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96-0387

Associated Indemnity v. CAT Contracting

PARSONS: This is an appeal from the bench trial judgment DC of Cameron County which resulted in a several million-dollar judgment against my client, the surety. It was then appealed to the Corpus court, the judgment was reduced but substantially affirmed in the amount of $1.3 million. The judgment arises from the tripartite suretyship relationship that this court recently wrote on in the Great American case.

I will refer to the parties below by their easy names: Associated I will refer to as the "surety." The respondents who were the contractor and indemnitors of the surety, I will refer to simply as the "contractor." And the owner of the project, who was not a party below, but a municipal utility district, I will refer to simply as the "owner."

The three fundamental sources of error by the courts below are first, that they took an indemnity contract in which the word "good faith" is mentioned as a condition precedent to the surety's right to recover indemnity. And they _____ that word or phrase to an affirmative unlimited duty owing by the surety to the contractor. And as a result, found both breach of contract and tort. The second fundamental source of error was to create an implied duty of good faith contrary to this court's holdings, and certainly this court's holding in Great American, and the error was compounded by adopting an improper good faith standard. The court below essentially adopted a negligence standard finding that the surety had not conducted a reasonable investigation before paying the claims, and that that breached the contract and tort duty of good faith that had been implied to the relationship.

From these errors, extraordinary results occurred. Not only did the surety not recover one dollar in $835,000 in expenses that it had advanced to the municipal district on the bond, but also had an affirmative judgment entered against it, and an affirmative recovery for the contractor so that the surety ended up paying not only the municipal utility district, but also the contractor, and ended up paying the contractor for damages which the contractor never litigated against the owner.

I want to make six points as to why the judgment below is error, why it should be reversed, why judgment should be rendered for the surety in the amount of its good faith expenditures.

The first is that the decisions in the courts below are clearly contrary to this court's precedent. Starting with the English v. Fisher case, in which this court very clearly held that

an implied duty of good faith will not be readily implied in contracts. Most recently to this court's decision in Great American in which the court very clearly once again held that the tripartite suretyship relationship is not the kind of relationship, not the kind of special relationship in which a duty of good faith will be implied.

The second point that I would want to make is that these holdings are very destructive of the contractual relationships which exist in the tripartite relationship. If you will look at the handout at Tab 2, this shows the existing contractual relationships between the parties. And you will note that the owner in the relationship is paramount. The owner is the party to whom the surety owes the bond obligation, the purpose of the bond is to ensure that municipal projects are completed in a timely fashion. The surety only owes an obligation of payment for performance to the owner. This court found in Great American that there is no duty of good faith owed in addition to the contractual duties - and rightly so.

You will also notice that the only relationship between the contractor and the surety is an indemnity relationship, and the only duties owed are a duty of indemnity in the event that the surety can show that its payments to the contractor had been made in good faith, and thereby, can unlock the lock to indemnity.

Now what the court below has done is summarized under Tab 3. You will see that they have imported to the relationship an implied duty of good faith. Thereby, totally changing the relationship between the parties. And that's the third point that I would like to cover. What they have done is clearly contrary to public policy. By doing this, it will mean that a surety will always lean toward not paying on the bond. Because by not paying on the bond, the surety does not expose itself to tort liability. There is a fixed amount of obligation under the bond. There is an unlimited liability in tort. And by importing the implied duty of good faith to the relationship between the surety and the contractor, surely that will be the result, the cost of bonds will go up, and the payment of bonds will become less frequent and litigation will escalate.

The fourth point that I want to cover is what I mentioned first. If we look at the indemnity contract, which is summarized in Tab 4, clearly in the contract the mention of good faith is as a condition precedent to the surety's right to indemnity. It is nothing more, nothing less. It is not an unlimited or affirmative duty owed by the surety to the indemnitors. And indeed if it were otherwise, it would reverse the relationship. Because in this case, we have a contract, the object of which is to insure that the surety as the indemnity will be paid and we've now totally turned the relationship on its head and we now have the indemnitors being paid, being paid for damages which really are damages if at all caused by the owner of the contract. They're retainage damages, they're lost profits, and also mental anguish claimed.

Now, turning to Tab 5, I think the point is made even more clearer by an analysis of the clause which starts: "The surety shall have the exclusive right to decide whether any claims brought against the surety on any such bond shall or shall not be paid." That right is

unlimited. It is not as respondent's argued somehow a right that is only with the discretion of good faith. Sureties must have the right to be able to make a payment on a bond, because if they are not, if they don't have that right, then they have exposure themselves. Now that doesn't mean that they are going to get indemnity. They have the exclusive right to make the payment on the bond, and then they are not exposed to the bond principle. If they have made the payment and it is subsequently found not to be in good faith, they are not entitled to indemnity. The two clauses are clearly separate, the two concepts are clearly separate, and the purpose of each is different.

The sixth point that I want to address with the court is that from the clear evidence in this case, the surety met the condition precedent of good faith.

HECHT: On that subject and also number 5, I take it you think that the good faith requirement that's in the contract is essential to balancing the interest of the parties?

LAWYER: It clearly is.

HECHT: So some good faith element is required?

LAWYER: Absolutely. And as this court analyzed, it is a sufficient deterrent to sureties that the good faith requirement that is imposed not only by this contract but also by law for an indemnitee that they have to show that the payment that they've made was made in good faith. It is a sufficient deterrent that the payment will not be made recklessly, and it is made at the peril of the surety. If the surety makes the payment and it is subsequently determined that the payment was not made in good faith, they don't get any of their money back. And that's a very significant point, and it is the point that this court analyzed with others in the Great American case in deciding that there was no need to imply a duty of good faith under the suretyship relationship.

ENOCH: I have a question about the evidence on the good faith. The argument is made that good faith was not exercised here because the surety didn't have an independent investigation of the...the allegations from the contractor is that we told everybody up front that the soil conditions would not permit what they are asking be installed. And, they're arguing that the surety did not exercise good faith because it failed to take an independent investigation but simply relied on the obligee and one of the competitors to give it a report on what was going on?

LAWYER: Let me address that. I think first of all, the finding that it wasn't in good faith flowed from the court's below application of an improper standard. It was essentially a negligence standard whether they had acted reasonably in the investigation. The point that I make at Tab 6 is that both in the respondent's reply brief and in our brief, the case law suggests that good faith is acting honestly with no improper motive. That's not what happened in this case.

If we go beyond that point to analyze the evidence there's something clearly again that the court's below didn't understand about the relationship. And that is, that the payments

here were made only after a final notice to cure had been issued by the district engineer, and after the 10-day period had lapsed within which the contractor had under the contract to challenge the decision if it wished to arbitrate. And under Tab 6b, you will see the court's correct analysis by the CA that in fact the decision was made and that the response by the contractor was untimely. Under 6b, the CA also recognized that the contractor had waived its right to arbitrate. And I have put behind Tab 6b, the clause from the construction contract, plaintiff's ex. 36, which makes it clear that arbitration was the exclusive remedy if they wanted to challenge the engineer's decision, and that was waived in this case. And the point is, that the surety's payment only came after that point in time. So the fact of the matter is, that the investigation at that point was surplusage and in any event, I would submit to the court, there is no evidence in this case that the investigation proceeded with improper motive. And, indeed, the courts below suggested that somehow what the surety did had prejudiced the contractor's rights. Again that flows from a misunderstanding of the contracts. If you will look at Tabs 6c and 6d, Tab 6c is plaintiff's ex. 30, the settlement agreement. And the settlement agreement between the surety and the owner makes it very clear that the settlement was for the surety for itself only.

OWEN: Where in the contract does it talk about the exclusive remedy is arbitration?

LAWYER: If you'll look under Tab 6b, the second page of paragraph 6.04 and 6.05 of the construction contract, plaintiff's ex. 36. It was the exclusive remedy.

SPECTOR: In this case then, since the contractor did not arbitrate, they could not sue the owners for money retained?

LAWYER: They could not question the engineer's decisions that they owed a duty to cure the lease and that they were in default. So whether they could have been entitled to any retainage, which by the way they did not sue for, they were not a party below, the contractor did not join them in this case.

SPECTOR: They could have without arbitrating once you had settled they could have come back and sued?

LAWYER: They certainly could have. And as the CA noted, there is nowhere in the record, no indication that they either pressed the rights for arbitration or that they sued. And the last point that I would like to make on that is that that's where the CA and the DC, I think, further erred. It's noted under Tab 6d, and that is that they took the position that somehow the surety had prejudiced the rights. But in fact under the indemnity agreement, the rights of the contractor are only assigned to the surety in the event of default. It's not upon a notice of default, but if in fact if default is proven in fact. And so the contractor was free at any point in time to press its position that it was not in default and to sue the owner. And nothing that the surety did prejudiced it.

OWEN: In the AmWest amicus briefs, they talk about §4 of the indemnity agreement,

and the phrase "deliberate malfeasance," are you relying on that in any way?

LAWYER: I am relying on it only to the extent that it would suggest to the court that the law in this state is that good faith is honesty in fact with no improper motive. And I would suggest to the court, that if you will look at the briefs, we could use a good definition from the SC as to what is required for good faith in an indemnity context. There is not one clear guiding case on point. But clearly the CA's cases that touch upon this make it clear that honesty in fact with no improper motive is the test. And that's not the test that was applied below.

OWEN: You're not relying _____?

LAWYER: If that were your formulation, I would not be unhappy with it. It think it is deliberate malfeasance in the sense that that would be another way of saying the opposite of honesty in fact with no improper motive.

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RESPONDENT

KELTNER: Let me address several of the questions that was just asked by the court, and then I will get to what I think the main issues in these case are.

Justice Owen you asked the question: Is deliberate malfeasance in the case? That is in a different paragraph. It is clear through the briefing that the petitioner does not rely on that. The reason it cannot is that in terms of indemnification in paying the indemnity, there is no doubt that the standard paragraph, and by the way they admit that this is a standard paragraph, page 31 of their brief, is very clear that the condition precedent to show good faith is there. This court has issued a standard on this in Fireman's Fund v. Commercial Standard, in 1972. And what the court said there is, it's not only lack of evil motive and honesty, but it is that the settlement itself is reasonable under the circumstances. And that is something they have dropped completely out on their claim for indemnity.

The evidence here was that it was not reasonable for a number of reasons. First off, remember that in this instance what happened is this: They took over repairs of the contract, admittedly without investigating whose fault it was. Second when they did that they eliminated the arbitration provision, and the evidence is clear on this arbitration had been suggested by the district, accepted by my client, and then what occurred was because repairs started there was no reason for the arbitration provision. So that was gone. Second, they undertook the repairs at a cost 10 times more than my client offered to do the repairs for, a cost three times more than the same contractor did identical repairs on another section of line for the district.

HECHT: To avoid later disputes about reasonableness, shouldn't that issue be resolved

in arbitration at the time?

KELTNER: Yes, sir.

HECHT: Is that the way it's structured to avoid it?

KELTNER: Yes, sir.

HECHT: Because nobody wants that hanging over them as they're out there doing all this work.

KELTNER: Absolutely true. We were robbed of that provision. But let me also tell you though, that irrespective of the arbitration clause, and I think this is extremely important on the indemnification issue, remember under the indemnification provision and under paragraphs 4 & 5 of the agreement, they had the power to take control of the project and the question of reasonableness was still there independently of the arbitration agreement that existed between the district and the contractor. The reasonableness provisions that this court in Fireman's Fund v. Commercial Standard imposed was between whether the settlement itself was reasonable. And part of this settlement was the repairs, because they were passed on. It was part of the settlement agreement that was reached by the parties. Part of the settlement was the payment of the $350,000. Part of the settlement additionally was waiving the claims for retainage that indisputably were due the contractor by the district, that never could be litigated again. And then also, waiving the claims for extras that my client can now never litigate again.

And let me take great exception to what Mr. Parson said regarding the settlement agreement, Tab 6c. If you will look at this, this settlement part of the provisions is exactly what we say in our brief waived our claims. Remember, under paragraphs 1 and 2 of the general indemnity agreement, as condition for executing the bond an agreement that only there are two sides two. There is the indemnitor, my contractor and his principals and their spouses, who they required to sign. The district is nowhere involved in this. But what happened is, we in paragraphs 1 & 2 of the indemnity agreement completely assigned all causes of action, every cause of action we had to the surety. And the surety here gives them up. It says, "Anything that we have acquired or may thereafter acquire, that happened automatically at the time the indemnification agreement was signed before the default.

The testimony on this is fascinating and proves up by itself the bad faith issue. And it is because what happened is when the irrespective with no notice, no notice to the contractor at all, this agreement was being reached on settlement. What occurred was, the district's attorney said, "Hey, you know, we may get sued (and this is undisputed evidence) by the contractor. Unsimplify the contract to make sure that we don't have any problem." Unsimplify is their word, not mine. And that's what happened. And so $425,000 due the contractor for the job; in terms of retainage $118,000; extras, $325,000 were waived. And that was all part of the settlement

agreement.

SPECTOR: So you disagree that the contractor after the settlement could have sued the owner?

KELTNER: Absent the settlement?

SPECTOR: No, after the settlement?

KELTNER: No, ma'am. It was waived right here under Tab 6c.

SPECTOR: So you disagree with counsel?

KELTNER: I very much disagree. I think there is no doubt about that, that is also a finding that has not been challenged by the other side that was made by the TC and talked about at the CA. So I think that on the basis of indemnity, that argument isn't before this court and is now gone.

The other issue that is important to this case is obviously whether a special relationship was created by the general indemnity agreement between the surety and the contractor and its principals? The answer to that in our opinion is, yes, for some very specific reasons. The second part is if it is created what is the duty? We believe it is the duty under Stowers. Basically, what I would call the golden rule duty for business. And that is, if you take control of my business operate it as you would your own business. Do unto others as you would have them do unto you. It's a workable standard, that this court has never had problems applying. And in fact, I will ask you, When was the last time a Stowers case in that form reached this court? In Maryland Insurance Co. v. Head, this court decided not to apply the duty of good faith and fair dealing with a radially different standard to third party insurance context saying, "The Stowers duty protects you," and that is discussed adopting Justice Cornyn and Justice Hecht's dissent in Soriano. In Kanal this court recently decided that it would extend that duty through equitable subrogation in excess insurance situations. This is not a difficult duty to understand. It does not suffer with the same things that the duty of good faith and fair dealings suffers with that has caused a division in this court under Jiles, Mikelow opinion and I think you're going to be revisiting that in a few minutes later today in Simmons. We think it is a very workable standard and we think it should apply.

Let me address whether a special relationship exist. It does. And it does for a number of reasons. I want you to think about what in paragraphs 1 and 2, the relationship between the contractor and the surety is. And unlike Justice Owen what you were looking at in the Great American v. Austin Mud case, with contract between different parties this general indemnity provision has something you did not consider, and could not have considered because it wasn't the agreement between the parties.

First off, we assign all causes of action that we may have now or later against

the district to the surety. We give the surety the power to settle those at its discretion at anytime. We give them the power to investigate and alter the terms of the contract in anyway. On default they can go in to not only defend, but even change the terms of the agreement.

Now does that give rise to a special relationship? I think so. And I think when you look at the court's recent decision in Stewart Title v. Aiello, where the court again is looking at this, what do you look at? You look at the relationship between the parties that was formed as a basis of the contract itself. Justice Owen looked at this in the Great American Mud case as well. And I think that the court's analysis there is very telling - looked at three things. First off, was there a difference in the bargaining power? In candor, I must tell you, that I have always read Arnold and also I think other courts have read Arnold to say, "it's not bargaining power entering into the deal, it is the bargaining power once you're within the context of the deal itself." And I think that that's certainly what Aiello says very specifically and I think that's what the test ought to be.

There is some mention by the petitioner in this case that it's bargaining power entering into this relationship in going and getting the bond. I disagree with that. But even if that is the test, we're fine, too. The evidence in this case, and you will see also from the amicus briefs that support our side from the two trade associations, are very clear that these are contracts of adhesion. The finding by the TC and the CA's opinion says: You either sign these indemnity agreements or you don't get the bond that the statute requires you to get.

PHILLIPS: How many providers of indemnity payments are there in a particular _____?

KELTNER: To be honest with you, there are a lot.

PHILLIPS: One of the amicus argues that there is a pressure to perform responsibly or you may not get much repeat business?

KELTNER: There is no doubt they make that argument. Let me tell you how we would reply, and I would reply by our own amicus briefs; and more importantly the testimony that was before the fact finder in this case, there is no doubt that there are a lot of surety companies. The question is, can you get a different deal with one surety company on the indemnity agreement than the other? The testimony in this case, and the only testimony on this issue is, no. You sign what they give you.

PHILLIPS: If you buy Coca Cola you are going to get the same formula. And if you like Pepsi better, you're going to go...

KELTNER: That's right. But you're fully apprized of those when you go in.

OWEN: But it's not the indemintor that mandates the terms of the contract, it's the statute?

KELTNER: No, ma'am. And bear with me on this. You are right that the terms of the bond itself are passed upon by the governmental entity. In this case the district or the attorney general's office. But that does not apply to the general indemnity agreement.

OWEN: Then it's not a contract of adhesion. There will be differences between companies?

KELTNER: I would disagree. The testimony is to the contrary in this case, that there were contracts of adhesion. This was presented on take or leave it basis. Also if you look at the Trade Association's amicus briefs, you will see they take the same position. I must admit that there is no doubt that the briefs that are filed in favor of the petitioner by the insurance company say, there are tons of bonds out there. What they don't say is when they talk about surety law, and when they talk about surety contract, they call this one a typical one. If you will look, it's a form. It's on a form contract that is totally unaltered. In the evidence in this case, we're golden. In terms of what the amicus say, they conflict. And I think that is something that is terribly important to this case.

Let me tell you again though, I don't believe the equality of bargaining power in getting into the issue was what was important in Arnold; and certainly this court in Aiello didn't discuss that. They talked about the equality of bargaining power once the special relationship was created and what effect one party could have on the other's performance according to the contract.

OWEN: But it runs both ways doesn't it? The contractor has a lot of control over the surety's liability. If the contractor doesn't do a proper job, they will cause a surety to be liable. It runs both ways doesn't it?

KELTNER: There is no doubt that what the contractor might do, might determine whether the surety has to come in or not. The issue though is once that occurs what the surety can do and what constraints are on the surety. For example: one of the things Mr. Parsons argued to you in answer to a question, I think was a very good one was, doesn't the duty of good faith in the indemnity contract adequately protect, and don't you rely on that? And he answered yes. I would argue a different answer, and here's what it is. The truth of the matter is, yes it protects for things that can be indemnified for. One of the things here that can't be indemnified for that is provided in the general indemnity agreement is that they gave up claims that we indisputably had against the district for $425,000. We're not entitled to stop indemnity on that because that was money that we were entitled to that now we can never get.

OWEN: That's another question. You said you are entitled to that. Of course the district was saying you weren't. The other way, that not only were you not entitled but you owed them additional performance or additional money for the costs that they had to prepare what you didn't do correctly. So there's a dispute about that?

KELTNER: Yes. There's no doubt there was a dispute and the fact finders decided what

the issue would be. The only fact finding because of the conduct of the surety we'll ever be able to get on that issue, and in fact that was very fully litigated. And what the fact finder found was that we had substantially completed the contract, and the evidence was that the line was completed and there was just 14 leaks in it. And the question was whether or not we were going to be paid for extra work or not? But you are absolutely right and we must admit that there was conflicting evidence on that, but when it was tried to a fact finder, they found in our favor that we were entitled to those monies. The judge decided that we were entitled to those monies.

OWEN: But at the time the surety has to make its decision it's looking at conflicting claims. The district saying vastly different than you're _____?

KELTNER: And I think that's an interest point. I want to recall for you the position that AM West and Universal took in the Great American case in their amicus brief before you, because it conflicts with what they say today. Remember in that case, in order to get the court not to hold that there was any kind of duty of good faith and fair dealing towards the obligee, in other words the owner or the district depending on how you say it, AmWest said, and I'll quote directly from their brief: "The surety owes a duty not to pay claims the principal does not owe." That's precisely what they said. In fact we don't have an absolute right to compromise unless the decision is reasonably prudent and made in good faith."

This court again and every court to have considered that applies the same standard saying you have to go in and look. And remember the statutes they lobby for and cited in your opinion say the same thing.

The surety has the right under the statute to not only assert the defenses of the contractor, but also it has the right to insist those things go to trial. And as a result of that, by statute public policy of this state there is no doubt that there has to be some reasonable investigation involved. And in fact in Ford v. Aetna, which they rely on their brief, one of the things the court said would be bad faith for indemnification purposes would be a failure to investigate. And that wilful lack of knowledge is absolutely no defense and would be an item that would tend to prove lack of good faith for the indemnity purposes.

One of the other things he has mentioned has been that somehow there is a conflict between the public entity, the district in this case, and a duty the surety might owe the contractor. There is not. To the extent that there might ever be, it already exists by the very statute cited in the Great American v. Austin Mud opinion, which allows you to force a trial on those types of issues.

Remember, every time courts have considered this, and this is one thing that is universal throughout the country, this is as conservative as it gets, you have a duty to be reasonable in making these decisions to pay, and prudent.

Now there is no doubt, and let me confess to you something that I think is unclear, we do not take the position that the good faith duty in paragraph 8 creates a cause of action. It is purely part of one thing: either a defense to their indemnity; or as they say a condition precedent which would be an element of their cause of action. We are suggesting that the duty of good faith arises from the unique special relationship the general indemnity agreement created. They say to you: Wait a minute that would be conflicting duties. If you impose on that, we won't pay when we're supposed to. We won't pay pursuant to our obligation. I don't think that's conduct we want to award. In the association's brief that was filed late yesterday afternoon, that I've just received, the American Insurance Association, they are the first one that has said what the conflict is. No one has raised what it is. What they say 1) we won't pay under our obligations; 2) cost of bonds may go up. I'm not sure that we can determine that. And next they say that we won't pay the governmental entity when we should. I don't think that that is a basis for not imposing a duty on this.

HECHT: But what's the answer to whether they would lean towards not doing that just to avoid tort liability? If you've got to make a call, the threat of tort liability is going to make you lean one way or the other?

KELTNER: Yes, I think that's fair. First off, I don't think there is a conflict they suggest. But in answer to your question, to the extent that that is a problem it already exist by statute and they argued it to you very hard for not applying the duty to an obligee and they said, the statute already says we don't have to pay until we're sued. That's the reason additionally there is time to make a decision and do a reasonable investigation.

OWEN: But in the meantime, cost can be amounting at a substantial rate, is that correct?

KELTNER: Yes.

OWEN: If they choose that route?

KELTNER: The only party that controls that as long as there is performance and investigation is the surety. So that is something they can control. They do make one argument that has not been brought up today, at least the association's do in their brief, that there is a fear somebody else might take over the project and costs out of their control might escalate. I don't think that's true. Look at what happened here. They are the ones that incurred the cost that we say are unreasonable that were never itemized as paragraph 8 says as well, including legal fees that turned out to have ADA dues, green fees, golf shop bills and the like, that we never even knew about till the time we got to trial to figure out what the itemizations of the bills were.

BAKER: The last part of your argument was that based upon the special relationship leads to a duty of good faith in the settlement process. Is that correct?

KELTNER: No, sir, and the fault is not yours. It's with my ability to communicate. There are two things: there is obviously and they have admitted a duty of good faith in the indemnification process; and I think it means much more than Mr. Parsons tell you it means.

BAKER: Are you're arguing it means the same thing as Arnold and Aranda says it is in the context of a common law cause for a breach of good faith and fair dealing?

KELTNER: No, sir, I must confess to you that I believe it does not given the prior decisions of this court. Again, I am going to take you back to Fireman's Fund v. Commercial Standard from which does say you must be reasonable. In fact even it is much more like a Stower's burden and duty. But I don't think it is the duty of good faith and fair dealing. What I am saying in answer to your question is, it's a unique special relationship that exist in very few places outside of surety law where you give one party the opportunity to run another's business completely and with sole authority and exclusively creates a duty like Stower's that is simply this: as long as you're going to run my business for me and can make all decisions treat me as you would treat yourself. And that's all the Stowers doctrine is, it is a doctrine this court has never had problems applying. I will submit to you in a review of the cases you will find it's a duty that the CA's had never had a problem applying.

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REBUTTAL

PARSONS: Let me start Justice Owen with a question that you asked responded to by Mr. Keltner, and that was about the fact that costs escalate as the surety waits. Clearly, that is the case in most projects, and that was the case here. I think it is flat wrong to suggest as Mr. Keltner did, that those are only in the surety's control. If you look at the general indemnity agreement, Tab 6d, I made this point before, but I think it's important to make again and that is that the assignment of contract rights in these situations is only in the event of default. The surety does not somehow become the surrogate for the contractor. That's what they've been arguing to the courts below and that's what they are arguing to this court and that is not the case. The contractor still has the ability as it did in this very project. The record is clear, the contractor was asked to cure these problems. It refused to do it. It absolutely flatly refused to do it. And it now comes in and says: Well the surety paid, too, much.

It had the ability, it had the control and its contract was the primary contract. The contract between the contractor and the owner is the primary contract here. It is the one that has primary performance obligations. And the only assignment of rights that occurs is if there has been a default. And that's so that if there is a default in fact, then the rights that the surety may release are rights that the contractor no longer has. There's no prejudice done to the contractor. But of course that was never litigated and as the CA noted, the contractor never made proof in this case that it would have prevailed in arbitration.

OWEN: But you did take the position when you stepped in that there wasn't a _____?

PARSONS: No, the surety did not. In fact when the surety stepped in to make repairs, and this is clear from the CA's decision, that repair agreement was without prejudice to the rights of anybody. They stepped in and made repairs without prejudice to the rights of anybody and when they finally settled they settled only for themselves without prejudicing the contractor's rights. And that happens many times in a suretyship context.

And so I think that this misunderstanding that Mr. Keltner has prevailed on this court with, and certainly the lower courts bought it, that the surety somehow gave up the claims of the contractor, that's not true. It's not true under the contracts and it's not true under the facts of this case, it is not true under the evidence. The contractor still had its claims, but it never arbitrated the claims against the owner, and it never joined the owner as a party to this case. Because it knew it had waived its right to arbitration.

It is clear as a bell here, that the reason this case came down like this is because the contractor knew it had waived its arbitration rights and the only thing it could do was to try to get the courts below to buy into an implied duty of good faith and sue the surety for the claims that it said it had against the owner.

OWEN: Mr. Keltner made some sort of reference to once you stepped in and started making repairs that that mooted or somehow prevented arbitration?

PARSONS: I heard him say that, but if you look at the record and if you also look at the CA's decision, the decision makes it very clear that the repair agreement that the surety entered into was without prejudice to the rights of anyone. And I think this brings up this last point that Mr. Keltner says that the standard in indemnity is one of reasonableness, and that all we're talking about here is having the due under the contractor as the surety would do onto itself. The problem with that kind of standard here is that the claims against the surety are directly and diametrically _____ in every case like this. In every case we have an owner who's saying that the contractor has defaulted, and we have a contractor who is saying that the owner is in breach.