THE LITIGATOR'S TOOL BOX: USE OF THE PRIMA FACIE CLAUSE FOR SUMMARY DISPOSITION

By: John F. Fatino and Samuel Craven

This article explores one of the most useful tools in the surety's litigation arsenal: the "prima facie clause" of the indemnity agreement. The article examines the background of the clause, how the clause can be employed, and the federal appellate-level case law interpreting such clauses, acquainting newcomers with the clause while serving as an easy reference piece for the seasoned litigator.

I. Background

As a precondition to execution of a surety bond, the surety will generally require the execution of an indemnity agreement.[1] The indemnity agreement will require, among other things, that the indemnitors, which usually consist of the principal, the party on whose behalf the bond is issued, and its individual owners and potentially others unaffiliated with the company, will make good on any loss the surety suffers.[2] Depending upon the specific language of the agreement, the obligation of reimbursement usually includes attorneys' fees,[3] court costs, and consultant's fees. The rationale for the indemnity agreement is beyond the scope of this article, but suffice it to say that the agreement is intended to draw upon the moral and financial capital of the indemnitors.[4] Because surety bonds are not underwritten on an actuarial basis (as life insurance is), the expectation is that the surety will suffer no losses.[5]

A typical prima facie clause of an indemnity agreement might read as follows:

> The Contractor and Indemnitors shall exonerate, indemnify, and keep indemnified the Surety from and against any and all liability for losses and/or expenses of whatsoever kind or nature (including, but not limited to, interest, court costs and counsel fees) and from and against any and all such losses and/or expenses which the surety [sic] may sustain and incur: (1) by reason of having executed or procured the execution of the bonds, (2) by reason of the failure of the Contractor or Indemnitors to perform or comply with the covenants and conditions of this agreement or (3) in enforcing any of the covenants and conditions of this agreement. Payment by reason of the aforesaid causes shall be made to the Surety by the Contractor and Indemnitors as soon as liability exists or is asserted against the surety, whether or not the Surety shall have made any payment therefor. Such payment shall be equal to the amount of the reserve set by the Surety. In the event of any payment by the Surety the Contractor and Indemnitors further agree that in any accounting between the Surety and the Contractor, or between the Surety and the Indemnitors, or either or both of them, the Surety shall be entitled to charge for any and all disbursements made by it in good faith in and about the matters herein contemplated by this Agreement under the belief that it is or was liable for the sums and amounts so disbursed, or that it was necessary or expedient to make such disbursements, whether or not such liability, necessity or expediency existed; and that the vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety.[6]

1 Peter Karney & John Fatino, *The Surety Relationship in the Agricultural Commodity Storage Context and Grain Indemnity Funds: A Jurisdictional Survey*, 40 Creighton L. Rev. 41, 50 (2006) [hereinafter Karney & Fatino].

2 *Id.* at 49-50.

3 Counsel will want to be mindful of any unique procedural issues when state law provides the rule of decision. *See, e.g.*, Iowa Code § 625.24 (2011) (requiring counsel to file an affidavit that fees will not be split with the client).

4 Karney & Fatino, *supra* note 1, at 49.

5 *Id.*

6 Armen Shahinian, *The General Agreement of Indemnity*, *in* The Law of Suretyship 488 (Edward G. Gallagher, ed., 2d ed., 2000). For an exhaustive treatment of the clause, see The Surety's Indemnity Agreement: Law and Practice (Marilyn Klinger et al. eds., 2d ed., 2008).

One of the important provisions of the clause is that the surety's books and records are "prima facie" evidence of what has been paid by the surety with respect to making good on the principal's obligations. The clause simplifies the surety's presentation of evidence of its losses, costs, and expenses, by allowing the surety to rely upon business records or other documents, without the need for testimony from individuals regarding the foundation for the underlying invoices.

Unfortunately, from time to time, for a variety of possible reasons, indemnitors fail to satisfy their obligations under the indemnity agreement. A l may be called upon to sue the indemnitors.

II. Use of the Clause

Using the Federal Rules of Civil Procedure and Federal Rules of Evidence as our procedural basis (assuming that both diversity jurisdiction and the amount in controversy can be met), counsel should specifically plead the existence of the indemnity agreement and breach thereof along with specific reference to the language of the clause itself.[7] The early presentation of the actual contract language is to interject the precise language into the record early on in the proceeding and to pave the way for future use of the materials later in the proceeding. After all, a defendant may actually admit the existence of the clause, which would allow the court to resolve the issue as a matter of law.

Counsel also should consider attaching the indemnity agreement to the complaint as an exhibit, which may make obtaining a default judgment simpler should the indemnitors default.[8] Attachment of the actual agreement would also expedite the presentation of the default motion because the court would have all of the available materials in the record.

Of course, if a party denies the existence of the clause or other material allegations of the complaint, plaintiff's counsel will need to turn to discovery requests to actually tie down the defendant's exact position for the denial of the existence of the clause (along with any other asserted defenses).[9] Depositions may even be warranted to probe the opponent's position, in real time, under oath, and without the artful drafting of a response by counsel.[10]

On the other hand, if counsel believes the record is strong enough, counsel should move for summary judgment.[11] Should the case not be resolved at the summary judgment stage, counsel should move again to enforce the clause as a matter of evidence before the trial court, or, at least, preclude argument to the contrary.[12] In short, counsel will want to prevent the opponent from arguing about the amount, foundation, or other fundamental aspects of the underlying invoices.

For the purposes of this article, let us assume that the surety has filed suit to enforce the indemnity agreement and obtain a money judgment against the indemnitors for the sums expended by the surety. Counsel should build a summary judgment motion around the clause as the key to recovery of the funds. Counsel would craft the summary judgment motion based upon the clause of the agreement and the uncontested facts that reflect the surety expended certain sums in reliance upon the indemnity agreement. Consequently, based upon the prima facie clause of the indemnity agreement, the surety is entitled to judgment as a matter of la

.

Should the court, for some reason, deny the summary judgment motion, counsel could again move *in limine* to prevent arguments by the indemnitors about the amount, foundation, or other fundamental aspects of the underlying invoices, which are contrary to and unnecessary in light of the parties' agreement. Indeed, in the language of the Federal Rules of Evidence, presentation of arguments that run contrary to the prima facie clause (the amount, foundation, or other fundamental aspects of the underlying invoices) should be excluded at trial because the arguments and evidence are irrelevant, misleading to the jury, and simply serve to confuse the issues at trial.[13]

Should the court deny the summary judgment motion, counsel will have to try the case. In the formation of the trial brief (a), counsel must be mindful of the elements of proof. At trial, counsel's task is to prove up the surety's loss-- a -- based upon the indemnity agreement. The elements of proof would consist of the fact that: (1) a (2) bonds were issued in reliance

7 Fed. R. Civ. P. 8(a).

8 Fed R. Civ. P. 10(c), 55.

9 *See* Fed. R. Civ. P. 33 (interrogatories), Fed. R. Civ. P. 34 (requests for production of documents), and Fed. R. Civ. P. 36 (requests for admissions).

10 Fed. R. Civ. P. 30-32.

11 Fed. R. Civ. P. 56.

12 Fed. R. Evid. 104(a).

13 Fed. R. Evid. 403.

upon the indemnity agreement; (3) the surety suffered a loss for which it seeks reimbursement; and (4) the indemnitors breached the agreement by not repaying the surety. Of course, the actual elements vary from jurisdiction to jurisdiction. At its core—the action is for breach of contract. Consequently, all of the pertinent case law regarding contract construction, interpretation, and breach would apply.

Counsel, at trial, should also use the indemnity agreement as a basis for cross-examination of the indemnitors. Cross-examination would proceed along the line that the indemnitors contractually agreed, in advance of any potential dispute, that the surety's books and records were sufficient proof of the damages it suffered. From that proposition, counsel can continue the cross-examination that it follows, therefore, again based upon the language of the agreement, the surety is entitled to a judgment in the same amount.

III. The Case Law

The case la low by circuit. When a final decision of a federal circuit court of appeals is not available or illustrative, counsel will explore lower court decisions within a given circuit that can serve as persuasive authority for the proposition discussed.

A. D.C. Circuit

In *Ideal Electric Security Co. v. International Fidelity Insurance Co.*,[14] the surety International Fidelity Insurance Company[15] brought an action against its indemnitors for recovery of attorneys' fees incurred in defending a claim brought by a subcontractor against Ideal, the general contractor and holder of the payment bond, for an alleged underpayment on subcontracted work. The district court granted summary judgment in favor of International but reduced the amount of fees owed to International based upon invoices withheld by International on the basis of privilege. The bond's indemnity agreement stated, in part, that "vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety."[16] The indemnity agreement provided a "good faith" standard for determining whether Ideal was obligated to indemnify International for attorneys' fees. The circuit court found that the clause shifts the burden to the indemnitors to show excessiveness, at least under these factual circumstances, of the attorneys' fees.[17] Therefore, the circuit court held that International could recover only those fees that were reasonable; and Ideal was entitled to disclosure of all billing statements offered by International in order to establish the amount of fees owed.

The circuit court ultimately affirmed the award of attorneys' fees to International but reversed and remanded the amount of the award for further determination on the reasonableness of the fees based upon a full review of the redacted portions.[18] "Under D.C. law, contractual provisions providing for the indemnification of attorneys' fees are generally enforceable in accordance with the intentions of the contracting parties, unless enforcement would be contrary to public policy."[19] As a practice pointer, the circuit court found waiver of the attorney-client privilege when International put the attorneys' fees into issue.[20]

B. First Circuit

In *United States ex rel. Doten's Construction v. JMG Excavating & Construction Co.*,[21] having obtained summary judgment in its favor on its claims, the surety, Greenwich Insurance Company,[22] sought damages against the third-party defendants, which were two corporate defendants, both of whom executed the indemnity agreement. The construction company, JMG Excavating & Construction Co., Inc.,[23] argued against the requested fees despite language in the indemnity agreement that stated, "the vouchers or other evidence of any such payment by [Greenwich] shall be prima facie evidence of the fact and amount of the liability of the [Indemnitors] to [Greenwich]."[24] The court recognized as follows:

> In cases in which the indemnity agreement at issue included the statement that vouchers or

14 129 F.3d 143 (D.C. Cir. 1997) (applying D.C. law).
15 Hereinafter International.
16 *Id.* at 148.
17 *Id.* at 151.
18 *Id* at 146.
19 *Id.* at 148 (citations omitted).
20 *Id* at 146, 151-52.
21 2005 WL 3557410 (D. Me. 2005) (applying Maine law).
22 Hereinafter Greenwich.
23 Hereinafter JMG.
24 2005 WL 3557410.

> other evidence of payment or compromise shall be prima facie evidence of the fact and amount of liability of the indemnitors . . . courts have generally held that the burden of proof shifts to the indemnitor when the surety seeks reimbursement of fees and expenses and that how the indemnitor may prove that the fees may not be recovered is dependent upon the language of the indemnity agreement.[25]

The court held that, if the clause calls for a "good faith standard," then the party in opposition "must prove fraud or lack of good faith."[26] The presiding magistrate ultimately recommended that the court award damages in the amount of $88,681.96, which was somewhat less than that requested by the surety. The court's decision to reduce the amount of fees awarded was based on Greenwich's demand that another insurer pay portions of the funds due from it to JMG whick was deemed to be similar to a refusal to defend. Therefore, the costs incurred by Greenwich in connection with its demand should have been deducted from its claim for purposes of the damages award.

C. Second Circuit

In *Kennerson v. Labarbera,*[27] the defendant general contractor failed to timely pay plaintiff subcontractor for work performed on a construction project, and the subcontractor commenced an action against the general contractor and the surety. Defendant surety, which had executed a performance bond, moved for summary judgment as to its cross-claim for indemnification from the general contractor for payments made to the subcontractor. The bond stated that "Indemnitors agree that the vouchers or other evidence of such payments sworn to by a duly authorized representative of Surety shall be prima facie evidence of the fact and extent of the liability of the indemnitors to Surety."[28] The general contractor disputed only the amount that was owed the surety, but because it offered no admissible evidence to contradict the surety's sworn statement and documentary proof regarding the amount of the surety's losses as a result of the execution of the bonds, the court awarded the surety a sum consistent with its prima facie showing of the amount of its losses.[29]

Indemnitors often refuse to assist the surety during the settlement process with third parties by the provision of information or assistance. Instead, the indemnitors will wait and argue the settlement was, for a myriad of reasons, unwarranted. The district court found waiver by the indemnitors based upon such "Johnny come lately" tactics.

D. Third Circuit

In *Fallon Electric Co. v. Cincinnati Insurance Co.,*[30] an action by plaintiff subcontractors against the general contractor, Ravin, Inc., and the surety for failure to pay for materials that the subcontractors provided for a project, the surety challenged through its appeal the amount of attorney's fees awarded to it by the district court. Despite the fact that the general contractor failed to introduce any evidence to demonstrate that the fees were incurred unreasonably, in bad faith, or through fraud, the district court awarded the surety fees in an amount that was $34,000 less than the sum requested. The appellate court vacated and remanded to the district court with instructions to enter judgment in favor of the surety based on the indemnity agreement, which established, in part, that "the voucher or vouchers or other evidence of such payment or compromise shall be prima facia [sic] evidence of the facts and the amount of the liability of [Ravin] under this Agreement."[31] As the court of appeals saw it, in light of the plain language of the agreement, which provided for "prima facie evidence," the district court impermissibly shifted to the surety the burden of proving that the attorneys' fees were incurred out of reasonable necessity.[32]

E. Fourth Circuit

In *American Insurance Co. v. Egerton,*[33] an indemnity action brought by the surety, the appellate court upheld an award of summary judgment to the surety and awarded the surety attorneys' fees based upon an indemnity agreement, which provided, in part, that "[a]n itemized statement of payments made by the Surety . . . or the voucher or vouchers for such payments, shall be prima facie evidence of the liability of the

25 *Id.*
26 *Id.*
27 536 F. Supp. 2d 305 (W.D.N.Y. 2008) (applying New York law).
28 *Id.* at 307.
29 *Id.* at 309.
30 121 F.3d 125 (3d Cir. 1997) (a
lecting cases).
33 59 F.3d 165, 1995 WL 371452 (C.A. 4(N.C.)).

indemnitors to reimburse the Surety for such payments, with interest."[34] The circuit court rejected the argument that the indemnity agreement only entitled the surety to recover "expenses" it incurred in attempting to enforce, through litigation, its rights against an indemnitor.[35] The court found unambiguous the language of the agreement that stated "the indemnitors will indemnify the Surety against any and all liability, loss, costs, damages, fees of attorneys and other expenses" it might suffer as a consequence of executing the bonds.[36]

F. Fifth Circuit

In *Engbrock v. Federal Insurance Co.,*[37] corporations entered into a construction contract with two school districts, and surety executed performance and payment bonds for the project. The two corporations and the owner, in his individual capacity, entered into an agreement to indemnify the surety for any losses under the bonds. Specifically, the agreement stated that, "the voucher or other evidence of payment by said [Surety] . . . shall be *prima facie* evidence of the fact and amount of each indemnitor's liability to said [Surety] under this agreement."[38] Under Texas law, the indemnitor must prove fraud or lack of good faith to overcome the clause.[39] In affirming the district court's award of fees and the exclusion of proffered evidence of excessive payments, the appellate court recognized that "[s]imilar provisions, although apparently harsh as to an indemnitor, often have been upheld and are not against public policy."[40] The court further stated that "[t]he accepted rationale is that 'the expense, dela le, and risk of loss to the guarantee company is a sufficient safeguard against an unwarranted payment.'"[41]

Experienced litigators will note that indemnitors will raise every conceivable argument regarding the invalidity of the indemnity agreement. Frequently, this will include the purported tardy execution of the indemnity agreement, for instance, when the bonds were actually issued before the agreement was executed. Observe that the district court also rejected the argument of the lack of consideration for belated execution of the indemnity agreement, which holding is also affirmed.[42]

G. Sixth Circuit

In *Transamerica Insurance Co. v. Bloomfield,*[43] the surety, Transamerica Insurance Company,[44] brought an action to recover on an indemnity agreement to indemnify and save harmless on account of a labor and material payment bond. The circuit court held that Transamerica could recover from the defendant pursuant to the terms of the indemnity agreement.[45] Additionally, the circuit court held that agreements granting the right to compromise and settle claims were not against public policy.[46]

H. Seventh Circuit

In *Continental Casualty Co. v. Guterman,*[47] the plaintiff surety, which paid off the principal's debts to a partnership, asserted a claim for indemnification under its indemnity agreement and filed for summary judgment. The magistrate submitted a report recommending that the court grant the motion for summary judgment, which the court adopted. The principal argued that the order granting summary judgment should be vacated because he did not learn about the magistrate's report until after the report was adopted by the court.[48] The court rejected the principal's arguments, instead holding that the indemnification agreement provided for indemnification by the principal regardless of whether the surety asserted equitable claims. Therefore, even if the surety paid off additional debts for which the principal was not liable, the surety was entitled to full reimbursement under the

34 *Id.* (noting indemnity language).

35 *Id.*

36 *Id.*

37 370 F.2d 784 (5th Cir. 1967) (a

(a

(6th Cir. 1992) (applying Kentucky law). For an analysis that does not specifically discuss the *prima facie* clause of the bond, but seemingly ignores such a clause in denying the surety indemnity for payments made in good faith to the general contractor under the subcontractor's performance bond, see Rust of Ky., Inc. v. TMS Contr., LLC (In re Rust of Ky., Inc.), 464 B.R. 748 (Bankr. W.D. Ky. 2012).

47 708 F. Supp. 953 (N.D. Ill. 1989).

48 *Id.*

indemnity contract. Indemnification was also required under the agreement regardless of whether the surety mitigated damages by selling the principal's collateral.[49]

I. Eighth Circuit

In *Spirtas Co. v. Insurance Co. of the State of Pa.*,[50] as a condition to executing a surety bond, the surety, Insurance Company of the State of Pennsylvania,[51] required appellants to enter into two general indemnity agreements, which provided that "an itemized statement of loss and expense incurred by [ICSP], sworn to by an officer of [ICSP], shall be prima facie evidence of the fact and extent of liability of [Appellants] to [ICSP] in any claim or suit by [ICSP] against [Appellants]."[52] The Eighth Circuit described the cla

.[53] The Eighth Circuit, like Missouri courts, infer a "reasonableness" requirement in all attorneys' fees claims arising under a contract.[54] The court summarily found that language of the indemnity agreement was unambiguous, and the fees and expenses incurred as the result of arbitration, were reasonable. The circuit court also held that ICSP was entitled to receive attorneys' fees and expenses from the appellants which were incurred as a result of defending a claim on the surety bond.

J. Ninth Circuit

In *Safeco Insurance Co. v. Mabra*,[55] the court awarded attorneys' fees to the surety where the surety prevailed in its claim and there was a valid agreement to pay legal expenses. [56]

K. Tenth Circuit

In *United States v. International Fidelity Insurance Co.*,[57] the United States brought an action against defendant surety on behalf of the Commodity Credit Corporation to recover on a warehouseman's bond and collateral agreements to settle with the United States. The court determined that the surety was entitled under the agreement of indemnity to settle with the United States and to deduct from the collateral it held under those agreements the settlement amount (along with its attorneys' fees and expenses). The court's decision was based on the fact that the bond contained a *prima facie* clause that stated "that the vouchers or other evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety."[58] Based on the prima facie clause and evidence of the fees and expenses incurred by the surety the court held that the fees and expenses were reasonable, were made in good faith, and conformed to the specifications of the indemnity agreement.[59]

L. Eleventh Circuit

In *Great American Insurance Co. v. General Contractors & Construction Management*,[60] pursuant to the terms of a bond executed by the plaintiff surety, the surety paid to cure the default of the contractor on one project, satisfied a subcontractor's claims on a second project, and paid to cover the surety's liability to a second subcontractor who sued the surety for payment. The surety sued the defendants, a contractor and two indemnitors, seeking indemnification and/or exoneration, and moved for summary judgment. The court granted the surety's motion for summary judgment on the issue of indemnification and based its decision on the fact that the indemnity agreement included a clause stating that, when the surety made payments thereunder, the "evidence of any such payments made by the Surety shall be prima facie evidence of the fact and amount of the liability to the Surety."[61]

IV. Application

As the foregoing discussion reflects, most of the cases that involve the prima facie cla

. Consequently, counsel will want to move promptly

49 *Id at 954; see also, Safeco Insurance Co. v. Siciliano, Inc.*, 2009 WL 212081 (C.D. Ill. 2009) (applying Illinois law).
50 555 F.3d 647 (8th Cir. 2009) (applying Missouri law).
51 Hereinafter ICSP.
52 555 F.3d at 651.
53 *Id.* at 654.
54 *Id.* at 653-54. (citations omitted).
55 932 F.2d 973, 1991 WL 73713 (Ca. A. 9 (Wash.))
56 *Id.*
57 999 F. Supp. 1420 (D. Kan. 1998).
58 *Id.* at 1423.
59 *Id.* at 1429.
60 2008 WL 2245986 (S.D. FLa))
61 *Id.*

for summary judgment based upon the clause. An early summary judgment motion also has the strategic advantage of requiring the indemnitors to put their defenses "on the table." Counsel can then focus on defeating any real defenses raised by the indemnitors. A

.

If the case proceeds to trial, counsel can again use the parties' indemnity agreement as both substantive evidence of the parties agreement and a basis for cross-examination of the indemnitors at trial. Regardless of the procedural phase of the case when the prima facie clause is used, counsel will want to use this powerful contractual device to obtain relief for counsel's surety client.

John F. Fatino is a member of and Samuel "Luke" Craven is an associate at Whitfield & Eddy, PLC, of Des Moines, Iowa