

NO. A07-2134

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State of Minnesota  
**In Court of Appeals**

Liberty Mutual Insurance Company,

*Respondent,*

v.

Northeast Concrete Products, LLC, Hallamore Corporation,  
Hallmark Mechanical Corporation, Brockton Rental Service, Inc.,

*Appellants,*

and

Northeast Concrete Products, LLC,

*Appellant,*

vs.

Liberty Mutual Insurance Company,

*Respondent.*

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**APPELLANTS' BRIEF**

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## STATEMENT OF ISSUES

- I. Are there genuine issues of material fact precluding summary judgment in favor of Liberty Mutual Insurance Company (“Liberty”) and against Northeast Concrete Products, LLC (“NECP”)?

In its order for partial summary judgment dated April 18, 2007 and entered April 24, 2007, the trial court ruled in the negative.

- II. Are there genuine issues of material fact as to whether Liberty’s settlement with Mortenson constituted bad faith?

The trial court ruled in the negative.

- III. Are there genuine issues of material fact as to whether Liberty waived over \$2,000,000 of NECP’s claims in bad faith when it stipulated with Mortenson as to the subcontract balance?

The trial court ruled in the negative.

- IV. Are there genuine issues of material fact as to whether Liberty’s actions constituted bad faith when Liberty demanded that NECP release its claims against Liberty or Liberty would reduce the subcontract balance to zero?

The trial court ruled in the negative.

- V. Are there genuine issues of material fact as to whether Liberty acted in bad faith given the fact that the record showed that Liberty did not inform NECP of the terms of its settlement with Mortenson prior to entering into the agreement with Mortenson?

The trial court ruled in the negative.

- VI. Are there genuine issues of material fact as to whether Liberty acted in bad faith despite the fact that NECP provided admissible expert testimony that it would be bad faith for a surety to:

- Settle claims with regard to a principal’s work on a project where a significant motive of the surety in settling is to further the surety’s business relationship with the obligee, rather than based on the merits of the claims settled;
- Settle claims by and against an obligee with regard to a principal’s work on a project without informing the principal of its intent to do so, without

informing the principal of the proposed settlement terms in advance of the settlement, and without seeking to obtain the principal's consent to the settlement;

- Threaten and/or follow through on a threat to a principal that, unless it agreed to pay the surety disputed amounts allegedly owed the surety by the principal under a General Agreement of Indemnity and give the surety a release of all claims the principal had against the surety arising out of the principal's work on a project, including claims for bad faith, then the surety would waive claims against the obligee for contract funds with regard to the principal's work on the project; and

- Offer to allow a principal to pursue a claim against an obligee for contract funds with regard to the principal's work on a project, but only if the principal would release the surety from all claims that the principal had against the surety arising out of the principal's work on a project, including claims for bad faith?

The trial court ruled in the negative.

VII. Prior to summary judgment being granted, did NECP have a right to conduct additional discovery pursuant to Minnesota Rules of Civil Procedure, Rule 56.06?

The trial court ruled in the negative.

VIII. Are there genuine issues of material fact precluding an order releasing the escrowed funds to Liberty?

The trial court ruled in the negative.

IX. Are there genuine issues of material fact precluding summary judgment on NECP's claims against Liberty?

In its order for judgment dated September 14, 2007 and entered September 18, 2007, the trial court ruled in the negative.

## STATEMENT OF CASE

Northeast Concrete Products, LLC, (“NECP”), Hallamore Corporation, Brockton Rental Services and Hallmark Mechanical Corporation bring this appeal on this consolidated action of two orders for summary judgment and one order by the trial court releasing funds held in escrow to Respondent . In this litigation, NECP initiated a breach of contract/bad faith action against Liberty and Liberty initiated an action against NECP demanding that NECP exonerate and indemnify Liberty as to all costs associated with the underlying construction project. Liberty’s action against NECP *et al.* and NECP’s action against Liberty were consolidated.

Appellants appeal from judgments entered on two orders of the trial court dated April 24, 2007 and September 18, 2007, and an order releasing escrowed funds to Liberty. In the first, Findings of Fact, Conclusions of Law, Order for Judgment and Judgment, entered April 24, 2007, the Honorable William R. Howard, Judge of District Court, ordered, *inter alia*, that:

1. Liberty was entitled to partial summary judgment on its claims against NECP; and
2. That, as a matter of law, Liberty acted in good faith as NECP’s surety.

(Judgment, April 24, 2007, A.224-A.223.) The second Judgment on appeal was filed September 18, 2007. In that ruling, the trial court, *inter alia*:

1. Granted Liberty’s motion for summary judgment on all of NECP’s claims against Liberty.

(Judgment, September 18, 2007, A.368-A.375.) In addition, in this action, Liberty moved for and was granted a temporary restraining order requiring that the \$400,000 be held by the Court in escrow. Then, during the course of this litigation, from the bench,

the trial court granted Liberty's motion to release the funds to Liberty. The trial court ordered the funds released to Liberty. NECP appeals from that order.

By this appeal, the Appellants now respectfully challenge the District Court's conclusions as to the above issues.

## STATEMENT OF FACTS

### **A. Background Facts**

M.A. Mortenson Company (“Mortenson”) was the general contractor on a project to construct a parking garage on the Naval base for the Navy in Maine (the “Project”). Mortenson subcontracted a portion of the work on the Project to NECP. Liberty issued a payment and performance bond on the Project (A.76-A.79, Hart Aff., Ex. “A”) on behalf of NECP, which was secured by a General Agreement of Indemnity naming NECP, Hallamore Corporation, Brockton Rental Services and Hallmark Mechanical Corporation as indemnitors (“Indemnitors”) (A.80-A.88, Hart Aff., Ex. “B”).

A dispute arose on the Project between Mortenson and NECP. Mortenson wrongfully declared NECP in default and demanded that Liberty take over the Project. Liberty did so pursuant to a Takeover Agreement (the “Takeover Agreement”) (A.89-A.93, Hart Aff., Ex. “C”), despite the fact that NECP denied being in default and affirmatively claimed that it was Mortenson that was in default (A.24, NECP’s Memo in opp of SJ). Liberty does not dispute that after the takeover, NECP continued to work, and in fact finished the work on the Project. As part of the takeover and because NECP’s contract with Mortenson was terminated, NECP became a subcontractor to Liberty for the balance of the Project (*id.*). In other words, Liberty stepped into NECP’s shoes and came into contractual privity with Mortenson. Accordingly, it follows that NECP’s work in finishing the Project was as a subcontractor to Liberty and not to Mortenson. As part of the takeover, Liberty required NECP to irrevocably “request” that Mortenson make all

contract payments directly to Liberty (who was then obligated to pay NECP as its subcontractor) (A.94, Hart Aff., Ex. "D").

In the ensuing arbitration (the "Arbitration"), Mortenson claimed that Liberty and NECP owed it damages and Liberty claimed that Mortenson owed it damages. In addition, because Liberty took over the Project and became the party in contractual privity with Mortenson and NECP had no direct claim for damages against Mortenson after the Takeover, Liberty pursued NECP's damage claims against Mortenson in the Arbitration on NECP's behalf (A.95-A.98, Liberty's Amendment to its Damage Submission, May 1, 2006, Hart Aff., Ex. "E").

Neither NECP nor Liberty asserted any claims against each other in the Arbitration (including NECP's claims against Liberty for the work NECP performed as a subcontractor to Liberty) because there was no arbitration agreement between them. Liberty and NECP were cooperating in the prosecution and defense of the Arbitration action. In fact, they were parties to a Joint Defense Agreement (A.99-A.111, Hart Aff., Ex. "F"). That all changed as the actual Arbitration date approached.

## **B. Disputed Facts Precluding Summary Judgment**

### **1. The Settlement**

There is no dispute that shortly before the Arbitration was scheduled to begin, Liberty decided to fend for itself and enter into a settlement agreement with Mortenson (A.112-A.119, Hart Aff., Ex. "G"). What is at issue in this case is whether Liberty acted in bad faith when abandoned its principal and placed NECP in a much worse position because of the settlement with Mortenson and when it subsequently attempted to blackmail NECP by stating that unless NECP released Liberty from all claims, including

claims of bad faith, then the contract balance would drop to zero and, instead of having a reduced claim against Mortenson in the Arbitration, NECP would have nothing. In support of its claims that Liberty settled with Mortenson in a manner which can only be viewed as “bad faith,” NECP set the following admissible facts before the trial court:

- First, Liberty settled the Arbitration with Mortenson (the “Liberty/Mortenson Settlement”) (A.112-A.119, Hart Aff., Ex. “G”) without informing NECP of the proposed terms ahead of time and without obtaining NECP’s consent (A.72; A.171-A.209, Hart Aff., ¶ 18; Ex. “P”).
- Second, the terms of Liberty’s settlement with Mortenson were outrageous. NECP (through Liberty) made claims against Mortenson totaling \$4,281,821.48 (A.95-A.98 and A.210, Hart Aff., Exs. “E” and “Q”). In the settlement agreement with Mortenson, Liberty “stipulated” that the subcontract balance was \$1,839,358 (*Id.*, Ex. G). By doing so, Liberty waived over \$2,000,000 of NECP’s claims (*see id.*). The “consideration” for stipulating to the reduced subcontract balance and waiving over \$2,000,000 of NECP’s claims was \$175,000 paid by Mortenson to Liberty - - nothing was paid to NECP (*Id.*).
- Third, Liberty also stipulated that, if the remaining claims were not assigned to NECP by the start date of the scheduled Arbitration, then the subcontract balance would be zero (A.112-A.119, Hart Aff., Ex. “G”). After it settled with Mortenson, Liberty demanded that unless NECP agreed to pay Liberty \$185,000 (the amount Liberty claimed to have been damaged after crediting the \$175,000 payment from Mortenson) and give

Liberty a release of all claims NECP had against Liberty -- including claims for the work NECP performed as a subcontractor to Liberty and for bad faith -- then Liberty would not assign the claim and, based on the stipulation, the subcontract balance would be zero! (A.112-A.119 and A.120-A.121, Hart Aff., Ex. "G" and "H.") Only if NECP would agree to Liberty's "blackmail" would Liberty "assign" the reduced subcontract balance claim to NECP, so that it could then pursue the claim in the Arbitration.

(*Id.*, Ex. "H.")

Because NECP was **unwilling** to agree that: (a) Liberty could keep the \$175,000 paid by Mortenson to Liberty; (b) NECP would pay Liberty \$185,000; (c) NECP would release Liberty of all liability, including claims for the work NECP performed as a subcontractor to Liberty and for bad faith; and (d) NECP would take an assignment of Liberty's claims against Mortenson and pursue them in the Arbitration, NECP rejected Liberty's "offer" and settled with Mortenson on its own, the best it could, while preserving its claims against Liberty ("Mortenson/NECP Settlement Agreement") (A.122-A.128, Hart Aff., Ex. "I"). All NECP was able to get in its settlement with Mortenson was \$400,000 (*Id.*). NECP was required to settle with Mortenson before the subcontract balance became zero on September 11, 2006, otherwise there would have been nothing left to settle (A.112-A.119, *see, id.*, Ex. G).

Liberty's bad faith conduct did not end with the Liberty/Mortenson Settlement and attempted blackmail. After learning that NECP had settled with Mortenson, Liberty acknowledged that the carrot (i.e., the assignment) was now "moot" (A.129-A.130, email

from W. Groscup to K. Hart, September 7, 2006, Hart Aff., Ex. "J"). Nevertheless, in a last ditch effort to cover its tracks, Liberty then purported to assign to NECP the right to pursue (but not keep the proceeds of or settle) a claim against Mortenson that had already been released (A.131-A.152, Purported Assignment, September 11, 2006, Hart Aff., Ex. "K"), a fact that did not escape either Mortenson's or NECP's attention (A.153-A.154, letter to W. Groscup from J. Hartnett, September 13, 2006, A.155, email to W. Groscup from K. Hart, September 13, 2006, Hart Aff., Exs. "L" and "M", respectively). Specifically, Mortenson's counsel acknowledged that because NECP didn't accept the terms of the assignment, Liberty had allowed the subcontract balance to go to zero (A.153-A.154, *Id.*, Ex. "L"). Mortenson's counsel, clearly acknowledging that this put Liberty into a predicament, stated that Liberty's "hard bargaining" with NECP was not Mortenson's problem and the purported assignment was not going to fly (*Id.*). Hard bargaining indeed. The fact that Liberty engaged in a last ditch attempt to "assign" the subcontract in this manner at bare minimum raises an inference that, when NECP wouldn't cave in to Liberty's demands, Liberty knew that it was in trouble.

## 2. Waiver of Claims

Liberty claims that it did not waive \$2,000,000 of NECP's claims and that NECP could have gone forward with the Arbitration -- presumably even after the subcontract balance became zero. Liberty makes this argument despite the fact that it has argued up to this point that all claims in this matter arose out of the subcontract (A.211-A.222, letter from W. Groscup to K. Hart, September 13, 2006, Hart Aff., Ex. "R"). The documents clearly show that when Liberty stipulated that the subcontract balance was \$1,839,358, it clearly intended to waive the balance of NECP's claims. Liberty's argument, that it

didn't waive anything, is nonsensical. First, unless something was waived, there was no reason to stipulate as to the subcontract balance. Further, notwithstanding the affidavit Liberty obtained from Mortenson and submitted in support of its motion, Mortenson previously acknowledged in its settlement with NECP that Liberty had waived all claims other than the stipulated subcontract balance, which had become zero by the time of the Arbitration:

Whereas, Mortenson contends that if the residual Unpaid Subcontract Balance claim is zero, then NECP has no further monetary claim against Mortenson arising out of the Project.

(A.123, Hart Aff., Ex. "I," p. 2; *see, also* Argument, *infra*.)

The contemporaneous document that Mortenson executed clearly establishes that Liberty waived all claims against Mortenson except the claim for the stipulated subcontract balance when it signed the settlement agreement with Mortenson.

The trial court ignored all this evidence and found that, as a matter of law, Liberty did not act in bad faith (A.224-A.233). The trial court determined that NECP could have negotiated with Liberty, but it refused to (*id.*). What the trial court refused or was unable to comprehend was that Liberty had already agreed, in writing with Mortenson, that the contract balance was \$2,000,000 less than NECP's claim (*cf.* A.210, NECP/Liberty damage claim and A.114, Liberty/Mortenson settlement) and no amount of negotiating with Liberty could have gotten that back. Because Liberty, and not NECP, was in contractual privity with Mortenson, Liberty had the direct claim against Mortenson, and Liberty had reduced that claim by \$2,000,000. In support of its motion for summary judgment, Liberty denied that it reduced the claim, yet failed to indicate how NECP could assert the claim for the additional \$2,000,000 without any privity of contract. Despite

this legal conundrum, the trial court bought Liberty's statement lock, stock and barrel, and granted the motion.

**C. Misstatements and Distortions of Fact By Liberty to the Trial Court**

The trial court also wholly ignored the fact that most of the allegations in Liberty's moving papers were gross distortions of the actual events, despite the fact that NECP listed them for the court (A.71, Hart Aff., ¶ 13). First, Liberty was never at risk for any losses arising out of NECP's conduct. In this regard, the indemnitors under the General Agreement of Indemnity had a net worth of in excess of \$25 million dollars (A.19, Affidavit of Leo Barry). Thus, to the extent that Liberty suffered any damages as a result of issuing the bond to NECP, then there was more than enough collateral to make Liberty whole had it acted properly and in good faith (A.71-A.72, *Id.*, ¶ 14). Accordingly, Liberty's claims that it settled with Mortenson to avoid costs is nonsense.

Second, Liberty did not dispute that, from the time of the takeover, it was always NECP's position that Liberty had acted wrongfully in entering into the Takeover Agreement with Mortenson (A.72). Thus, NECP had always disputed Liberty's right to be made whole under its General Agreement of Indemnity. This is why NECP repeatedly told Liberty that NECP was not interested in any settlement pursuant to which Liberty was made "whole" (A.72, *id.*, ¶ 15). Further, Because NECP and Liberty were prosecuting/defending the Arbitration with Mortenson pursuant to a Joint Defense Agreement (A.99-A.111, Ex. "F"), NECP also believed that the disputes between NECP and Liberty were going to be resolved outside of the Arbitration after the Arbitration was over (A.72, *Id.*, ¶ 16). Thus, while NECP knew that Mortenson and Liberty were discussing a potential settlement in August 2006, NECP was shocked to learn on

August 23, 2006, of the actual settlement and, in particular, the terms of the settlement between Mortenson and Liberty (A.72; A.112-A.119, *Id.*; Ex. "G," ¶ 17).

The trial court, however, refused to give these facts any credence whatsoever, and held that, because NECP knew that Liberty was negotiating with Mortenson, Liberty met its duty of good faith (A.224-A.232). The court's finding wholly ignores the fact that that NECP was never told that Liberty was going to settle and certainly was never given any indications of the terms prior to the execution of the agreement between Liberty and Mortenson (A.72).

The Liberty/Mortenson settlement was shocking to NECP in numerous regards:

- First, Liberty settled the arbitration with Mortenson without informing NECP of the proposed terms ahead of time, and without obtaining NECP's consent.
- Second, Liberty "stipulated" that the subcontract balance was \$1,839,358. By doing so, Liberty waived over \$2,000,000 of NECP's claims, including both change order claims and delay claims. The "consideration" for stipulating to the reduced subcontract balance and purported waiver of over \$2,000,000 of NECP's claims was \$175,000 paid to Liberty -- nothing was paid to NECP.

(A.72, *Id.*, ¶ 18.)

The most shocking thing, however, was how bold Liberty was after the settlement with Mortenson in attempting to blackmail NECP. In this regard, Liberty's counsel, Mr. Groscup, had previously acknowledged that the claims Liberty and NECP were pursuing against Mortenson were strong:

**IN VIEW OF THE STRENGTH OF OUR COMBINED  
CASE AGAINST MORTENSON, I'VE ADVOCATED...**

(A.73, Groscup Aff., Ex. 2C, A.296, emphasis added). Nevertheless, Liberty threatened to stipulate that the value of those claims was zero unless NECP paid Liberty an amount

that NECP disputed was owed to Liberty (\$185,000) and agreed to give Liberty a release of all claims, including claims for bad faith (A.73, *Id.*, ¶ 19).

Liberty argued that NECP and its attorneys refused to negotiate or respond to settlement overtures after Liberty entered into the Liberty/Mortenson settlement agreement -- as if NECP was required to do so (A.73, *id.*, ¶ 20). Obviously, NECP was not legally required to engage Liberty in any settlement talks and chose not to do so after Liberty engaged in blatant bad faith conduct by entering into the Liberty/Mortenson settlement (A.73, *id.*, ¶ 21). From NECP's perspective, it was not willing to seek a settlement with a surety who:

- waived millions of dollars of claims without any advance notice and without seeking NECP's consent in advance;
- engaged in self help by taking \$175,000 from Mortenson when NECP disputed that it was owed to Liberty under the General Agreement of Indemnity or any other agreement;
- threatened to stipulate that the subcontract balance was zero unless NECP would agree to pay Liberty \$185,000 (which NECP disputed was owed) and waive all claims against Liberty, including NECP's claims for bad faith.

(A.73, *Id.*)

Because NECP was unwilling to capitulate to Liberty's demands, NECP decided to settle with Mortenson on the best terms that it could negotiate, while preserving its claims against Liberty (A.122-A.128, Ex. "I"). NECP had to negotiate a settlement with Mortenson or agree to the assignment before September 11, 2006, or the subcontract balance became zero. After that date, NECP would have had nothing to settle with Mortenson. Thus, Liberty's complaint that NECP settled with Mortenson before it had the opportunity to assign NECP the claim is sophistry. If Liberty had been acting in good

faith, then it would not have waived any claims and it would have assigned all of the claims to NECP to pursue while maintaining a security interest in the claims under its General Agreement of Indemnity. Instead, Liberty chose blackmail (A.73-A.74, *Id.*, ¶ 22).

The trial court dismissed these facts by contending that NECP had the opportunity to negotiate with Liberty, but refused to do so (A.230). At bare minimum, given these facts, the question of whether NECP's refusal to negotiate with Liberty was reasonable was a question of fact. Instead, the trial court ruled, as a matter of law that Liberty acted in good faith.

The bottom line is that it should have been up to a jury to decide whether Liberty acted in good faith when it waived millions of dollars of claims, engaged in self help to collect disputed amounts it claimed that it was entitled to recover under its General Agreement of Indemnity, and threatened NECP that it would stipulate that the contract balance claim was zero unless NECP waived all claims against Liberty. As NECP pointed out to the trial court, it is one thing to be a surety; it's all together another thing to think that you can get away with blackmail (A.26).

## ARGUMENT

### A. The Standard for Summary Judgment

Summary judgment is a harsh remedy to be granted only if there is “*no genuine issue as to any material fact*” in the case. Minn. R. Civ. P. 56.03 (emphasis added). Minnesota courts view summary judgment as a “blunt instrument” that should be used only when “it is perfectly clear that no issue of fact is involved, and where it is neither desirable nor necessary to inquire into facts which might clarify the application of the law to the issues involved.” *Donnay v. Boulware*, 275 Minn. 37, 45, 144 N.W.2d 711, 716 (1966); *Drager v. Aluminum Indus. Corp.*, 495 N.W.2d 879, 882 (Minn. Ct. App. 1993), *review denied* (Minn. Apr. 20, 1993). As the moving party, Liberty had the burden of demonstrating that no such genuine issue of material fact exists. *Thiele v. Stich*, 425 N.W.2d 580, 583 (Minn. 1988). Despite the fact that Liberty failed to meet this burden, the trial court granted summary judgment.

The appropriate role of the trial court was not to weigh the evidence but, instead, to determine whether, as a matter of law, any genuine factual conflict exists. *United States for Use and Benefit of Cobb-Strecker-Dunphy & Zimmerman, Inc. v. M.A. Mortenson Co.*, 706 F. Supp. 685, 689 (D. Minn. 1989), *aff'd.*, 894 F.2d 311 (8<sup>th</sup> Cir. 1990). In making that determination, all evidence and factual interferences must be viewed in a light most favorable to the nonmoving party. *Sauter v. Sauter*, 244 Minn. 482, 484-85, 70 N.W.2d 351, 353 (1955). The court, therefore, must accept all facts properly set forth by the non-movant. *Grondahl v. Bulluck*, 318 N.W.2d 240, 242 (Minn. 1982); *De Cosse v. Armstrong Cork Co.*, 319 N.W.2d 45, 47 (Minn. 1982). In

Minnesota, if there are fact issues regarding an indemnity agreement, summary judgment is not appropriate:

An action based on an indemnity agreement is for the recovery of money based upon the promise to pay and is therefore triable by a jury. If fact issues exist with respect to the indemnity agreement, they are for the jury. *Raymond Farmers Elev. Co. v. American Surety Co.*, 207 Minn. 117, 119, 290 N.W. 231, 233 (1940).

*New Amsterdam Casualty Co. v. Lundquist*, 293 Minn. 274, 198 N.W.2d 543, 551 (1972).

In this case, the trial court turned the standard on its head and viewed every possible inference in a light most favorable to Liberty.

**B. Summary Judgment Was Not Proper on Liberty's Claims**

Liberty moved for Summary Judgment on its claims and the trial court granted the motion. The pivotal issue before this Court on this appeal is whether NECP presented sufficient evidence to show that there is a genuine issue of material fact as to whether Liberty acted in good faith in its dealing with NECP. The trial court acknowledged as much in a hearing early on in the case: "Oh, I agree that they have to act in good faith . . . ." (A.331, Transcript, Groscup Aff., Ex. 7, p. 34). Liberty did not deny that NECP would prevail on the motion if there was a genuine issue regarding NECP's bad faith claim against Liberty. However, Liberty contended that NECP's claims are "absurd" as a matter of law (A.264). Liberty's argument was disingenuous at best. In granting summary on this basis, the trial court completely ignored the essential inquiry, namely, whether Liberty showed that there was "no genuine issue as to any material fact." Minn. R. Civ. P. 56.03. Liberty and the trial court ignored that, as the moving party, Liberty had the burden of showing that there was no genuine issue of material fact and that it was

entitled to judgment as a matter of law. Instead, the court granted Liberty's motion despite a plethora of factual issues.

Following the initial bad faith of taking over the project and settling claims without the knowledge or consent of the principal, Liberty exponentially expanded its bad faith by attempting to blackmail its principal. Liberty was and is clearly under the impression that the indemnity agreement gave Liberty the right to act in the manner it did. (A.235-A.236). NECP's memorandum made it clear that Liberty failed to set forth in its moving papers the well established law in Minnesota: a surety's discretion in setting a principal's claim *is not unfettered* (A.21). The trial court acknowledged as much when it held that the surety cannot act in bad faith (A.224-233). Under the law, and despite Liberty's claim otherwise in its memorandum (A.21), "bad faith" does not have a rise to the level of fraud. Bad faith under Minnesota law is any improper conduct that prejudices the rights of the indemnitor. Liberty has acted and continues to act in bad faith.

1. Minnesota Law Does Not Define Bad Faith as Fraud

Liberty claimed that NECP must prove that Liberty's actions constituted fraud in order to show bad faith (A.45). That is a misstatement of the law and a contortion of the terms of the General Agreement of Indemnity. With regard to the law, Liberty's reliance on *Florenzano v. Olson*, 387 N.W.2d 168, 173 (Minn. 1956) is misplaced. First, *Florenzano* is not a bad faith surety case. More importantly, Liberty turns the definition of bad faith on its head when it cites *Florenzano* for the proposition that "Fraudulent intent is, in essence, dishonesty or bad faith." (A.257). Any freshman logic class would be able to draw a Venn diagram showing that while "fraudulent intent" may be defined as

bad faith, it does not follow that bad faith must be defined as fraud. In fact, Liberty goes on to cite the unreported case, *Old Republic Surety Co. v. H.E.A.T. Inc.*, 2005WL 288790 (Minn. Ct. App. 2005) that defines bad faith as “conscious doing of wrong because of dishonest purpose or moral obliquity.” Liberty’s action in waiving \$2,000,000 of NECP’s claim, taking \$175,000 from Mortenson that Liberty knew NECP claimed belonged to NECP and not Liberty, blackmailing NECP to pay money and release its bad faith claim and finally, by not assigning the balance of the contract claim thus waiving it, is the epitome of moral obliquity (A.45).

In *Old Republic*, the court affirmed summary judgment for the surety. *Old Republic* is inapposite to the case at bar. In *Old Republic*, the principal based its bad faith claim solely on the fact that the surety had defenses to the obligee’s claims that the surety settled. *Id.* at \*3. In this case, NECP’s claims of bad faith are based on four separate facts: 1) Liberty’s ongoing business relationship with Mortenson was an improper motive for taking over the Project and settling the claims; 2) Liberty waived \$2,000,000 of NECP’s “strong” claim for no valid reason (and then disingenuously denied to the trial court that it did so); 3) taking \$175,000 from Mortenson despite knowing that Mortenson owed NECP and that NECP had a bad faith claim against Liberty; and 4) Liberty attempted to blackmail NECP by demanding that in exchange for an assignment of the remainder of the claims for work on the project, NECP would have to pay Liberty \$185,000 and release its bad faith claim -- otherwise, Liberty would waive the strong claims against Mortenson for zero dollars!

Liberty cited an unreported case (*Old Republic*) and yet failed to cite the premier Minnesota case on the rights of indemnitors in a construction bond case because it clearly

supports NECP's position. In *New Amsterdam Casualty Co. v. Lundquist*, 293 Minn. 274, 198 N.W.2d 543 (1972), the Minnesota Supreme Court discussed the well settled law in Minnesota, which is that an indemnitee can recover under an indemnity agreement only if the indemnitee's actions did not prejudice the indemnitor's rights. *Id.* at 549, citing *Elk River Concrete Products Co. American Cas. Co.*, 268 Minn. 284, 292, 129 N.W.2d 309, 315 (1964). The *New Amsterdam* court noted that it would follow that, if the indemnitor's rights were prejudiced, then the rule would be different and the indemnitee could not recover:

We adopt this rule and hold that an indemnitee owes a duty of good faith to its indemnitor and that any act of the indemnitee which prejudices the rights of the indemnitor will release his obligation to the extent of the prejudice.

*New Amsterdam*, 198 N.W.2d at 549. The court further stated that:

Since this duty of "good faith" on the part of the indemnitee is basic, it cannot be waived by contractual agreement between the parties. This court has recognized that in the interest of public policy, certain basic rights in an indemnitor-indemnitee relationship cannot be subject to waiver by agreement. *Fidelity & Cas. Co. v. Eickhoff*, 63 Minn. 170, 65 N.W. 351 (1895). In that case the court concerned itself with a contract which provided that "vouchers" showing the indemnitee had paid out money based on the surety contract would be conclusive evidence as to the fact and extent of liability over the indemnitor (the employee who was covered under the fidelity bond). Mr. Justice Mitchell said for the court (63 Minn. 178, 65 N.W. 352):

" \* \* \* The right of a party to waive the protection of the law is subject to the control of public policy, which cannot be set aside or contravened by any arrangement or agreement of the parties, however express. \* \* \* In the present case the attempt is to provide that, after the alleged cause of action has accrued, the plaintiff shall be the sole and conclusive judge of both its existence and extent. Such an agreement is clearly against public policy."

*Id.* at n. 4.

Accordingly, Liberty's argument that, simply because it incurred costs, NECP must indemnify it is *not* the law in Minnesota. The *New Amsterdam* court specifically held that because the surety failed to take any steps to protect the principal's assets, the indemnitor's obligation was released. *Id.* at 550. In this case, not only did Liberty fail to protect NECP's asset (its claim), Liberty deliberately sacrificed the claim first by waiving \$2,000,000 and then by waiving the balance by not assigning the claim to NECP (A.47). Either of these two facts, let alone both of them gave rise to at least a fact question as to whether Liberty's action constituted bad faith. It is critical to remember that the claims Liberty stipulated were worth zero dollars were "strong" claims according to Liberty's own counsel (A.47, A.295-297, Affidavit of William Groscup, Ex. 2-C).

Finally, the *New Amsterdam* court also held that:

In determining the good faith of the insurer, an important question is whether the insurer informed the insured of all proceedings, including communication of settlement offers. *Larson v. Anchor Cas. Co.*, 249 Minn. 339, 352, 82 N.W.2d 376, 384 (1957); 9B Dunnell, Dig. (3 ed.) § 4875c(19).

This rule is extended to surety agreements, and we hold that the indemnitee is required to communicate to the indemnitor all offers of settlement which affect the indemnitor's obligation to the indemnitee. In this case, it is undisputed that *New Amsterdam* failed to do this. It reserved to itself the prerogative of making a business judgment as to the reasonableness of accepting the offer of settlement.

*Id.* at 551. Despite this clear language, the trial court ruled that because NECP was aware of ongoing settlement negotiations between Liberty and Mortenson, Liberty met its duty under the law and acted in good faith (A.224-A.233). The record reflects absolutely no dispute as to the fact that Liberty never communicated that it had agreed to terms with

Mortenson nor it is disputed that Liberty never communicated the terms of the offer to NECP. NECP certainly never agreed to the settlement (A.72, Hart Aff., ¶18).

Liberty's contention that because the general agreement of indemnity gave it the sole right to settle all claims, it is entitled to summary judgment despite NECP's bad faith claims also flies in the face of Minnesota law in cases where one party has the unilateral right to act for another. Based on the general agreement of indemnity, Liberty had the right to settle claims, but as *New Amsterdam* court made clear, the surety cannot settle claims in a vacuum. In fact, the right to unilaterally settle the claims brings with it a heightened duty to the principal. Because Liberty had the unilateral right to settle claims, Liberty owed NECP a fiduciary duty (and an obligation to settle claims in good faith) because its decisions directly affected NECP's right to recoup the several million dollars it was owed for its work on the project. See *May v. First Nat. Bank of Grand Forks*, 427 N.W.2d 285, 289 (Minn. Ct. App. 1988), citing *Klein v. First Edina Nat'l Bank*, 196 N.W.2d 619, 623 (Minn. 1972) (to make a *prima facie* showing of a fiduciary relationship, evidence must indicate defendant knew or ought to have known, plaintiff was placing her trust and confidence in defendant, and depended on defendant to look out for her interest).

Liberty contention that the good faith requirement is met so long as there is no fraudulent conduct is not the law in Minnesota and it is not the general rule nationally. Minnesota law is in keeping with the quintessential surety bad faith case. In *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 838 A.2d 135 (Conn. 2004), the jury was asked to determine if the surety acted in bad faith. The surety was seeking indemnification for the \$700,000 it had paid a subcontractor in satisfaction of its claim

under the surety's payment bond. The contractor claimed that the payment was made in bad faith, and as such, the indemnitors were not obligated to reimburse the surety. The jury returned a verdict in favor of the indemnitors, finding that the surety had breached the implied covenant of good faith and fair dealing in the indemnification agreement when it made the payment bond payments at issue. The appellate court was then asked to reverse the judgment entered in favor of the indemnitors and against the surety.

The surety had argued that the indemnity agreement the right to compromise and settle all claims. *Id.*, 838 A.2d at 147-149. The court rejected the surety's argument that it had full discretion to settle the claims based on the indemnity agreement itself. While acknowledging that "indemnity agreements, such as the one here, typically guarantee the surety wide discretion in settling claims made upon a payment bond," the court also noted "[that] [t]his discretion is, however, not unfettered." *Id.*, 838 A.2d at 150 (emphasis added). The court noted that "the surety is entitled to indemnification only for payments that are made in good faith," as required by the implied covenant of good faith and fair dealing in every contract, including indemnity agreements. *Id.*

The *PSE Consulting* court then set forth an extensive survey of surety bad faith law as it determined how to define "bad faith":

The majority of courts agree that the principal must establish something more than mere negligence to prove bad faith. See, e.g., *Engbrock v. Federal Ins. Co.* supra, 370 F.2d at 787 ("neither lack of diligence nor negligence is the equivalent of bad faith"); *Frontier Ins. Co. v. International, Inc.*, 124 F. Supp.2d 1211, 1214 (N.D.Ala.2000) (same); *United States Fidelity & Guaranty Co. v. Feibus*, supra, 15 F. Supp.2d at 587 ("[g]ross negligence or bad judgment is insufficient to amount to bad faith"); *Employers Ins. of Wausau v. Able Green, Inc.*, 749 F. Supp. 1100, 1103 (S.D.Fla. 1990) (surety's actions may have been negligent but did not rise to level of deliberate malfeasance required to establish bad faith); *American Employers' Ins., Co. v. Horton*, 35 Mass. App. 921, 924, 622 N.E.2d 283 (1993) ("bad judgment, negligence or insufficient zeal" not evidence of bad

faith); *Fidelity & Deposit Co. of Maryland v. Wu*, supra, 150 Ft. at 231, 552 A.2d 1196 (“[a]t best, the jury could draw the conclusion that [the] plaintiff was negligent . . . there was no evidence of lack of good faith for the jury”). Unfortunately, many of these jurisdictions do not go past this label to define the term “bad faith.” In those jurisdictions that do further define the term, one common characterization used frequently, is that bad faith, in essence, means that the surety acted with an “improper motive” or “dishonest purpose.” See, e.g., *Engbrock v. Federal Ins. Co.*, supra, at 787 (improper motive); *Travelers Casualty & Surety Co. of America, Inc. v. Jadum Construction Ins.*, United States District Court, 2003 WL 21653368, \*2, 2003 U.S. Dist. Lexis 11861 \*5 (July 11, D.Mass. 2003) (dishonest purpose); *Fidelity & Guaranty Ins. Co. v. Keystone Contractors, Inc.*, United States District Court, Docket No. 02CV1328, 2002 WL 1870476, \*4, 2002 U.S. Dist. Lexis 15403, \*4, 2002 U.S. Dist. Lexis 15403, \*13 (E.D.Pa. August 14, 2002) (dishonest purpose); *Frontier Ins. Co. v. International, Inc.*, supra, at 12143 (improper motive; dishonest purpose); *Safeco Ins. Co. of America v. Criterion Investment Corp.*, 732 F. Supp. 834, 841 (E.D.Tenn. 1989) (improper motive); *Associated Indemnity Corp. v. CAT Contracting, Inc.*, supra, 964 S.W.2d at 285, 289 (improper motive; dishonest purpose); *Ford v. Aetna Ins. Co.*, 394 S.W.2d 693, 698 (Tex.Civ.App. 1965) (improper motive)...

After full consideration of the issue before us, we join those jurisdictions that define bad faith as requiring an “improper motive” or “dishonest purpose” on the part of the surety...

We are careful to note, however, that we do not interpret this standard as requiring the improper motive to rise to the level of fraud. To do so would virtually obliterate the prophylactic effect of the covenant of good faith and fair dealing.

*Id.*, 838 A.2d at 151-153.

Liberty’s argument that the law requires fraud to prove bad faith is also contrary to the General Agreement of Indemnity, draft by Liberty. In this regard, the General Agreement of Indemnity expressly provides that Liberty is only entitled to recover costs that it incurs in “good faith”:

“In the event of any payment by the surety . . . the surety shall be entitled to charge for any and all disbursements made by it in good faith in and about the matter herein contemplated by this agreement under the belief that it is, or was, or might be liable for the sum and amounts so disbursed . . . .”

(A.80-A.88, Hart Aff., Ex. "B") (emphasis added). It clearly is reasonable to equate Liberty's conduct with a lack of good faith.

2. Genuine Issue of Material Fact Existed as to Whether Liberty's Actions Constituted Bad Faith

In its moving papers, Liberty claimed that NECP could have gone forward in the Arbitration because in its settlement with Mortenson, it did not waive any of NECP's claims and NECP retained its \$2,000,000 claim over and above the subcontract balance (see A.237, Liberty Memorandum, p. 4). In fact, Liberty has gone so far as to obtain an affidavit from Mortenson in support of its claim (A.278-A.279, Affidavit of B. Funk ¶ 4). Liberty's argument was based either on ignorance of contractual privity or a purposeful attempt to mislead the trial court, but in any event, the trial court was misled. Liberty's after the fact affidavit was in direct contravention of the agreement signed by Mr. Funk at the time of the settlement (A.122-A.128, Mortenson/NECP Settlement Agreement, Hart Aff., Ex. "T"). The Mortenson/NECP Agreement specifically stated:

WHEREAS, Mortenson contends that if the residual Unpaid Subcontract Balance claim is zero, then NECP has no further monetary claim against Mortenson arising out of the Project.

(A.123, Mortenson/NECP Settlement Agreement, Hart Aff., Ex. "T", p. 2.)

Despite this clear language, Liberty argued and the trial court agreed that, as a matter of law, Liberty didn't waive any of NECP's claims (A.224-A.232).

The trial court ruled in Liberty's favor despite the fact that, notably, Mr. Funk's affidavit was significantly different than the affidavit that Mortenson's lawyer agreed to provide -- but, ultimately did not provide (A.42). Based on a document obtained by NECP in working on its response to Liberty's motion, NECP discovered that Liberty's

counsel had tried to get an affidavit from Mortenson to support its position, but couldn't (see A.42-A.43). On November 10, 2006, James Hartnett, one of Mortenson's attorneys, sent NECP's counsel a copy of the affidavit he agreed to sign for Liberty. Mr. Hartnett only agreed to say:

To the extent that Liberty, in fact, assigned the residual subcontract balance claim to NECP, Mortenson expected that NECP would have continued to assert in the arbitration all of the arbitrable claims, subject to a \$175,000 reduction, reflecting Mortenson's payment to Liberty under the Mortenson/Liberty settlement agreement.

(A.156, E-mail from J. Hartnett to K. Hart, November 10, 2006, Hart Aff., Ex. "N.") Mr. Hartnett **did not say** that "all of the arbitrable claims" included the \$2,000,000 claim, and Liberty chose not to include Mr. Hartnett's affidavit in its moving papers. Mr. Hartnett's affidavit was in keeping with the Mortenson/NECP settlement agreement, which states that NECP would have no further claims against Mortenson if the subcontract balance claim was reduced to zero (A.123, Mortenson/NECP Settlement Agreement, Hart Aff., Ex. "I", p. 2). Thus, Mr. Pisarcik and Mr. Funk's self serving affidavits in support of Liberty's motion were very much in dispute, disproven by the contemporaneous documents, and at bare minimum raised genuine issues of material fact as to whether Liberty waived the \$2,000,000 claim.

Finally, it is nothing short of ironic that Liberty's counsel specifically argued to the trial court as well as to NECP and Mortenson that NECP wasn't entitled to its \$400,000 settlement with Mortenson because all claims made by NECP arose out of the subcontract (see A.211-A.222, Hart Aff., Ex. "R"). The trial court agreed and ordered NECP to deposit the \$400,000 into escrow with the court, which NECP did. Then in its

summary judgment motion, Liberty took the opposite position and argued that NECP's \$2,000,000 claim arose outside of the subcontract. The trial court again agreed with Liberty. Apparently, all monies arise out of the subcontract when it suits Liberty, but the \$2,000,000 didn't arise out of the subcontract when that fact wasn't favorable to Liberty. In both cases, the trial court agreed with Liberty.

This trial court ruled that an indemnitee owes a duty of good faith to its indemnitor and any act of the indemnitee's that prejudice the indemnitor's rights will release the indemnitor's obligation to the indemnitee to the extent of the prejudice. (Order, Conclusions of Law, p.3, citing *New Amsterdam Casualty Co. v. Lundquist*, 293 Minn. 274, 198 N.W.2d 543, 549 (1972).) Despite this, the court granted Liberty's motion for summary judgment.

### 3. NECP's Expert Testimony Raised Genuine Issues of Material Fact

In reaching its decision, the trial court never mentioned the expert evidence NECP submitted in opposition to Liberty's motion. NECP's expert, Brian E. Downey, opined as to what does and does not constitute good faith as a surety. Mr. Downey has extensive experience with surety claims issues and, specifically, with issues involving indemnity agreements (*see* A.58-A.64, Affidavit of Brian E. Downey, C.V., attached as Exhibit A). Mr. Downey is familiar with the standards, rules, customs and practices followed by and expected of reputable sureties throughout the United States in handling and settling surety bond claims and claims against indemnitors under General Agreements of Indemnity. These standards, rules, customs and practices are generally uniform between and among reputable sureties and do not vary from state to state or region to region (*Id.* ¶ 4). Based on his education, training and experience, Mr. Downey opined:

Whether a surety is deemed to have acted improperly, wrongfully, unfairly and/or in bad faith is an inherently factual inquiry, dependent on the totality of the circumstances. However, in my expert opinion, it is objectively improper, wrongful, unfair and in bad faith for a surety to engage in any and/or all of the following conduct:

- Settling claims with regard to a principal's work on a project where a significant motive of the surety in settling is to further the surety's business relationship with the obligee, rather than based on the merits of the claims settled.
- Settling claims by and against an obligee with regard to a principal's work on a project without informing the principal of its intent to do so, without informing the principal of the proposed settlement terms in advance of the settlement, and without seeking to obtain the principal's consent to the settlement.
- Threatening and/or following through on a threat to a principal that, unless it agreed to pay the surety disputed amounts allegedly owed the surety by the principal under a General Agreement of Indemnity and give the surety a release of all claims the principal had against the surety arising out of the principal's work on a project, including claims for bad faith, then the surety would waive claims against the obligee for contract funds with regard to the principal's work on the project.
- Offering to allow a principal to pursue a claim against an obligee for contract funds with regard to the principal's work on a project, but only if the principal would release the surety from all claims that the principal had against the surety arising out of the principal's work on a project, including claims for bad faith.

(Affidavit of Brian E. Downey, ¶ 5). Based on the documents Mr. Downey had an opportunity to review as of the time of the motion, Mr. Downey concluded:

I have reviewed the payment and performance bonds issued by Liberty Mutual Insurance Company ("Liberty") to Northeast Concrete Products, LLC ("NECP") with regard to the project at issue in this matter, as well as the General Agreement of Indemnity signed by the indemnitors involved in this matter. These documents include the terms, conditions and agreements that I would expect to find in similar documents utilized by sureties throughout the United States. Nothing in the documents would change the opinions I expressed above in paragraph 5.

(*Id.* ¶ 6). Based on Mr. Downey's affidavit and the facts before the Court, there are clear genuine issues of material fact precluding summary judgment. Despite these facts, the

court determined that Liberty acted in good faith without so much as mentioning Mr. Downey's views.

4. NECP At Minimum Was Entitled to Conduct Discovery

NECP was the first party to initiate any discovery in this action (A.66, Hart Aff., ¶ 5). On January 9, 2007, NECP served its first set of discovery on Liberty (A.157-A.170, First Set of Discovery to Liberty, Hart Aff., Ex. "O"). NECP received Liberty's responses on February 12, 2007 (A.171-A.209, Liberty's Responses to First Set of Discovery to Liberty, Hart Aff., Ex. "P"). No other discovery had been conducted (A.66, Hart Aff., ¶ 5).

a. NECP Requested It Be Allowed to Take Depositions

The fact that additional discovery was required should not have been in dispute (*id.*, ¶6). In its informational statement filed with the Court, NECP stated that it expected to take ten depositions (*Id.*). Similarly, Liberty stated that it expected to take 5 or 6 depositions (*id.*). In opposition to Liberty's motion, NECP, by a Minn. R. Civ. P 56.06 affidavit, NECP declared that it anticipated deposing the following witnesses, at a minimum:

- a. Brad Funk, Mortenson (negotiation of settlement with Liberty; terms/interpretation of settlement agreement with Liberty; invalidity of Liberty assignment; negotiations concerning the affidavit submitted in support of Liberty's motion for summary judgment);
- b. Corporate designee, Mortenson (insurance/surety relationship with Liberty);
- c. Counsel for Mortenson, Jim Hartnett, Faegre & Benson (negotiation of settlement with Liberty; terms/interpretation of settlement agreement with Liberty; invalidity of Liberty assignment; negotiations concerning the affidavits submitted in support of Liberty's motion for summary judgment);

- d. Dennis Pisarcik, Liberty (takeover agreement; circumstances surrounding takeover; settlement with Mortenson; settlement discussions with NECP; purported assignment, facts set forth in affidavit submitted in support of Liberty's motion for summary judgment; Liberty's alleged damages);
- e. Corporate designee, Liberty (insurance/surety relationship with Mortenson); and
- f. C. William Groscup, Watt, Tieder, Hoffar & Fitzgerald, L.L.P. (negotiation of settlement with Mortenson; terms/interpretation of settlement agreement with Mortenson; invalidity of Liberty assignment; negotiations concerning the affidavits submitted in support of Liberty's motion for summary judgment; Liberty's alleged damages (i.e., attorney's fees).

(A.66-A.67, Hart Aff., ¶ 6). Because NECP had not yet been able to take these depositions, NECP requested that Liberty's summary judgment motion be continued (*id.*).

b. NECP Had A Right To Discovery As To Settlement Negotiations

NECP informed the trial that there were a number of specific discovery issues NECP was entitled to look into prior to a summary judgment motion, including: that NECP asked Liberty to admit that Liberty settled the Arbitration with Mortenson without informing NECP of the proposed terms prior to the Settlement (A.157-A.170, First Set of Discovery to Liberty, Hart Aff., Ex. "O"). Liberty denied this request, stating that the trial court already made its findings on this issue (A.171-A.209, *id.*, Ex. "P"). Liberty was wrong as of that date. At the motion for the restraining order, the trial court made it clear that it was not going to be deciding the facts at that early juncture of the case. Rather, all the Court was going to do was "make a quick call . . ." (A.328, Groscup Affidavit, Ex. 7, p. 31). Moreover, while the court acknowledged that NECP was aware of settlement discussions, there was no finding that NECP knew that Liberty and

Mortenson were going to stipulate to the subcontract balance thereby waiving \$2,000,000 of the claim. (*See supra.*) Further, NECP had no idea that Liberty would settle claims for \$175,000 (A.67-68, Hart Aff., ¶7(a)). Accordingly, NECP never formally objected to the settlement prior to its execution by Liberty and Mortenson because NECP was unaware of any of the proposed terms. NECP was entitled to further discovery on this issue in deposition and/or in a motion to compel. NECP never got the opportunity because the trial court ruled that Liberty acted in good faith despite all of the outstanding questions.

By interrogatory, NECP also asked Liberty to describe all communications it had “during the course of the settlement negotiations with Mortenson that specifically related to the claims made by NECP in the Arbitration, including but not limited to all communications involving the stipulated subcontract balance.” (A.164, Hart Aff., Interrogatory 10, Ex. “O”). Liberty’s response was to refuse to provide the information, claiming that it is privileged under Rule 114.08 of the General Rules of Practice (A.171-A.209, *id.*, Ex. “P”) Liberty’s objection was without merit, but NECP never got an opportunity to compel answers because the law of the case was that Liberty acted in good faith. The rule cited by Liberty pertains to communications in the mediation proceeding not being admissible at trial. Obviously, communications with opposing counsel are not privileged and even if they were, this is discovery, not trial. Further, there is no privilege for settlement discussions when those discussions are the topic of a different case than the case that was settled. Rule 408 of the Minnesota Rules of Evidence provides:

Evidence of (1) furnishing or offering or promising to furnish \* \* \* a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible

to prove liability for or invalidity of the claim or its amount, Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. *This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negating a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.*

(Emphasis added). Thus, the express language of the rule excludes evidence only where the settlement negotiations are sought to be admitted to prove liability for the claim or its amount. It does not require exclusion for other purposes. *See also State v. O'Hagan*, 474 N.W.2d 613, (Minn. Ct. App. 1991) (determining that document created for settlement negotiations in another unrelated case was admissible in a separate action where the document was not offered to show liability or amount); *Esser v. Brophrey*, 212 Minn. 194, 196, 3 N.W.2d 3, 4 (1942) ("the law favors the settlement of disputed claims without litigation, and to encourage such settlements will not permit either party to use offers of settlement made by the other as **evidence of an admission of liability.**" (emphasis added)). Accordingly, Rule 408 does not require exclusion of settlement negotiations in a subsequent action regarding the terms of the settlement. NECP was entitled to challenge the contention that a privilege attaches to the communications.

c. Discovery Was Needed Regarding Liberty's Reasons For Settling

One of the indications of whether a surety acted in good faith is whether it had a legitimate basis for settling the principal's claims. Liberty contended that it had a sole discretion to settle, so it settled. At the time Liberty settled, it had out of pocket costs of approximately \$260,000 (*See* A.112-A.121, Hart Aff., Exs. "G" and "H"). It is NECP's contention that Liberty was never in any peril because of the net worth of the indemnitors

was in excess of \$25 million dollars (*see* A.1-A.19, Northeast Concrete Products, LLC's Memorandum in Opposition to Liberty Mutual Insurance Company's Motion for a Restraining Order; Affidavit of Leo Barry; and Affidavit of Kyle E. Hart). Based on these facts, it is NECP's contention that Liberty's motive for agreeing to take over the project and for waiving and settling NECP's claims could not have been based, as Liberty contends, on a "business decision" involving the project. Thus, further discovery could have provided additional evidence of bad faith.

If Liberty was aware of the net worth of the indemnitors, then Liberty would clearly have known that settling the claims for pennies on the dollar was not warranted. The fact that Liberty was not at all worried about the indemnitor's ability to satisfy any obligations was already evidenced by the fact that Liberty did not demand collateral until October, 2006, well after the settlements (*see* A.274-A.277, Affidavit of Dennis Pisarcik, submitted with Liberty's moving papers, Ex. 6). To further examine this issue, NECP asked Liberty in discovery to identify all personnel or representatives of Liberty or entities or people hired by Liberty who performed any investigative services or due diligence relating to the Bonds and the Indemnitors (A.68-A.69; A.165, *id.*, ¶ 7(c); Interrogatory 14, Ex. "O"). Liberty refused to answer, stating "Liberty objects to this request as vague, overly broad, unduly burdensome and not reasonably calculated to lead to admissible evidence" (A.171-A.209, *id.*, Ex. "P"). Because of the trial court's ruling that, as a matter of law, Liberty acted in good faith, NECP never got the opportunity to challenge this response.

NECP also explained to the trial court that it was NECP's position that one of the reasons Liberty was so willing to accommodate Mortenson is that Liberty writes millions

of dollars of bonds and insurance for Mortenson (A.38, citing A.67-A.69, Hart Aff., ¶ 7). NECP sought discovery on Liberty's significant ongoing business relationship with Mortenson to support its claim that Liberty was unwilling to rock the proverbial boat with Mortenson for the sake of this relatively small subcontractor (A.167, Interrogatories 20 and 21, Ex. "O"). Specifically, NECP asked Liberty to identify the bonds and insurance it issued to Mortenson since January 1, 2000 (A.167, *id.*). Liberty categorically refused to provide this information, claiming that it relates to a "wild accusation" by NECP (*id.*, Ex. "P") It is not Liberty's role to decide what allegation NECP gets to make. NECP should have been allowed to challenge this response.

Under the Minnesota Rules of Civil Procedure, Rule 56.06 allows the trial court to refuse the application for judgment or to continue the matter until the party opposing the motion has had an adequate opportunity to conduct discovery. A continuance "should be liberally granted, especially when the continuance is sought because of a claim of insufficient time to conduct discovery." *Lewis v. St. Cloud State University*, 693 N.W.2d 466, 473 (Minn. Ct. App. 2005). NECP, in its Opposition papers informed the trial court that specifically, NECP wanted to take additional discovery on the following topics:

- Whether Liberty's takeover of the project was wrongful. Although the circumstances surrounding the takeover were the subject of some discovery during the arbitration, NECP did not focus on Liberty's wrongful conduct in taking over the project because Liberty and NECP had entered into a Joint Defense Agreement pursuant to which they agreed to resolve any disputes between themselves later, after the arbitration was done (A.39, citing A.69, A.99-A.111, Hart Aff., ¶ 8; Ex. "F");

- Information Liberty and Mortenson exchanged involving the settlement, including but not limited to any and all drafts of the settlement agreement (A.39, citing A.69, Hart Aff., ¶ 8);
- Whether Liberty's purported assignment on September 11, 2006 (A.39, citing A.131-A.132, Ex. "K") complied with the requirements of its settlement with Mortenson. In this regard, Liberty claims that the assignment was valid. Both NECP and Mortenson claim the contrary (A.39, citing A.153-A.155, Ex. "L" and "M"). Obviously, this is a factual dispute that needs to be flushed out in discovery (*id.*);
- The extent of Liberty's ongoing business relationship with Mortenson (A.39);
- The knowledge of Liberty as to the ability of the indemnitors to satisfy any judgment against them (*id.*);
- The decision by Liberty not to request collateral until October 4, 2006, after the settlement and initiation of this case (A.40, citing A.66-A.68, Hart Aff., ¶ 3 and 7);
- Drafts of affidavits requested from Mortenson in support of this motion and communications regarding the affidavits (A.40, citing A.67-69, Hart Aff., ¶ 7). In this regard, on February 12, 2007, NECP's counsel called Mortenson's counsel and asked for "all of [his] communications with Bill Groscup and/or Liberty and/or its representatives about [his] proposed affidavit and the actual affidavit signed by Brad Funk, including but not limited to all drafts of the affidavits and followed the request with an email (A.40, citing A.70, A.223, *id.*, ¶ 8; Ex. "S"). Mortenson's attorneys provided the requested documents on Friday, February 16, 2007. NECP had not had time to review and analyze the documents as of the date

of the opposition to Liberty's moving papers and NECP informed the trial court of this fact (*id.*, ¶ 8);

- The multitude of factual representations made by William Groscup and Dennis Pisarcik in their affidavits submitted in support of Liberty's motion for summary judgment (A.40); and
- Damages, including Liberty's alleged \$185,000 in out-of-pocket construction costs and attorney's fees (*id.*).

NECP informed the trial court that it expected that this additional discovery would reveal that: (a) Liberty had a very profitable and long-running business relationship with Mortenson that gave Liberty a motive to wrongfully enter into the takeover agreement and settle NECP's claims on terms very favorable to Mortenson and adverse to NECP; (b) Liberty knew that it was not at risk when Mortenson sought to default NECP because the indemnitors under NECP's bond has a significant net worth; (c) Liberty and Mortenson understood and contemplated that, in entering into the Liberty/ Mortenson settlement, Liberty was waiving over \$2,000,000 of NECP's claims; and (d) much of Liberty's alleged damages were overstated and were not incurred in good faith (A.41, citing A.70-71, Hart Aff., ¶ 9).

NECP also stated that it needed more time to get its experts up to speed on the case so that they could provide the best possible opinions to aid the jury in making the required determinations at trial (A.41). NECP expected that, given an adequate opportunity to review the required files, documents, pleadings and depositions, NECP's experts will be able to opine that Liberty's conduct in this case was improper, wrongful, unfair and in bad faith and that it severely prejudiced NECP (A.41, citing A.71, *id.*, ¶ 10).

NECP had pointed out that all of the contemplated discovery could have easily been completed without disrupting the trial court's calendar (A.41, citing A.71, *id.*, ¶ 11). In this regard, NECP noted that the case was so new that the trial court had not yet issued a scheduling order and that it was less than one month before the summary judgment motion that the court denied NECP's motion to dismiss the very Complaint that Liberty was now seeking summary judgment on (A.41). As of the date of the Rule 56.06 Affidavit, there was no deadline for the parties to amend the pleadings, join additional parties, complete discovery, disclose experts or file motions. Nor had the case been set for trial. Under these circumstances, Liberty's rush to judgment was unnecessary and inappropriate (*id.*). Accordingly, NECP requested that the summary judgment motion be denied or continued to allow NECP to conduct the required additional discovery so that it could fully defend against the motion (*id.*). The trial court ignored this request without comment.

**C. The Court Erred in Releasing The Escrowed Funds**

Liberty claimed that NECP converted its \$400,000 by settling with Mortenson. Liberty made this argument based on the contention that Liberty is entitled to all proceeds arising out of the subcontract (*see* A.211-A.222, Hart Aff., Ex. "R"). In its findings on Liberty's summary judgment motion, the trial court held that NECP could have pursued its additional claims against Mortenson because they were outside of the contract balance and outside of Liberty's claims against Mortenson under the agreement. (A.230-A.231, *Order*, Memorandum, pp.7-8.) NECP argued to the trial court that, if that is the case, then surely, NECP had a right to settle those claims against Mortenson, which using the court's rationale, it did.

NECP also argued that NECP's own affirmative claims, which included a claim that Liberty acted in bad faith, precluded the release of the funds (A.376-A.383). NECP argued that there was no doubt that NECP was entitled to be paid for the work it performed as a subcontractor to Liberty on the Mortenson contract and that there were undisputed facts that the garage at the naval base had been built that there were no viable bond claims pending against Liberty (A.382). By the time Liberty made its motion for the release of the \$400,000, the trial court had already ruled that an indemnitee owes a duty of good faith to its indemnitor and any act of the indemnitee's that prejudice the indemnitor's rights will release the indemnitor's obligation to the indemnitee to the extent of the prejudice. (A.226, Order, Conclusions of Law, p.3, citing *New Amsterdam Casualty Co. v. Lundquist*, 293 Minn. 274, 198 N.W.2d 543, 549 (1972).) Based on the evidence submitted to the court as to NECP's claims of bad faith, NECP asked that the court not release the \$400,000 to Liberty.

NECP noted that the trial court had made no monetary award and that there was no dispute that at the time of the underlying arbitration, Liberty's out of pocket costs, including attorney fees were \$260,000 (A.381-A.382). Of that amount, Liberty recovered \$175,000 in its settlement with Mortenson (A.120, Kyle Hart Affidavit initially submitted to the Court in opposition to Liberty's motion for the TRO, Exhibit H, which is Liberty's letter to NECP's counsel dated August 23, 2006, admitting that claimed damages suffered by Liberty were \$185,000). Liberty had admitted that its damages were only \$185,000 at the time of the settlement (*Id.*). Other than attorney fees expended in the consolidated actions, damages were **more than** hypothetical and speculative, they were **highly unlikely** (A.382). There was no pending bond claim litigation and the year in which to

bring a claim on the bond had long since run (A.382). Accordingly, NECP argued that the court should not release the funds to Liberty.

In its motion, Liberty claimed that it was entitled to the money as collateral. Yet, Liberty failed to state what claims it needed to protect against. To obtain an award of \$400,000, the threatened injury should have been real and substantial. Despite the fact that Liberty failed to set forth any actual loss or any threatened loss entitling it to this sum, the trial court ordered the release of funds from the bench and then released the funds to Liberty without ever issuing a written order.

**D. Genuine Issues of Material Fact Precluded Summary Judgment on NECP's Claims**

Finally, Liberty moved for Summary Judgment on the NECP's claims (A.234). In its motion, Liberty contended that NECP's claims were "absurd" and "frivolous" as a matter of law and argued that the trial court has already agreed (A.264). In lieu of Liberty's argument on the law of the case, NECP requested that the trial court revise its prior ruling and that the court deny this motion (A.356). Under Minn. R. Civ. P. 54.02, the court had the inherent authority to revise its decision on Liberty's previous motion for summary judgment and to deny the motion on NECP's claims (A.356-A.357). At minimum, NECP again respectfully requested that it be allowed to take the discovery necessary to show the court that Liberty failed in its burden of showing that there is no genuine issue of material fact and that it is entitled to judgment as a matter of law (A.357). The trial court granted Liberty's motion as to NECP's claims (A.368-A.374) and in entering that final judgment, concluded the case (A.375). For the same reasons

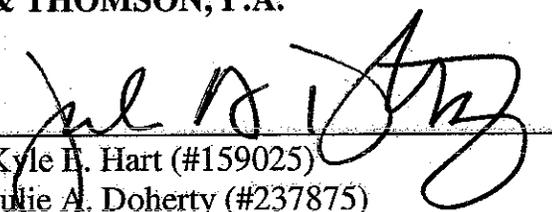
that Liberty was not entitled to summary judgment on its claims, it was not entitled to summary judgment on NECP's claims.

### CONCLUSION

In conclusion, summary judgment was not warranted on Liberty's claims for indemnification and exoneration or against NECP on NECP's claims. Liberty was not entitled to the \$400,000 escrowed funds. NECP's claims of bad faith wholly precluded the summary judgments and the release of the funds. Liberty completely stepped over the bounds of what is acceptable surety behavior notwithstanding Liberty's disingenuous clamor about "far fetched" theories and "absurd" allegations. Liberty is fully aware, as is Mortenson, that Liberty waived \$2,000,000 of claims. Second, a surety's demand that its principal's "strong" claims will be *zero* unless it pays \$185,000 and releases the surety from all bad faith claims is wholly improper. Minnesota law is clear. The custom and practices in the surety industry are clear. The indemnity agreement did not give Liberty the right to throw away claims and hold the remaining claims hostage. While NECP has the burden of proving bad faith at trial, Liberty had the burden to show there are no issues of fact for trial. Liberty did not meet its burden.

DATED: December 12, 2007

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