and payment of any claims on Safeco's bonds.

When the principals defaulted on the Projects and the Corps made claims on Safeco's bonds, Safeco retained three separate law firms to defend and prosecute its interests, including the completion of the bonded contracts. Highly contentious litigation ensued, beginning with Safeco's motion for partial summary judgment and efforts to enforce its rights to obtain collateral security.

After that, the Defendants engaged in a series of appeals, motions for reconsideration, and other tactics that prolonged the litigation by failing to provide collateral security and required discovery. The Defendants then filed an action against Safeco that alleged every claim under the sun, including bad faith, tortious interference with contract, breach of contract, tortious interference with prospective economic advantage, fraudulent misrepresentation and concealment, and civil conspiracy. The court ultimately granted summary judgment in favor of Safeco in March 2017 and dismissed the Defendants' claims against Safeco.

Keeping this history in mind, and after a two day hearing, the court concluded that Safeco's $5 million fee application was reasonable. The court rejected efforts by the Defendants to attack the fees' reasonableness based upon alleged top heavy administration of workload, billing for clerical and administrative work, having too many ancillary billers, block-billing, duplicative work between firms, and undocumented expenses.

In determining the reasonableness of Safeco's attorneys' fees, the court considered the following, among other factors: (1) the complexity and difficulty of the case; (2) the available expertise and capacity of the client's other counsel (if any); (3) the resources required to prosecute the case effectively (taking account of the resources being marshaled on the other side but not endorsing scorched earth tactics); (4) the timing demands of the case; and (5), whether an attorney might have an interest (independent of that of his client) in achieving the ends of the litigation or might initiate the representation himself.

In the decision, the court walks through, at great length, each and every phase of this "extraordinary" litigation in its scope and aggressiveness. From the initial defaults through the investigation, discovery, collateral security enforcement efforts, settlement negotiations, counterclaims, and extensive motion practice, the court noted that the Defendants' actions were the primary cause of Safeco's attorneys' fees reaching millions of dollars. Finally, in light of Defendants' history of re-litigating every issue in this case, the court cautioned them against filing for reconsideration and warned that such a motion could result in the imposition of sanctions.

Based on this decision, when a surety seeks to recover its attorneys' fees in litigation, it is most likely to be successful where: (a) the language in the indemnity agreement is rock-solid, as it was here; and (b) its counsel is as specific as possible in its documentation of time spent defending or prosecuting the surety's interests. F&D

1 2018 U.S. Dist. LEXIS 97231 (E.D.N.Y June 8, 2018).

New York Court Finds Labor Trustees' Claims Timely Pursuant to Labor Law § 220-g

TODD R. BRAGGINS

The limitation period contained within New York Labor Law Section 220-g has long been a source of concern for sureties because of its seeming indefinite extension of time to commence a payment bond action for labor or wage underpayments. Section 220-g provides that such an action may be brought within one year from the date of the last underpayment or within one year from the date of the determination of a wage or supplement underpayment by the commissioner or other fiscal officer.

A New York trial court recently found that for the first prong of that provision the controlling date for statute of limitations purposes is one year from the date that the last member of the organization was underpaid: "... it would appear that the last date on the project for the trade association as a whole controls for statute of limitations purposes."[1] In contrast, the surety for the bankrupt principal contended that the timeliness of each claim should be evaluated individually, not collectively. According to the surety, each worker is required to commence an action within one year of the date of each employee's last individual underpayment, which in this case would have rendered the bulk of the claims untimely. The court rejected the surety's position, citing the remedial nature of the statute, and finding the action timely because it was commenced within one year of the date the last carpenter and last paver performed project work for which each was underpaid. The court then granted summary judgment in favor of the plaintiffs.

The surety also asserted that it needed additional discovery to defend the claim, and that summary judgment was consequently premature. The surety claimed that the principal had manipulated the certified payroll reports and that there was no proof that the named employees had actually worked on the project. The court disagreed, finding that the certified payroll reports naming each employee, the days worked, and the number of hours worked, was sufficient proof. The court also cited the speculative nature of the allegation, together with the lack of any discovery effort on this issue during the pendency of the action.

Finally, the surety further opposed the motion by contending that it intended to add a third party defendant to the action. The court rejected that defense as well, noting that that a separate action could still be commenced against that party, and concluding that "[t]he time for summary judgment in this action has arrived."

While it may not be the answer sureties hoped for, at least one court has brought some clarity to the first prong of the limitation period contained in Labor Law Section 220-g. However, since this this decision is from trial court level, it likely does not represent the final word on this subject. E&D

1 *Trustees of the NY City Dist. Council of Carpenters Pension Fund v Arch Ins. Co.*, 2018 NY Slip Op 30578(U) (Sup. Ct. NY Cty., April 2, 2018).

ERNSTROM & DRESTE LLP

NEW YORK
925 Clinton Square
Rochester, New York 14604

Visit us online at:
WWW.ERNSTROMDRESTE.COM

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FIRM NEWS

Kevin Peartree and Martha Connolly are preparing the 2019 annual supplement to the ConsensusDocs Contract Documents Handbook.

Todd Braggins attended the ABA Fidelity & Surety Law Committee meeting held in Santa Fe, New Mexico in May.

John Dreste attended the DRI Surety Roundtable Conference in Chicago in May.

Todd Braggins will be attending the National Bond Claims Association Annual Meeting in Pinehurst, NC in October, 2018.

Timothy Boldt will be attending the Syracuse Surety Association's Saratoga Race Track outing on August 15.