

## Forgery No Defense Where Indemnitor Ratifies GIA

NELL M. HURLEY

An indemnitor who claimed his signature had been forged on the original general indemnity agreement was nonetheless held liable, personally and on behalf of his companies, where his conduct convinced the court he had subsequently ratified the obligations of the agreement. The surety thus obtained summary judgment against the indemnitors.

In *Developers Surety & Indemnity Co. v. Chicago Architectural Metals, Inc.*,<sup>1</sup> the principal, Chicago Architectural Metals, Inc. ("CAM"), obtained payment and performance bonds from surety, Developers Surety & Indemnity Co. ("Developers"), for a project at Joliet Junior College in which CAM was a subcontractor performing metalwork installation. Prior to issuing the bonds, in November 2009, CAM executed an indemnity agreement with Developers, as did three individuals and another corporate indemnitor, including an individual named Jonathan Von Samek. Mr. Von Samek signed the GIA both individually and on behalf of the non-principal corporate indemnitor. A few months later, the broker who issued the bonds told Mr. Von Samek that the orig-

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## Demanding Collateral Security? Irreparable Harm a Difficult Showing for Surety

NELL M. HURLEY

A federal district court for the Southern District of New York recently denied a surety's motion for a preliminary injunction to require its principal to deposit collateral, despite the surety's clear contractual right to it and the principal's transfer of its assets to a trustee. The court found that the indemnitors' refusal to deposit collateral, in itself, failed to constitute the irreparable harm required for the surety to obtain a preliminary injunction. Further, said the court, the principal's transfer of assets to a trustee was not a dissipation of assets that placed the surety at risk of irreparable harm. The court refused to follow holdings by other circuits finding that the failure to deposit required collateral irreparably harms the surety by depriving it of pre-judgment relief to which it is contractually entitled.

The surety in the case,<sup>1</sup> Westchester Fire Insurance Company ("Westchester"), issued surety bonds on behalf of its principal, DeNovo Constructors, Inc. ("DeNovo"). The general indemnity agreement imposed standard collateral security deposit obligations that DeNovo, and the other indemnitors, failed to honor. Faced with over \$3 million in bond claims, Westchester moved for a preliminary injunction demanding indemnitors post collateral security as required by the indemnity agreement. Westchester argued that DeNovo's failure to deposit collateral constituted irreparable injury because Westchester risked becoming a general unsecured creditor in the principal's bankruptcy proceeding.

The court was unpersuaded, finding the numerous cases cited by Westchester, both in New York and from other jurisdictions, to be distinguishable or misinterpreted. The court further concluded that Westchester's arguments improperly conflated "the specific performance inquiry about an adequate remedy at law with the preliminary injunction inquiry into irreparable injury." Since the injury here was an easily quantifiable monetary award, it failed to meet the irreparable harm standard. This ruling did not prohibit Westchester from seeking the remedy of specific performance through a summary judgment motion but found that it was not entitled to a preliminary injunction because it could not demonstrate irreparable harm.

The court declined Westchester's invitation to join other circuits that hold that failure to deposit collateral constitutes irreparable harm to the surety, citing to Second Circuit authority that prohibits contract language from defining irreparable injury. The court held that "a collateral security deposit provision, standing alone, is insufficient to demonstrate irreparable injury." The court noted that breach of the collateral security provision in the indemnity agreement may be considered irreparable harm when there is a risk of disposition of the indemnitor's assets.

Westchester also argued that DeNovo's transfer of assets was a "dissipation of assets"

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## Surety Cases of Interest to Contractors

MARTHA A. CONNOLLY

Courts in New York have increasingly forced claimants to strictly comply with conditions precedent prior to making bond claims. These three recent New York cases highlight various sureties' efforts to be released from liability under their bonds and how courts have interpreted sureties' obligations under their payment and performance bonds.

### **MG Hotel, LLC v. Bovis Lend Lease, LMB, Inc.**<sup>1</sup>

In relation to the construction of a Marriott Residence Inn in NYC, the plaintiff developer hired a construction manager, who in turn hired an HVAC subcontractor for installation of heat pump air conditioning units specifically chosen by the developer and supplied by Trane. Vigilant Insurance Company, as surety, issued a performance bond for the HVAC subcontractor naming both the developer and the construction manager as obligees. When issues arose with the Trane units, the developer sought recourse under Vigilant's performance bond and ultimately brought an action against the construction manager, the HVAC subcontractor, Trane and Vigilant.

According to the terms of the bond, Vigilant was only answerable for a default of its principal where the principal was declared by either of the obligees to be in default, in breach, and to have failed to perform in any manner under the Subcontract. Vigilant moved for summary judgment dismissing the developer's claim for breach of the performance bond on the grounds that there was no evidence of the HVAC subcontractor's default or breach. In fact, quite to the contrary, the evidence overwhelmingly supported the position that the HVAC subcontractor's installation of the units was performed according to the contract specifications. The developer, its architect, and the construction manager approved and accepted the HVAC subcontractor's work "as 100% completed and installed 'in accordance with [plaintiff's] Contract Documents.'" The developer also certified in its requisitions to its lenders that no default had occurred in any of the construction contracts and work was performed in accordance with approved plans.

Vigilant argued that a default or breach by its principal was an express condition precedent to its liability under the bond and that the developer had not (and could not) satisfy this condition. The court agreed with Vigilant finding that there was no evidence of the HVAC subcontractor's default or any deviation from the contract specifications. The court further noted that where an owner or developer has certified that a contractor's work was completed in accordance with the contract documents, summary judgment is properly granted. The developer's claim for breach of the performance bond was dismissed.

The court, however, found that both the express warranty and the limitation of liability were enforceable under New York law.

### **ACS Systems Associates, Inc. v. Safeco Insurance Company of America**<sup>2</sup>

Plaintiff was an unpaid subcontractor on a school renovation project that made a claim on the general contractor's payment bond, issued by the defendant surety, Safeco Insurance Company of America ("Safeco"). It was undisputed that the School Construction Authority ("SCA") paid the general con-

tractor for the subcontractor's work and that the general contractor failed to pay the subcontractor.

Under N.Y. General Municipal Law § 106-b (2), a general contractor is required to promptly pay its subcontractors within seven days after receipt of payment from a public owner, but may deduct from those payments "an amount necessary to satisfy any claims, liens or judgments against the subcontractor...which have not been suitably discharged." Safeco adopted its principal's position that payment could be withheld from the claimant subcontractor based upon a "potential" claim for liquidated damages that the SCA might assert against the general contractor for delays on the project (and which, presumably, the general contractor intended to pass on to the subcontractor).

The court held that such a "potential" claim by the SCA against the general contractor was not a claim for damages against the plaintiff subcontractor that would justify an offset in the payment due to the subcontractor. As a result, the general contractor had failed to pay promptly under the General Municipal Law and Safeco was liable under its payment bond. The subcontractor was awarded damages in the amount of \$1,502,964, plus \$399,421.77 in interest, making the decision by the surety not to pay the claim a very expensive one.

### **Granger Construction Company, Inc. v. TJ, LLC**<sup>3</sup>

This is another case demonstrating the importance of the obligee's requirement to strictly comply with conditions precedent of the performance bond prior to making a claim.

The defendant owner entered into a contract with the plaintiff contractor for construction of a hotel. The defendant surety issued payment and performance bonds for the contractor, naming the owner as obligee. While construction was still ongoing, but the hotel was in use, the fire-alarm system malfunctioned requiring the owner to close the hotel. The owner demanded that the plaintiff contractor repair the fire-alarm system, but the contractor refused because the owner was behind in its payments. The owner then performed the repairs itself and, in doing so, discovered other problems with the construction and proceeded to hire other contractors to perform repairs.

The owner then notified the surety of its intent to place the contractor in default, which notification triggered a conference among the owner, contractor, and surety in an attempt to resolve the issues. Because no resolution was reached, the owner allegedly sent a formal notice of default to the surety. Both the surety and general contractor, however, denied having received the notice. Litigation ensued.

After being sued by the contractor, the owner commenced a third party action against the surety under the performance bond. The surety moved for summary judgment dismissing the owner's claim on the grounds the owner failed to satisfy the express conditions precedent in the bond, thus releasing the surety from any obligation to the owner.

Under the bond, the surety's obligations "*shall arise*" after the following conditions are met:

- (1) the owner notifies the contractor and surety that it is considering a declaration of contractor default and

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requesting a conference with the parties;

(2) the owner formally declares a contractor in default and terminates the contractor's right to finish its work, which could not occur earlier than 20 days after the parties received the first notice;

(3) the owner agrees to pay the balance of the contract price to the surety or to a contractor selected to perform the remainder of the contract work.

Per the language of the bond, only after these conditions were satisfied was the surety required to perform under the bond. The surety could also waive these rights and tender payment to the owner or deny liability.

Under the bond, the surety also had a reasonable time to proceed once the owner satisfied the referenced conditions. If it did not, the surety would only be deemed in default 15 days after receiving an additional notice from the owner demanding the surety's performance.

The court held that the owner failed to strictly comply with each condition precedent of the bond, which relieved the surety of liability. The court accepted the surety's assertion that it did not receive the owner's notice of default and noted that this, by itself, was enough to discharge the surety from liability under the bond. The court, however, went on to cite the owner's hiring of other contractors prior to giving the surety any notice of intent to declare a contractor default as an additional basis for releasing the surety from its obligations. Lastly, the owner admitted to not providing additional notice to the surety prior to commencing a lawsuit; a final nail in this owner's coffin. The surety's summary judgment motion was granted and the owner's action dismissed.

This particular case drives home the importance of complying with conditions precedent prior to making claims against a performance bond. **E&D**

1 133 A.D.3d 519 (1st Dept 2015).

2 134 A.D.3d 413 (1st Dept 2015).

3 134 A.D.3d 1329 (3d Dept 2015).

that justified injunctive relief. The court found, however, that the transfer in this case did not create a danger of depletion of assets or otherwise indicate that the assets were likely to disappear. Instead, the court noted that DeNovo had executed a transfer to a trustee for the benefit of creditors and represented that the trustee had set aside \$5 million for Westchester's use. Thus, the court concluded, Westchester failed to show that the assets were "likely to disappear" so as to be entitled to the preliminary injunction requiring the deposit of the collateral.

As the Westchester case demonstrates, New York's irreparable harm standard remains a high bar for the surety to meet in order to fully protect its interests when faced with significant exposure and an uncooperative or insolvent principal. While the surety would likely be entitled to specific performance through a summary judgment motion, it could not obtain an injunction without meeting the high irreparable harm standard. **E&D**

1 *Westchester Fire Ins. Co. v. DeNovo Constructors, Inc.*, 15-CV-7940 (AJN), 2016 WL 1381821 (S.D.N.Y. April 8, 2016).

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inal GIA was "lost" and asked him to execute another one. Mr. Von Samek refused.

In February 2011, the general contractor made a claim against the performance bond. In March 2011, CAM sent a letter to Developers acknowledging that CAM could not complete its bonded scope of work and requested financing from Developers. The financing request letter admitted that CAM defaulted under the bonds and the GIA and agreed that the expenses Developers incurred or would incur were debts owed by CAM under the 2009 indemnity agreement. Mr. Von Samek signed the letter as president of CAM. Developers ultimately expended over \$500,000 to complete the contract and resolve the bond claims.

In the subsequent indemnity lawsuit, CAM argued that Developers could not prove the existence of a valid and enforceable contract because Mr. Von Samek did not sign the 2009 indemnity agreements. The court found the

alleged forgery to be of no effect, since Mr. Von Samek's subsequent actions and writings ratified the obligations under the indemnity agreements and, therefore, the indemnitors were bound by them. Mr. Von Samek's "failure to disavow the [2009] indemnity agreement[s] in the March 2011 letter constitutes ratification of [them]," the court said.

Mr. Von Samek's signature on the March 2011 financing request letter in his capacity as president of CAM, rather than individually, made no difference to the court. It held that Mr. Von Samek had an affirmative obligation to disavow any agreement he claims he knew was forged. Developers relied on Mr. Von Samek's failure to disavow the allegedly forged agreement and was thus entitled to summary judgment against all indemnitors, including Mr. Von Samek, personally. **E&D**

1 No. 14 C 665, 2016 WL 878233 (N.D. Ill. March 8, 2016).



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## FIRM NEWS

Kevin Peartree will be speaking at the Associated General Contractors of America BuildCon in Atlanta on October 18th, on the topic “Which Standard Form Design-Build Contract is Right for You and Your Project”. He will be presenting on this same topic at the Design-Build Institute of America Conference in Las Vegas on November 3rd and at the 2016 Construction Super Conference in Las Vegas on December 6th.

Thomas K. O’Gara will be presenting at the National Bond Claims Association Annual Meeting in Hilton Head, South Carolina this fall on the topic of “Dealing with the Difficult Owner.”