

**Colonial Sur. Co. v Eastland Constr., Inc.**

2009 NY Slip Op 31756(U)

July 30, 2009

Supreme Court, New York County

Docket Number: 603656/08

Judge: Barbara R. Kapnick

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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Barbara Kapnick  
Justice

PART 39

Colonial Surety Company

INDEX NO. 603656/08

MOTION DATE \_\_\_\_\_

- v -

Eastland Construction, Inc.,  
Nancy Shulman and Allan Schulman

MOTION SEQ. NO. 001

MOTION CAL. NO. \_\_\_\_\_

The following papers, numbered 1 to \_\_\_\_\_ were read on this motion to/for \_\_\_\_\_

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...

Answering Affidavits — Exhibits \_\_\_\_\_

Replying Affidavits \_\_\_\_\_

PAPERS NUMBERED
_____
_____
_____

Cross-Motion:  Yes  No

Upon the foregoing papers, it is ordered that this motion

**MOTION IS DECIDED IN ACCORDANCE WITH  
ACCOMPANYING MEMORANDUM DECISION**

**FILED**  
AUG 03 2009  
COUNTY CLERK'S OFFICE  
NEW YORK

Dated: 7/30/09

[Signature]  
**BARBARA R. KAPNICK** J.S.C.

Check one:  FINAL DISPOSITION  NON-FINAL DISPOSITION

Check if appropriate:  DO NOT POST  REFERENCE

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: IA PART 39

-----x  
COLONIAL SURETY COMPANY,

Plaintiff,

DECISION/ORDER  
Index No. 603656/08  
Motion Seq. No. 001

-against-

EASTLAND CONSTRUCTION, INC.,  
NANCY SCHULMAN AND ALLAN SCHULMAN,

Defendants.

-----x  
BARBARA R. KAPNICK, J.:

**FILED**

AUG 03 2009

COUNTY CLERK'S OFFICE  
NEW YORK

This action arises from two public works construction projects known as the Additions and Alterations to the Hartsdale Fire Station No. 2 - Phase 2, located at 300 West Hartsdale Avenue, Clarkstown, New York (the "Hartsdale Project") and the Clarkstown Central School District modernization and Addition to the North High School and Addition to the New City School located in Clarkstown, New York (the "Clarkstown Project").<sup>1</sup>

**I. Background**

Defendant Eastland Construction, Inc. ("Eastland") was the general contractor pursuant to two separate underlying construction contracts. Plaintiff Colonial Surety Company ("Colonial"), as surety to Eastland, issued Payment and Performance Bonds for both of these projects.

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<sup>1</sup> There was a third project. However, Colonial indicates that it has not received any claims in connection with that Bond.

In consideration for and to induce Colonial to issue the Bonds, defendants Eastland, Nancy Schulman and Allan Schulman<sup>2</sup> executed a General Indemnity Agreement dated May 2, 2006 in favor of Colonial as Indemnatee.

Plaintiff's Complaint sets forth claims for: (i) specific performance of the Indemnity Agreement to enforce Colonial's Demand for Collateral Security in the amount of \$1,065,273.35; (ii) specific performance of the Indemnity Agreement to inspect books and records; (iii) contractual indemnification; (iv) exoneration; (v) *quia timet*; (vi) common law indemnification; (vii) statutory trust fund violation; and (viii) contractual trust fund violation.

Plaintiff now moves by Order to Show Cause for a preliminary injunction directing defendants, their officers, agents, employees, attorneys and other persons acting on their behalf, to:

(1) deposit collateral with plaintiff in the amount of \$1,065,273.25, or, alternatively, enjoining and restraining defendants, their officers, agents, employees, attorneys and other persons acting on their behalf, from transferring, conveying, selling or encumbering, in any manner, any property or assets, which are jointly or solely owned by the defendants;

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<sup>2</sup> Allan G. Schulman is the Project Executive with Eastland.

(2) provide plaintiff with full and complete access to all of defendants' books, records, and other documents, including financial books, records, documents and accounts maintained by them or any of them in which they may have an interest, for inspection and copying; and

(3) render plaintiff a full and complete accounting of all assets owned by them or any one of them in which they or any one of them may have an interest.<sup>3</sup>

Plaintiff argues that it will undoubtedly prevail on the merits because Colonial is contractually entitled under Paragraph 7 of the Indemnity Agreement to receive collateral security from Eastland.<sup>4</sup>

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In signing the Order to Show Cause on December 15, 2008, this Court granted plaintiff's request for a temporary restraining order only to the extent of enjoining and restraining defendants "from transferring, conveying, selling, encumbering, in any manner, any property or assets to the extent of \$1,065,273.25 which are jointly or solely owned by the Defendants."

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Paragraph 7 ("Collateral Security") provides as follows:

If a claim is made against Surety, or if Surety deems it necessary to establish a reserve for potential claims, and upon demand from Surety, Indemnitor shall deposit with Surety cash or other property acceptable to Surety, as collateral security, to protect Surety with respect to such claim or potential claims and any anticipated expenses and attorneys' fees. Such collateral security shall be in such amount as Surety in its sole discretion deems appropriate. Such collateral may be held by Surety until it has received satisfactory evidence of its complete discharge from such claim or potential claims,

In addition, Paragraph 10.Y. of the Agreement provides that defendants' failure "to deposit with the Surety, immediately upon demand, the sum demanded by Surety as collateral security shall cause irreparable harm to Surety for which Surety has no adequate remedy at law." It further provides that Colonial "shall be entitled to injunctive relief for specific performance of the obligation [of the Indemnitor] to deposit with Surety the sum demanded as collateral security and hereby expressly waive any claims or defenses to the contrary."

Defendants argue that plaintiff cannot demonstrate a likelihood of success on the merits because:

(a) the bonds that were posted by Eastland for the Hartsdale Project have been discharged. Defendants argue that the terms of the General Indemnity Agreement between defendants and Colonial only impose an obligation to indemnify on the part of the defendants to the extent Colonial's bond obligations remain in effect;

(b) Colonial possesses adequate collateral in the form of remaining contract balances; i.e., on the Hartsdale Project, the owner is allegedly withholding contract balance money due and owing to Eastland totaling \$500,000.00; and on the Clarkstown Project,

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and until it has been fully reimbursed for all losses, expenses, fees, and paid all premiums due. Surety has no obligation to Indemnitor to provide interest on the collateral deposit.

the owner is allegedly withholding the sum of approximately \$196,743.47 in contract monies due and owing to Eastland; and

(c) Colonial is not entitled to seek *quia timet* relief or exoneration since Colonial has failed to demonstrate that it is in jeopardy of sustaining a loss under the Payment or Performance Bonds.

Defendants further argue that plaintiff cannot demonstrate that it will suffer irreparable harm since this matter relates to monetary damages and Colonial has not incurred any out-of-pocket expenses.

Finally, defendants argue that Colonial has failed to demonstrate that the equities balance in its favor.

## **II. The Standard for Granting a Preliminary Injunction under New York Law**

The Court of Appeals has articulated that "[a] preliminary injunction may be granted under CPLR Article 63 when the party seeking such relief demonstrates: (1) a likelihood of ultimate success on the merits; (2) the prospect of irreparable injury if the provisional relief is withheld; and (3) a balance of equities tipping in the moving party's favor." *Doe v. Axelrod*, 73 NY 2d 748, 750 (1988).

### III. Colonial's Demand for Specific Performance of the Indemnity Agreement's Collateral Security Requirement

#### A. Colonial's Likelihood of Success on the Merits

Colonial argues that the clear language of the Indemnity Agreement requires Eastland to deposit money or property acceptable to Colonial in the event a claim is made or if Colonial deems it necessary, and provides Colonial the express right to determine the amount of collateral to be deposited and to hold such funds until any claims against Colonial have been discharged.

The Appellate Division, First Department has held that "[t]he obligation to make the deposit is subject to enforcement by specific performance. 'The damage resulting from the failure to give security is not ascertainable, and the legal remedy is therefore inadequate.'" *BIB Const. Co. v Fireman's Ins. Co. of Newark, N.J.*, 214 AD2d 521, 523 (1st Dep't 1995). See also, *Colonial Surety Co. v. Genesee Valley Nurseries, Inc.*, 5 AD3d 1024, 1025 (4th Dep't 2004) which enforced the same collateral security provision at issue herein, holding that

[p]ursuant to the Agreement, defendants are required to furnish collateral security upon plaintiff's demand if a claim is asserted against plaintiff. Plaintiff submitted proof in admissible form that it received claims under the bonds it issued on behalf of [the indemnitor], and it is thus entitled to specific performance of that part of the

Agreement requiring defendants to furnish collateral security.

With regard to defendants' argument that Colonial's Bonds were discharged, defendants offer no conclusive evidence of any formal discharge of the Bonds from either project. Concerning the Hartsdale Bonds, defendants point to a series of inconclusive correspondence between Eastland, the Schulmans, Colonial and the Hartsdale Fire District as evidence of a full discharge of all obligations under the Hartsdale Payment and Performance Bonds.

Concerning the Clarkstown Payment and Performance Bonds, defendants simply assert that as Eastland was never terminated from the project and had "substantially completed" work on the Clarkstown Project by September of 2008, Colonial's obligations under those Bonds should be considered discharged.

Since Eastland has failed to conclusively demonstrate that Colonial's obligations under the Payment and Performance Bonds for either the Hartsdale or Clarkstown projects have terminated, this Court cannot conclude that those obligations have in fact been terminated.

Defendants' argument that Colonial already possesses adequate collateral in the form of outstanding balances on both the

Hartsdale and Clarkstown projects is unavailing given the plain and unambiguous language of Paragraph 7 of the Indemnity Agreement. See, *Colonial Surety Co. v. Medtek, Inc.*, No. CIV.A.03-6377, 2005 WL 459642 (E.D. Pa. 2005) at \*1 where the Court, reviewing the identical provision, determined that this language required deposit of whatever amount of collateral security the surety (i.e. Colonial) demanded notwithstanding any outstanding contract balances on any bonded construction projects.

Defendants' argument that Colonial is not entitled to *quia timet* relief or exoneration fails due to both the unambiguous language in the Indemnity Agreement specifically providing Colonial with these remedies in the event that Eastland defaults on its collateral security obligation<sup>5</sup> and because Colonial's request for *quia timet* relief satisfies New York's standard for granting such relief.

*Quia timet* relief is "the right of a surety to demand that the principal place the surety 'in funds' when there are reasonable grounds to believe that the surety will suffer a loss in the future because the principal is likely to default on its primary obligation to the creditor." *Borey v. Nat'l Union Fire Ins. Co.*,

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<sup>5</sup> Paragraph 10.H. of the Indemnity Agreement provides: "Surety shall have every right, defense or remedy which a personal surety without compensation would have, including the remedies of exoneration and *quia timet* relief."

934 F.2d 30, 32 (2d Cir. 1991); see also *Abish v. Northwestern Nat. Ins. Co. of Milwaukee, Wis.*, 924 F.2d 448, 450-51 (2d Cir. 1991). In the instant case, *quia timet* relief is appropriate since Eastland has been hesitant to provide any accounting of its financial health to Colonial despite Colonial's repeated requests for that information. Colonial is concerned that should equitable relief be denied herein, Colonial might be left with no adequate remedy at law. This, coupled with the unambiguous language in the Indemnity Agreement providing for *quia timet* relief, renders unavailing Eastland's argument that *quia timet* relief is inappropriate here.

"Exoneration, though closely related, is distinct. It is the surety's right, after the principal's debt has matured, to compel the principal to honor its obligation to the creditor." See *Borey v. Nat'l Union Fire Ins Co, supra* at 32; *Milwaukie Const. Co v. Glen Falls Ins. Co.*, 367 F.2d 964, 966-67 (9th Cir. 1966). In the instant action, the common law rule of exoneration allows Colonial to enforce Eastland's obligations by demanding that Eastland post adequate collateral to satisfy all claims pending against the Hartsdale and Clarkstown Bonds. See *Admiral Oriental Line v. United States*, 86 F.2d 201, 204 (2d Cir. 1936). Exoneration is also provided for as a matter of contractual right in the Indemnity Agreement.

Eastland argues that exoneration is inappropriate here because "exoneration is the proper remedy once liability has matured and the principal has defaulted on his debt to the creditor. ... [T]he debt [must be] presently due ... the principal ... [must ultimately] be liable for the debt, and...absent equitable relief, the surety [must show it] will be prejudiced because it will be forced to advance the money to the creditor." *Borey v. Nat'l Union Fire Ins. Co of Pittsburgh, PA, supra* at 32-33. Eastland claims that because Colonial has not presented evidence that Eastland is in default with regard to its underlying contractual obligations, this Court cannot, as a matter of law, grant Colonial exoneration.

This assertion, however, ignores the unambiguous language of the Indemnity Agreement which requires Eastland to deposit collateral security upon Colonial's receipt of claims against the Hartsdale and Clarkstown Payment and Performance Bonds. As Colonial has received claims against those Bonds, has demanded collateral security from Eastland and Eastland has failed to deposit the required collateral security, Eastland is in default of its contractual obligations and thus exoneration is not foreclosed.

#### **B. Colonial's Claim of Irreparable Harm**

Colonial argues that the express language of the Indemnity Agreement provides that Eastland's failure to deposit requested

collateral constitutes an "irreparable harm" sufficient to satisfy the requirements for granting a preliminary injunction. See Paragraph 10.Y. of the Indemnity Agreement.

In addition, Colonial points out that without specific enforcement of a collateral security agreement, a surety that bargained for "special" security is effectively relegated to the same status as any other unsecured creditor with respect to the assets of the principal in the event that the principal goes bankrupt. *Am. Motorists Ins. Co. v. Penn. Beads Corp.*, 983 F.Supp. 437, 440-41 (S.D.N.Y. 1997). Colonial argues that because there are outstanding claims against the Payment and Performance Bonds for both the Hartsdale and Clarkstown projects, this Court must order specific performance of the Indemnity Agreement to preserve Colonial's "special" security for which it bargained in forming its contract with Eastland.

Defendants, arguing that Colonial has failed to demonstrate irreparable harm sufficient to satisfy the test for granting a preliminary injunction, note that "irreparable injury means injury for which a monetary award cannot be adequate compensation." *Abish v. Northwestern Nat. Ins. Co. of Milwaukee, Wis.*, *supra* at 453. Defendants insist that "[i]n determining whether irreparable harm exists, the critical inquiry is not whether the surety's rights are

lost, but whether the loss of those rights will cause serious or irreparable harm." *Id.* at 453.

However, defendants' argument must fail as it ignores the unambiguous language of Paragraph 10.Y. of the Indemnity Agreement which specifically defines a failure to deposit collateral security on demand as "irreparable harm" for which Colonial can be afforded "no adequate remedy at law". Furthermore, the Appellate Division has determined that, as a matter of law, the harm to a surety is irreparable where the surety cannot obtain injunctive relief in the event that a principal defaults on its collateral security obligation. See *BIB Const. Co. v. Fireman's Ins. Co. of Newark, N.J.*, *supra* at 523.

### **C. The Balance of Equities between the Parties**

Colonial argues that the equities clearly balance in its favor as Eastland will suffer no harm if the requested injunctive relief is granted. Furthermore, Colonial insists that should this Court decline to issue an injunction for specific performance of the Indemnity Agreement, it will suffer undue hardship as it will be left vulnerable to pending claims against both the Hartsdale and Clarkstown Payment and Performance Bonds. In addition, Colonial argues that its demand for injunctive relief goes no further than to require that Eastland comply with its contractual duties to which it bound itself in arms-length negotiations with Colonial,

and that enforcing Eastland's contractual duties would be equitable.

Defendants, insisting that the equities balance in their favor, invoke both the doctrine of unclean hands and the doctrine of estoppel against inconsistent positions. The doctrine of estoppel against inconsistent positions requires that there have been a legal proceeding in which a party assumes a position, is successful in maintaining that position and subsequently alters that position to support a change in that party's interests. *Environmental Concern v. Larchwood Constr. Corp.*, 101 A.D.2d 591, 593 (2d Dep't 1984). Here, there were no prior legal proceedings. Rather, defendants insist that Colonial's demand for collateral security despite having been discharged from its obligations under the Hartsdale and Clarkstown Bonds is patently inconsistent and thus barred by the doctrine of estoppel against inconsistent positions. However, as discussed, *infra*, defendants' position that the Bonds have been discharged is unsubstantiated.

Defendants' invocation of the doctrine of unclean hands similarly fails as it relies on the same unsubstantiated assertion.

#### **IV. Colonial's Demand for Books and Records**

Colonial claims that the clear language of Paragraph 10.I. of the Indemnity Agreement specifies that, until it is fully discharged from its Bond obligations and fully indemnified for any

claims against it, Colonial shall have "free access to the books, records, and accounts of Indemnitor for the purpose of examining and copying them." As discussed above, there are claims pending against both the Hartsdale and Clarkstown Payment and Performance Bonds, and no conclusive evidence of Colonial's discharge from any of the Bonds has been furnished. Therefore, this Court grants that portion of Colonial's motion seeking specific performance of this portion of the Indemnity Agreement.

Moreover, the Indemnity Agreement defines "Indemnitor" as "[a]ll persons executing this Agreement with the Surety, including the Principal." Indemnity Agreement, Paragraph 1. Thus, this Court also grants Colonial's motion to examine the books and records of Nancy and Allan Schulman.

#### **V. Conclusion**

Accordingly, plaintiff Colonial's motion is granted to the extent that:

(1) defendants Eastland Construction, Inc., Nancy Schulman and Allan Schulman are directed to immediately deposit collateral with plaintiff Colonial Surety Company in the amount of \$1,065,273.25; and

(2) all defendants are directed to provide Colonial with free access to their books, records, and accounts for inspection and copying.

Counsel for all parties are directed to appear for a conference on the remaining issues in this case on September 23, 2009 at 10:00 a.m. in IA Part 39, 60 Centre Street, Room 208.

This constitutes the decision and order of this Court.

Dated: July 30, 2009

  
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BARBARA R. KAPNICK  
J.S.C.

**BARBARA R. KAPNICK  
J.S.C.**

**FILED**  
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