IN THE SUPREME COURT OF MISSISSIPPI
NO. 2009-TS-00446

FIDELITY AND DEPOSIT COMPANY
OF MARYLAND — APPELLANT

VS.

RALPH MCKNIGHT & SON CONSTRUCTION
INC., TOMMY L. MCKNIGHT
and VONDA L. MCKNIGHT — APPELLEES

APPEAL
FROM THE CHANCERY COURT OF ATTALA COUNTY, MISSISSIPPI

REPLY BRIEF OF APPELLANT FIDELITY AND DEPOSIT COMPANY OF MARYLAND

ORAL ARGUMENT REQUESTED

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FIDELITY AND DEPOSIT COMPANY
OF MARYLAND

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At the outset, it should be noted that McKnight did not substantively respond to any argument set forth by F&D in its brief. The overwhelming majority of McKnight's brief is cut directly from its Motion to Dismiss and pasted into its brief.[1] For the reasons stated below, as well as those articulated in F&D Appellant's Brief, the Chancery Order is incorrect and the trial court committed reversible error in issuing it. Accordingly, F&D requests that this Court reverse the Chancery Order. Additionally, F&D requests that this Court reverse and render the trial court's denial of F&D's Motion for Summary Judgment, requiring McKnight to post collateral equivalent to the amount set on reserve by F&D, and allow F&D to have access to McKnight's books and records.

I. The Court Erred In Granting McKnight's Motion to Dismiss

A. F&D's Basis for its Demand for Indemnity is McKnight's Possible Breach of Contract to C&I.

McKnight continually argues that it should not be required to indemnify F&D because F&D asks to be indemnified for its own negligence. This argument is completely meritless, irrelevant and inapplicable to the facts at hand. An understanding of basic suretyship law shows the flaw in McKnight's argument.

The tripartite relationship between the surety, principal, and the obligee is the bedrock on which the law of suretyship is anchored. A surety's liability to an obligee is accessory to that of the principal, so that if the principal is not liable, then neither is the surety.[2] For over 150 years Mississippi has adhered to this basic tenant of surety law. In 1837, the High Court of Errors and Appeals of Mississippi held that a surety's liability is secondary to that of its principle, "arising only

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[1] See Clerk's Papers, Vol. I, pp. 17-27.

[2] 74 Am. Jur. 2d Suretyship § 20 (2008).

upon the default of the principle being judicially ascertained."[3] More recently, the Supreme Court of the State of Mississippi, in Brazeale v. Lewis, held as a matter of law that if a principal has no liability, the surety cannot be held liable because "no liability may be imputed to its surety beyond that of its principal."[4] In accordance, the United States Court of Appeals for the Fifth Circuit stated that, "the general rule of law which governs the liability of sureties upon bonds is that the surety is not liable unless the principal is, and, therefore, may plead any defense available to the principal."[5] Furthermore, the United States District Court for the Southern District of Mississippi stated that, "[a] surety's liability is always measured by the express terms of his covenant, which is contained in. . .the conditions of the bond."[6]

In this case, McKnight and the trial court failed to recognize that F&D demands indemnity against a possible loss occurring as a result of McKnight's breach of its contract with C&I, not any alleged negligence on the part of F&D. As Brazeale stated, without a finding that McKnight is liable to C&I, F&D cannot be liable to C&I. Therefore, it is a legal impossibility for F&D to be found liable unless McKnight is liable, and F&D's exposure to liability through McKnight's breach of contract is the basis for the demand for indemnity.

Paragraph 6 of C&I's complaint against F&D states that the "contractor [McKnight] failed to perform its part of the building contract by performing unsatisfactory workmanship and the use

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[3] McNiell v. Burton, 1 Howard 510, 1836 WL 1245, *3 (Miss. Err. App. 1837).

[4] Brazeale v. Lewis, 498 So. 2d 321 (Miss. 1986).

[5] National Surety Corp. v. United States, 143 F.2d 831, 835 (5th Cir. 1944); see also Pacific Lining Co., Inc., v. Algernon-Blair Construction Co. v. J.A. Construction Co, 812 F.2d 237, 241 (5th Cir. 1987) ("the derivative liability of a surety cannot exist unless the principal is first liable.").

[6] Chain Electric Co. v. National Fire Ins. Co. of Hartford, 2006 WL 2973044, *5 (S.D. Miss. 2006) (citing Alexander v. Fidelity and Casualty Co., 100 So. 2d 347, 349 (Miss. 1958).

of substandard material resulting, among other deficiencies, in the failure of the roof and which failure resulted in damage to the building and loss of the use of the skating rink and parts of the movie theatre."[7] This is the basis for C&I's claim on the Bond and its complaint against F&D, and the reason that F&D demands collateral be posted pursuant to the Indemnity Agreement. F&D was sued by C&I because McKnight allegedly breached its contract with C&I, and C&I sought payment from F&D. Consequently, F&D was forced to set its reserve at $475,000 in the event that McKnight's default was "judicially ascertained."[8] This is the precise amount that F&D requests McKnight post in collateral in accordance with the Indemnity Agreement.

McKnight fails to understand F&D's purpose in requiring McKnight to post collateral. By requiring McKnight to post collateral, F&D thereby allows McKnight to defend itself against C&I in its separate suit. If F&D pays the claim pursuant to the provisions of the Bond, as McKnight, in its brief, oddly suggests that F&D could do,[9] McKnight would forfeit its defense against C&I, and McKnight, as it admitted, would owe F&D indemnity for the full amount paid.

McKnight's position that F&D could pay C&I's claim is illogical. If McKnight refuses to post collateral, it certainly does not want to pay indemnity. Indeed, McKnight contends that it completed the contract with C&I and does not owe any amount to C&I.[10] To the contrary, McKnight contends that it is owed money by C&I.[11] F&D, through an independent investigation and in reliance

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[7] Clerk's Papers, Vol. I, p. 30.

[8] McNiell, 1836 WL at *3.

[9] See Brief of Appellees, p. 9 ("[h]ad F&D paid C&I's claim pursuant to the provisions of the bond, McKnight stipulates that the terms of the indemnity agreement may have applied at that point.").

[10] See Clerk's Papers, Vol. I, pp. 81-82.

[11] Id.

on McKnight's defense, denied C&I's claim, and McKnight has asserted its defense against C&I. F&D's right to rely on McKnight's defense is well settled surety law. The Fifth Circuit Court of Appeals recognized this when it stated that "[t]he derivative nature of a surety's liability and its right to rely on the defenses of its principal compel the conclusion that a surety, like its principal, should be entitled to test the merits of an obligee's claim without the imposition of extracontractual duties to the bond obligee."[12]

Clearly, McKnight does not believe that F&D should have paid C&I's claim on the Bond. That would be an admission that McKnight had breached the contract, that its suit with C&I is frivolous, and that it is subject to Rule 11 sanctions. McKnight instead is saying that F&D had no right to rely on McKnight's defenses. This is simply wrong as a matter of law. F&D seeks indemnification from McKnight for possible damages that result if McKnight breached its contract with C&I. The trial court erred in granting McKnight's Motion to Dismiss because it failed to recognize this fundamental principle of surety law, and, as shown above, the law requires a reversal.

B. McKnight's Misapplication of Law Should be Disregarded.

McKnight relied on the wrong body of law in its brief. As this is a case involving a surety seeking indemnity pursuant to an Indemnity Agreement executed in connection with a construction bond, the court should examine other courts' decisions involving a surety seeking indemnity under an indemnity agreement. While F&D directed the court to national jurisprudence involving the exact indemnity agreement as is present here, McKnight attempts to confuse the court with its misguided reliance on the wrong body of law. In its brief, McKnight cites 37 cases for its proposition that the

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[12] See Marshall Contractors, Inc. v. Amwest Surety Ins. Co., 116 F.3d 479, 1997 WL 256892, *2 (5th Cir. 1997) (quoting Great American Ins. Co. v. North Austin Mun. Utility Dist. #1, 908 S.W. 2d 415, 420 (Tex. 1995); see also National Surety Corp. v. United States, 143 F.2d 831, 835 (5th Cir. 1944)("The general rule of law which governs the liability of sureties upon bonds is that the surety is not liable unless the principal is, and, therefore, may plead any defense available to the principal.").

trial court correctly granted its Motion to Dismiss. However, McKnight failed to examine law involving sureties and/or bonds in general. In fact, of the 37 cases cited by McKnight in its brief, only six (6) even mentioned the word surety and/or bond, and only two (2) involved facts that are similar to the case at issue. Of the two cases that were somewhat factually similar, Greenwich Insurance Co. v. ICE Contractors, Inc.,[13] and Fidelity & Deposit Co. of Maryland v. Bristol Steel,[14] the courts in both cases granted summary judgment in favor of the surety, holding that the Indemnity Agreement was valid.

Instead of examining cases involving construction bonds, McKnight relies heavily on cases such as Turnbrough v. Ladner,[15] stating that it is factually similar.[16] To the contrary, Turnbrough is completely distinguishable. Turnbrough has nothing to do with construction, sureties, or bonds, but instead involves an injury that occurred during a deep sea dive instruction class.[17] While in both Turnbrough and in this case, the plaintiff signed a piece of paper, the similarities end there.

In its brief, F&D presented case law dealing with the exact fact scenario as is present here.[18] This Court should not be persuaded, as the trial court was, by McKnight's attempt to distract this Court from examining case law involving almost identical facts and the exact Indemnity Agreement as is present here.

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[13] 541 F.Supp. 2d 327 (D.C. Cir. 2008).

[14] 722 F.2d 1160 (4th Cir. 1983).

[15] Turnbrough v. Ladner, 754 So. 2d 467 (Miss. 1999).

[16] See Brief of Appellees, p. 7.

[17] Turnbrough, 754 So. 2d at 468.

[18] See infra note 23.

C. The Indemnity Agreement is Unambiguous

In its brief, McKnight attempts to persuade this Court that the trial court's granting of its Motion to Dismiss was proper by arbitrarily declaring that some provisions of the Indemnity Agreement are clear and unambiguous, while other provisions are ambiguous. However, the only proof McKnight offers as to any purported "ambiguities" are empty words, while F&D cited a litany of case law holding that the exact Indemnity Agreement is clear and unambiguous.[19]

McKnight, in reference to line nine (9) of the Indemnity Agreement, states that "[t]he 'Agreement of Indemnity' clearly and unequivocally states that its purpose is to ensure McKnight's 'performance of contracts' that are bonded by F&D."[20] McKnight then arbitrarily argues that the second paragraph of the Indemnity Agreement, the paragraph requiring McKnight's indemnity, is ambiguous.[21] While McKnight is correct that the purpose of the Indemnity Agreement is to ensure McKnight's performance of its contract with C&I,[22] McKnight fails to cite any precedent where the Indemnity Agreement at issue has been held ambiguous.

In its brief, F&D alerted this Court to numerous opinions that have held that the Indemnity Agreement in question, specifically the provision requiring the contractor to post collateral, is clear and unambiguous.[23] While McKnight's recitation of the law regarding the inferences associated with

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[19] Id.

[20] Brief of Appellees, p. 5.

[21] Id. at 7-9.

[22] In Section I, A of its reply brief, F&D examines C&I's complaint against F&D, showing that the performance of McKnight's contract is the reason behind C&I's suit against F&D and subsequently, the reason for F&D's suit against McKnight.

[23] See International Fidelity Insurance Co. v. Vimas Painting Co., Inc., 2009 WL 485494 (S.D. Ohio 2009); see also Fidelity & Deposit Company of Maryland v. Tri-Lam Company, Inc., 2007 WL 1452632 (W.D. Tex. 2007); see also International Fidelity Insurance Co. v. Anchor Environmental, 2008 WL 1931004 (E.D. Pa. 2008); see also Great American Insurance Co. v. McElwee Brothers, Inc., 106 Fed.

ambiguous terms of a contract might be correct, it sets forth no binding or persuasive precedent showing that the Indemnity Agreement in question is, in fact, ambiguous.

This Court should not entertain McKnight's baseless arguments regarding the ambiguous nature of the Indemnity Agreement, but should find, as every other court that has interpreted this Indemnity Agreement has found, that the Indemnity Agreement is unambiguous and requires McKnight to post collateral equivalent to the amount set in reserve by F&D and allow F&D to have access to McKnight's books and records.

As shown above, McKnight's misapplication of Mississippi law and the trial court's granting of McKnight's Motion to Dismiss is manifest error, and the law requires a reversal. Affirming the trial court's granting of McKnight's Motion to Dismiss would destroy the cornerstone on which the law of suretyship stands. It would render a surety's right of indemnity useless, and run opposite to every court that has interpreted this Indemnity Agreement in the last 25 years.[24]

Appx 197, 2004 WL 1345120 (5th Cir. 2004); see also United States Fidelity and Guaranty Company v. Diaz Matos, 2007 WL 878571 (D. Puerto Rico 2007); see also Ohio Farmers Ins. Co. v. Special Coatings, LLC, 2008 WL 5378079 (M. D. Tenn. 2008); see also Constructora Andrade Gutierrez, S.A. v. American Internat'l Ins. Co. of Puerto Rico, 467 F.3d 38 (1st Cir. 2006); see also North American Specialty Ins. Co. v. Montco Const. Co., Inc., 2003 WL 21383231 (W.D.N.Y. 2003).

[24] See Internat'l Fid. Ins. Co. v. Vimas Painting Co., Inc., 2009 WL 485494 (S.D. Ohio 2009); see also Fid. and Dep. Co. of Maryland v. D.M. Ward Constr. Co., Inc., 2008 WL 2761314 (D. Kan. 2008) (holding that language under the same indemnity agreement allowed for specific performance and required the principal to post collateral equal to the amount the surety put on reserve).; see also Internat'l Fid. Ins. Co. v. Anchor Environ., 2008 WL 1931004 (E.D. Pa. 2008) (granting summary judgment and specific performance to the surety because the indemnity agreement, which is exactly like the one here, was unambiguous and required the principal to post collateral equal to the amount on reserve by surety); see also Great Am. Ins. Co. v. McElwee Bros., Inc., 106 Fed. Appx 197, 2004 Wl 1345120 (5th Cir. 2004); see also Lamp, Inc. v. Internat'l Fid. Ins. Co., 493 N.E. 2d 146 (Ct. App. III. 1986) (applying the same language as here, the Court held that the right to indemnity arose at the time of a claim on the bond, regardless of the principal's liability on the underlying claim); see also Fid. and Dep. Co. of Maryland v. Refine Constr. Co., Inc., 1984 WL 536 (S.D.N.Y. 1984) (summary judgment was granted for the surety and the Court held that the principal was required to "indemnify F&D with respect to losses it *might* sustain under surety bonds issued by F&D").

D. The Trial Court Erred in Applying Miss Code Ann. § 31-5-41.

Lastly, McKnight argues that since the Bond incorporated by reference the contract between McKnight and C&I, the trial court correctly applied Miss Code Ann. § 31-5-41. This is patently incorrect. The statute clearly states, **"[t]his section does not apply to construction bonds or insurance contracts or agreements."**[25] As is shown in F&D's initial brief, to which McKnight puts forth no opposition, the Bond at issue is a construction bond. It makes no difference that the Bond incorporates another contract by reference. It is undisputed that F&D is a bonding company that issued a construction bond to McKnight. Therefore, as Miss Code Ann. § 31-5-41 plainly states, it cannot be applied to a construction bond.

McKnight further argues that the Chancery Order is correct in stating that since F&D presented no case law precedent showing that suretyships are not an exception to the statute, Miss Code Ann. § 31-5-41 applies. The reason for F&D's lack of case law precedent in this matter is simple: the statute so clearly states that it does not apply to construction bonds, that there is no case law available where a court has been forced to rule on this issue.

In support of its argument that the trial court correctly applied Miss Code Ann. § 31-5-41, McKnight cites Hartford Accident & Indemnity Co. v. Natchez Inv. Co., Inc.[26] for the statement that the Mississippi Supreme Court has held that a contract that was incorporated by reference into a surety bond became as much a part of the bond as the printed form of the bond itself.[27] McKnight

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[25] Miss Code Ann. § 31-5-41 (2009).

[26] 132 So. 535 (Miss. 1931)

[27] See Brief of Appellee, pp. 10-11. It should be noted that F&D found no such quote in Hartford. In fact, F&D found no such quote in any Mississippi case.

then twists this statement to say the exact opposite by arguing that F&D actually became a party to the McKnight/C&I contract.[28] While McKnight is correct that the provisions of the McKnight/C&I contract became a part of the Bond, it is incorrect in arguing that F&D became a party to the C&I/McKnight contract.

No case that McKnight cited stated that the surety becomes a party to the construction contract. Instead, the cases cited state that the construction contract becomes a part of the surety bond. Since this litigation stems from a construction bond, and Miss Code Ann. § 31-5-41 specifically states that it does not apply to construction bonds, the trial court erred in granting McKnight's Motion to Dismiss by applying Miss Code Ann. § 31-5-41.

II. F&D's Motion for Summary Judgment is Ripe for Appeal Even Though McKnight Chose Not to Respond to it.

Mississippi law states that if an issue is brought before a chancellor, it is ripe for appeal.[29] As is evidenced in the transcript of the Hearing held on November 10, 2008, and contrary to McKnight's statement in its brief, the trial court addressed F&D's Motion for Summary Judgment; therefore, this issue is ripe for appeal. At the Hearing on November 10, 2008, Judge Cynthia Brewer stated twice that F&D's Motion for Summary Judgment was being argued.[30] In granting McKnight's Motion to Dismiss, the Chancery Court necessarily denied F&D's Motion for Summary Judgment.

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[28] Id.

[29] Cossit v. Cossit, 975 So. 2d 274, 282 (Miss. App. 2008).

[30] See Transcript of Hearing on November 10, 2008, p. 3, lines 16-22, and p. 5, lines 18-21.

McKnight states that because the trial court did not issue a separate opinion specifically denying F&D's Motion for Summary Judgment, Summary Judgment was not denied. However, McKnight cites no precedent stating that a court must draft a separate opinion in order to deny a motion. It should also be noted that prior to the hearing, McKnight, even though given ample opportunity, chose not to respond to F&D's Motion for Summary Judgment. F&D filed its Response to McKnight's Motion to Dismiss and its Motion for Summary Judgment on May 23, 2008. McKnight replied to F&D's response to its Motion to Dismiss, but for reasons unknown, chose not to respond to F&D's Motion for Summary Judgment. McKnight should not be rewarded for disregarding the procedural rules of responding to motions.

This issue is ripe for appeal and, as set forth in F&D's brief, **every court** that has interpreted the Bond in question has held that summary judgment is appropriate.[31] The trial court erroneously denied F&D's Motion for Summary Judgment, and this Court should, relying on F&D's unopposed argument in its brief, reverse the trial court's decision and grant summary judgment for F&D, requiring McKnight to post collateral equivalent to the amount set in reserve by F&D and allow F&D to have access to McKnight's books and records pursuant to the Indemnity Agreement.

CONCLUSION

For the foregoing reasons, as well as those articulated in F&D's Appellant's Brief, the Chancery Order is incorrect and the trial court committed reversible error in issuing it. Accordingly, F&D requests that this Court reverse the Chancery Order. Additionally, F&D requests that this

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[31] See supra note 23.

Court reverse and render the trial court's denial of F&D's Motion for Summary Judgment.

Respectfully submitted,

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By: _____

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CERTIFICATE OF SERVICE

Pursuant to Miss. R. App. P. 25(a), the undersigned certifies that I have this day addressed and forwarded via United States Mail an original and three copies of the Reply Brief of Appellant and one computer disk of the Reply Brief of Appellant in PDF format, and further certify that I have forwarded via United States Mail, postage pre-paid, a true and correct copy to the following:

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This the 19th day of August, 2009.

ALEC M. TAYLOR