No. 92744-8

IN THE SUPREME COURT OF THE
STATE OF WASHINGTON

KING COUNTY,

Respondent,

v.

TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA, a Connecticut corporation; LIBERTY MUTUAL INSURANCE COMPANY, a Massachusetts corporation; FEDERAL INSURANCE COMPANY, an Indiana corporation; FIDELITY AND DEPOSIT COMPANY OF MARYLAND; a Maryland corporation; and ZURICH AMERICAN INSURANCE COMPANY a New York corporation,

Petitioners.

AMICUS CURIAE BRIEF OF THE SURETY & FIDELITY ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONERS

R. Daniel Lindahl, WSBA 14801
BULLIVANT HOUSER BAILEY PC
888 SW Fifth Avenue, Suite 300
Portland, Oregon 97204-2089
Telephone: 503.228.6351
Attorneys for Amicus Curiae The
Surety & Fidelity Association of America

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Washington Statutes

United States Statutes

Statement of Interest

The Surety & Fidelity Association of America ("SFAA") is a national trade association of companies licensed to write fidelity and surety insurance in the United States. SFAA's 411 member companies are sureties on the vast majority of contract performance and payment bonds written in the United States, including bonds required on public projects to comply with the federal Miller Act[1] and comparable state statutes, including R.C.W. 39.08.010.

SFAA has read the supplemental briefs filed by Respondent King County and Petitioners Travelers Casualty and Surety Company of America, Liberty Mutual Insurance Company, Federal Insurance Company, Fidelity and Deposit Company of Maryland, and Zurich American Insurance Company ("Sureties"). SFAA agrees with the arguments and

[1] 40 U.S.C. § 3131, *et seq.*

authorities set forth in Sureties' supplemental brief and will not repeat them.

Introduction

A surety bond is a three-party contract in which the primary obligor, the principal, promises to perform an obligation and the secondary obligor, the surety, promises to perform if the principal fails to do so. The surety promises to answer for the principal's debt or default. The third party to the bond, the obligee, is the person to whom the principal's and surety's promises run.

Although surety is a line of insurance, it is different from other lines in certain ways. Sureties seek to avoid losses by carefully underwriting the prospective principal's ability to perform the bonded obligation. Sureties do not spread the risk of fortuitous losses over a large population exposed to them. The surety is entitled to indemnification from the principal, and other indemnitors often help the principal qualify for the bond by contracting to indemnify the surety. Ultimately, the principal and any indemnitors bear the risk of financial loss.[2]

Summary of Argument

The lower courts erred in awarding King County over $15 million of attorney fees and related costs incurred in its litigation with its prime contractor, Vinci Construction Grands Projects/Parsons RCI/Frontier-Kemper, JV ("VPFK") and the Sureties. The lower courts relied on *Olympic Steamship Company v. Centennial Insurance Co.*, 117 Wn.2d 27, 811 P.2d 673 (1991) ("*Olympic Steamship*") and *Colorado Structures, Inc. v. Insurance Company of the West*, 161 Wn.2d 577, 167 P.3d 1125 (2007) ("*Colorado Structures*") in awarding fees against the Sureties even though VPFK was not liable for fees either as primary obligor on the statutory performance bond or as prime contractor on the project.

---

[2] For a more detailed explanation of surety bonds and their differences from other types of insurance see Gallagher, *The Law of Suretyship, 2nd Ed.* (American Bar Association 2000) at pp.1-2, which is attached as an appendix to this brief.

This Court should reverse the attorney fee award against Sureties on any or all of three grounds:

First, this Court should reconsider the majority holding of *Colorado Structures* that the *Olympic Steamship* exception to the American Rule on attorney fees applies to contract performance bonds.

Second, even if the Court declines to reconsider *Colorado Structures*, it should not extend the *Olympic Steamship* rule to statutory performance bonds on public works projects.

Third, even if *Olympic Steamship* applied to the statutory performance bond on VPFK's contract with King County, the underlying litigation was over the amount owed by VPFK, and therefore by its sureties, and not the coverage of the bond. Thus, no *Olympic Steamship* fees should have been allowed.

Argument

In *Olympic Steamship* the Court relied on the "disparity of bargaining power between an insurance company and its policyholder" as establishing a difference between an insurance policy and an ordinary commercial contract. The Court also noted the insured's desire for protection against the expenses of litigation, rather than litigation with the insurer, and a public interest in the prompt payment of claims. In *McGreevy v. Oregon Mutual Insurance Co.*, 128 Wn.2d 26, 904 P.2d 731 (1993) the Court declined to overrule *Olympic Steamship* and stated:

> In *Olympic Steamship*, we identified two significant differences between insurance contracts and other commercial contracts. First, we noted that there is a recognized "disparity of bargaining power between an insurance company and its policyholder." *Olympic S.S.*, 117 Wn.2d at 52. In our judgment, this disparity is at its greatest when an insurance company presents a current or prospective insured with a standardized, or "form" document, in essentially a nonnegotiable, "take-it-or-leave-it" environment. Second, we observed that a motivation for an individual to obtain a contract of insurance is to "seek[ ] protection from

> expenses arising from litigation, not 'vexatious, time-consuming, expensive litigation with his insurer.'" *Olympic S.S.*, 117 Wn.2d at 52 (quoting *Hayseeds*, 352 S.E.2d at 79).

McGreevy, 128 Wn.2d at 35.

Colorado Structures involved a subcontract performance bond on a private construction project. The main issue litigated between the prime contractor as obligee on the bond and the subcontractor's surety was whether the bond's requirement that the obligee declare the subcontractor to be in default was a condition precedent to the surety's liability. The plurality opinion by four justices held that such a declaration of default was not a precondition and that the rule of *Olympic Steamship* justified awarding attorney fees in excess of the bond penalty. In a separate opinion, Justice Sanders dissented as to the declaration of default issue but concurred as to the award of attorney fees, which thus prevailed by a 5-4 margin.

I. The majority opinion in *Colorado Structures* should be reconsidered and overruled.

The grounds for the *Olympic Steamship* rule on attorney fees simply do not exist in the context of a contract performance bond. First, the surety does not dictate the bond form. On the contrary, the obligee, whether the owner requiring a bond from its prime contractor or a prime contractor requiring the bond from its subcontractor, either dictates the terms of the bond or reviews the proposed bond before accepting it. There are many performance bond forms, but they are not published by sureties or by surety industry groups. The performance bond in *Colorado Structures* was on a form published by the American Institute of Architects as a part of its package of contract documents.[3] The architect on a project works for the owner not for prospective sureties. Similarly, the Associated General Contractors of America (contractors and

[3] http://www.aia.org/contractdocs/about/synopsis/aseries/AIAB088232

subcontractors)[4] and the Engineers Joint Contract Documents Committee (engineers)[5] publish bond forms along with other types of contract documents. Sureties, separately or collectively, do not dictate the terms of the performance bond. On the contrary, the obligee has the final word on what terms are acceptable to it.

For example, the Miller Act requires performance and payment bonds on federal construction projects, and the required[6] bond forms, Standard Form Nos. 25 and 25A, are mandated in the Federal Acquisition Regulations at 48 C.F.R. §§ 53.301-25 and 53.301-25-A.

Insurers typically are required to file proposed policy forms with the state insurance departments who determine that they are fair and reasonable before allowing their use. Washington insurance law recognizes that surety bond forms

---

[4] http://www.consensusdocs.org/Catalog?globalcategoryid=ba8ca357-c3da-4b89-9ac9-e9ce00b6a839

[5] http://www.ejcdc.org/wp-content/uploads/2014/10/BondRELEASE_FINAL.pdf

[6] 48 C.F.R. §28.106-1.

are not drafted or mandated by the surety company by exempting such forms from this filing requirement.

R.C.W. 48.18.100(1) states:

> **(1)** No insurance policy form or application form where written application is required and is to be attached to the policy, or printed life or disability rider or endorsement form may be issued, delivered, or used unless it has been filed with and approved by the commissioner. This section does not apply to:
> **(a)** Surety bond forms;
>
> * * *

In addition, if the bond principal defaults, the obligee is not in a vulnerable position similar to an insured where an insurer wrongfully denies coverage. Instead, the obligee has other protections against financial loss in addition to the bond. Construction contracts and subcontracts call for progress payments only as the owner's representative (usually its architect or engineer or in-house project manager) inspects the work and approves it for payment. The obligee pays only for completed, acceptable work and holds the balance of the contract price (plus any retainage called for in the contract) to pay to complete the work if the bond principal defaults.

Indeed, as the facts of *Colorado Structures* demonstrate, the bond obligee often would prefer to supplement the forces of the bond principal or bring in a new contractor of its choosing rather than wait for the surety to investigate and re-let the work. Unlike a typical insured that needs the insurer to pay to re-build the damaged structure or pay for defense costs, bond obligees require performance bonds for the commercial advantage of a deep pocket guarantor that will ultimately pay what is owed.

The legal and factual bases of the *Olympic Steamship* rule simply do not exist in the context of a contract performance bond. There is no fiduciary relationship between the surety and the obligee, and the obligee is neither vulnerable nor incapable of protecting itself in the event of a default.

In support of its application of the *Olympic Steamship* rule to a performance bond, the plurality opinion in *Colorado Structures* cited *Estate of K.O. Jordan v. Hartford Accident &*

Indemnity Co., 120 Wn.2d 490, 844 P.2d 403 (1993) and *Axess International Ltd. v. Intercargo Insurance Co.*, 107 Wn. App. 713, 30 P.3d 1 (2001). However, neither case involved a contract performance bond. *Estate of Jordan* was a claim on a fidelity bond, which is a two-party insurance contract to protect against employee dishonesty. Such fidelity bonds are drafted by insurance companies or their representatives and filed with the state insurance departments. They are not three-party surety bonds.

The bond in *Axess International* was a surety bond required by the federal government from non-vessel owning common carriers. The dispute primarily involved application of state law and federal preemption, and the Court of Appeals did not discuss the relevance of *Olympic Steamship* except to state, "The *Olympic Steamship* rule extends to an action to recover on a surety bond" citing only *Estate of Jordan*, which, of course, did not involve a surety bond.

Olympic Steamship relied on the fiduciary duty owed by an insurer to its insured to justify allowing an attorney fee award to an insured that prevails in coverage litigation. But that justification does not exist in the context of a contract performance bond. A surety and obligee have an arms-length relationship based on a contract that the obligee negotiates with the principal and a bond that the obligee either drafts or chooses. If the obligee wants a right to collect attorney fees, it is free to include it in the bonded contract, as the obligee did in the *Colorado Structures* subcontract. If the obligee elects to omit an attorney fee provision from the contract and bond form, there is no public policy or recognized ground in equity supporting the imposition of an attorney fee obligation on the surety because it contests coverage of the bond. In *Colorado Structures* the surety argued that a declaration of default was a precondition to its liability (an argument with which three justices of this Court agreed). That reasonable, good faith argument should not have triggered an obligation to pay the obligee's attorney fees separate and apart from any contractual provision.

The contention that a surety, or sureties in general, will have no incentive to pay valid claims in the absence of an attorney fee sanction is simply wrong. Sureties are well aware that bonds are required only because they benefit obligees. Congress, for federal projects, and the legislatures of every state for other public projects, require performance and payment bonds precisely because experience has shown they are in the public interest. If valid claims were met with stonewalling and litigation, rather than payment, obligees would not require bonds and would find an alternative product, such as letters of credit or cash deposits, to secure their contractor's obligations.

II. The rule of *Olympic Steamship* should not extend to the statutory performance bond required by R.C.W. 39.08.010.

SFAA agrees with the arguments set forth at pages 3-11 of the Sureties' supplemental brief and will not repeat them. The County required the performance bond form as part of the project bid documents, and neither VPFK nor the Sureties could change its terms. If the bond was a contract of adhesion, the principal and sureties, not the County, were its adherents.

King County is the 13th most populous county in the United States with a budget of approximately $9 Billion.[7] It is well able to protect its interests on a level playing field. There is no basis to impose a judicially-created, one-sided attorney fee shifting rule that the parties did not contract for and that would be contrary to the Legislature's determination that attorney fee provisions in public construction contracts should be mutual.

---

[7] http://your.kingcounty.gov/aimshigh/documents/pdf/KingCounty-Performance-Scorecard.pdf and http://www.kingcounty.gov/depts/executive/performance-strategy-budget/budget/2015-2016.aspx

III. The dispute in this case was over amount and not coverage.

Even if the *Olympic Steamship* rule applied in this case, there would be no basis to award fees because the dispute between King County and the Sureties was not over coverage of the performance bond. The issue was what, if anything, the bond principal, VPFK, owed the County under the contract and, therefore, under the bond. In *Colorado Structures* the surety argued that the bond required a declaration of default as a condition precedent to the surety's obligation. That was a coverage dispute. In the instant case, VPFK and the Sureties argued that the bond principal was not indebted to the County and, therefore, there was nothing for the Sureties to pay the County.

In the context of a contract performance bond, a dispute between the contractor and the obligee must be resolved to determine what amount, if anything, the surety owes. The surety is the secondary obligor on the bond and owes only what the principal owes but fails to pay. There is a coverage dispute only if there is an amount owed by the principal which the surety nevertheless argues is not a bond obligation; *i.e.* is not covered by the bond.

Therefore, in applying the coverage-versus-amount distinction, the question should not be whether King County's attorney fees can be segregated between those to sue VPFK and those to sue the Sureties. The question should be whether the County incurred any fees to prove liability on the bond as distinct from liability under the contract. Proving the amount owed does not qualify for fee shifting pursuant to *Olympic Steamship*, and to prove the amount the surety owes under the bond, the obligee must prove the amount the bond principal owes under the contract. That is what was litigated in the courts below, and the resulting fees were not incurred to establish the "coverage" of the bond.

The distinction between coverage and amount in the context of a performance bond is apparent from a comparison of the instant case with *Colorado Structures*. In *Colorado Structures* the bonded subcontractor failed to perform, and the obligee prime contractor spent more than the subcontract balance to complete the work in a timely fashion. The subcontractor owed this overrun. The issue was whether the bond covered the overrun given that the prime contractor failed to default the subcontract and call on the surety to perform the work. That was an issue of the coverage of the bond.

By contrast, in the instant case the dispute was between VPFK and the County over responsibility under the contract for certain costs. That dispute would have been the same if there had been no bond or if it had had different terms. Resolution of the dispute between VPFK and the County determined the amount owed under the bond not the bond's coverage. To characterize this matter as a "coverage dispute" effectively amends the bilateral fee provisions of R.C.W. 4.84.330 to hold VPFK liable for attorney fees. As stated previously, by virtue of its indemnity obligations VPFK ultimately is liable for the Sureties' obligations.

Conclusion

SFAA respectfully suggests that the courts below erred in awarding King County attorney fees and urges this Court to reverse the award for the reasons discussed above.

DATED: November 23, 2016.

BULLIVANT HOUSER BAILEY PC

By ______________________
R. Daniel Lindahl, WSBA 14801
Attorneys for Amicus Curiae
The Surety & Fidelity Association of America

APPENDIX

The Law of Suretyship

SECOND EDITION

Edward G. Gallagher, *Editor*

TORT AND INSURANCE PRACTICE
AMERICAN BAR ASSOCIATION

Defending Liberty
Pursuing Justice

Cover design by Jim Colao.

The material contained herein represents the opinions of the authors and editors and should not be construed to be the action of either the American Bar Association or the Tort and Insurance Practice Section unless adopted pursuant to the Bylaws of the Association.

Nothing contained in this book is to be considered as the rendering of legal advice for specific cases, and readers are responsible for obtaining such advice from their own legal counsel. This book and any forms and agreements herein are intended for educational and informational purposes only.

04 03 02 01 00 5 4 3 2 1

Library of Congress Cataloging-in-Publication Data

The law of suretyship / Edward G. Gallagher, editor.
p. cm.
Includes bibliographical references.
ISBN 1-57073-780-0
1. Suretyship and guaranty—United States. I. Gallagher, Edward G. (Edward Graham)
II. American Bar Association. Tort and Insurance Practice Section.

KF1223 .L39 2000 00-029305
346.7307'4--dc21

Discounts are available for books ordered in bulk. Special consideration is given to state bars, CLE programs, and other bar-related organizations. Inquire at Publications Planning & Marketing, American Bar Association, 750 North Lake Shore Drive, Chicago, Illinois 60611.

www.abanet.org/abapubs

1

Introduction

Edward G. Gallagher

A surety is traditionally defined as someone who contracts to answer for the debt or default of another.[1] The principal is the primary obligor, the obligee is the person to whom the principal and surety owe a duty, and the surety is the secondary obligor.[2] Under the statute of frauds, a suretyship contact must be in writing.[3]

Compensated sureties are almost invariably[4] insurance companies, and by statute in most states sureties are regulated by the insurance commissioner. It is important to understand, however, that surety is a unique type of insurance governed in many ways by very different principles. Several chapters in this book will address the differences between suretyship and other types of insurance. In brief, however, suretyship is a financial guarantee under which the surety suffers a loss only if the principal fails to perform its obligation and is financially unable to reimburse the surety. Surety underwriting is based on the financial and technical capability of the principal. The surety does not anticipate a loss, and if there is any appreciable likelihood of a default, the surety will not write the bond. The surety provides the obligee with prequalification of possible bidders and assurance that the project will be completed for the contract price.

An insurer, on the other hand, spreads the risk of fortuitous losses over the group exposed to them. The insurer expects that a certain percentage of its insureds will suffer a loss during the policy period and sets its premiums accordingly. If a covered loss is suffered, the insurer, in effect, has the primary obligation to pay and has no recourse against the insured. The insured has exchanged the possibility of a loss for the certainty of a, presumably smaller, "loss" (*i.e.*, the premium). The insurer pays for losses instead of avoiding them through prequalification, financing or other techniques available to a surety.

At one time, fidelity bonds were a type of suretyship in which the surety knew or investigated the proposed principal and satisfied itself of his or her honesty before writing the bond. Modern fidelity bonds, however, are really insurance against loss through certain types of dishonesty. The premiums are actuarially based on the insured's type of business, financial performance, internal controls and number of employees. The insurer almost never evaluates the integrity of the insured's individual employees. This book, therefore, does not include fidelity bonds

---

1. Stearns, *The Law of Suretyship*, § 1.1 (5th ed. W.H. Anderson Co., 1951); 74 *Am. Jur.* 2d *Suretyship* § 1.
2. 74 *Am. Jur.* 2d *Suretyship* § 1.
3. The first comprehensive statute of frauds was enacted in England in 1676 (29 Car. II § 4) and provided that no action could be brought on a promise to answer for the debt, default or miscarriage of another unless the promise or some memorandum thereof was in writing.
4. At one time, defaults by Individual Sureties were a significant problem for United States contracting agencies and, particularly, for unsuspecting subcontractors and suppliers who assumed they were protected by a solvent, Miller Act surety. In 1989 the applicable regulations were amended to make an individual surety provide a security interest in certain types of assets to guarantee performance of his or her bond obligations. See 48 C.F. R. § 28.203. Holding prospective individual sureties to financial standards has largely eliminated the problem.

which have, in any event, been extensively discussed in other American Bar Association publications.[5]

In order to understand the unique position of the surety and its obligations and rights, one must know the historical background and development of the law of suretyship. It is not enough to know a rule or result in a particular case if one does not understand why the case was decided as it was. Sureties, like virtually all other businesses, are faced with a constantly changing legal environment. In order to identify the proper response to each new issue, the surety or its attorneys and advisors must understand the past and reason from it. This book describes the law applicable to modern corporate sureties and the reasoning behind the law.

5. See, for example, Clore, ed. *Financial Institution Bonds*, Second Edition (American Bar Association, 1999); Keeley and Sukel, ed. *Handling Fidelity Bond Claims*, (American Bar Association, 1999); and Schroeder, ed. *Commercial Crime Policy* (American Bar Association, 1997).

CERTIFICATE OF SERVICE

I certify that on the date shown below, a copy of AMICUS CURIAE BRIEF OF THE SURETY & FIDELITY ASSOCIATION OF AMERICA IN SUPPORT OF PETITIONERS was sent as stated below.

Howard M. Goodfriend Catherine W. Smith Smith Goodfriend PS 1619 8th Avenue N. Seattle, WA 98109-3007 howard@washingtonappeals.com cate@washingtonappeals.com	☐ via efiling/email ☐ via messenger ☒ via US Mail ☐ via fax
Peter N. Ralston Thomas R. Krider Oles Morrison Rinker & Baker LLP 701 Pike Street, Suite 1700 Seattle, WA 98101 ralston@oles.com krider@oles.com	☐ via efiling/email ☐ via messenger ☒ via US Mail ☐ via fax
Frederic D. Cohen Mitchell C. Tilner Horvitz & Levy 15760 Ventura Blvd., 18th Floor Encino, CA 91436 fcohen@horvitzlevy.com mtilner@horvitzlevy.com	☐ via efiling/email ☐ via messenger ☒ via US Mail ☐ via fax

Leonard J. Feldman Peterson Wampold Rosato Luna Knopp 1501 Fourth Ave., Suite 2800 Seattle, WA. 98181 Feldman@pwrlk.com	☐ via efiling/email ☐ via messenger ☒ via US Mail ☐ via fax
David R. Goodnight Karl F. Oles Hunter Ferguson Stoel Rives LLP 600 University Street, Suite 3600 Seattle, WA 98101 david.goodnight@stoel.com karl.oles@stoel.com hunter.ferfuson@stoel.com	☐ via efiling/email ☐ via messenger ☒ via US Mail ☐ via fax

I declare under penalty of perjury under the laws of the state of Washington, this 23rd day of November, 2016.

R. Daniel Lindahl, WSBA 14801
Attorneys for Amicus Curiae The Surety & Fidelity Association of America