



Surety Bad Faith after *PSE Consulting*: An Implicit Bar to Indemnification

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In the construction industry, parties to general agreements of indemnity (commonly known as GAIs) once thought these agreements gave sureties unlimited discretion and protection in settling bond claims. Parties should not think this way anymore. Earlier this year, the Connecticut Supreme Court ruled that a surety is only protected when it settles a claim in good faith, despite specific language commonly found in GAIs. This decision is sound, and is likely to be adopted in other jurisdictions. A surety's right to indemnification is not absolute, but instead, is subject to review by the trier of fact.

At one time, it was widely presumed that a surety was entitled to indemnification whenever it settled a claim based solely on two provisions found in GAIs: the right to settle and prima facie evidence provisions. The Connecticut Supreme Court's decision in *PSE Consulting*,¹ however, changes that presumption. The court recognized that the GAI is one of two contracts governing the surety. The other is the bond(s) issued by the surety. Most construction projects require the principal, usually the general contractor or a subcontractor, to obtain payment and performance bonds from the surety and to provide those bonds to the owner of the construction project, known as the obligee, as security for the contractor's performance. However, even though the surety has conflicting obligations to the claimant and the principal under the GAI and the bond, it owes a duty of good faith to both. The *PSE Consulting* case makes this clear.

The *PSE Consulting* court held that a payment bond surety's bad faith settlement with a subcontractor precludes its right to contractual indemnifi-

fication from the principal/general contractor, despite the GAI containing right to settle and prima facie evidence provisions.² In *PSE Consulting*, the general contractor obtained payment and performance bonds³ from the surety and provided them to the owner.⁴ As a condition of providing the bonds, the general contractor agreed to indemnify the surety for any costs incurred by the surety pursuant to its bond obligations.⁵

The GAI in *PSE Consulting* contained the following indemnity language:

[The general contractor] will indemnify and save [the surety] harmless from and against every claim, demand, liability, cost, charge, suit, judgment and expense which [the surety] may pay or incur in consequence of having executed, or procured the execution of such bonds ... including, but not limited, to fees of attorneys ... and the expense of procuring, or attempting to procure, release from liability, or in bringing suit to enforce the obligation of ... [the general contractor] under this [GAI].⁶

The GAI also contained the following "prima facie evidence" provision:

In the event of payments by [the surety], [the general contractor] agree[s] to accept the voucher or other evidence of such payments as prima facie evidence of the propriety thereof, and of [the general contractor's] liability therefore to [the surety].⁷

The GAI also contained the following "right to settle" provision:

[The surety] shall have the exclusive right to determine for itself and [the general contractor] whether any claim or suit brought against [the surety] or [the general contractor] upon any such bond shall be settled or defended and its decision shall be binding and conclusive upon [the general contractor].⁸

The *PSE Consulting* court explained that the terms set forth in both these provisions "are typical of indemnity agreements utilized throughout the surety industry, and courts routinely have upheld the validity of similar or identical provisions."⁹ The court said, "We agree that indemnity agreements, such as the one here, typically guarantee the surety wide discretion in settling claims made upon the bond."¹⁰ But stated affirmatively: "This discretion is, however, not unfettered."¹¹

Most jurisdictions, now including Connecticut, have held that the surety is entitled to indemnification only for payments made in good faith.¹² While some jurisdictions limit the surety's duty of good faith to cases where the indemnity agreement expressly imposes that duty upon the surety¹³, courts in other jurisdictions recognizing the existence of an implied covenant of good faith and fair dealing have concluded that a surety owes a duty of good faith to its principal irrespective of whether the indemnity agreement expressly imposes that duty.¹⁴

In the *PSE Consulting* case, National Fire Insurance Company of Hartford, Inc. (NFI), a surety, knew that it had to prove to the jury that it settled the subcontractor's claim in good faith. During a five-day conference following the close of evidence in a jury trial in superior court in Stamford,

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Connecticut, NFI's attorney said, "I have to prove that I made a payment under a bond in good faith. ... I have that burden."¹⁵ NFI's attorney, however, did not meet his burden. The jury found that NFI breached the implied covenant of good faith and fair dealing in its indemnity agreement with its principal, a general contractor, Frank Mercede & Sons, Inc. (Mercede), when it paid a subcontractor's claim, over the objections of Mercede, in its own self-interest, and without adequately investigating the claim.¹⁶

NFI argued that the indemnity agreement gave it "broad discretion to settle claims upon the payment bond, even over the objection of the principal, Mercede."¹⁷ But, since Connecticut recognizes an implied covenant of good faith and fair dealing in every contract, the jury was charged with deciding whether that decision was made in good faith. It decided the settlement was made in bad faith and the Connecticut Supreme Court affirmed the superior court's judgment on the verdict.¹⁸

Background

Suretyship is a unique contractual relationship, whereby the surety undertakes an obligation to be held answerable for the debt or default of the principal.¹⁹ Owners of construction projects often require contractors to provide bonds to guarantee performance and payment. These bonds, commonly known as performance and payment bonds, create rights and obligations among three parties: the party secured by the bond (the obligee), the bond principal (the obligor), and the surety. The bond principal is typically the general contractor or a subcontractor. The obligee is usually the project owner under a performance bond, or the subcontractors, materialmen, and equipment suppliers under a payment bond. The surety most often is an insurance company or financial institution engaged in, among other things, the business of issuing bonds.

Because of the tripartite relationship inherent in suretyship, the parties have conflicting rights and obligations with respect to one another. The bonds

themselves create certain rights and obligations among the parties. Under a performance bond the surety binds itself financially if the principal does not perform or pay. It guarantees the obligee, if the principal fails to perform its contractual duties, that the surety will discharge the duties itself, either by performance or payment of the excess costs of performance.²⁰ Under a payment bond, the surety guarantees that the principal will pay the obligees for the labor, materials

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and equipment furnished in connection with the project.²¹

It is common practice in the construction industry for sureties to require contractors for which they write bonds to execute GAIs by which the contractor (the principal) and its individual backers (the indemnitors) agree to indemnify the surety against any loss that they may incur as a result of writing bonds on behalf of the contractor. GAIs create additional rights and obligations to the parties. Accordingly, a surety has conflicting obligations to the claimant and the principal. However, irrespective of these conflicting obligations, the surety owes a duty of good faith both to the claimant and to the principal. If the surety has not acted in good faith, it cannot recover. Yet, while seemingly

straightforward, there is no uniform standard by which courts, state and federal, define bad faith.

Defining Bad Faith in *PSE Consulting*

An implied covenant of good faith and fair dealing has long been recognized in contract law.²² Under Connecticut common law, every contract carries with it an implied covenant of good faith and fair dealing, which imposes upon each party a duty of good faith and fair dealing in performance and enforcement of a contract.²³ Indemnity agreements and surety bonds are written contracts. The Uniform Commercial Code defines good faith as "honesty in fact in the conduct or transaction concerned."²⁴ Good faith requires that "neither party do anything that will injure the right of the other to receive the benefits of the agreement."²⁵ Good faith further dictates that a party with contractual discretion exercises that discretion for a purpose consistent with the intent and expectations of the parties at the time the contract was formed and not in an attempt to recover an opportunity that was exchanged by the terms of the contract.²⁶

The *PSE Consulting* court, following a comprehensive survey of the standards of other jurisdictions in applying the implied covenant of good faith and fair dealing in the surety context, adopted the majority view in requiring an "improper motive" or "dishonest purpose" on the part of the surety in order to establish bad faith.²⁷ Such a standard "preserves a proper balance between affording the surety the wide discretion to settle that it requires, while ensuring that the principal is protected against serious and willful transgression."²⁸ While mere negligence is not enough, the surety's actions need not rise to the level of fraud. Adopting the majority view, the *PSE Consulting* court affirmed the trial court's ruling that the jury could reasonably find, based on the evidence adduced at trial, that the surety acted in bad faith in settling the subcontractor's payment bond claim.

In *PSE Consulting*, the surety's acts, or

lack thereof, while not rising to the level of fraud, were sufficient to show improper motive or dishonest purpose on the part of the surety. The *PSE Consulting* court held, based on the evidence admitted at trial, that a jury could reasonably find that the surety acted in bad faith by failing to adequately investigate a claim upon the payment bond and by improperly settling the claim out of self-interest. The court affirmed the trial court's ruling, notwithstanding the exclusive right to settle and prima facie evidence provisions of the GAI and the principal's refusal, over the surety's demands, to post collateral following the subcontractor's submission of the payment claim in issue.

Applying its bad faith standard to the evidence adduced at trial, the *PSE Consulting* court concluded that the jury reasonably could have determined that the surety breached the implied covenant of good faith and fair dealing by failing to adequately investigate the subcontractor's bond claim in violation of the requirements of the payment bond²⁹ and by improperly settling the claims solely out of self-interest.³⁰ Specifically, the court concluded, based on the evidence at trial, that the jury could have reasonably determined that the surety did not investigate the claim in a manner sufficient to determine whether the amount claimed was in dispute (in violation of the bond requirements) and that it engaged in only a superficial review of the claim.³¹

It was adduced at trial that NFI's claims manager never reviewed the company's project records prior to settlement. In fact, he lacked the necessary knowledge and experience to make an adequate assessment of the claim.³² Further evidence established that NFI did not even have its in-house engineer evaluate the claims until almost two years after it was obligated under the payment bond to respond to the claims.³³ Although at first blush these failures may be viewed as mere negligence per se, the *PSE Consulting* Court held that:

Although mere negligence or failure to make the inquiries which a

reasonably prudent person would make does not of itself amount to bad faith, if a party fails to make an inquiry for the purposes of remaining ignorant of facts which he believes or fears would disclose a defect in the transaction, he may be found to have acted in bad faith.³⁴

A surety that knowingly fails to make an inquiry during its investigation of a claim because it believes or fears that such an inquiry will impose liability has acted in bad faith. A failure to inquire is mere negligence only if there is no belief or fear of the consequences of the inquiry; otherwise, it may rise to the level of bad faith. While recognizing that the surety is

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obligated to conduct a proper investigation, the court warned that, "the failure to investigate, standing alone and not accompanied by other evidence of an improper motive, is not enough to constitute bad faith."³⁵ At a minimum, a surety must act as a reasonably prudent person during its investigation of a claim. Thus, the court concluded:

[A] surety's failure to conduct an adequate investigation of a claim upon a payment bond, when accompanied by *other evidence, reflecting an improper motive*, properly may be considered as evidence of the surety's bad faith.³⁶ [Emphasis added.]

The *PSE Consulting* court further concluded, based on the evidence adduced at trial, that the jury could have reasonably determined that the surety settled the claim upon the payment bond solely to protect its own self-interest.³⁷ Specifically, the general contractor proffered evidence that: (1) the surety settled the claim because it feared possible action by the Connecticut Insurance Commissioner based upon its failure to process the subcontractor's claim properly as required by the payment bond; (2) the surety's sole motivation to settle the claim was to release itself from the subcontractor's claims that it had acted in bad faith and in violation of the Unfair Trade Practices Act, Conn. Gen. Stat. § § 42-110a *et seq.* (CUTPA) by failing to perform in accordance with the requirements of the payment bond; (3) shortly before the subcontractor filed its lawsuit on the payment bond, the surety's attorney met with the subcontractor's attorney, without the general contractor's knowledge, in an attempt to settle the bad faith and CUTPA claims against the surety; and, (4) the surety only obtained a release of all claims against itself, and not against itself and its principal, which the general contractor claimed, showed that the \$700,000 in payments made by the surety to the subcontractor were only in settlement of the subcontractor's bad faith and CUTPA claims against the surety, instead of in settlement of all of the subcontractor's claims against the bond.³⁸

The law on the issue of whether a self-interested settlement constitutes bad faith, like the law on the issue of whether a surety's failure to investigate a claim properly, is sparse.³⁹ Jurisdictions are split on whether a surety has acted in bad faith in seeking indemnification from a principal simply because the principal objected to and raised colorable defenses to payments made by the surety to the claimant.⁴⁰ Taking guidance from other courts, the *PSE Consulting* court held that a principal's liability for claims upon which the surety seeks indemnification pursuant to a GAI is not a prerequisite.⁴¹ The court turned

for guidance to a frequently cited case on the issue of self-interested settlement, *Fidelity & Deposit Co. of Maryland v. Bristol Steel & Iron Works, Inc.*,⁴² which stands for the proposition that a surety does not engage in bad faith per se even when it settles questionable claims to protect its own interests, as opposed to the interests of the indemnitors.

In *Fidelity & Deposit Co. of Maryland*, the Fourth Circuit, applying Pennsylvania law, affirmed the district court's award of indemnification to sureties that settled claims on the performance bond brought by the obligee, the Pennsylvania Department of Transportation (PennDOT), in the face of threats to blacklist the sureties from issuing bonds on subsequent PennDOT construction projects.⁴³ There, the contractor constructed a bridge, which PennDOT refused to accept. PennDOT brought a performance bond claim, which was denied by both the principal and the sureties. Subsequently, an arbitration commenced between PennDOT and the contractor. During the arbitration, PennDOT, displeased with the sureties' refusal to pay, disqualified the sureties from bonding future PennDOT projects. The sureties then sought and were awarded indemnification under an indemnity agreement requiring reimbursement of all payments made by the sureties "in good faith ... under the belief that [they were] liable for the sums or amount so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed."⁴⁴ The court concluded that the surety's right to indemnification was preserved, absent other evidence of bad faith other than the self-interested settlement.⁴⁵ In reaching its holding, the *Fidelity & Deposit Co. of Maryland* court considered the facts surrounding the payment. First, the principal, with full knowledge of the sureties' payment and purpose, never objected to the payment. Further, prior to the payment, the principal informed the surety that its actions were reasonable under the circumstances. Also, under applicable Pennsylvania law, the principal was bound "not simply to indemnify the

surety but to keep it unmolested."⁴⁶

After reviewing the principles set forth in *Fidelity & Deposit Co. of Maryland*, the *PSE Consulting* court distinguished that case on its facts. In *PSE Consulting*, the jury reasonably could have found that the principal either was unaware that the surety

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was making payments to the claimant, or objected to them once it was made aware.⁴⁷ The evidence admitted at trial showed that the surety initially supported the general contractor's defenses against the subcontractor's claims against the payment bond, only to abandon such support after the subcontractor claimant filed its complaint with the Connecticut Insurance Commissioner and threatened litigation against the surety based upon claims of bad faith and violation of CUTPA.⁴⁸ Recognizing a different standard of indemnity, the *PSE Consulting* court concluded that "the self-interested settlement ... was not cloaked in good faith garb, but rather, was tainted by a confluence of circumstances from which a jury could properly have inferred improper motive."⁴⁹

The *PSE Consulting* court acknowledged that a surety's conflicting obligations to the principal and claimant make it difficult to articulate circumstances when a self-interested settlement is improper:

Due to the unique nature of the tri-

partite relationship among surety, principal and claimant, that a surety may subject itself to bad faith claims from the claimant simply by defending the principal and refusing to settle the claimant's demand upon the payment bond. Similarly, a surety may face claims, such as in this case, by its principal when it settles with a claimant. Consequently, sureties, by the nature of their business, may find themselves caught between Scylla and Charybdis. [Footnote omitted.] As a result, even though motives of self-interest may constitute bad faith under some circumstances, *it does not follow that the self-interested exercise of rights under a contract necessarily constitutes a per se violation of the implied covenant of good faith and fair dealing....*

Inherent in this determination is our appreciation of the public policy supporting the discretion afforded a surety under an indemnity agreement, in that, such agreements make it possible for a surety to compensate unpaid subcontractors and vendors or to complete a project in response to a performance bond claim without having to await the adjudication of every possible defense by the principal.

Although we acknowledge the policy behind a surety's discretionary authority, we also question, however, the wisdom of allowing potentially suspect claims to control or interfere with the contract obligations between a principal and its surety. ... Consistent with [cases holding that bad faith can preclude indemnification where a self-interested settlement is accompanied by an improper motive] and recognizing the difficulties associated with the surety business, we conclude that *a self-interested settlement, when accompanied by other evidence of improper motive, can constitute bad faith.*⁵⁰ [Emphasis added.]

The court weighed the interests of the surety, that has wide discretion to

settle claims under an indemnity agreement, against those of the principal, that is entitled to protection from a surety settling potentially suspect claims for improper motives. A self-interested settlement, standing alone, is not a breach of the implied covenant of good faith and fair dealing. Thus, to overcome the public policy in favor of giving the surety wide discretion in settling claims, the settlement must be both self-interested *and* accompanied by other evidence of improper motive or dishonest purpose.

A bad faith jury instruction is proper, if when read as a whole, it adequately conveys the law of good faith and fair dealing to the jury.⁵¹ The trial court in *PSE Consulting* charged the jury on the implied covenant of good faith and fair dealing as follows:

You must decide whether [the surety] fulfilled its obligation to exercise good faith. Good faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with justified expectations of the other party. Good faith and fair dealing mean an attitude or state of mind denoting honesty of purpose and freedom from intent to defraud. It means being faithful to one's duty and obligation under the contract. Good faith is defined as the opposite of bad faith. If [the surety] engaged in bad faith, you must find that it did not fulfill the implied covenant. Bad faith generally implies a design to mislead or deceive another or neglect or refusal to fulfill some duty or some contractual obligation not prompted by an honest mistake as to one's right or duties. Bad faith is simply not bad judgment or negligence, but it implies the conscious doing of a wrong because of dishonest purpose.⁵²

The *PSE Consulting* court held that specific language that "[bad faith] contemplates a state of mind affirmatively operating with furtive design or ill will" did not have to be in the charge.⁵³ It

determined that the jury charge, read as a whole, does not equate unhappiness or ill feelings when one exercises a contractual right to the detriment of the other with bad faith. The court further held that a jury instruction listing 14 factors for use by the jury in determining bad faith did not misguide the jury on whether the surety acted in bad faith.⁵⁴ Specifically, the court concluded that the instruction, "you need not find all of these allegations have been proven by the evidence for you to find a violation of the implied covenant of good faith and fair dealing," did not lead the jury to believe that any of the items on the list constituted a per se violation of the implied covenant.⁵⁵

Bad Faith outside of Connecticut

The standards defining surety bad faith vary from state to state. A survey of the laws of each state, however, is beyond the scope of this article. The majority of states require that the principal establish something more than mere negligence to prove bad faith.⁵⁶ Even though many of these states do not define the term "bad faith," those that do, imply that bad faith means that the surety acted with an "improper motive" or "dishonest purpose."⁵⁷ In *Engbrock v. Federal Ins. Co.*, the indemnitors attempted to escape liability from their obligations under the indemnity agreement by claiming that the surety failed to mitigate losses on the construction project.⁵⁸ The Fifth Circuit affirmed judgment in favor of the surety, holding that:

At most, the pleading alleges negligence by [the] surety. But neither lack of diligence nor negligence is the equivalent of bad faith; and improper motive, which is not alleged, is an essential element of bad faith. ... Hence, we conclude that it was not error for the trial judge to deny admission into evidence of the testimony of [the indemnitors] that the payments were excessive.⁵⁹

In *Employers Ins. of Wausau v. Able Green, Inc.*, the principal asserted that

the surety had acted in bad faith by negligently failing to obtain complete copies of all construction agreements and improperly paying claims in order to forgo litigation.⁶⁰ Recognizing that the surety's actions were negligent, the district court held that such acts do not rise to the level of deliberate malfeasance, which is required under Florida law to establish bad faith.

A minority of states view bad faith under a less stringent standard, namely, one defining bad faith as conduct that is unreasonable or negligent.⁶¹ In *Arntz Contracting Co. v. St. Paul Fire and Marine Ins. Co.*, the California Court of Appeals held that a principal could prove bad faith by showing "objectively unreasonable conduct, regardless of the [surety's] motive."⁶² Absent direct evidence of evil motive or intent on the part of the surety in incurring expenses, the *Arntz* court nevertheless held that the surety acted in bad faith in incurring certain expenses based on substantial evidence that the expenses were neither warranted, desirable or necessary.⁶³

Some states require only that the indemnitors prove that the surety failed to make a reasonable investigation of the claims to prove bad faith. In *The Hartford v. Tanner*, the Kansas Court of Appeals affirmed summary judgment dismissing the surety's claims based on its conclusions that the surety "did not conduct a thorough investigation," had "simply paid the claims and sought indemnification," and had "made no attempt to mitigate the claims."⁶⁴ However, the *Tanner* court implied that it may have allowed recovery if the surety offered evidence of what its losses would have been had its conduct been reasonable.⁶⁵

A principal's claims of bad faith settlement practices by a surety as a defense to enforcing the GAI have only been successful in a few cases.⁶⁶ To the contrary, courts have gone so far as to hold principals/indemnitors liable under the GAI when the surety not only settles the bond claim, but also settles the principal's affirmative claims against the owner over the objection of the principal.⁶⁷ Courts have also held indemnitors liable under the GAI when a surety

settles for reasons other than the merits of the bond claim.⁶⁸ A clear majority of states define surety bad faith as something akin to, but not quite rising to, the level of fraud, but clearly more than unreasonable or negligent conduct.

A duty of good faith and fair dealing, which is implied in every indemnity agreement, overrides the surety's sole discretion to settle claims. In *Portland v. George D. Ward & Assocs., Inc.*, the Oregon Court of Appeals held that there was sufficient evidence for a jury to find that the surety failed to make a good faith investigation in settling a claim, despite express language permitting the surety to settle the claim in its "sole discretion."⁶⁹ The court reasoned that "[the surety] was bound by its implied covenant of good faith to exercise its discretion in compromising the claim so that the reasonable expectations of all parties would be effectuated."⁷⁰ The court further concluded that despite the language relating to the surety's sole discretion, the parties under an indemnity agreement "must reasonably expect that compromise and payment will be made only after reasonable investigation of the claims, counterclaims and defenses" if undertaken by the surety.⁷¹ The court found that sufficient evidence existed to establish that the surety failed to reasonably investigate the claims, citing the testimony of the surety's attorney that he did not investigate whether the contractor was in violation of its permit, or whether the owner city gave proper notice of suspension of delivery under the contract.⁷² The surety's attorney also testified that the surety did not independently calculate the city's damages nor did it press the city's failure to mitigate damages. From this evidence, the court held that a jury could infer that the surety acted in bad faith by failing to reasonably investigate the city's claims prior to settlement.⁷³

Other states require actual fraud in order for the surety's actions to rise to the level of bad faith.⁷⁴ A federal court, applying New York law, analogized the surety's discretion in settling claims to the business judgment rule in corporate law, noting that the sure-

ty's "decision ought to be regarded as presumptively correct" in the absence of self-interest or fraud.⁷⁵

It Is the Surety's Conduct That Governs

The *PSE Consulting* decision holds sureties accountable. It recognizes that while sureties have discretion in settling claims under GAIs, their right to indemnification is not absolute. Sureties must reasonably process and investigate claims, free of dishonest purpose and improper motives, and without intentionally remaining ignorant of facts that they believe or fear will impose liability. After *PSE Consulting*, sureties can no longer use the GAI as a guaranty to indemnification. Instead, principals can now assert surety bad faith as an implicit bar to indemnification.

The probability is high, based on the comprehensive analysis in the *PSE Consulting* decision and its sound reasoning, that the case will be a leading authority on surety bad faith for many years to come. The *PSE Consulting* standard of bad faith establishes a system of checks and balances among the parties to a construction project. It still gives sureties discretion to settle claims because of their importance to the viability of the project, and because the economic incentives motivating their actions are a safeguard against payment of invalid bond claims. It also gives the obligees and claimants—the owners, general contractors, subcontractors, and suppliers—assurances that defaults by any of the other parties will not result in a loss to them. This ensures that subcontractors and suppliers, especially on large construction projects, receive reasonably prompt payment for the labor and materials furnished to the project. In some instances, prompt payment is necessary for these subcontractors and suppliers to remain solvent and stay in business. Finally, the decision ensures that principals are protected against surety bad faith.

Whether sureties modify their standard indemnity agreements based on the *PSE Consulting* case remains to be seen. The *PSE Consulting* decision makes it clear that

while sureties enjoy discretion in settling claims under the right to settle and prima facie evidence provisions of GAIs, a surety's right to indemnification from its principal is precluded if the settlement involves improper motive or dishonest purpose. In the end, the trier of fact will determine bad faith based on the surety's acts and omissions in investigating and processing bond claims. Therefore, it is the surety's conduct—not the provisions of the bonds and GAIs—that governs.

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Endnotes

1. *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 267 Conn. 279, 838 A.2d 135 (2004). Garcia & Milas, P.C., was trial and appellate counsel to Cross-Claim Defendant—Appellee Frank Mercede & Sons, Inc.
2. *Id.* at 283.
3. The bonds were payment and performance bonds on AIA Form A312.
4. *PSE Consulting, supra*, 267 Conn. at 283.
5. *Id.*
6. *Id.* at 291, ¶ 2, GAI. While the GAI did not expressly require the surety to act in good faith, the general contractor and the surety recognized, both at trial and oral argument before the Connecticut Supreme Court, that the implied covenant of good faith and fair dealing applies to sureties. *Id.* at 301.
7. *Id.*, ¶ 2, GAI.
8. *Id.*, ¶ 5, GAI.
9. *Id.* at 291-92.
10. *Id.*
11. *Id.*
12. *Id.* at 300. See, e.g., *Gundle Lining Constr. Corp. v. Adams County Asphalt, Inc.*, 85 F.3d 201, 210-11 (5th Cir. 1996); *Fidelity & Deposit Co. of Maryland, supra*, 722 F.2d at 1162-63 (4th Cir. 1983); *Transamerica Ins. Co. v. Bloomfield*, 401 F.2d 357, 362 (6th Cir. 1968); *Engbrock v. Federal Ins. Co.*, 370 F.2d 784, 786 (5th Cir. 1967); *Carroll v. National Surety Co.*, 24

F.2d 268, 270-71 (D.C.Cir.1928); United States Fidelity & Guaranty Co. v. Feibus, 15 F.Supp.2d 579, 583-85 (M.D.Pa.1988); National Surety Corp. v. Peoples Milling Co., 57 F.Supp. 281, 282-83 (W.D.Ky.1944); Martin v. Lyons, 98 Idaho 102, 105-06, 558 P.2d 1063 (1977); United States Fidelity & Guaranty Co. v. Klein State., 190 Ill.App.3d 250, 255, 146 Ill. Dec. 848, 558 N.E.2d 1047 (1989); *The Hartford, supra*, 22 Kan.App.2d at 70; United States Fidelity & Guaranty Co. v. Napier Electric & Const. Co., 571 S.W.2d 644, 646 (Ky.App.1978); Int'l Fidelity Ins. Co. v. Spadafina, 192 App.Div.2d 637, 639, 596 N.Y.S.2d 453 (1993); *Portland, supra*, 89 Or.App. at 456-57; Hess v. American States Ins. Co., 589 S.W.2d 548, 550 (Tex.Civ.App.1979); Fidelity & Deposit Co. of Maryland v. Wu, 150 Vt. 225, 230, 552 A.2d 1196 (1988).

13. *Id.* at 301. See Assoc. Indemnity Corp. v. CAT Contracting, Inc., 964 S.W.2d at 278.

14. *Id.*

15. Brief of the Cross-Claim Defendant—Appellee Frank Mercede & Sons, Inc., *PSE Consulting, supra*, n.1.

16. *PSE Consulting, supra*, 267 Conn. at 282.

17. *Id.* at 300.

18. *Id.* at 283.

19. B.C. Hart, *A Bad Faith Litigation Against Sureties*, TORT & INSURANCE L.J. (1988).

20. United States Fid. & Guar. Co. v. Feibus, 15 F.Supp.2d 579, 580 (M.D.Pa.1998), *aff'd*, 185 F.3d 864 (3d Cir.1999).

21. *Id.* at 581 n.2.

22. RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

23. Gupta v. New Britain Gen. Hosp., 239 Conn. 574, 687 A.2d 111 (1996); Warner v. Konover, 210 Conn. 150, 553 A.2d 1138 (1989).

24. U.C.C. § 1-201(19) (2001).

25. *Gupta, supra*, 239 Conn. at 598.

26. *Warner, supra*, 210 Conn. at 150.

27. *Id.* at 304-05.

28. *Id.* at 305.

29. *Id.* The payment bond provides in relevant part that the surety must after it receives a claim:

6.1 Send an answer to the Claimant with a copy to the Owner within 45 days of receipt of the claim stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.

6.2 Pay or arrange for payment of any undisputed amounts.

30. *Id.* at 318.

31. *Id.* at 306.

32. *Id.*

33. *Id.* at 306-07. The surety's engineer advised the claims manager that the reasonable value of all work performed by the subcontractor was just under \$1 million. At that point, however, the general contractor had paid the subcontractor more than \$1.3 million.

34. *Id.* at 309-10.

35. *Id.* at 308-09.

36. *Id.* at 310.

37. *Id.* at 318.

38. *Id.* at 310-12.

39. *Id.* at 313.

40. *Id.* at 314. See, e.g., Transamerica Ins. Co. v. Avenell, 66 F.3d 715, 718, 721 (5th Cir.1995)(surety's settlement of litigation over principal's objections not bad faith); General Accident Ins. Co. of America v. Merritt-Meridian Constr. Corp., 975 F.Supp. 511, 518 (S.D.N.Y.1997) (no bad faith wherein surety settled claims despite possible defenses by principal). But see, e.g., Travelers Cas. v. F&F Mechanical Contractors, Inc., 29 Conn.L.Rptr. 719, 2001 WL 576662 (Conn. Super. May 8, 2001) (surety breaches implied covenant of good faith and fair dealing when it pays a claim that it knows its principal disputes and objects to); *Hartford, supra*, 22 Kan. App.2d at 64 (surety breaches implied covenant of good faith and fair dealing when it fails to conduct a good faith investigation or fails to take reasonable steps to mitigate the potential damages for which its principal could become responsible).

41. *Id.*

42. Fidelity & Deposit Co. of Maryland v. Bristol Steel & Iron Works, 722 F.2d 1160, 1164-65 (4th Cir. 1983).

43. *Id.* at 1164-65.

44. *Id.* at 1163-65.

45. *Id.*

46. *Id.*

47. *PSE Consulting, supra*, 267 Conn. at 316.

48. *Id.*

49. *Id.*

50. *Id.* at 316-18.

51. *Id.* at 325.

52. *Id.*

53. *Id.*

54. *Id.* at 323. The factors are: Whether [the surety] considered and paid amounts that [the principal] was disputing that were due under the payment bond. Whether [the surety] conducted a reasonable investigation. Whether [the surety] acted in its own self-interest. Whether [the surety] was settling claims [the claimant] asserted against it for which [the principal] was not responsible for the amounts claimed under bad faith and CUTPA.

Whether [the surety] responded promptly to [the claimant] under the terms of the payment bond. Whether it responded within forty-five days as required by the payment bond. Whether [the surety] considered colorable defenses asserted by [the principal]. Whether [the surety] acted as a volunteer in making the payments to [the claimant] for which it had no legal responsibility under the payment bond. Whether [the surety] acted as a volunteer in making the payments to [the claimant] to settle [the surety's] exposure for bad faith and/or CUTPA damages to [the claimant]. Whether [the claimant] had asserted sufficient claim as state[d] in [its] revised and amended complaint. Whether [the surety] made an unreasonable demand for collateral. Whether [the surety] settled due to fear of actions by the Connecticut Insurance Commissioner. Whether conduct of [the surety] in refusing to issue consent of surety ... [a]nd whether the amount paid in settlement to [the claimant] was reasonable.

55. *Id.* at 324.

56. *Id.* at 303.

57. *Id.* at 303-04. Such states include Massachusetts, Pennsylvania, Florida, Alabama, Tennessee, Texas, and Vermont.

58. Engbrock v. Federal Ins. Co., 370 F.2d 784 (5th Cir. 1967).

59. *Id.* at 787.

60. Employers Ins. of Wausau v. Able Green, Inc., 749 F.Supp. 1100, 1103 (S.D.Fla. 1990).

61. *PSE Consulting, supra*, 267 Conn. at 304. Such states include California, Illinois, Hawaii, Kansas, and Oregon.

62. Arntz Contracting Co. v. St. Paul Fire and Marine Ins. Co., 54 Cal.Rptr.2d 888, 899 (Cal.Ct.App.1996).

63. *Id.*

64. *The Hartford v. Tanner*, 910 P.2d 872 (Kan.Ct.App. 1996)

65. *Id.* at 875.

66. A detailed review of more than 1,000 reported decisions revealed that principals are only successful in a handful of cases in proving that a surety breached the implied covenant of good faith and fair dealing in its settlement of a claim on a payment bond, thereby precluding indemnification under the standard GAI.

67. Hutton Constr. Co., Inc. v. County of Rockland, 52 F.3d 1191 (2d Cir. 1995)(finding breach of GAI when principal failed to make indemnity payments to sureties, effectuating assignment of principal's claims to sureties under assignment clause of GAI and allowing sureties to settle prin-

principal's affirmative claims against owner over objection of the principal).

68. *Fidelity & Deposit Co. of Maryland*, *supra*, 722 F.2d at 1164-65.

69. *Portland v. George D. Ward & Assocs., Inc.*, 89 Or. App. 452, 454, 750 P.2d

171 (Or.Ct.App.1988).

70. *Id.* at 457-58.

71. *Id.* at 458.

72. *Id.*

73. *Id.*

74. *PSE Consulting, supra*, 267 Conn. at

304. Such states include Massachusetts, New York, Rhode Island, and Georgia.

75. *Banque National de Paris S.A. v. Ins. Co. of North America*, 896 F.Supp. 163, 166 (S.D.N.Y. 1995).