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Recommended Citation

Gluth, David T., "Summary of Insurance Company of the West v. Gibson Tile Company, 122 Nev. Adv. Op. 40 " (2006). *Nevada Supreme Court Summaries*. 537.

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***Insurance Company of the West v. Gibson Tile Company, 122 Nev. Adv. Op. 40
(May 11, 2006)***¹

SURETYSHIP

Summary

Appellant surety (Insurance Company of the West) appealed a decision from the Eighth District which entered a judgment upon a jury verdict in favor of respondent principal (Gibson Tile) for breach of contract. The surety also appealed the district court's ruling on its indemnity claim.

Disposition/Outcome

Reversed and remanded. The Nevada Supreme Court held that appellant surety was entitled to bring its indemnity claim under the terms of the general indemnity agreement. The court held that the district court's instruction stating that a surety owed a fiduciary duty to its principal was erroneous. Finally, the court held that there was no oral contract for additional bonds between the parties.

Factual and Procedural History

Appellant surety, Insurance Company of the West (ICW), entered into a surety contract with respondent Gibson Tile (Gibson) to provide performance bonds for a construction project at the McCarran International Airport. Pursuant to NRS 339.025,² performance bonds were required on public work projects. ICW and Gibson entered into a general indemnity agreement providing that ICW could seek indemnification from Gibson for any payments or expenses incurred as a result to Gibson's failure to perform on the construction contract. In 1997, ICW issued the performance bond for Gibson's work at the airport.

In 1998 and 1999, two suppliers sued both Gibson and ICW for failing to make payments. Gibson provided the defense for these to claims on behalf of ICW. In 2000, ICW filed an indemnity action against Gibson alleging ICW had incurred costs enforcing the terms of

¹ By David T. Gluth

² NEV. REV. STAT. § 339.025 (1)(a) (2005) provides in pertinent part:

1. Before any contract, except one subject to the provisions of chapter 408 of NRS, exceeding \$100,000 for any project for the new construction, repair or reconstruction of any public building or other public work or public improvement of any contracting body is awarded to any contractor, he shall furnish to the contracting body the following bonds which become binding upon the award of the contract to the contractor:

(a) A performance bond in an amount to be fixed by the contracting body, but not less than 50 percent of the contract amount, conditioned upon the faithful performance of the contract in accordance with the plans, specifications and conditions of the contract. The bond must be solely for the protection of the contracting body which awarded the contract.

the surety contract. Gibson counterclaimed alleging that ICW breached an oral contract for the issuance of additional bonds.

In 2001, Gibson settled with both suppliers without the presence or knowledge of ICW. ICW filed a motion for reconsideration of the good-faith settlement alleging the terms violated the terms of the contract because the settlement funds should have been placed into a trust fund held jointly by both ICW and Gibson. The district court denied ICW's motion.

In 2003, sixteen months after the hearing on ICW's reconsideration motion, the district court signed an order submitted by Gibson's counsel. The order stated that the court accepted the settlement and the case was closed except for Gibson's counterclaim for breach of contract. Subsequently, the district judge taking over the case only allowed Gibson's counterclaim to proceed to trial. During the trial, ICW objected to a jury instruction that stated that a surety owed a fiduciary duty to its principal. The jury found for Gibson awarding compensatory damages of \$1,585,000 and punitive damages of \$4279,552. ICW filed a timely appeal.

Discussion

1. The district court erred when it denied ICW an opportunity to pursue its indemnity claim

The court held that ICW, as the surety company, was entitled to pursue an indemnity claim for costs incurred. The court noted that even though ICW may not have made a payment on the bond, ICW may have incurred fees and costs enforcing the provisions of the general indemnity agreement. Therefore, that the order signed by the district court incorrectly dismissed ICW's indemnity claims against Gibson.

2. A surety cannot be liable for the tortious breach of the covenant of good faith and fair dealing

A tort action for the breach of covenant of good faith and fair dealing only arises when there is a special relationship between the victim and the tortfeasor. A special relationship is one where there are "elements of public interest, adhesion, and fiduciary responsibility."³ The court concluded as a matter of law no special relationship exists between ICW and Gibson. The court distinguished a surety and its principal from other relationships like and insurer and insured and declined to extend tort liability to a surety for the breach of breach of the covenant of good faith and fair dealing. Therefore, the district court erred when it allowed Gibson to proceed with its tort action against ICW.

3. The district court erred when it instructed the jury on fiduciary duty

Because the court held that no special relationship exists between a surety and its principal, the district court erred in giving the instruction that stated that the surety (ICW) owed a fiduciary duty to its principal (Gibson). If a jury instruction is erroneous, it must also be found

³ Insurance Co. of the West v. Gibson Tile Co., 122 Nev. Adv. Op. 40 (May 11, 2006) (citing Great American Ins. v. General Builders, 113 Nev. 346, 355, 934 P.2d 257, 263 (Nev. 1997)).

prejudicial to constitute reversible error. As a matter of law, the court held that the fiduciary duty instruction was both erroneous and prejudicial because it supported the jury's finding of bad faith.

4. Because ICW could not be liable in tort to Gibson, the jury could not award punitive damages

The court also held that, as a matter of law, there was no basis for the jury's award of punitive damages because punitive damages cannot be based upon a cause of action solely based in contract.⁴

5. ICW and Gibson did not form an oral contract for the issuance of additional bonds

Finally, the court concluded that the jury's award of compensatory damages found not stand because there was no oral contract between ICW and Gibson. The court found that Gibson did not give additional consideration to create a new contract or modify an existing one for the issuance of additional bonds. Therefore, there was no basis for the award of compensatory damages.

Concurring opinion

Chief Justice Rose, Justice Douglas, and Justice Parraguirre concurred.

Justice Maupin, with whom Justices Becker and Hardesty also concurred. Justice Maupin wrote separately to emphasize some of the errors committed in the dismissal of ICW's indemnity claim that were not addressed by the majority. Justice Maupin noted that the district court dismissed ICW's indemnity claim without formal application or notice to ICW, thereby violating due process considerations. Further, Justice Maupin highlighted that as a matter of law a good-faith settlement never bars non-parties to the settlement from bringing their claims.

Conclusion

The court concluded that the district court erred when it dismissed ICW's indemnity claim. The court also held that because a surety/principal relationship is not a special relationship giving rise to the tortious breach of good faith and fair dealing, there was no basis for the jury's award of punitive damages. Further, the district court erred when it instructed the jury that a surety owes a fiduciary duty to its principal. The court also found that ICW and Gibson did not form an oral contract for the issuance of additional bonds so there was no basis for the award of compensatory damages. Therefore, the court reversed the district court's judgment and remanded.

⁴ NEV. REV. STAT. § 42.005(1) (2005).