IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

TAYLOR RIDGE ESTATES, INC.,	*	
	*	CIVIL NO. 4-01-CV-90058
Plaintiff,	*	
	*	
v.	*	
	*	
STATEWIDE INSURANCE COMPANY and JOHN GITTEMEIER, JR. CONSTRUCTION COMPANY, INC., a corporation,	*	
	*	**MEMORANDUM OPINION AND ORDER**
Defendants.	*	

Plaintiff Taylor Ridge Estates, Inc. ("TRE") originally filed its Petition in the Iowa District Court for Taylor County alleging breach of contract and negligence against John Gittemeier, Jr. Construction Company (the "Contractor"), and breach of contract, bad faith and intentional interference with a contract against Statewide Insurance Company (the "Surety") (collectively, "Defendants"). These claims arose out of a contract for the construction of a 30-bed assisted living facility in Lenox, Iowa between TRE and the Contractor (the "Construction Contract"), for which Statewide was surety. Defendants removed the case to this Court. Subsequently, TRE filed a Motion to Compel Arbitration and Firstar Bank, N.A. (the "Bondholder") filed an Application to Intervene, both of which were considered and denied by Magistrate Judge Shields.

The Defendants move (1) to dismiss TRE's Petition based on the *Colorado River* abstention doctrine; (2) to strike and dismiss TRE's claims on the Payment Bond in Counts III, IV and V of TRE's Petition pursuant to Federal Rule of Civil Procedure 12(f); and (3) alternatively, to dismiss Counts II, IV and V of TRE's Petition for failure to state a claim upon

which relief can be granted pursuant to Federal Rule of Civil Procedure 12(b)(6). TRE and the Bondholder object to Magistrate Judge Shield's denial of the Bondholder's Application to Intervene and move to reconsider that decision. TRE also requests the Court to reconsider Judge Shield's denial of its Motion to Compel Arbitration. After all motions were briefed, responses filed, and replies submitted, the Court held a hearing on all pending motions. For the reasons set forth below, Defendants' Motions to Dismiss are GRANTED in part, and DENIED in part; the Bondholder's Application to Intervene is GRANTED; and TRE's Motion to Compel Arbitration is GRANTED.

I. BACKGROUND

The facts according to TRE's Petition are as follows. Plaintiff, TRE, is a non-profit corporation that operates a nursing care facility located in Lenox, Taylor County, Iowa. The Contractor is a Missouri corporation engaged in the construction business in the State of Iowa. The Surety is a surety company organized in the State of Illinois that does business in the State of Iowa. In April, 1999, TRE obtained revenue bonds from Taylor County under the provisions of Iowa Code Chapter 419 for the construction of an assisted living facility on land adjacent to the existing Taylor County nursing care facility. Under the Construction Contract, TRE retained the Contractor as the general contractor for the construction project. To guarantee the performance of the Construction Contract, the Contractor, as principal, and the Surety executed a Performance Bond and a Payment Bond naming TRE as obligee. The Contractor commenced performance of the Construction Contract on or about April 21, 1999.

The Contractor's performance was defective in several respects, including the installation of the roof trusses. Due to this defective performance, and in accordance with the Construction

Contract, TRE terminated the Contractor as general contractor in March 2000. TRE thereafter requested that the Surety meet its obligations for the completion of the project and the Surety responded by retaining an onsite representative to manage the project, and commissioning an engineering firm to review the deficiencies in the roof truss installation. Shortly after receipt of the preliminary engineering report confirming the existence of substantial defects in the roof truss work, the Surety determined that TRE's architect for the project (the "Architect") had allegedly improperly certified progress payments for defective work by the Contractor. The Surety demanded that TRE repay the amount of the alleged improperly certified payments to the contract fund as a condition before the Surety would continue to go forward with the work of completing the project. TRE did not return the funds, but obtained bids from other general contractors for the cost to complete the project. After learning that the cost to complete the project exceeded the sum of the revenue bonds issued to finance the project and failing to obtain alternative financing, TRE defaulted on its revenue bond obligations.

The Surety proceeded to file a lawsuit in Missouri state court alleging breach of contract by TRE, negligence by the Architect, and seeking indemnity by the Contractor. TRE then filed its original action in Taylor County, Iowa, which was later removed to this Court. The Missouri state action continues with various pre-trial motions pending.

II. *COLORADO RIVER* ABSTENTION

Generally, the rule between state and federal courts is that "the pendency of an action in the state court is no bar to proceedings concerning the same matter in the Federal court having jurisdiction . . . ." *McClellan v. Carland*, 217 U.S. 268, 282 (1910). *See Donovan v. City of Dallas*, 377 U.S. 408 (1964). However, the Supreme Court in *Colorado River Water*

Conservation Dist. v. United States, 424 U.S. 800 (1976), recognized that certain circumstances may permit "the dismissal of a federal suit due to the presence of a concurrent state proceeding for reasons of wise judicial administration." *Id.* at 818. In determining whether dismissal of concurrent action is appropriate, a federal court may consider such factors as the inconvenience of the federal forum; the desirability of avoiding piecemeal litigation; the priority and progress of the state action; whether questions of federal law are present; the adequacy of the state forum in protecting the federal plaintiff's interests; and problems with exercising concurrent jurisdiction over the same piece of property. *Id.* While none of these factors is determinative, together they must be balanced and considered in light of the strong presumption against abstention.

The Supreme Court has recognized in the past that federal courts have a "virtually unflagging obligation . . . to exercise the jurisdiction given them." *Colorado River*, 424 U.S. at 817, *quoting Kerotest Mfg. Co. v. C-O-Two Fire Equip. Co.*, 342 U.S. 180, 183 (1952). Grants of abstention are to be rare and exercised only in the most exceptional circumstances. *Moses H. Cone Hosp. v. Mercury Constr.*, 460 U.S. 1, 14 (1983), *quoting Colorado River*, 424 U.S. at 813 ("[A]bstention from the exercise of federal jurisdiction is the exception, not the rule."); *see also County of Allegheny v. Frank Mashuda Co.*, 360 U.S. 185, 188-89 (1959) ("Abdication of the obligation to decide cases can be justified under this doctrine only in the exceptional circumstances where the order to the parties to repair to the state court would clearly serve an important countervailing interest."). The Contractor and the Surety have not presented a set of circumstances that meets the exceptionally high standard so as to warrant abstention by this Court.

At the center of this litigation is a construction project located in Iowa, financed by an

Iowa bank pursuant to bonds issued by an Iowa county. The owner, TRE, is a non-profit corporation located in Iowa. The Contractor executed a contract to perform work in Iowa, the adequacy of which is a matter of dispute in this case. The choice of law provisions in the Construction Contract indicate that it is to be interpreted and enforced under Iowa law. Although the primary places of business of the Contractor and the Surety are not located in Iowa, their voluntary involvement in this project weakens any argument as to the inconvenience of the federal forum located in Iowa.

The Court must also consider whether the state forum adequately protects the interests of TRE, the federal plaintiff. In accordance with the unresolved allegation that the Missouri court lacks personal jurisdiction, TRE claims that the Missouri forum cannot fully protect TRE's interests. If TRE's pending motion to dismiss for lack of personal jurisdiction in Missouri is granted, TRE's only remaining forum to litigate or arbitrate its rights would be this Court. Since the Missouri court has not yet resolved that motion, this Court will not give weight to Defendants' argument that the Missouri forum adequately protects the rights of TRE.

The current stage of the Missouri litigation is also relevant in considering abstention. Although it was filed prior to this action and the court there has held a scheduling hearing, the parties all agree that the Missouri case remains in the early pre-trial stages and in a holding pattern awaiting the decision of this Court. Because no extensive discovery or testimony has occurred, this factor carries little weight.

Defendants also cite the lack of a federal question as a factor weighing in favor of abstention. Although this action is based solely upon diversity of citizenship, TRE's reference to

the Federal Arbitration Act is not completely misplaced.[1] State and federal courts both retain the power to compel arbitration pursuant to a valid arbitration clause; however, such power is subject to the existence of jurisdiction over the underlying claim, which is in question in Missouri. The Federal Arbitration Act embodies a broader federal policy in favor of enforcing arbitration clauses wherever applicable. Although no federal questions exist here, no particular questions of Missouri law are present either, and this Court has an interest in supporting a federal policy which the Missouri state court may be without jurisdiction to support.

Finally, Defendants note the desirability of avoiding piecemeal litigation. While the Court recognizes the importance of efficient and uncomplicated proceedings, this interest is only one of many factors and alone cannot provide the basis for crossing the high threshold to abstention. *See Colorado River*, 424 U.S. at 818 (citing numerous factors to consider). In addition, it is important to recognize that by their nature, most disputes containing multiple parties which are subject to potential arbitration will face the inevitable reality of piecemeal resolution.

For the reasons state above, and in recognition of this Court's "unflagging obligation" to exercise jurisdiction, the Court DENIES Defendants' Motion to Dismiss based on the *Colorado River* abstention doctrine.

III. MOTION TO STRIKE AND DISMISS CLAIMS BASED ON PAYMENT BOND IN COUNTS III, IV AND V

Counts III, IV and V of TRE's Petition seek recovery based on both the Performance

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[1] Although the Federal Arbitration Act creates a body of substantive law, it does not create independent federal question jurisdiction under 28 U.S.C. § 1331. *Moses H. Cohen*, 460 U.S. at n.32.

Bond and the Payment Bond issued by the Surety. The Surety asks this Court to strike and dismiss any claims based on the Payment Bond pursuant to Federal Rule of Civil Procedure 12(f), claiming the Payment Bond provides TRE with no enforceable rights.

A performance bond and a labor and material payment bond are two distinct bonds, each giving rise to different contractual rights and obligations. A *performance bond* is intended to secure the performance and completion of construction contract work in the event of a breach by the general contractor. The purpose of a *payment bond* is to afford payment for labor and material provided by workers, subcontractors and suppliers if the general contractor fails to pay them. A payment bond also protects the equity of the owner by preventing an unpaid claimant from filing a mechanic's lien against the owner/obligee's property.

The Payment Bond issued by the Surety ensures that payments are made to:

> all persons, firms, and corporations furnishing materials for or performing Labor in the prosecution of the WORK provided for in such contract, and any authorized extensions or modification thereof, including all amounts due for materials, lubricants, oil, gasoline, coal and coke, repairs on machinery, equipment and tools, consumed or used in connection with the construction of such WORK, and for all labor cost incurred in such WORK, including that by a SUBCONTRACTOR, and to any mechanic or materialman lien holder . . . .

In addition, the Payment Bond limits recovery under the bond to "SUBCONTRACTORS, and persons, firms, and corporations having a direct contract with the PRINCIPAL or its SUBCONTRACTORS." TRE does not have a "direct contract" with the principal, the Contractor, within the limited meaning defined by the Payment Bond.

Count III of TRE's Petition alleges that the Surety breached its obligations under both the Payment and Performance Bonds by "refusing to continue to perform its obligation to complete the project." TRE's brief in resistance to the Surety's Motion to Strike does not resist dismissal

of claims relating to the Payment Bond, but merely reasserts the prima facie case relating to breach of the Performance Bond. TRE does not allege that it has a direct claim for material or labor against the Contractor so as to make it a proper claimant under the Payment Bond. Both the language of TRE's Petition and the distinct functions of the bonds suggest that TRE's breach of contract claim is based solely on the Performance Bond. Similarly, TRE's bad faith (Count IV) and intentional interference (Count V) claims do not properly allege claims under the Payment Bond as they refer only to the Surety's required performance pursuant to the underlying Construction Contract.

Rule 12(f) provides in relevant part . . . "the Court may order stricken from any pleading any insufficient defense or any redundant, immaterial, impertinent or scandalous matter." Because reference to the Payment Bond is immaterial to TRE's breach of contract, bad faith and intentional interference claims as they relate to the Surety's performance obligations, the Surety's Motion to Strike and Dismiss claims based on the Payment Bond in Counts III, IV and V is GRANTED. TRE's breach of contract, bad faith and intentional interference claims based on the Performance Bond remain.

IV. MAGISTRATE'S ORDER DENYING THE BONDHOLDER'S APPLICATION TO INTERVENE

Firstar Bank, N.A. (the "Bondholder") filed an Application to Intervene in the case at bar. The parties submitted briefs and Magistrate Judge Shields denied the application. The Bondholder subsequently filed an Objection. This Court must consider that Objection and "modify or set aside any portion of the magistrate judge's order found to be clearly erroneous or contrary to law." Federal Rule of Civil Procedure 72(a).

A. Background

The Bondholder seeks intervention based on its financial involvement in the construction project. A brief summary of the financing structure follows. Taylor County, Iowa (the "County") issued $3,000,000 in revenue bonds pursuant to a Loan Agreement between the County and TRE for the purpose of financing the construction of a 30-bed assisted living addition to an existing nursing home in Lenox, Iowa operated by TRE. The Bondholder purchased all of the bonds which were secured by a Trust Indenture between the County and U.S. Bank Trust National Association (the "Trustee"). Pursuant to the Trust Indenture, TRE executed and delivered a mortgage and security agreement (the "Mortgage") for the benefit of the Trustee. The Mortgage provided the Trustee with a security interest in TRE's leasehold in the property, which was acquired pursuant to a 30-year ground lease from the County, as well as any current or future fixtures and improvements on the land. Pursuant to the Trust Indenture, the County assigned all of its rights under the Loan Agreement to the Trustee. Additionally, the terms of the Trust Indenture gave any person holding more than fifty percent of the bonds authority to direct the Trustee in the method of all proceedings to be taken in connection with enforcement of the Trust Indenture. The Bondholder holds one hundred percent of the bonds and therefore is vested with this authority.

After TRE defaulted on its bond payments, the Bondholder directed the Trustee to allow the Bondholder to foreclose on the Mortgage and subsequently filed a Petition in Equity. The Bondholder now seeks to enter this lawsuit by standing in the shoes of the Trustee, pursuant to the Trust Indenture, for the purpose of protecting its security interest.

B. Analysis

The standards for intervention are set out in Federal Rule of Civil Procedure 24. It provides in relevant part:

> **(a) Intervention of Right.** Upon timely application anyone shall be permitted to intervene in an action . . . (2) when the applicant claims an interest relating to the property or transaction which is the subject of the action and the applicant is so situated that the disposition of the action may as a practical matter impair or impede the applicant's ability to protect that interest, unless the applicant's interest is adequately represented by existing parties.
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> **(b) Permissive Intervention.** Upon timely application anyone may be permitted to intervene in an action . . . (2) when an applicant's claim or defense and the main action have a question of law or fact in common.

The Bondholder seeks to intervene by right or, alternatively, by permission of the Court.

1. Intervention of Right

In order to determine whether the Bondholder may intervene as of right, the Court must consider whether the Bondholder has a recognized interest in the litigation; whether its interest would be impaired by an ultimate disposition of the litigation; and whether its interest is merely contingent or remote. *United States v. Union Elec. Co.*, 64 F.3d 1152, 1161-62 (8th Cir. 1995). The Court must also consider whether the existing parties can adequately protect the Bondholder's interest.

The Magistrate did not find the Bondholder's interest to be "direct, substantial and legally protectable." The Magistrate's Order denies intervention of right based on the finding that the Bondholder "holds no mortgages on the property in question, and has no security interest." Nonetheless, even though the Bondholder is not the legal trustee under the Trust Indenture, that same document gives the Bondholder authority to step into the shoes of the Trustee and protect

the security interest in the mortgaged property.

It is well-settled law in Iowa that a mortgagee, as lien holder, may sue a third-party for injury to its security interest. *Walch v. Beck*, 296 N.W. 780, 782 (Iowa 1941); *Bates v. Humboldt Co.*, 277 N.W. 715, 716 (Iowa 1938); *Matthews v. Silsby Bros.*, 201 N.W. 94, 96 (Iowa 1924). The Mortgage expressly includes an interest in any future fixtures or buildings on the land. The Mortgage and Trust Indenture were executed in anticipation of and reliance upon the construction of a 30-bed assisted living facility. If either the Contractor or the Surety wrongfully breached their contracts so as to prevent the construction of such buildings contemplated at the inception of the financing agreement, the mortgagee's interest was damaged and it has a right to sue for that injury. Where, as here, the Bondholder is acting in place of the mortgagee, it does have a recognizable interest.

Next, the Court must consider whether that interest is being adequately protected by the existing parties. The Bondholder argues that TRE cannot adequately protect its interests given the financial constraints of a non-profit corporation. Indeed, given the possibility that counterclaims will be filed in this case[2], TRE's interests and tactics may necessarily vary from those of the Bondholder. *See Turn Key Gaming, Inc. v. Oglala Sioux Tribe*, 164 F.3d 1080, 1082 (8th Cir. 1999) (recognizing that the presence of a counterclaim may make the original parties unable to adequately represent a putative intervenor's interests). In addition, TRE's interest in pursuing arbitration does not, as the Magistrate's Order suggests, demonstrate TRE's ability to protect the Bondholder's interests throughout litigation. Conversely, the desire to pursue

[2] The Court makes this assumption based upon the existence of the Missouri lawsuit in which the Surety has filed claims against TRE.

arbitration may evince a greater inclination to settle existing claims. For the above-mentioned reasons, it was an error to conclude that the Bondholder's interests are adequately protected by TRE.

2. Permissive Intervention

In determining whether to grant permission for the Bondholder to intervene, the applicant's claim and the main action must have a common question of law or fact. The Magistrate found no common elements to permit intervention. Indeed, on their face, the Bondholder's claims allege almost identical facts and legal theories as presented by TRE. Resolution of all claims is dependent upon interpretation of the same contracts and discovery of the same facts. Intervention by the Bondholder would neither unduly delay nor prejudice the adjudication of the rights of the original parties; therefore, this Court alternatively grants the Bondholder's request for permissive intervention.

Upon reconsideration of the Magistrate Judge's Order by this Court, the Bondholder's Application to Intervene is GRANTED.

V. MAGISTRATE'S ORDER DENYING TRE'S MOTION TO COMPEL ARBITRATION

In an Order dated May 18, 2001, Magistrate Judge Shields denied TRE's Motion to Compel Arbitration (the "Arbitration Order"). One day earlier, the Magistrate issued an Order denying the Bondholder's Motion to Intervene (the "Intervention Order"). The Bondholder and TRE filed Objections with this Court to the Intervention Order, but did not file formal objections to the Arbitration Order. The Bondholder's Objection regarding intervention explicitly discusses its opposition to the Arbitration Order and TRE's Objection concurs in those arguments.

At the hearing before this Court on all pending motions, the Bondholder and TRE renewed their objections to both of the Magistrate's Orders. The Surety and the Contractor argued that this Court has no jurisdiction and may not consider these informal objections as they relate to the Arbitration Order because formal objections were not filed within the ten-day limit set by Federal Rule of Civil Procedure 72(a) and the Magistrate's Order is the law of the case. Therefore, before reviewing the Arbitration Order, this Court must first determine whether there is jurisdiction and authority to review an order of a magistrate judge without written objection by the parties.

A. Grounds for Reconsideration

The guidelines and deadlines for filing objections to a magistrate judge's order are detailed in Federal Rule of Civil Procedure 72(a):

> **(a) Nondispositive Matters**. A magistrate judge to whom a pretrial matter not dispositive of a claim or defense of a party is referred to hear and determine shall promptly conduct such proceedings as are required and when appropriate enter into the record a written order setting forth the disposition of the matter. Within 10 days after being served with a copy of the magistrate judge's order, a party may serve and file objections to the order; a party may not thereafter assign as error a defect in the magistrate judge's order to which objection was not timely made. The district judge to whom the case is assigned shall consider such objections and shall modify or set aside any portion of the magistrate judge's order found to be clearly erroneous or contrary to law.

This Rule is based on the powers granted under 28 U.S.C. § 636:

> (b)(1) Notwithstanding any provision of law to the contrary –
> (A) a judge may designate a magistrate to hear and determine any pretrial matter pending before the court . . . . A judge of the court may reconsider any pretrial matter under this subparagraph (A) where it has been shown that the magistrate's order is clearly erroneous or contrary to law.

A number of circuit courts have recognized the district court's ability to reconsider magistrate

judges' orders *sua sponte* under their local rules. *See, e.g.*, *Wingerter v. Chester Quarry Co.*, 185 F.3d 657, 661 (7th Cir. 1998) (recognizing local rule that provided for reconsideration *sua sponte* by district court judge of magistrate judge's pretrial orders); *United States v. Fernandez*, 780 F.2d 1573 (11th Cir. 1986); *United States v. Flaherty*, 668 F.2d 566, 585-86 (1st Cir. 1981); *United States v. Jones*, 581 F.2d 816 (10th Cir. 1978). Although this Court's local rules neither grant nor prevent such action by district courts, these holdings demonstrate that no jurisdictional barrier to review *sua sponte* exists in either the Federal Rules of Civil Procedure or 28 U.S.C. § 636.

One purpose for limiting a party's ability to object after the ten-day deadline is to assist the courts of appeals in defining issues appropriate for appeal. Circuit courts will not hear a party's objection to a magistrate judge's order on appeal unless it was objected to and reviewed by the district court. However, this requirement does not limit the ability of a district court to review *sua sponte* any orders issued by a magistrate judge in the same case.

The fact that the Magistrate issued an *order* pursuant to 28 U.S.C. § 636(b)(1)(A), allowing decisions on non-dispositive matters, instead of a *recommendation* under sub-section (B), which is always reviewed by a district court, does not serve to constrain the authority of the this Court. Rather, "the purpose of the Act's referral and review provisions is to define the limits of the power which a court may allow a magistrate to exercise, not to restrict the ultimate authority of an Article III court over a case pending before it." Wright & Miller, Federal Practice & Procedure § 3069 (citing *Delco Wire & Cable, Inc. v. Weinberger*, 109 F.R.D. 680, 685 (E.D.Pa. 1986)). The power to review *sua sponte* a magistrate's order is consistent with the recognized power of a district court to reconsider its own rulings in a case or the rulings of a

previously-assigned district court. Although the district court may choose to refer some issues to a magistrate, "the entire process takes place under the district court's total control and jurisdiction," and the judge "exercise[s] the ultimate authority to issue an appropriate order." *United States v. Raddatz*, 447 U.S. 667, 681-82 (1980).

Given that this Court is not constrained by jurisdictional or other legally-imposed barriers, it will proceed to review the Magistrate's Order denying TRE's Motion to Compel Arbitration.

B. Analysis

TRE makes its Motion to Compel Arbitration pursuant to 9 U.S.C. § 4, which provides in relevant part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement.

Article 4 of the Construction Contract requires that "[a]ny controversy or Claim arising out of or related to the Contract, or the breach thereof, shall be settled by arbitration . . . and judgment upon the award rendered by the arbitrator or arbitrators may be entered in any court having jurisdiction thereof . . . ."

There is little doubt that the terms of this arbitration clause can be enforced under 9 U.S.C. § 4. Rather, the question before the Magistrate Judge and now before this Court is whether TRE may rightfully compel arbitration in light of its actions and responses in the pending lawsuits. First, the Court must determine whether TRE's actions have constituted a

waiver of the right to arbitrate. Second, the Court must determine whether TRE is a "party aggrieved" under the Federal Arbitration Act.

We agree with the Magistrate's conclusion that TRE has not waived its right to arbitrate. "In light of the strong federal policy in favor of arbitration, any doubts concerning waiver of arbitrability should be resolved in favor of arbitration." *Nesslage v. York Sec., Inc.*, 823 F.2d 231, 234 (8th Cir.1987). Even if TRE acted inconsistently with its duty to arbitrate by failing to demand arbitration in Missouri or by filing the present case, those actions have not substantially prejudiced the Defendants here so as to constitute a waiver of TRE's right. *See Stifel, Nicolaus & Co. v. Freeman*, 924 F.2d 157, 158 (8th Cir.1991) (finding waiver "where the party claiming the right to arbitrate: (1) knew of an existing right to arbitration; (2) acted inconsistently with that right; and (3) prejudiced the other party by these inconsistent acts").

A more complicated question is whether TRE is a "party aggrieved" under 9 U.S.C. § 4. The Magistrate Judge found that it is not and denied TRE's Motion on this basis. The Magistrate's Order suggests that to be "aggrieved," TRE would have had to invoke the arbitration process at a much earlier stage in the lawsuits by following the procedures of the arbitration clause and the Federal Arbitration Act.

TRE, on the other hand, argues that it became an aggrieved party as soon as the Surety filed the Missouri action, in contravention of the arbitration clause, because TRE was then subject to judicial proceedings instead of the bargained-for arbitration. TRE filed an answer in the Missouri action asserting the necessity of arbitration and a Motion to Dismiss for lack of personal jurisdiction.

The Federal Arbitration Act, 9 U.S.C. § 4, requires that the district court compelling

arbitration have an independent source of jurisdiction over the underlying case. In light of this provision, it is understandable that TRE would not seek to compel arbitration in Missouri. TRE could not move to compel arbitration while its motion for lack of personal jurisdiction was pending as this request would presuppose the Missouri court's jurisdiction over the case and parties and thereby defeat TRE's primary objection to the proceedings in Missouri. Instead, TRE filed its own claims in Taylor County, Iowa which were later removed to this Court. Only after numerous pretrial motions did TRE seek to compel arbitration. Although this Court questions the delay in requesting arbitration, it is reasonable to believe, as TRE asserts, that TRE first sought to establish jurisdiction with the intent of later asking for the Court to compel arbitration. The Magistrate's Order did not fully consider this argument.

The Defendants also object to an order compelling arbitration based on the fact that the case at bar does not contain all of the relevant parties to the dispute, namely the County and the Architect. However, under the Federal Arbitration Act, courts must enforce arbitration agreements notwithstanding the presence of persons who are parties to the underlying dispute, but not to the arbitration agreement. *See Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985) (stating a policy of "rigorously enforc[ing] agreements to arbitrate, even if the result is 'piecemeal' litigation" due to the presence of parties whose conduct or contractual obligations are not subject to arbitration); *see also Sedco, Inc. v. Petroleos Mexicanos Mexican Nat'l Oil Co. (Pemex)*, 767 F.2d 1140, 1148 (5th Cir. 1985) (noting that the Federal Arbitration Act does not give courts discretion to compel arbitration, but instead "mandates that district courts shall direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed" despite the "possible inefficient maintenance of separate proceedings in different

forums”).

Given the strong federal policy in favor of enforcing arbitration clauses embodied in the Federal Arbitration Act, this Court believes in applying a liberal interpretation of “party aggrieved” so as to allow TRE to compel arbitration. In addition, the correct interpretation of the Construction Contract and Performance Bond will necessarily require an understanding of construction and financing practices and terminology. An arbitrator familiar with the industry is most likely to accomplish this. Therefore, this Court submits TRE’s remaining claims against the Contractor and the Surety to arbitration. Upon reconsideration of the Magistrate Judge’s Order, TRE’s Motion to Compel Arbitration is GRANTED.

Finally, it is the province of this Court to interpret the arbitration clause and determine in the first instance which parties are bound by that agreement[3]. Section 4.5.5 of the Construction Contract provides:

> No arbitration arising out of or relating to the Contract Documents shall include . . . the Architect . . . except by written consent containing specific reference to the Agreement and signed by the Architect, Owner [TRE], Contractor and any other person or entity sought to be joined. No arbitration shall include . . . parties other than the Owner, Contractor . . . and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration. No person or entity . . . shall be included as an original third party or additional third party to an arbitration whose interest or responsibility is insubstantial. . . .”

At the hearing before this Court, the parties questioned whether the Surety could or would be a party to any potential arbitration. Given the terms of the Construction Contract, the related

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[3] *Litton Fin. Printing Div., a division of Litton Bus. Sys., Inc. v. N.L.R.B.*, 501 U.S. 190, 208 (1991) (“Whether or not a company is bound to arbitrate, as well as what issues it must arbitrate, is a matter to be determined by the court, and a party cannot be forced to "arbitrate the arbitrability question.") (citing *AT & T Techs., Inc. v. Communications Workers*, 475 U.S. 643, 651 (1986)).

incorporation of that contract into the Performance Bond and the fact that the Surety has relied upon other favorable provisions in the Construction Contract[4], it is the belief of this Court that the Surety is a proper participant in this arbitration.

Given the nature of the claims against the Surety and its own claims filed against TRE in Missouri, the Surety is a properly joined party. As required by the arbitration clause, the Surety is "substantially involved in a common question of fact or law" and its "presence is required if complete relief is to be accorded in arbitration." In addition, the Surety's extensive involvement in both lawsuits demonstrates that its interest and responsibility are not "insubstantial" under the terms of the arbitration clause.

This Court recognizes that the circuit courts are split as to whether an incorporation clause in a performance bond serves to bind the surety to the arbitration provisions in the underlying construction contract. Despite the fact that many circuits have interpreted the performance bond to incorporate the arbitration clause[5], the Eighth Circuit recently stated its unwillingness "to construe an incorporation clause whose obvious purpose was to clarify the extent of the surety's secondary obligation as also reflecting a mutual intent to compel arbitration of *all* disputes between the surety and the obligee under the bond." *AgGrow Oils, L.L.C. v. Nat'l Union Fire Ins. Co. of Pittsburgh, P.A.*, 242 F.3d 777, 782 (8th Cir. 2001) (emphasis added).

Unlike *AgGrow*, where one party resisted full incorporation, TRE and the Surety both

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[4] In its briefs supporting its Motions to Dismiss, the Surety argues that the Performance Bond incorporates all terms of the Construction Contract, so as to benefit from the express waiver of consequential damages.

[5] *See, e.g.*, *Commercial Union Ins. Co. v. Gilbane Bldg. Co.*, 992 F.2d 386, 386-89 (1st Cir. 1993); *United States Fid. & Guar. Co. v. W. Point Constr. Co.*, 837 F.2d 1507, 1507-08 (11th Cir. 1988); *Exch. Mut. Ins. Co. v. Haskell Co.*, 742 F.2d 274, 275-76 (6th Cir. 1984).

seek the benefits of fully incorporating the Construction Contract into the Performance Bond – TRE for the purpose of enforcing the arbitration clause, the Surety for purposes of barring consequential damages. The Surety, then, must be prepared to take the bitter with the sweet by submitting to arbitration pursuant to another clause in the Construction Contract.

The claims by TRE and the defenses of the Surety, especially those related to TRE's alleged duty to return contract funds and mitigate damages, are not collateral to the underlying Construction Contract. Resolution of these disputes will necessarily require an interpretation of not only the Surety's obligations under the Construction Contract incorporated by the Performance Bond, but also TRE's duties as defined by the Construction Contract. This Court agrees with the Eighth Circuit that the Surety cannot be made to arbitrate claims solely based upon interpretation of the Performance Bond, which contains no arbitration provision. But to the extent that TRE's claims are dependent upon defining TRE's duties or the Surety's secondary obligations under the Construction Contract, the Surety is bound to arbitrate.[6]

This Court does not rule on the duty of the Architect or the Bondholder to participate in the arbitration, but rather notes that by the terms of the arbitration clause permitting consensual joinder, neither party is completely barred from participating. Additionally, it is the belief of this Court that participation by all of the affected parties would assist in the most efficient and effective resolution of the controversy pursuant to the bargained-for terms of the underlying contracts.

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[6] State courts in both New York and New Jersey have adopted this reasoning, which distinguishes claims arising under the performance bond from claims arising under the construction contract. *See Gloucester City Bd. of Educ. v. Am. Arbitration Ass'n*, 755 A.2d 1256 (N.J. Super. Ct. App. Div. 2000); *Fidelity & Deposit Co. v. Parsons & Whittemore Contractors Corp.*, 397 N.E.2d 380 (N.Y. 1979).

TRE's Motion to Compel Arbitration is GRANTED and its claims in this Court are dismissed. Upon compelling arbitration, this Court finds Defendant's remaining Motions to Dismiss under Federal Rule of Civil Procedure 12(b)(6) moot. On their face, TRE's claims are disputes governed by the Construction Contract and therefore more properly resolved by the arbitrator. This Court will stay the Bondholder's remaining claims for the duration of the pending arbitration.[7]

IT IS SO ORDERED.

Dated this ___1st___ day of October, 2001.

ROBERT W. PRATT
U.S. DISTRICT JUDGE

[7] "In some cases . . . it may be advisable to stay litigation among the non-arbitrating parties pending the outcome of the arbitration. That decision is one left to the district court . . . as a matter of its discretion to control its docket." *Moses H. Cone*, 461 U.S. at n.23 (citing *Landis v. N. Am. Co.*, 299 U.S. 248, 254-55 (1936)); *see also Contracting Northwest, Inc. v. City of Fredericksburg*, 713 F.2d 382, 387 (8th Cir. 1983) (stating that the district court has discretion to stay "third party litigation [that] involves common questions of fact that are within the scope of the arbitration agreement").