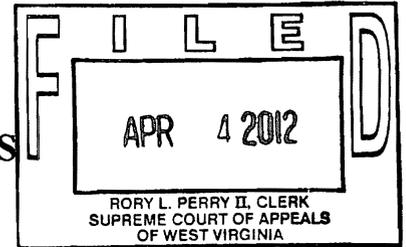


**IN THE SUPREME COURT OF APPEALS
OF THE STATE OF WEST VIRGINIA**



**BRIEF FILED
WITH MOTION**

**HARTFORD FIRE INSURANCE COMPANY,
PETITIONER, DEFENDANT BELOW,**

V.

**MICAH A. CURTIS AND ANGELA L. CURTIS,
RESPONDENTS, PLAINTIFFS BELOW.**

**CASE NO.: 12-0037
(CIRCUIT COURT OF JACKSON COUNTY,
CIVIL ACTION NO. 08-C-157)**

***AMICUS CURIAE* BRIEF OF THE SURETY & FIDELITY ASSOCIATION
OF AMERICA IN SUPPORT OF PETITIONER AND SUPPORTING
REVERSAL OF THE CIRCUIT COURT'S ORDER GRANTING PARTIAL
SUMMARY JUDGMENT**

Gene W. Bailey, II - WV State Bar #203
Jill E. Hall - WV State Bar #8812
Bowles Rice McDavid Graff & Love LLP
600 Quarrier Street
Charleston, West Virginia 25301
(304) 347-1100; (304) 347-1756 Fax
gwbailey@bowlesrice.com
jhall@bowlesrice.com

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I. STATEMENT OF INTEREST¹

The Surety & Fidelity Association of America (SFAA) is a national trade association of companies licensed to write fidelity and surety bonds in the United States. SFAA collects statistics on surety premiums and losses and files those statistics with the insurance regulators of each state. SFAA is licensed by the West Virginia Offices of the Insurance Commissioner as a Rating Organization.

The members of SFAA are sureties on the vast majority of bonds written in the United States and in West Virginia, including bonds written to comply with the licensing requirements for mortgage lenders found in Chapter 31, Article 17 of the West Virginia Code. Consequently, SFAA and its members have a substantial interest in the issue presented to this Court, specifically the effect a default judgment against a bond's principal has on the surety. In this appeal, the Court must determine whether, under the bond form required by the Commissioner of Banking, a claimant can force the surety to pay without ever proving that the bond has been breached or that the claimant has suffered damages as a result of any breach.

This issue is of great importance to sureties asked to provide bonds for licensed mortgage lenders. Under the result reached by the Circuit Court, there is serious potential for abuse by claimants who can sue a defunct mortgage lender without notice to the surety, obtain default judgment and force the surety to pay without any opportunity to assert defenses or contest damages. If this Court affirms the result reached by the Circuit Court, it will increase the risk associated with such license bonds and make them more difficult to obtain for every mortgage lender doing business in West Virginia. Such a result will necessarily impact other potential claimants under the same bond who may find the bond has been exhausted by payment

¹ Neither counsel for, nor the parties to, this appeal have authored this brief, in whole or in part. Neither counsel for, nor the parties to, this appeal, nor anyone other than the amicus curiae, its members or its counsel, made

of a default judgment obtained by a claimant who did not, in fact, suffer damages arguably covered by the bond.

SFAA is in a position to address the broader policy and economic implications of the issues raised in this appeal as well as analyze relevant case law from other jurisdictions not presented to the Circuit Court. SFAA notified the parties to the appeal of its intention to file this brief and has sought the consent of the parties to file the same. As of the time of filing, however, SFAA has not received such consent. Accordingly, filed herewith is a Motion for Leave to File Amicus Curiae Brief.

II. ARGUMENT

SFAA believes the Circuit Court erred in its construction of the bond form at issue and in its interpretation of West Virginia Code Section 45-1-3 and the application of *State v. Myers*, 74 W.Va. 488, 82 S.E. 270 (1914).² By statute, an applicant for a mortgage lender's license must file a bond "in a form and with conditions as the commissioner may prescribe. . ." W. VA. Code § 31-17-4(d)(3). A licensee must abide by the provisions of Chapter 31, Article 17 of the West Virginia Code (referred to herein as the "Act"). The statute does not address the parties' rights under the bond. Consequently, one must look to section 45-1-3 which provides, in general, that no judgment against a principal in a suit to which the surety was not a party shall be binding on the surety, and the surety, in an action brought against it, shall be allowed to make any defenses that could have been made by the principal in the suit in which the judgment was rendered. W. VA. Code § 45-1-3.

a monetary contribution to this brief.

² SFAA will not delve into the facts of this appeal nor repeat the legal arguments that will undoubtedly be aptly set forth in the parties' briefs. It does wish, however, to comment briefly on the bond at issue and the interpretation afforded to the plain language of the bond by the Circuit Court.

In this case, the Circuit Court found the default judgment obtained against the principal in an action to which the surety was not a party was binding on that surety, even though the surety did not have an opportunity to assert defenses that could have been asserted by the principal or to contest the amount of damages at issue. The Circuit Court found the *Myers* exception to the general rule set forth above applied in this case. *State v. Myers* held the general rule found in section 45-1-3³ does not apply when a surety intentionally and explicitly agrees to be bound by a judgment against the principal by virtue of the plain language of the *judgment bond* at issue. *Myers*, 82 S.E. at 272.

The Circuit Court's ruling, then, is based on the faulty premise that the bond at issue is a judgment bond. It is not. The bond does not guarantee the surety's payment unconditionally. Rather, the bond is enforceable once it is established in an action against the principal that the principal failed to comply with the laws and regulations applicable to it and that damages resulted from that breach. There has been no determination that such laws and regulations actually were breached, and because the surety had no notice of the proceedings against the defunct principal in this case, it had no opportunity to assert defenses that might be applicable. Nor has the surety had an opportunity to contest the amount of damages at stake.

Permitting the Circuit Court's ruling to stand will open the floodgates to abuse of the bond's procedural requirements. Claimants' attorneys could merely sue a defunct mortgage lender, obtain default judgment and present the judgment to a surety for satisfaction. The surety will not be afforded any opportunity to assert affirmative defenses and contest the amount of damages. This imposition of what amounts to strict liability will have serious adverse consequences, not only to sureties but also to other claimants under the bond with viable claims

³ At the time *Myers* was decided, a precursor to section 45-1-3 was at issue.

who have suffered real damages. That is not to say that the claimants in this case have not suffered real damages. Whether they have or not simply has not been established, and under the Circuit Court's ruling, damages never will have to be established.

A. THE BOND AT ISSUE IS NOT A JUDGMENT BOND BECAUSE IT IS CONDITIONED ON COMPLYING WITH THE ACT OR PAYING THE STATE FOR VIOLATIONS OF THE ACT.

The Circuit Court's holding that the bond at issue is a judgment bond rested on its view that there were no conditions of the bond other than to pay a judgment rendered against the principal. The plain language of the bond, however, clearly establishes that the bond is subject to conditions, and is not merely a guarantee of payment of a judgment. In this case, the condition of the bond is found in the first sentence of the third paragraph:⁴

NOW THEREFORE, if the said principal CALUSA INVESTMENTS, LLC shall conform to and abide by the provisions of said Act and of all rules and orders lawfully made or issued by the Commissioner of Banking thereunder, and shall pay to the State and shall pay to any such person or persons properly designated by the State any and all moneys that may become due or owing to the State or to such person or persons from said obligor in a suit brought by the Commissioner on their behalf under and by virtue of the provisions of said Act, then this obligation shall be void, otherwise it shall remain in full force and effect.

Thus, the principal does not breach the bond if it either (1) abides by the Act and the rules issued by the Commissioner of Banking; or (2) pays any damages to the State for a violation of the Act or rules. If the principal breaches this condition, then the surety becomes liable.

The sentence immediately following the bond's condition instructs the claimant *how* to make a claim against the bond and establishes a condition precedent to making such a claim. That sentence states, "If any person shall be aggrieved by the misconduct of the principal, he may upon recovering judgement (sic.) against such principal issue execution of such judgement (sic.) and maintain an action upon the bond . . ." Thus, the *procedure* to be followed

⁴ The full text of the bond will not be repeated here.

in asserting a claim on this bond is to recover a judgment against the principal and, if such judgment goes unpaid, sue the surety (“maintain an action upon the bond”).

Clearly, a plain reading of the bond at issue establishes that it does not guarantee payment unconditionally. The bond is conditioned on complying with the Act or making payment to the State for violations of the Act. To recover under the bond, claimants must establish that the condition of the bond was breached. *See Lingo v. Hartford Fire Ins. Co.*, 2010 WL 1837718, 3 (E.D.Mo. 2010) (“the right to recover on a surety bond depends on a breach of the condition of the bond . . .”). Consequently, the general rule -- that a judgment against the principal is not binding on a surety that had no opportunity to assert defenses and contest damages -- applies to the case at hand, and the exception set forth in *Myers* does not apply.

Although the Circuit Court relied, in part, on *Myers* in its holding that the surety was bound by the default judgment obtained against the principal, such reliance is misplaced. In *Myers*, the bond at issue was a retail liquor dealer’s license bond which was required by statute. *Myers*, 82 S.E. 270. The dealer was found to have violated a condition of the license, and this finding was found to be conclusive of the surety’s liability under the bond. The court found that the surety had expressly agreed to pay any judgment rendered against the principal and therefore was precluded from asserting any defenses. Significantly, “[t]he [*Myers*] court specifically stated that it was not undertaking to decide the effect of the statute on ‘the rights of a surety on a bond with collateral conditions other than to pay a judgment that may be recovered against his principal.’” *Rashid v. U.S. Fidelity and Guaranty Co., Inc.*, 1992 WL 565341, 5 (S.D.W. Va. 1992) (quoting *Myers*, 82 S.E. at 272)). The issue in this appeal is one that the *Myers* court specifically declined to address because the bond at issue in this appeal clearly is conditioned on

compliance with the Act or payment to the State for violations of the Act. It does not guarantee payment unconditionally.

Although each state has different laws and different bond forms, several other states have recently held that their mortgage broker and lender bonds are not judgment bonds. *Hartford Fire Insurance Co. v. iFreedom Direct Corp.*, 718 S.E.2d 103 (Ga.App. 2011) (“This statutorily-created administrative remedy cannot be extended beyond its plain terms to create an additional private cause of action against a mortgage lender’s bond based on a failure to pay a judgment.”); *Lingo*, 2010 WL 1837718 at 3 (“The bonds at issue are not judgment bonds, but rather performance bonds as they are conditioned upon the bond principal . . . failing to ‘faithfully conform to and abide by the provisions of the . . . Act’”); *All Cities Privacy Class v. Hartford Fire Insurance Co.*, 798 N.W.2d 909 (Wis.App. 2011) (“Hartford is not required to pay the judgment rendered against All Cities under the plain terms of the surety bond and WIS STAT. §224.72(4)(d)(1).”).

The mortgage lender bond at issue in this appeal is not a judgment bond. It is clearly conditioned on compliance with the Act or payment to the State for violations of the Act. To recover under the bond, claimants must establish that this condition was breached. Neither such breach nor the resulting damages was established in this case. Consequently, the protections afforded by section 45-1-3 of the West Virginia Code should be afforded the surety to assert defenses and contest the amount of damages allegedly caused by the principal.

B. A DEFAULT JUDGMENT AGAINST THE PRINCIPAL CANNOT OPERATE TO BIND THE SURETY WHERE BREACH OF THE ACT AND THE AMOUNT OF DAMAGES ARE NEVER ESTABLISHED ON THE MERITS.

The authorities relied upon by claimants below, and by the Circuit Court, do not address the question presented to this Court which is whether a default judgment against the principal precludes the surety from litigating the merits of the action when the claimant has neither litigated the merits of the action against the principal nor established damages. The concern voiced by the *Myers* court in support of its holding was that claimants should not be forced to litigate against a principal who fails to pay a judgment and then retry their case against the surety to enforce that judgment when liability and damages have been established already in a court of law. *Myers*, 82 S.E. at 272 (to hold otherwise “would make it necessary to retry, in a separate suit against the surety, the matter already litigated and determined in the action against the principal.”). Significant to the court’s holding in *Myers* was the surety’s “express[] undertak[ing]” to satisfy the very judgment obtained against the principal. *Id.* Not only is the kind of “express undertaking” that was at play in *Myers* absent from the bond at issue here, as discussed above, but the admittedly valid concern of the *Myers* court regarding forcing claimants to try their cases twice has no application in default judgment cases where the claimants never litigate the merits of their actions in the first place.

The Court of Appeals of Kentucky has squarely addressed the issue of whether a default judgment issued against a principal precludes the assertion of defenses by a surety in a later filed action. *Five Star Lodging, Inc. v. George Construction, LLC*, 344 S.W.3d 119 (Ky.App. 2010) (review denied) (default judgment issued against the principal did not preclude the surety from asserting a statute of limitations defense under the bond at issue). In *Five Star Lodging*, a hotel owner brought an action against the principal for failure to perform under a

payment and performance bond. After the principal failed to answer, default judgment was entered in favor of the claimant. The claimant then sued the surety, and the surety moved for summary judgment asserting a statute of limitations defense.

“Essentially, *Five Star* attempts to impute the default judgment entered against [the principal] to [the sureties] who were not parties to the proceedings and had no opportunity to defend the action.” *Id.* at 124 (emphasis added). The Kentucky court held that the statute of limitations defense could be asserted by the surety, rejecting the claimant’s argument that the defense was barred by the doctrine of *res judicata*. *Id.* at 124, 125 (citing *Ohio Cas. Ins. Co. v. Kentucky Natural Resources*, 722 S.W.2d 290 (Ky.App.1986) (“A default judgment entered against a principal is not binding upon a surety and *res judicata* does not prevent the surety from defending any argument it could have made had it been a party to the underlying action against the principal.)). “[A] default judgment is not a judgment on the merits” *Id.*

Although the precise issue presented in this appeal has not previously been addressed in West Virginia, support for SFAA’s position is found in this State’s well-established collateral estoppel law. It is settled under West Virginia law that a default judgment is not a basis for collateral estoppel. *Christian v. Sizemore*, 185 W.Va. 409, 413, 407 S.E.2d 715, 719 (1991) (“Ample authority exists for the proposition that a default judgment has no collateral estoppel effect.”) (citing RESTATEMENT (SECOND) OF JUDGMENTS § 27e (1982)). This Court instructed in *Christian* that collateral estoppel requires, among other things, that an issue actually be litigated in an earlier proceeding and that a judgment be rendered on the merits. *Id.* “The Restatement recognizes that issues are not actually litigated in a default judgment action and, consequently, that default judgments are not appropriate foundations for the application of collateral estoppel.” *Id.*; see also *Stillwell v. City of Wheeling*, 210 W.Va. 599, 601, 558 S.E.2d

598, 602 (2001) (“We conclude that a default judgment is not a proper foundation for the application of offensive collateral estoppel.”).

SFAA respectfully posits that the reasoning employed in the above-cited cases should apply with equal force under the circumstances presented in this appeal. In West Virginia, collateral estoppel operates to bar subsequent litigation only when an issue has actually been litigated and decided on the merits. Default judgment is not a basis for the application of collateral estoppel because the issues were not actually litigated and decided on the merits. Likewise, a default judgment obtained against a principal under a bond should not bind the surety because a breach of the bond’s condition was never established on the merits.

C. THE CIRCUIT COURT’S RULING ADVERSELY IMPACTS THE SURETY MARKET

It is easy to see where the Circuit Court’s ruling may lead if upheld. Claimants’ attorneys need do nothing more than sue a defunct mortgage lender, obtain default judgment, wait until the time for appealing such judgment has expired, and look to the surety to satisfy the judgment without ever proving liability on the part of the principal and without ever establishing the amount of damages suffered. If this Court sanctions such a procedure, it would open the door to abuse of the bond at issue. The West Virginia legislature sought to prevent such abuse by enacting section 45-1-3. Claimants are not prejudiced by serving the surety with process in an action against the principal. Failure to do so should not allow them the opportunity to later argue that a default judgment against a defunct principal binds the surety.

Upholding the Circuit Court’s ruling will have an adverse impact on all mortgage lenders doing business in West Virginia and their customers because it will be more difficult for such lenders to obtain bonds. Anyone who has done business with a mortgage lender in West Virginia will be able to sue the lender and hope for a default. If the lender does default, the

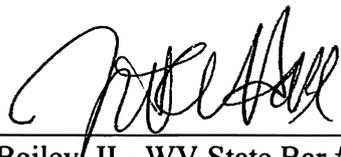
claimants will be able to collect up to \$100,000, the full amount of the bond, without ever proving their case. This will certainly increase the risk of writing such bonds in West Virginia and make it harder for honest, legitimate lenders to obtain the bonds. It will also mean that the bond may be exhausted by a claimant who was not in fact damaged thereby leaving no bond amount for other, deserving claimants.

III. CONCLUSION

If upheld, the Circuit Court's ruling is sure to adversely impact the surety market. Of course, if section 31-17-4 of the West Virginia Code or the Commissioner of Banking required a bond conditioned on payment of any judgment entered against the licensee, then this Court would have to enforce that condition. Neither the statute nor the bond form in this case, however, conditions the surety's obligation on paying a judgment. The condition of the bond is that the principal abide by Chapter 31, Article 17 and the Commissioner's rules or pay any damages to the State if it fails to so comply. There must be a showing that this condition was breached to recover under the bond. A surety should not be bound by a default judgment obtained against the principal when the breach of the bond's condition and the resulting damages are never established. For these reasons, and for those set forth in Petitioner's brief, as well as others apparent to the Court, SFAA respectfully urges this Court to reverse the Circuit Court's ruling and permit Petitioner to assert all available defenses, including any that might have been available to the principal, and to contest the damages at issue.

**THE SURETY & FIDELITY
ASSOCIATION OF AMERICA**

By Counsel



Gene W. Bailey, II - WV State Bar #203
Jill E. Hall - WV State Bar #8812
Bowles Rice McDavid Graff & Love LLP
600 Quarrier Street
Charleston, West Virginia 25301
(304) 347-1100; (304) 347-1756 Fax
gwbailey@bowlesrice.com
jhall@bowlesrice.com

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HARTFORD FIRE INSURANCE COMPANY,

Petitioner, Defendant below,

v.

**CASE NO.: 12-0037
(Circuit Court of Jackson County,
Civil Action No. 08-C-157)**

MICAH A. CURTIS and ANGELA L. CURTIS,

Respondents, Plaintiffs below.

CERTIFICATE OF SERVICE

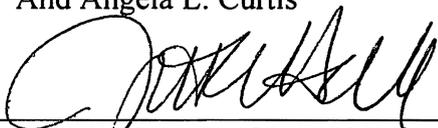
I, Jill E. Hall, hereby certify that on the 4th day of April, 2012, the foregoing
**“AMICUS CURIAE BRIEF OF THE SURETY & FIDELITY ASSOCIATION OF
AMERICA IN SUPPORT OF PETITIONER AND SUPPORTING REVERSAL OF THE
CIRCUIT COURT’S ORDER GRANTING PARTIAL SUMMARY JUDGMENT”** was
served by regular United States Mail, postage prepaid, on the following:

Archibald Wallace, III
WallacePledger, PLLC
7100 Forest Avenue, Suite 302
Richmond, Virginia 23226
Counsel for Hartford Insurance Company

Daniel F. Hedges
Mountain State Justice, Inc.
1031 Quarrier Street, Suite 200
Charleston, West Virginia 25301
Counsel for Micah A. Curtis
And Angela L. Curtis

Thomas V. Flaherty
Flaherty, Sensabaugh & Bonasso, PLLC
200 Capitol Street
Charleston, West Virginia 25301
Counsel for Hartford Insurance Company

Scott S. Blass
Bordas & Bordas, PLLC
1358 National Road
Wheeling, West Virginia 26003
Counsel for Micah A. Curtis
And Angela L. Curtis



Jill E. Hall (State Bar No. 8812)