EXPERT REPORT OF GREGORY S. ARNOLD, 2014 Misc. Filings LEXIS 6987

UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON

Case No. 3:12cv5982

April 17, 2014

Reporter
2014 Misc. Filings LEXIS 6987 *

STELLAR J CORPORATION, a Texas Corporation, Plaintiff, v. ARGONAUT INSURANCE COMPANY, an Illinois corporation, Defendant. UNISON SOLUTIONS, INC., an Iowa Corporation, Defendant -- Third Party Plaintiff, v. TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA; XCHANGER, INC, a Minnesota corporation; and ROHDE BROTHERS, INC., a Wisconsin corporation, Third-Party Defendants.

Expert Name: ***Gregory S Arnold***, , J.D., , LL.M.

Judges

[*1] HONORABLE RONALD B. LEIGHTON

Text

EXPERT REPORT OF STELLAR J CORPORATION IN CONNECTION WITH THE MEDIATION COMMENCING APRIL 30, 2014

I, ***Gregory S. Arnold***, reviewed portions of the following materials in preparation for this report:

➢ The Argonaut Insurance Company Claim File, consisting of twelve 3-ring binders of Bates-stamped documents;

➢ The Pleadings, Motions, and Deposition Transcripts in this case, consisting of three 3-ring binders of documents, including the April 16, 2012 Order On Defendant's Motion For Summary Judgment;

➢> The Law of Performance Bonds, Second Edition (2009);

➢ The Construction Law Handbook (2009); and

➢ The case of Colorado Structures v. Insurance Company of the West.

I was not given any instructions by Stellar J Corporation (hereinafter simply **[*2]** "Stellar J") or its attorneys on the content or structure of this report. This report contains my own observations, impressions and conclusions, without influence from any company or person.

My qualifications include almost thirty (30) years of handling surety claims of all types as both a surety company claims adjuster and as an outside consultant. I have a JD and an LL.M (Insurance Law). Part of my LL.M curriculum was a course in Fidelity and Surety Law. I received my in-house training from Great American Insurance Company. A large percentage of my experience includes the handling of performance bond claims. I have handled surety claims in all regions, and most states, in the United States. I have responded on behalf of surety companies to performance bond claims in the state of Washington. I have been qualified as an expert in other surety cases. [1] Based upon my experience and education, I believe that I am qualified to provide an expert opinion in this case.

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Background on the Methodology of Handling a Performance Bond Claim:

A surety claims professional, or adjuster, learns a standard initial approach to responding to a claim against a bond. The first task is to confirm coverage, so as to avoid acknowledging a claim that is on a project or contract not bonded by that particular surety, and perhaps, because of mistaken assumptions by the claimant, by no surety. With modern technology the coverage confirmation can be immediate by resort to computer databases. Sometimes there are unrecorded bonds or some other delay or issue, so confirmation can sometimes take longer than one might expect.

Next is to prepare a response letter to a claimant as soon as possible, but ideally no later than the time required by state statute. Sometimes a claim is not acknowledged within the required time, and an adjuster attempts to explain the reasons for the delay to the claimant, with an apology. The acknowledgement, or first response letter, is typically based upon a template, sometimes referred to a form letter. Details of the bond and the claim, such as the bond number, claim number, project and obligee, are included in a caption, and the name of **[*4]** the claimant and its address are inserted in the proper places. In the case of payment bond claims, the acknowledgment letter is often accompanied by a blank proof of loss form, which the adjuster asks the claimant to complete and return with any claim support documents not already received by the surety. In the case of a performance bond claim, it would be rare for such a proof of claim form to accompany an acknowledgment letter.

Typical information requested from an obligee in the case of a performance bond are copies of contracts; copies of change orders; copies of approved payment estimates between the obligee and the claimant; plans, drawings, specifications pertaining to the principal's scope of work; communications between the obligee and claimant pertinent to any disputes; and similar documents within the control of the obligee.

In addition to the acknowledgment letter, a standard letter to the principal is prepared, usually also based upon a template. The principal is also an indemnitor, so writing to the principal is also writing to at least one of typically several indemnitors on an account. The letter to the principal encloses the notice of claim from the claimant, plus **[*5]** any claim support documentation received to date.

Depending upon the severity of the claim or number of other claims already received against the bonds of the same principal or account (an account can be more than one named principal or group of

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[1] Bank One Texas, N.A. v. Highlands Insurance Company, Highlands Underwriters Insurance Company, Brown-Carpenter Curtainwall Systems, Inc., Brown Carpenter & Company, Dee Brown Masonry, Inc., and Carpenter Carruth & Hover, 113th District Trial Court, Superior Court, Harris County, Texas (1997) (Trial Docket 91-23339).

companies that are somehow related for underwriting purposes), the adjuster may take immediate action to commence the independent surety investigation, and prior to receipt of anything in response from the principal, other than perhaps a first telephone call with the principal. This immediate investigation can include review of the documents received, self-education about the technical issues involved in the claim and, where complex materials, equipment, systems, etc. are involved, the lining up and/or actual retention of a technical consultant or expert, such as an independent engineer or surety consulting company. Typically a surety consulting company will be staffed by engineers. Where they do not have the requisite expertise for an assignment, they will retain a properly credentialed and/or experienced person to help respond to the claim.

Also, depending upon the severity of the claim or number of other claims already received against **[*6]** the bonds of the same principal or account, the adjuster may or may not send a letter to all of the several indemnitors, including the principal/indemnitors. Such letters are also based upon a template or form letter, with appropriate modifications. In the case of low-risk assessment in response to a claim, such a letter to indemnitors may never go out. Where there is a reassessment of risk, leaning to higher risk, such a letter usually gets mailed by the adjuster or its outside counsel, and is typically sent several weeks or months after the initial letters to the claimant and principal have gone out.

Where the adjuster immediately perceives significant risk against one or more bonds, the surety company typically reacts in a team approach, involving the agent, underwriter and claims department. Risk assessment can involve outside counsel and surety consultants early-on in the life of a claim. The result of this surety company team approach, with or without the assistance of outside professionals, is the mailing of certified letters to the indemnitors to, at a minimum, ensure all indemnitors are on notice of the claim(s) and, occasionally, demanding immediate action by the indemnitors, **[*7]** including settlement of any undisputed claims and/or the posting of collateral to secure the surety against its exposure. Where the General Indemnity Agreement among the surety and the indemnitors requires it, the surety company posts reserves prior to demanding any collateral from the indemnitors.

Depending upon the experience, skill level and particular practice of the surety claims handler, he or she may also at this time look for dispositive issues, such as failure to perfect a claim by giving notices as required by the bond, contract and/or statute, and such issues as the possible expiration of the statute of limitations. The adjuster may also seek an outside legal opinion, especially when handling a claim in an unfamiliar state, and an adjuster may give some consideration to the filing of a declaratory judgment action, or paying a claim amount into the registry of a court, as a means of handling a disputed claim.

The claims handler may also review the Bond File and the Underwriting File that are maintained by the surety's underwriters, and/or ask the procuring agent for certain documents relevant to one or more particular bonds or the underwriting process in general (financials **[*8]** statements, for example). Other claim handlers will await receipt of a proof of loss form (if a payment bond claim) or other supporting documents from a claimant before performing this additional analysis. Depending upon the type of claim, severity of claim, or other concerns of a surety with respect to a claim, this underwriting review becomes more important and more immediate.

If the matter ends up in suit before the dispositive issues analysis can be done, the handler will typically defer to counsel for the notice perfection and statute of limitations issues analysis, while monitoring and directing that litigation. When handling a claim in unfamiliar territory, a claims adjuster will typically confer with a local attorney to ensure there are no surprises in an analysis even before a claim goes to suit. The idea is to respond timely and handle a claim fairly so as to avoid unnecessary litigation. Sometimes the claims adjuster has little control over whether suit is filed, either because the claimant takes an

unreasonable position or because the claims adjuster is convinced (sometimes wrongly) that his or her analysis of dispositive issues (notice perfection and statute of limitations) **[*9]** is correct.

In this case, according to the April 16, 2014 Order On Defendant's Motion For Summary Judgment, denying Argonaut's Motion For Summary Judgment, the Court stated that Argonaut's interpretation of the statute of limitations was wrong, and the limitations period stated in its bond was impermissible and void under Washington law.

Typically, the review of the underwriter's records will still be performed by the surety claims handler, regardless of the pendency of any litigation.

Argonaut Insurance Company's Claims Handling:

Initial Claims Response:

The March 29, 2012 Claim Acknowledgment Letter:

From an initial administrative perspective, Argonaut handled the Stellar J claim the same as most surety companies would. After receipt of the March 26, 2012 notice of claim from Stellar J [2], there were internal communications between the underwriting department and the claims department, and there were communications involving the agent. A timely response letter dated March 29, 2012 [3], was sent to Stellar J, acknowledging the claim. For the most part, at this point in the claims response process, Argonaut's handling of the Stellar J claim was fairly standard, at least on **[*10]** the surface

However, there were some irregularities.

One such irregularity was the content of the acknowledgment letter to Stellar J. There was no mention of a claim number, and surety claim acknowledgment letters invariably contain some reference to a claim number in the caption. Some surety companies use the bond number followed by some code as the claim number. Argonaut's claims department may do this, but there is no indication one way or the other.

Also, while a performance bond claim acknowledgment letter typically requests several enumerated relevant contract documents from the claimant to support the claim, Argo's March 29, 2012 letter did not request a single document by either document name or type. Rather, Argonaut requested "...that your company complete and return the enclosed Proof of Claim form and the supporting documentation requested in the form." The Proof of Claim form [4] requested the types of documents one would request from a payment **[*11]** bond claimant, such as paragraph 4, "Type of material supplied or labor furnished"; paragraph 8 (F) "Total Payments Received to Date"; paragraph 9 "Date of Notice to Owner"; paragraph 10 "Date of Notice of Nonpayment to Bonded Principal"; paragraph 11 "Date of Notice of Nonpayment to Surety"; paragraph 15.d, "Copies of all checks received from the principal (whether on this project or any other project), including joint checks, since you started work on this project"; and paragraph 1.e., "A copy of any ledger or similar record listing the dates and amounts of all payments received from the principal or on behalf of the principal". An obligee does not supply material or furnish labor to its own material supplier. An obligee does not receive payments from its own material supplier. An obligee does not give a notice to owner in connection with a claim against its own material supplier. An obligee does not give a notice of nonpayment to its own material supplier. An obligee does not give a notice of nonpayment to a surety of its own material supplier. An obligee does not receive checks from its

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[2] Bates AIC 006690.

[3] Bates AIC 006884.

[4] Bates AIC 006692.

own material supplier. An obligee does not maintain a ledger or similar record of payments received **[*12]** from a principal, because an obligee does not receive such payments from a material supplier. Rather, an obligee makes payments to a material supplier, unless the material supplier is in breach of its own materials agreement.

In my experience in working for small, medium-sized and large surety companies, such Proof of Loss or Proof of Claim forms go only to payment bond claimants. Occasionally, because of inexperience or the volume of claims, or secretarial / administrative oversight, a claims handler will mistakenly allow a proof of loss form to go out to an obligee. I have made the same mistake myself. It is embarrassing, and one typically met with a phone call from an obligee asking if I really wanted the obligee to complete a form meant for a payment bond claim. An apology and instruction that there is no need to complete the form is sufficient to resolve the mistake. I have never seen a proof of loss form for a performance bond claim. They might exist in some surety company claims **[*13]** departments, but I've never seen one.

Argonaut's Claims Handling Post Initial Response:

Argonaut was seriously concerned about its principal during the first week of having received the Stellar J claim. As early as April 2, 2012 [5], a very short period of time after receipt of the Stellar J. March 26, 2012 notice of claim, Argonaut was sending certified letters to its indemnitors, demanding collateral. The text of paragraph 2 of 3 paragraphs is as follows:

"Please be advised that due to recent events and activities, the Surety has grown concerned about a direct adverse affect on the Surety's risk under the Bonds. As such, at this time, in accordance with the terms and conditions, specifically contained in paragraph 3, of the General Indemnity Agreement, ("GIA"), signed by each of you, a copy of which **[*14]** is enclosed for your review, the Surety hereby makes formal demand on the Indemnitors to immediately deposit $ 500,000 with the Surety, which is a sum of money equal to the anticipated liability and losses under these Bonds. Such funds will be held by the Surety as collateral against potential future Losses or if need be, can be used by the Surety to pay losses."

The next day, on April 3, 2012 [6], Argonaut sent another letter to the same indemnitors, addressing collateral demand issues. The second of five paragraphs states verbatim as follows:

"Please be advised that due to recent events and activities, the Surety has grown concerned about a direct adverse impact on the Surety's risk under the Bond(s). As such, in accordance with the terms and conditions, specifically contained in Paragraph 10, of the General Indemnity Agreement, ("GIA"), signed by each of you, a copy of which has been previously provided to you, the Surety may, in its sole discretion, determine one or more of the **[*15]** following: (a) the Indemnitors financial condition has been or is believed to be deteriorating; or (there has been or is believed to be some other challenge that adversely impacts the Surety's risk, under the Bond(s), Argo may at any time demand that within thirty (30) days of such demand, the Indemnitors shall procure a full and complete release of any and all bond(s) issued by the Surety to any of the Indemnitors by providing competent written evidence of release-satisfactory to Argo. Furthermore, failure on the part of the Indemnitors in procuring a full and complete release of any and all bond(s) issued by the Surety to any of the Indemnitors by providing competent written evidence of release satisfactory to Argo of any bond(s) within thirty (30) days of such

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[5] Bates AIC 006951-AIC 006956, Letter "Argo Surety" to Jan Scott and Dave Broihahn on behalf of Unison Solutions, Inc., and to Jan Scott and Dave Broihahn in their capacities as individual indemnitors.

[6] Bates AIC 007203.

demand, the Indemnitors shall, within seven (7) additional days thereafter, deposit with the Surety collateral amount of one hundred percent (100%) of all unreleased liability under the bond(s)."

Although demanding collateral early was a prudent course of action for Argo, because of its serious and growing concerns about Unison's financial ability and claims exposure, Argonaut was not showing the same level of concern about **[*16]** beginning a genuine investigation of the performance bond claim filed by Stellar J.

While Argonaut was seriously concerned about its own exposure and protecting its self-interests with relation to its indemnitors, Stellar J was anxious about its exposure, as evidenced by placing a telephone call to Vince Miseo, sending a letter dated March 26, 2012, and following up with an e-mail on March 27, 2012, stating:

"Attached is Stellar J Corporation's claim notice to Argo's regarding the subject supply bond as well as a copy of Claim # 1 to Unison. We will send remaining claim notices and costs in the near future."

Additional Claim Notices:

Additional claim notices were filed by Stellar J on April 12, 2012 and April 14, 2012. These were recognized using the word "acknowledge" in Argonaut's letters dated May 1, 2012, June 1, 2012, and June 18, 2012. Recognizing or mere "acknowledging" is not the same as meaningfully responding. A surety should contemporaneously acknowledge and meaningfully respond to each notice of claim from an obligee, and not wait to recognize several claims notices in a wholesale fashion in letters forwarding a principal's response, asking for items that cannot **[*17]** legally be required (notice of default), or denying the various claims. None of the letters showed an appreciation for the urgency of Stellar J's claims. None of the letters addressed the details of the problems on the job or demonstrated an interest in resolving the issues before they became more serious.

The Completed Proof of Claim Dated April 10, 2012:

The completed Proof of Claim form was returned by Stellar J to Argonaut on April 10, 2012. [7] The claims decision was not communicated until June 18, 2012 [8], several days more than the statutory time [9] within which to communicate the decision, and there was no request for an extension of time.

The April 30, 2012 Letter from the Attorney for Unison Solutions:

Attorney William E. McCardell, of DeWitt Ross & Stevens, on behalf of Unison, wrote a letter on April 30, 2012 [10], addressed to Stellar J, and much anticipated by Argonaut to support **[*18]** its defensive posturing in lieu of investigation. The letter states in part as follows:

"Stellar J is an Additional Obligee under the June 22, 2009 Dual Obligee Rider to Supply Bond SUR0001957 of same date issued by Argonaut Insurance Company, (the "Supply Bond")." McCardell letter, page 1, first paragraph.

"First, Unison has no contractual obligation to Stellar J. Unison's only contractual obligations with respect to the Project are those found in the purchase order negotiated and executed between Unison and

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[7] Bates AIC 007246-AIC 007249.

[8] Bates AIC 007215-AIC 007216.

[9] See note 23, infra.

[10] Bates AIC 007529.

AFT..." Third, the Supply Bond covers only Unison's performance of its defined contractual obligations with AFT. Fourth, AFT has failed to pay all sums due and owing Unison strictly in accordance with the purchase order. As such, neither AFT nor Stellar J can make claims against the Supply Bond. Fifth, Stellar J has failed to make a claim according to the express terms of the Supply Bond, and any such further attempted claim is otherwise untimely. Finally, Unison owes no **[*19]** independent duty to Stellar J that might allow Stellar J to pursue any negligence claim against Unison. The bottom line is that, if Stellar J wishes to pursue remedies for any losses it has incurred on the Project, Stellar J will need to do so from AFT (and its Surety, if any), not from Unison" McCardell letter, page 1, second paragraph.

On page 7, sixth paragraph, Mr. McCardell states: "There exists no contract whatsoever between Unison and Stellar J with respect to the Project. Instead, Unison worked on the Project solely through the July 10 AFT PO. Since Unison has no contractual obligation to Stellar J. Stellar J cannot hold Unison liable under any breach of contract claim."

Also on page 7, last paragraph, Mr. McCardell wrote: "The injuries Stellar J claims do not arise from the breach of any independent duty owed it by Unison." On page 8, Mr. McCardell stated in paragraph six, "...AFT itself confirmed in April 2010 that Unison's performance was '[e]xcellent.'"

On page 8, last paragraph, and continuing onto page 9, Mr. McCardell wrote: "Stellar J has no basis for making any claim against Unison or Argonaut Insurance Company under the Supply Bond. If you persist **[*20]** in bringing these spurious claims, not only will we vigorously defend Unison and Argonaut against your claims, we will prosecute our own action against you and Stellar J for pursuit of knowingly frivolous claims." [underlining emphasis added.]

Mr. McCardell recognized Stellar J's position as a Dual Obligee on the bond Argonaut issued on behalf of principal, Unison. The bond is a three party contract. As part of that three-party contract, Unison has contractual obligations to Stellar J. Stellar J has reciprocal obligations to Unison under the same bond. Argonaut had obligations to Stellar J under the bond. Whether any of the parties breached their respective obligations under that bond is something to be determined in the course of the litigation. For purposes of this review, the point is that Mr. McCardell is incorrect when he claims there is no contractual relationship between Unison and Stellar J. The same holds for Mr. McCardell's statement that "… the Supply Bond covers only Unison's performance of its defined contractual obligations with AFT." The Material Contract was by and between Unison and AFT. That is correct. But, a clear condition in the contract between Stellar J **[*21]** and AFT was that Unison agree to bind itself to Stellar J by the vehicle of the performance bond naming Stellar J as an Additional Obligee. Also, Mr. McCardell's letter sidesteps the fact that, from November 2010 forward, Unison worked directly under Stellar J, and to the extent Stellar J was billed by Unison, Stellar J paid Unison directly. As recognized by The Honorable Ronald B. Leighton in his April 16, 2012 Order on Defendant's Motion For Summary Judgment, "Unison obtained a supply bond (Bond) from Argonaut, which guaranteed both Stellar J. and AFT that Unison would perform." [Order, page 1, emphasis added]. Judge Leighton further stated as follows:

"But, Unison's obligations under the contract did not end with delivery. Indeed, it would not even be paid the last 10% of the price until its materials had undergone successful testing." [Order, page 2.]

With respect to the statement that "...AFT itself confirmed in April 2010 that Unison's performance was '[e]xcellent.'", same was made by AFT in a Status Report to Argonaut Insurance at a time when AFT was embroiled in its own disputes with Stellar J, and it would not have been in AFT's best interests to admit that it, **[*22]** or any of its suppliers or other vendors, had problems with their respective portions of the project. As such, the statement is self-serving and not reliable. In my experience, obligees occasionally make statements on such Status Reports which they recant when questioned by a surety company or other interested party.

The May 1, 2012 Letter from Argonaut to Stellar J:

On May 1, 2012, Vincent Miseo of Argonaut wrote to Robert J. Kinghorn, commenting upon Unison's response drafted by attorney McCardell, in part as follows:.

"Argo Surety ('Argo' or the 'Surely') received your letters, enclosures and executed Proof of Claim, Specifically, we received documents from you on March 26, 2012, April 12, 2012, and April 24, 2012. We "are in the process of independently investigating your company's claim. Should we determine in the course of our investigation that we need additional information from you, we will advise you. [emphasis added.]

"Also, it is our understanding that on May 1, 2012. Unison Solutions sent you its-response asserting its position on Stellar J's claims under the bond. We were copied on Unison's response letter. If for some reason you are not in receipt of **[*23]** this response, please let us know and we can provide them to you. Because we are continuing our independent investigation, we ask that you please provide us with a written response and any new documents that have not been previously provided that support Stellar J's response to Unison's position within seven (7) days from the date of this letter."

The final paragraph is a standard disclaimer paragraph.

As mentioned above, rather than conduct a reasonable investigation of the claim, Argonaut instead waited for a written response from the attorney for its principal, Unison and, once the final, formal version of the April 30, 2012 letter was received on May 1, 2012, [11] simply forwarded that along to Stellar J and asking Stellar J for its own response to principal's attorneys' letter -- all without investigation; without asking probing questions; without making observations (at least none recorded in the Claim File); and without making other comment. It appeared Argonaut had all it needed from Stellar J, because it did not request anything, and stated "Should we determine in the course of our investigation that we need additional information from you, we will advise you." There **[*24]** was no follow-up asking for anything, other than a June 1, 2012 letter, that feigned a search for additional documentation, but was fashioned to show some additional effort at "investigating" before the denial letter was sent on June 18, 2012.

This May 1, 2012 letter was an opportunity for Argonaut to let Stellar J know whether Argonaut Insurance adopted the positions and threats of Unison Solutions, Inc., and to correct any misstatements or unfounded conclusions stated in the Unison letter, as they applied to Argonaut. For example, Argonaut should have, but failed to, inform Stellar J that there is in fact a contractual relationship between Unison and Stellar, contrary to the position taken by Unison's counsel. Furthermore, with respect to Unison's attorney's statement "If you persist in bringing these spurious claims, not only will we vigorously defend Unison and Argonaut against your claims, we will prosecute our own action against you and Stellar J for pursuit of knowingly frivolous **[*25]** claims.", Argo should have taken the opportunity in this letter of May 1, 2012, to inform Stellar whether Argonaut adopted Unison's threat to prosecute their own action against Mr. Kinghorn and Stellar J. These are strong positions to take, especially when the limitations period and language stated in the Argonaut bond were impermissible and void under Washington law and Unison had walked off a project with problems that were its responsibility.

As Argonaut did not send such a letter to Stellar, and since we have no record of Argonaut sending a letter to Unison or its attorneys disclaiming any of the positions stated by Unison's attorney in the April 30, 2012 letter from attorney McCardell, it appears that Argonaut in fact adopted the entirety of the Unison response as the response of Argonaut.

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[11] Bates AIC 007259.

The June 1, 2013 Letter from Argonaut to Stellar J:

This third letter, dated June 1, 2012, treated the performance bond claim as a payment bond claim and asked for an item not required under Washington law, i.e., a written notice of default. Specifically, the letter requested:

"1. Written evidence (delivery ticket(s), labor time cards, service ticket(s), etc.) supporting the verified **[*26]** statement contained in Stellar J's executed Proof of Claim that the date labor ended or materials last supplied (not including warranty period) was November 14, 2011; and

"2. A copy of Stellar J's written notice to the Surety of Unison's default under the Material Contract, as that term is defined in the June 22, 2009 Supply Bond."

With respect to some confirmation that the date labor ended or material was last supplied was November 14, 2011, the Court, in ruling on Argonaut's Motion For Summary Judgment, did not have a problem coming to this conclusion. The Court did not require delivery tickets, labor time cards, service tickets, to reach this result. This is because such items have no place in a performance bond claim, as they are the types of documents that would support a payment bond claim.

With respect to the request for a copy of "Stellar J's written notice to the Surety of Unison's default under the Material Contract, as that term is defined in the June 22, 2009 Supply Bond", this was not a legitimate request, and the term was not defined in the Supply Bond or elsewhere.

Surety adjusters and outside counsel alike are taught from their first day of training on performance **[*27]** bond claims handling that an obligee must first declare a default before the surety can be expected to respond favorably to an obligee's performance bond claim. The L & A Contracting Company v. Southern Concrete Services, Inc. [12] case and its progeny are regarded as gospel in surety company claims departments. Other surety claims handlers have run afoul of the minority jurisdiction holding in Colorado Structures, but few, if any, have been held accountable for their lack of understanding of the special rules in Washington. I personally learned about the Colorado Structures case a year or two after it was decided, and after first responding to a performance bond claim in Washington in a manner based upon my indoctrination of the L & A case and its progeny. Mistakes can and will happen, but it is how a surety responds after learning of its mistakes that can determine whether it has acted unfairly or deceptively in response to a claim.

Being a surety claims adjuster **[*28]** is admittedly a hard job. The adjuster typically works in a surety company that is authorized to write bonds in all states and territories, or at least a majority of them. As such, the adjuster may be a specialist with respect to the laws of the state where he or she resides, and the adjuster may be admitted to the bars of one or more states. However, the adjuster is frequently confronted with claims in states where the adjuster rarely sees claims, and, in this case, this was the first claim of any sort that Argonaut had received in the state of Washington.

When faced with a claim, a surety adjuster consults standard claims and legal reference materials. These include The Law of Performance Bonds, [13] with second edition in 2009. The reference give guidance on handling claims in Washington, and specifically mentions the Colorado Structures case. "In Colorado Structures the court expressly stated that L&A Contracting was 'wrongly decided' with respect to the default and notice of default as 'conditions' of the surety's liability. The Washington Supreme Court found

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[12] *17 F.3d 106 (5th Cir. 1994)*.

[13] The Law of Performance Bonds, American Bar Association (2009), pages 37-39.

that 'by the plain terms of the bond, the obligee was not required to formally declare the principal in default..." [14] **[*29]** "The court's reasoning in rejecting L&A Contracting is based upon the 'condition clause' of the performance bond and the use of the word 'otherwise' with that clause." [15]

Another resource that was available to Argonaut at the time was The Construction Law Handbook, [16] which contains a chapter on Performance Bonds authored by Roger P. Sauer, Esq., one of the most qualified surety attorneys in the country and, who, incidentally, is the attorney for Argonaut in this case. There were two other authors of the Performance Bond chapter. There is a 2013 Annual Update. I assisted attorney Sauer with that update.

The "Performance Bonds" chapter in **[*30]** The Construction Law Handbook makes reference to cases that do not require a declaration of default by the obligee to invoke performance bond coverage.

§ 34.04 [B] Declaration of Default

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§ 34.04 [B], last paragraph:

"The requirement for a formal declaration of default as a condition precedent for a suit against a surety, however, is not absolute. Rather, since a bond is a contract, courts that examine these issues start with the language in the bond. In a recent case, a court found that although an American Institute of Architects (ALA Doc. No. 311, Performance Bond), references a declaration of default, it does not require a formal declaration of default as a condition precedent to instituting legal action on the bond.[36]"

…

"In contrast to the foregoing, a late 2007 opinion by the Washington Supreme Court takes an approach to this issue that is basically unique in the reported case law.[41] The court essentially bifurcated the performance bond, an A311 form document, into two sections, one dealing with language of conditions, and the other dealing with language of promissory undertakings. Provisions in the bond calling for various steps to be **[*31]** taken in the event of default were deemed to be options that the obligee could pursue, but not such as to waive the prefactory condition of the bond remaining in force and effect unless the principal were to faithfully perform its obligations. Without declaring a default, the obligee "supplemented" the contractor's forces, and the court held the surety to be nonetheless liable for these charges."

"FN 36. *Walter Concrete Constr. Corp. v. Lederle Labs., 99 N.Y. 2d 603 (Ct. App. 2003)*. See also *Gloucester City Bd. Of Educ. V. American Arbitration Ass'n, 333 N. J. Super. 511 (App. Div. 2000)* (interpreting a New Jersey statutory bond required on public projects); *Colorado Structures, Inc. v. Insurance Co. of the West, 106 P.3d 815 (Wash. App.)*, cert. granted, *126 P.3d 1279 (2005)*."

…

"FN 41. *Colorado Structures, Inc. v. Insurance Co. of the West, 167 P.3d 1125 (Wash. 2007)*."

Comparison of Bond Forms -- West and Argonaut:

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[14] *167 P.3d at 1130*.

[15] See note 13, supra, at 37.

[16] Aspen Publishing (2009).

I have set forth verbatim, in the Attachment to this report, the texts of both the ICW and Argonaut bonds, plus the Argonaut Dual Obligee Rider. I have highlighted the use of the word **[*32]** "otherwise" in both bonds, plus the labels [A] -- [D] and drawn a bifurcation line between [B] and [C] of both bonds. The tri-partite relationship among obligee, surety and principal are identical, and would line up perfectly if graphical transparency overlays were used as an exhibit. Of course, both bonds involve an owner and a project, and those labels have been included in the diagrams at Figures 1 and 3.

I have set forth both bonds the way the Colorado Structures Court did, and the way Stellar J Court is likely to do. I have made some observations in the footnotes to the texts of those bonds. The Attachment to this report also contains some verbatim language of the Argonaut General Indemnity Agreement which I find helpful to the analysis of the Argonaut response to the Stellar J performance bond claim.

Neither Jaime Perkins nor Vince Miseo testified in their depositions that they consulted any particular treaties, hornbooks, or manuals for guidance. Although not specifically asked, they did not mention referring to either The Law of Performance Bonds or The Construction Law Handbook.. There was testimony that Argonaut's Surety Claims Department learned of the case of **[*33]** Colorado Structures through a communication from one of the surety law firms on the West Coast at about the time of the Stellar J claim. Although there was some guidance on the issue if one were to consult The Law of Performance Bonds and / or The Construction Law Handbook, I personally am not critical of Argonaut for not knowing about the Colorado Structures case in the initial stages of its claims handling.

The standard reference materials mentioned above do not contain references to the Washington Administrative Code ("WAC"), the Washington Insurance Fair Conduct Act ("WIFCA" or "IFCA"), or the claims handling statutes or acts in other states. Both Mr. Miseo and Ms. Perkins are licensed adjusters in the State of Texas, where they would be required to have a good understanding of the Texas Unfair Claims Settlement Practices Act, the Texas Deceptive Trade Practices Act, and the Texas Insurance Code in general. They would not be expected to be intimately familiar with the insurance statutes of the other states, with the possible exception of California, which, until Colorado Structures, was universally regarded as the state to watch, because of its comprehensive laws that served as **[*34]** a yardstick for behavior in all other states.

In their depositions, Vince Miseo and Jamie Perkins both state that they consulted the Washington Administrative Code "(WAC") and the Washington Insurance Fair Conduct Act ("WIFCA" or "IFCA") early on and as a normal course of responding to the claim. Mr. Miseo first became aware of these laws "At the inception of when we received notice from Mr. Kinghorn." (Miseo 69:18). This research was done online (Miseo 70:14). This is interesting because, although the WACs apply to all claims, including third party claims, the Washington Insurance Fair Conduct Act ("WIFCA") only apply to first party claims, not third party claims such as payment bond claimants. From a review of the Claim File, it appears Argonaut was of the opinion it was acknowledging a payment bond claim.

May 10, 2012 E-mail From Agent Jack Anderson re April 30, 2012 Letter From Unison's Attorney:

From my review, it is clear that Argonaut review the April 30, 2012 letter from attorney McCardell. Argonaut's comments to the letter were solicited by Mr. McCardell. Moreover, as evidenced by Jack Anderson's May 10, 2012 e-mail, Argonaut was waiting for this important letter to **[*35]** confirm a decision whether to continue with its demand for the $ 500,000 ILOC collateral.

The May 31, 2012 Memo from Jaime Perkins to Vince Miseo:

The May 31, 2012 Memo from Jaime Perkins to Vince Miseo [17] evidences a claim posture begging for investigation, but ends in a denial eighteen (18) days later based upon "insufficient information".

The memo states on page 2, "There was no formal notice of default or termination of Unison." The section commenting upon Unison's attorneys' April 30, 2012 letter contains four bullet points, as follows:

➢ "Unison's response dealt mostly with items not relative to Argo Surety

➢ "The only items relating to the bond claim were (a) that the bond only covered the Purchase Order and (b) that it was untimely.

➢ Unison asserts that it provided all items contained in the 5/18/12 purchase order as was later modified by the 7/10/09 purchase order. Unison also confirms AFT's approval of the delivery and Unison's **[*36]** performance was 'excellent,', as of April 2012.

➢ Unison also asserts that Stellar J's bond claim is time barred because the claim was due no later than January 19, 2011. Yet, Stellar J Waited over a year and gave notice of its claim on March 26, 202. Therefore, according to Unison, the bond claim is lime barred.

That is a lot of information from the April 30, 2012 McCardell letter. Ms. Perkins stated in her deposition that she did not read this letter.

Also on page 2 of the Perkins' Memo, she comments upon "Argo's investigation. This consists of one bullet point, as follows:

➢ "Argo has sent correspondence to both Stellar J and Unison soliciting facts, information and any supporting documents to support the respective positions. After over 2 months, Argo has obtained voluminous documents and information from Stellar J and Unison. Currently, it has been a month since any new information has been forthcoming. Currently, this claim is ripe for determination as the result of no new information or supporting documentation."

This comment simply mentions the voluminous documents received and correspondence sent as part of an administrative function. There was no **[*37]** "adjusting" or "analysis" involved in this. This status statement of Argonaut's investigation represents no representation whatsoever. This is contrasted with the heavy reliance upon the four bullet points of the McCardell letter on behalf of Unison, where Perkins is relying heavily on the firming up of defensive issues such as the statute of limitations defense. Two of the four bullet points mention the timing of the claim. One bullet point commented upon Unison's assertion that it provided all items contained in the applicable purchase order and repeated the self-serving AFT statement that Unison's work was "excellent".

Later in Perkins' memo, page 2, she acknowledges that "(t)he most significant issue that has come up for all 3 of Stellar J's claims is that there is a material fact question that looms...There is a material fact as to whether Unison supplied all materials according to the purchase orders. Based on this, Argo must deny the claim because we are not in a position to be a determiner of fact."

On page 3 of her memo, she goes so far as to appreciate that "...there is an issue as to whether any of these claims are latent defect type claims." Also, "..in Stellar J's executed **[*38]** proof of claim, they state that the last material and/or labor supplied was 11/14/2011. I am not sure what they are referring to but if it is materials last delivered, that could be an issue. Before we deny on this basis, it may be worthy of requesting more information on this issue from Stellar J. to be absolutely certain."

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[17] Bates AIC 006894-006896.

The next paragraph references that "...there is no notice of default or termination anywhere in the provided information and documentation". Also, "As far as I can see in the provided documentation, Unison has never been formally defaulted or terminated. Again, before we deny on this basis, it may by [be] worthy of requesting more information on this issue from Stellar J to be absolutely certain."

"The admitted existence of "material facts" does not equate to "insufficient information". There was a material fact whether Unison supplied all materials according to the purchase orders. That is something to investigate, not something to call "insufficient information".

The statement, "Based on this, Argo must deny the claim because we are not in a position to be a determiner of fact," is odd and not true. Argonaut is not forced to deny a claim. There is no "must" **[*39]** about it. There are several options for a surety, that have already been mentioned in this report. One can inform a claimant that an investigation has been completed, if that is honest and true, and that the surety cannot determine if the obligee is right or the principal is right. In such a case, the parties should resort to the help of a fact finder, and seek guidance from their dispute resolution clauses, if any, in there agreements. Here, there do not appear to have been such clauses, so Argonaut could not point to a contract clause, but could point the parties in the direction of a mediator, arbitrator or court of competent jurisdiction (the Court where the matter is now).

Perkins made reference to possible latent conditions and the fact she wasn't sure what Stellar J was referring to with respect to when items were last delivered. These are the types of questions that drive honest investigations; not the types of problems that get ignored in favor of determining one has "insufficient information".

There is mention of possibly denying the claim because of all of these unsolved questions that were not investigated -- but rather only noted. There is even mention of possibly denying **[*40]** the claim because there was no proof of a written notice of default. In light of this "smoking gun" memo, Argonaut cannot hide its true motivations for the denial. Argonaut can spin the denial letter as being based upon "insufficient information", but the obvious justifications were that Argonaut was convinced that the statute of limitations had run and it could defend on the basis that there was no written notice of default.

The June 18, 2012 Denial Letter:

As the Proof of Claim was received by Argonaut on April 10, 2012, [18] the claim decision was due May 9, 2012. It was given late on June 18, 2012. It stated as follows:

"Dear Mr. Kinghorn.

"As you will recall, Argonaut Insurance Company ('Argo' or the 'Surety') received your company's supporting documents and acknowledged same by way of letter dated May 1, 2012, a copy of which is attached. As you will further recall, the aforementioned May 1 letter advised you that we were in the process of investigating your **[*41]** company's claim and should we determine in the course of our investigation that we needed additional information from you, we would advise you.

"In performing our independent investigation, we determined that we needed additional information. As such, we sent you a letter dated June 1, 2012, a copy of which is attached, whereby we requested the following:

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[18] Bates AIC 003710-003711.

"1. Written evidence (delivery ticket(s), labor time cards, service ticket(s), etc.) supporting the verified statement contained in Stellar J's executed Proof of Claim that the date labor ended or materials last supplied (not including warranty period) was November 14, 2011; and

"2. A copy of Stellar J's written notice to the Surety of Unison's default under the Material Contract, as that term is defined in the June 22, 2009 Supply Bond."

"We requested that you provide Argo with this information on or before June 8, 2012. To date, we have not received this important information,

"As a result, based upon our independent review of all of the documents made available to us. Argo has determined that there is insufficient information to determine the validity of Stellar J's bond claim. Therefore, Argo must respectfully **[*42]** deny Stellar J's payment bond claim.

"If you intend to proceed with this matter, it is requested that you provide documentation not previously submitted that may warrant the Surety's further consideration of this claim. Please forward them to the attention of the undersigned."

The last paragraph is a standard disclaimer paragraph.

There was no mention of being beyond 30 days to provide a response from the time of receipt of the Proof of Loss, and there was no apology. There is no claim number.

This fourth letter, dated June 18, 2012, continued to treat the performance bond claim as a payment bond claim and regurgitated the position that Argonaut was entitled to a written notice of default, despite not being entitled to insist upon that pursuant to applicable law.

The statement "[u]pon our independent review of all the documents provided to us, Argo has determined that there is insufficient information to determine the validity of the bond claim," does not make sense under the circumstances. There was no review other than to receive and pass on the April 30, 2012 letter from Unison's counsel. There was no conscientious effort to correct the misstatements in Unison's counsel's **[*43]** letter regarding the existence of a contract between Unison and Stellar J, to or disclaim any intent to file a claim by Argonaut against Stellar.

There were "voluminous documents" as represented in the Memo from Jaime Perkins to Vince Miseo. According to Jaime Perkins April 25, 2012 e-mail to Bill McCardell, "...at this point, we have received 5 different packages with correspondence and voluminous documents from Stellar J. However, we have not yet received a formal written response from Unison as to any of these claims. We are looking forward to receiving a (sic) this written response, which we hope will be forthcoming." Elsewhere, as referenced by the underwriters, the quantify of documents received by Argonaut was "twice the size of the Bible". Argonaut did not ask specific questions about the materials supplied by Unison to the project, so as to overcome any supposed lack of information. The statement that "[t]herefore, Argo must respectfully deny Stellar J's payment bond claim" makes no sense under the circumstances. There is no requirement that Argo "must" deny any claim. It can honor a questionable performance bond claim. It has this right in its GIA, and is required to by **[*44]** law, to honor a claim when liability has become reasonably clear. It can seek additional information, where warranted, in lieu of denying a claim. It can state that, unless additional information is received, where warranted, it may deny a claim. It can also retract a denial that was made in haste or in bad judgment, or otherwise. It could have sought a declaratory judgment, paid money into the registry of the court, or sought an independent, objective legal opinion from qualified surety counsel in Washington.

The reference to "payment bond claim" is incorrect and should have been corrected with A follow-up letter.

In her deposition, Ms. Perkins insisted that Argonaut denied the claim, for "lack of information" (Perkins depo 64:14). In their deposition, both Ms. Perkins and Mr. Miseo admitted that what they had really been waiting for was the written notice of default (Perkins 192:9) and (Miseo at 67:5-12). The line of questioning in Vincent Miseo's deposition was as follows:

Q: Why did you deny the claim?

A. Insufficient information.

Q. What insufficient information?

A. It's outlined by Ms. Perkins twice.

Q. Tell me what sufficient information would have **[*45]** been.

A. Any kind of written notice that Stellar J. had declared Unison in default, something as simple as that.

This admission that "sufficient information" would have been as simple as a "written notice that Stellar J. had declared Unison in default" belies any argument from Argonaut that the denial was based upon "lack of information". Argonaut put false hope in a search for a written document that would do it no good, and which put it off the correct course of investigating a claim rather than posturing for the defense of a claim. Argonaut outsmarted itself, and boxed itself into a corner. It had spent its time protecting itself under its rights in its GIA with its indemnitors and huddling with its principal's counsel. Up against a deadline to provide a response to a claim, and without having conducted a true investigation of the claim, it crafted a denial letter based upon the thinly disguised reed of "insufficient information."

When Argonaut realized that it cannot demand such a written notice of default under the Colorado Structures case, it could have changed its position and put a genuine investigation into place. Instead, it dug in, compounding its problems, and leading **[*46]** to a situation exposing it to damages for WIFCA and WAC violations.

Parallels Between the Colorado Structures Case and the Stellar J Case:

1. Argonaut's Focus was Protecting Its Self-interest Under the Indemnity Agreement

Argonaut's (a) early focus on protecting its self-interest vis-à-vis its indemnitors, and (b) lack of investigation of the performance bond claim, are two of many parallels with the Colorado Structures case. From my review, the first two letters in the Argonaut Claims File were the March 29, 2012 claim acknowledgment letter and March 29, 2012 letter to the attorneys for Unison. [19] The March 29, 2012 letter to Unison is curious, because it makes reference to letters dated April 12, 2012 and April 14, 2012. I am not sure what to make of that, but the paradox should be evident to any reviewer of the file.

[*47]

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[19] Bates AIC 007253. "Mr. McCardell: Please be advised that Argo Surety, the surety for your client has now received 5 sets of documents with correspondence from Stellar J dated March 26, April 12 and April 14, 2012. It is also my understanding that at this time, you have received copies of all of these. However, if I am mistaken and you are not in receipt of these, please let me know and I will provide these to you. I have requested Stellar J respond to your letter. A copy of our letter is enclosed. Presuming I receive their response, I will for (sic) it to your attention for reply. Very truly yours, Jaime Perkins".

The next two letters, dated April 2, 2012 and April 3, 2012, were to the indemnitors, demanding collateral. In Colorado Structures, the Court was critical of West because, rather than investigate the claim, one of the first things West did was to obtain a judgment against its indemnitors "for an amount that included potential payment to Structures on the performance bond." [20]

Like ICW who did not send an adjuster or other representative to Vancouver, WA to investigate in the Colorado Structures, [21] case, Argonaut did not send any adjuster or other representative to meet with Stellar J or to inspect the project in Roosevelt, WA.

[*48]

2. Argonaut Insisted That Obligee Stellar J Provide Written Notice of Default

Vince Miseo testified that, despite insisting that the reason for the denial of the claim was "insufficient information", the reason for the denial included the lack of proof of a written notice of default (Miseo deposition, 67:5-12).

Even in a case in a different state, where declaration of default is required according to case law, when a surety tenders to an obligee a Proof of Claim form, there is a question in my mind whether a surety should not also insist upon a declaration of default. [22]

Also, from a tactical perspective, some surety companies learned not to send a Proof of Loss or Proof of Claim form, even to payment bond claimants, in one state. Under old Texas law, a payment bond claimant was required to send a "Sworn Statement of Account" with a notice of claim, lest it fail to properly perfect a claim, and **[*49]** hand the surety a reason to deny the payment bond claim. Adjusters learned it would backfire on them to send a Proof of Loss form to those claimants, because the claimants could and would argue that the Sworn Statement of Account requirement was waived by the surety curing that defect for them. An experienced adjuster handling Texas payment bond claims would be sensitive to the sending of a Proof of Loss form to any claimant, whether a first party obligee or a third party payment bond claimant. This raises some question whether a surety would ever send a Proof of Loss form to an obligee, even on a case-by-case basis, and even if the Proof of Loss did not specifically inquire about the facts of any alleged "default".

The gravamen of the Colorado Structures case was that West insisted it had no liability under the performance bond without its principal first being declared in default. West was wrong. Argonaut is also wrong. The parallel between the Colorado Structures case and the Stellar J case, is clear.

3. Argonaut, Like West, Did Not Have Appropriate Procedures in Place For the Prompt and Fair Investigation of a Performance Bond Claim in the State of Washington

A. Argonaut Did **[*50]** Not Have Appropriate Claim Forms

A performance bond acknowledgment letter contains a list of contract documents that a surety would like to review. It does not ask the obligee to complete and return a proof of loss form. A surety claims

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[20] Colorado Structures, at 585.

[21] Colorado Structures, at 583 ("...Structures asked West's surety manager to attend an on-site meeting in an attempt to discuss Action's difficulties and Structures' supplementation of Action's crews. However, despite Structures' multiple please to the bonding company, West refused to send a representative to visit the site and discuss the situation. West refused to participate in discussions regarding Action's performance or to comment on Structures' chosen remedy. Structures continued to supplement Action's crews to minimize cost and delay and complete the project on time").

[22] The attorneys for Stellar J also commented upon this in the First Amended Complaint, page 13, line 16.

department typically has appropriate follow up letters to send to an obligee claimant, and none of those ask for documents that only relate to payment bond claims.

B. Argonaut Did Not Have A Proper Procedure to Investigate This Performance Bond Claim

This was Argonaut's first surety claim in Washington. It was the front-line adjuster's first performance bond claim to handle without shadowing another adjuster. Argonaut handled the claim to some extent as it would handle a claim outside of Washington. In other ways, it didn't handle the claim in any standard manner. The claim was too urgent and complicated to handle by "telephone adjusting" or "paper pushing". Rather than administration, the claim required a "boots on the ground" investigation, with experienced technical people to size up the exposure, confirm claim exposure, and advise Argonaut on how to fairly resolve the claim. Argonaut's procedures either included such practices and they **[*51]** weren't followed, or such practices are not part of Argonaut's procedures, and should be. After this case, these will likely be Argonaut's procedures and practices in Washington.

4. As In Colorado Structures, Stellar J Chose to Supplement Rather Than Terminate

Both cases refer to obligee's interest in supplementing rather than default terminating, because of the lost productivity from a default shut down; the desire to mitigate liquidated damages; and the desire to maximize overall efficiency and profit on a troubled job. As stated by Judge Leighton in his Order on Defendant's Motion For Summary Judgment, "The project did not go as planned, and Unison ended up walking away without performing" [Order, page 1]. Default terminating can be an unnecessarily legally complicated procedure, and is not as efficient as supplementing on a time-sensitive project. This interest of the obligees tracks clearly through both the Colorado Structures and Stellar J cases.

5. Like the Performance Bond in Colorado Structures, The Performance Bond in Stellar J Has the Word "Otherwise" in the Condition Paragraph

The Colorado Structures Court found that use of the word "otherwise" in the condition paragraph **[*52]** evidenced that the bond only had one condition. This is set out in the Attachment to this report.

There are the above parallels between the Colorado Structures and Stellar J cases, and there is the one irrelevant difference. The Stellar J case involves a Dual Obligee Rider. As an Additional Obligee, Stellar J has a direct right against Argonaut, without resort to any argument that it is a beneficiary of one type of another. More importantly, there are serious difference in the two cases. In the Stellar J case, Argonaut has much more at stake than faced by West in Colorado Structures. Not only is Argonaut's performance bond penal sum much larger than that of West in the Colorado Structures case, but in addition to exposure for Olympic Steam Ship damages, as in Colorado Structures, Argonaut faces a plaintiff obligee that is "seeking it all" -- by leveraging the Colorado Structures case to ask for something not sought in that case -- i.e., treble damages under WIFCA.

Based upon the foregoing background, observations and arguments, it is fair to conclude that Argonaut has some exposure under WIFCA and the WACs. A review of those, with comments, follows:

RCW 48.30.015 Unreasonable **[*53]** denial of a claim for coverage or payment of benefits.

(1) Any first party claimant [Stellar J] to a policy of insurance [performance bond] who is unreasonably denied a claim for coverage or payment of benefits by an insurer [surety] may bring an action in the superior court of this state to recover the actual damages sustained, together with the costs of the action, including reasonable attorneys' fees and litigation costs, as set forth in subsection (3) of this section.

Argonaut's insistence upon being provided by Stellar J with a written notice of default before there could be a finding of liability on the bond was an unreasonable denial of a claim for coverage or payment of benefits under the bond. The Memo dated May 31, 2012, along with the deposition testimony of the Argonaut claims adjusters, prove the true reasons for the denial were a belief that the statute of limitations had run and a written notice of default was a condition precedent to bond coverage. Argonaut did not feel comfortable admitting that these were its reasons for denial, and instead used the justification of "insufficient information".

(2) The superior court may, after finding that an **[*54]** insurer [surety] has acted unreasonably in denying a claim for coverage or payment of benefits or has violated a rule in subsection (5) of this section, increase the total award of damages to an amount not to exceed three times the actual damages.

This is for the Court to decide, but it is clear there is sufficient evidence to support treble damages.

(3) The superior court shall, after a finding of unreasonable denial of a claim for coverage or payment of benefits, or after a finding of a violation of a rule in subsection (5) of this section, award reasonable attorneys' fees and actual and statutory litigation costs, including expert witness fees, to the first party claimant [Stellar J] of an insurance [surety] contract who is the prevailing party in such an action.

This is for the Court to decide, but it is clear there is sufficient evidence to support an award of reasonable attorneys' fees and actual and statutory litigation costs, including expert fees, to Stellar J.

(4) "First party claimant" means an individual, corporation, association, partnership, or other legal entity asserting a right to payment as a covered person under an insurance policy or insurance **[*55]** contract [surety bond] arising out of the occurrence of the contingency [failure of Unison to perform] or loss covered by such a policy or contract.

Stellar J, as an obligee, is a first party claimant. The parties do not dispute this. Failure of Unison to faithfully perform is the occurrence of the contingency, a condition subsequent in the bond.

(5) A violation of any of the following is a violation for the purposes of subsections (2) and (3) of this section:

(a) WAC 284-30-330, captioned "specific unfair claims settlement practices defined";

(1) Misrepresenting pertinent facts or insurance policy [bond] provisions

Argonaut misrepresented that the term "default" was defined in the bond when there is no such definition in the bond. This was arguably the result of intentional misrepresentation and not a failure to simply read the full bond, as this was a representation of what the bond said, as opposed to overlooking something really contained in the bond.

Argonaut misrepresented that a written notice of default was necessary before there could be coverage under the bond. This was a misstatement of law and fact Argonaut did not disclaim adoption of **[*56]** Unison's position that there was no contract between Unison and Stellar J. Failure to disclaim is arguably an adoption, and the statement by Unison was a misrepresentation of fact. The arguable adoption of the statement by Argonaut was also a misrepresentation of pertinent fact.

(2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies [bonds]

Argonaut promptly acknowledged the first notice of claim, but failed to Promptly acknowledge additional notices of claim, and then attempted to Excuse that failure by referring to all claims as being one under the label "multi-part claim"

Argonaut failed to provide its claims decision within the statutory time [23] from receipt of the completed Proof of Loss from Stellar J, and had not requested an extension of time.

[*57]

(3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies [bonds]

Argonaut did not have reasonable standards for the prompt investigation of the Stellar J performance bond claim. Rather than conducting a fair investigation, it pushed papers in an administrative fashion, relied upon information from its indemnitors without verification; and relied upon its preliminary analyses of hopeful dispositive surety defenses. It did not obtain an objective legal opinion regarding its defenses, such as statute of limitations, and its reliance upon a limitations period in its bond that was impermissible and void under Washington law.

(4) Refusing to pay claims without conducting a reasonable investigation

Argonaut refused to pay Stellar J or reimburse Stellar J for its costs in supplementing Unison's Materials Contract and/or correcting defective materials supplied by Unison. Argonaut did not conduct a reasonable investigation of the Stellar J performance bond claim. Rather than conducting a reasonable investigation, processed the claim in an administrative fashion, relied upon information from its indemnitors **[*58]** without verification; and relied upon its preliminary analyses of hopeful dispositive surety defenses. It did not obtain an objective legal opinion regarding its defenses, such as statute of limitations, and its reliance upon a limitations period in its bond that was impermissible and void under Washington law.

(5) Failing to affirm or deny coverage of claims within a reasonable time after fully completed proof of loss documentation has been submitted

The claim decision was given more than the statutory number of working days [24] after the completed proof of loss documentation was received. There was no request for an extension.(6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonable clear

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[23] § 284-30-380. Settlement standards applicable to all insurers

(1) Within fifteen working days after receipt by the insurer of fully completed and executed proofs of loss, the insurer must notify the first party claimant whether the claim has been accepted or denied. The insurer must not deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference to the specific provision, condition, or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer must contain a copy of the denial.

(3) If the insurer needs more time to determine whether a first party claim should be accepted or denied, it must notify the first party claimant within fifteen working days after receipt of the proofs of loss giving the reasons more time is needed. If after that time the investigation remains incomplete, the insurer must notify the first party claimant in writing stating the reason or reasons additional time is needed for investigation. This notification must be sent within forty-five days after the date of the initial notification and, if needed, additional notice must be provided every thirty days after that date explaining why the claim remains unresolved.

[24] See note 23, supra.

Argonaut attempted to rely upon limitations language in its bond that was impermissible and void under Washington law. Argonaut relied upon its early analysis of the claim without investigation, and **[*59]** had convinced itself that it could prevail on the void limitations clause and insistence upon a written default notice, despite Washington law forbidding a surety from demanding such a document in the analysis and adjustment of the bond claim. Despite having accumulated what it described as "voluminous documentation", and without revealing its true motivations for not paying the claim, Argonaut chose to deny the claim on the basis of "insufficient information". In depositions, its claims adjusters admitted that "sufficient information" would have been satisfied by the very written notice of default that Washington case law says a surety cannot demand of an obligee claimant on a performance bond.

11. Delaying the investigation or payment of claims by requiring a first party claimant [bond obligee] or his or her physician to submit a preliminary claim report and then requiring subsequent submissions which contain substantially the same information

Argonaut was not satisfied with the "voluminous documentation" it had received directly from obligee first party claimant Stellar J. Rather than accept the fact that it had substantial claim documentation suitable for purposes of **[*60]** advancing a fair and reasonable investigation of the performance bond claim, Argonaut chose instead to act in an administrative, paper-pushing exercise, repeatedly asking Stellar J to confirm this was all the information, to confirm information that was not relevant to the claim; to confirm information that related to a payment bond claim when what was presented was a performance bond claim; and to have the bonded principal confirm what the obligee claimed and then ask the obligee to confirm what the principal claimed. All of this was a waste of time and poor substitute for a surety investigation of relevant issues; all at a time of urgency when obligee was trying to mitigate the liquidated damages being charged against it by the owner on the project.

(13) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement

There was no offer of a compromise settlement.

The explanation for the denial of the claim was not reasonable. The stated reason was "insufficient information". The true fact was there was "voluminous documentation" and **[*61]** what was insufficient was the nature of the surety's investigation. The basis the surety had developed behind the scenes, early on in the claim process, was that the statute of limitations had expired and a written notice of default had to be presented to the surety before there was any coverage on the bond. The limitations in the bond was determined by the Court to be impermissible and void under Washington law. The case of Colorado Structures cited frequently in this report states that a surety cannot demand a written notice of default before finding coverage on the bond. Rather than stating its true reasons for denying the claim (both reasons would have been unreasonable), Argonaut fashioned a different, but equally unreasonable explanation, i.e., "insufficient information". Argonaut had all the sufficient information it needed just below its nose had it care to use it as a reasonable starting point for sending qualified personnel to the project site in Roosevelt, Washington, to conduct a "boots on the ground" reasonable and fair surety claim investigation;

(b) WAC 284-30-350, captioned "misrepresentation of policy [bond] provisions";

(c) WAC 284-30-360, captioned "failure **[*62]** to acknowledge pertinent communications";

(d) WAC 284-30-370, captioned "standards for prompt investigation of claims";

(e) WAC 284-30-380, captioned "standards for prompt, fair and equitable settlements applicable to all insurers" [sureties]; or

§ 284-30-380. Settlement standards applicable to all insurers

(1) Within fifteen working days after receipt by the insurer of fully completed and executed proofs of loss, the insurer must notify the first party claimant whether the claim has been accepted or denied. The insurer must not deny a claim on the grounds of a specific policy provision, condition, or exclusion unless reference to the specific provision, condition, or exclusion is included in the denial. The denial must be given to the claimant in writing and the claim file of the insurer must contain a copy of the denial.

(2) If a claim is denied for reasons other than those described in subsection (1) and is made by any other means than in writing, an appropriate notation must be made in the claim file of the insurer describing how, when, and to whom the notice was made.

(3) If the insurer needs more time to determine whether a first party claim should **[*63]** be accepted or denied, it must notify the first party claimant within fifteen working days after receipt of the proofs of loss giving the reasons more time is needed. If after that time the investigation remains incomplete, the insurer must notify the first party claimant in writing stating the reason or reasons additional time is needed for investigation. This notification must be sent within forty-five days after the date of the initial notification and, if needed, additional notice must be provided every thirty days after that date explaining why the claim remains unresolved.

(4) Insurers must not fail to settle first party claims on the basis that responsibility for payment should be assumed by others except as may otherwise be provided by policy provisions.

(5) Insurers must not continue negotiations for settlement of a claim directly with a claimant who is neither an attorney nor represented by an attorney until the claimant's rights may be affected by a statute of limitations or a policy or contract time limit, without giving the claimant written notice that the time limit may be expiring and may affect the claimant's rights. This notice must be given to first party **[*64]** claimants thirty days and to third party claimants sixty days before the date on which any time limit may expire.

(6) The insurer must not make statements which indicate that the rights of a third party claimant may be impaired if a form or release is not completed within a specified period of time unless the statement is given for the purpose of notifying the third party claimant of the provision of a statute of limitations.

(7) Insurers are responsible for the accuracy of evaluations to determine actual cash value.

Note: Statutory Authority: RCW 48.02.060 and 48.30.010. 09-11-129 (Matter No. R 2007-08), § 284-30-380, filed 5/20/09, effective 8/21/09; 78-08-082 (Order R 78-3), § 284-30-380, filed 7/27/78, effective 9/1/78.

(f) An unfair claims settlement practice rule adopted under RCW 48.30.010 by the insurance commissioner intending to implement this section. The rule must be codified in chapter 284-30 of the Washington Administrative Code.

(6) This section does not limit a court's existing ability to make any other determination regarding an action for an unfair or deceptive practice of an insurer [surety] or provide for any other remedy that is available **[*65]** at law.

…

[2007 c 498 § 3 (Referendum Measure No. 67, approved November 6, 2007).] Notes: Short title -- 2007 c 498: "This act may be known and cited as the insurance fair conduct act." [2007 c 498 § 1.]

RCW 48.30.010 Unfair practices in general -- Remedies and penalties.

(1) No person engaged in the business of insurance shall engage in unfair methods of competition or in unfair or deceptive acts or practices in the conduct of such business as such methods, acts, or practices are defined pursuant to subsection (2) of this section.

(2) In addition to such unfair methods and unfair or deceptive acts or practices as are expressly defined and prohibited by this code, the commissioner may from time to time by regulation promulgated pursuant to chapter 34.05 RCW, define other methods of competition and other acts and practices in the conduct of such business reasonably found by the commissioner to be unfair or deceptive after a review of all comments received during the notice and comment rule-making period.

(3)(a) In defining other methods of competition and other acts and practices in the conduct of such business to be unfair or deceptive, and after **[*66]** reviewing all comments and documents received during the notice and comment rule-making period, the commissioner shall identify his or her reasons for defining the method of competition or other act or practice in the conduct of insurance to be unfair or deceptive and shall include a statement outlining these reasons as part of the adopted rule.

(b) The commissioner shall include a detailed description of facts upon which he or she relied and of facts upon which he or she failed to rely, in defining the method of competition or other act or practice in the conduct of insurance to be unfair or deceptive, in the concise explanatory statement prepared under RCW 34.05.325 (6).

(c) Upon appeal the superior court shall review the findings of fact upon which the regulation is based de novo on the record.

(4) No such regulation shall be made effective prior to the expiration of thirty days after the date of the order by which it is promulgated.

(5) If the commissioner has cause to believe that any person is violating any such regulation, the commissioner may order such person to cease and desist therefrom. The commissioner shall deliver such order to such person direct **[*67]** or mail it to the person by registered mail with return receipt requested. If the person violates the order after expiration of ten days after the cease and desist order has been received by him or her, he or she may be fined by the commissioner a sum not to exceed two hundred and fifty dollars for each violation committed thereafter.

(6) If any such regulation is violated, the commissioner may take such other or additional action as is permitted under the insurance code for violation of a regulation.

(7) An insurer engaged in the business of insurance may not unreasonably deny a claim for coverage or payment of benefits to any first party claimant. "First party claimant" has the same meaning as in RCW 48.30.015.

Conclusions:

Argonaut did not have systems, procedures, practices or proper forms in place to properly acknowledge and investigate a performance bond claim in the state of Washington.

Argonaut should not have sent a denial letter for any reason. "Lack of information" is not a reason to deny a claim. Where it is true that a surety needs more information or documentation, then that is a reason to send a letter either stating that the file will be put in a pending **[*68]** status until more information is received, or a letter stating that, if more information is not received be a specific date, the

surety might deny the claim for failure to maintain the claim or because it appears it may have been abandoned.

From my review of the materials, it appears Argonaut had all the information it needed and should not have been asking for more information. This is typically how a claims handler responds when he or she either (a) does not have time to look at a file, (b) mistakenly does not think the file contains what it should, or (c) does not want to look at a particular claim file, based upon laziness or improper analysis leading to a conclusion that it is not ready for review.

From my review of the Perkins and Miseo depositions, it appears the "big elephant in the room" reason for denial was a misplaced assumption that Stellar needed to issue a declaration of default and the statute of limitations defense was not thoughtfully considered, yet relied upon. The limitations stated in the performance bond is impermissible and void under Washington law, as confirmed by the Court hearing this case.

Argonaut can still retract its denial letter. Nothing required **[*69]** that Argonaut "must" have denied the claim. Nothing prevents a surety that has made a mistake on a coverage issue from learning from that mistake and correcting its course of action. Argonaut has had its education. It has learned Washington surety law is different, and that it needs to abandon the idea that coverage under the bond requires Stellar J to provide written notice of default.

Stellar provided any required notices, through claims correspondence and in its pleadings. It complied with the request that it complete a Proof of Loss form. It does not have additional hurdles such as the notice of default Argonaut insists upon.

Respectfully submitted,

Gregory S. Arnold
Surety Claims Expert
327 S.E. 1st St., # 102
Pendleton, OR 97801
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Appendix

[SEE ATTACHMENT A STELLAR J CORPORATION EXPERT REPORT IN ORIGINAL]

Attachment A

Stellar J Corporation Expert Report

Figure 1

Tri-Partite Relationship of the ICW Performance Bond

Colorado Structures, Inc. v. Insurance Company of the West*, aka *CSI v. ICW* or *CSI v. West

OBLIGEE
Colorado Structures, Inc. ("CSI" or "Structures")

OWNER –
Wal*Mart Stores

PROJECT – Wal*Mart Store,
Vancouver, WA
$472,290

SURETY
Insurance Co. of
The West
("ICW" or "West")

PRINCIPAL
Action Excavating and
Paving, Inc.
(sewer subcontractor)

Attachment A

Stellar J Corporation Expert Report

Figure 2

West's Bond Language:[1]

[A] Action Excavating & Paving, Inc…, hereinafter called Principal, and Insurance Company of the West…, hereinafter called Surety, are held and firmly bound unto CSI Construction Co…, hereinafter called Obligee, in the amount of…$472,290…

[B] WHEREAS, Principal has…entered into a subcontract with Obligee…, which subcontract is by reference made a part hereof, and is hereinafter referred to as the subcontract, NOW

THEREFORE, THE CONDITION OF THIS OBLIGATION IS SUCH THAT, if Principal shall promptly and faithfully perform said subcontract, then this obligation shall be null and void; otherwise it shall remain in full force and effect.

--------Bifurcation of Bond by the Court. Above "Supplement", Below Default Terminate---------

[C] Whenever Principal shall be, and declared by Obligee to be in default under the subcontract, the Obligee having performed Obligee's obligations thereunder:

(1) Surety may promptly remedy the default, subject to the provisions of paragraph 3 herein, or;

(2) Obligee after reasonable notice to Surety may, or Surety upon demand of Obligee may arrange for the performance of Principal's obligation under the subcontract subject to the provisions of paragraph 3 herein;

(3) The balance of the subcontract price, as defined below, shall be credited against the reasonable cost of completing performance of the subcontract. If completed by the Obligee, and the reasonable cost exceeds the balance of the subcontract price, the Surety shall pay to the Obligee such excess, but in no event shall the aggregate liability of the Surety exceed the amount of this bond. If the Surety arranges completion or remedies the default, that portion of the balance of the subcontract price as may be required to complete the subcontract or remedy the default and to reimburse the Surety for its outlays shall be paid to the Surety at the times and in

[1] Yellow highlighting, [A] – [D], and yellow break line, by virtue of the Court's analysis of this bond form.

the manner as said sums would have been payable to Principal had there been no default under the subcontract. The term "balance of the subcontract price," as used in this paragraph, shall mean the total amount payable by Obligee to Principal under the subcontract and any amendments thereto, less the amounts heretofore properly paid by Obligee under the subcontract.

[D] Any suit under this bond must be instituted Before the expiration of two (2) years from date on which final payment under the subcontract falls due.

Attachment A

Stellar J Corporation Expert Report

Figure 3

Tri-Partite Relationship of the Argo Performance Bond is Identical to that in the *Colorado Structures* Case

DUAL OBLIGEES
Applied Filter Technology, Inc. ("AFT") – Primary Obligee
Stellar J Corporation ("Stellar") – Additional Obligee

OWNER –
Klickitat County PUD

PROJECT –
Construction of Inlet
Blower Package to Klickitat
PUD, H.W. Hill Landfill Gas Expansion,
Roosevelt, WA

May 18, 2009 - $3,671,113.00 then
Modified by July 10, 2009 - $3,520,322.00

SURETY
Argonaut Insurance
aka Argo

PRINCIPAL
Unison
Solutions, Inc.

Attachment A

Stellar J Corporation Expert Report

Figure 4

Argonaut's Bond Language:[2]

[A] KNOW ALL MEN BY THESE PRESENTS; That Unison Solutions, Inc., 5451 Chavanelle Road, Dubuque, IA 52002, called the Principal, and Argonaut Insurance Company, an Illinois corporation, called the Surety, are held and firmly bound unto Applied Filter Technology, Inc., 19524 75th Avenue SE, Snohomish, WA 98296, called the Obligee, in the amount of Three Million Six hundred Seventy One Thousand One Hundred Thirteen & No/100 U.S. Dollars ($3,671,113.00), for the payment whereof Principal and Surety bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, as provided herein.

[B] WHEREAS, Principal entered into that certain material contract with the Obligee dated May 18, 2009 for Inlet Blower Package to Klickitat UPD, HW Hill Landfill Gas Project, Roosevelt, WA, a copy of which is by referenced made a part hereof ("Material Contract").

NOW, THEREFORE, if Principal shall faithfully comply with all terms and conditions of said Material Contract, or if the Principal shall pay, indemnify, and hold harmless the Obligee from all direct damages sustained by the Obligee as a result of any default by the Principal under the Material Contract, then this obligation shall be void, otherwise, to remain in full force and effect.

---Bifurcation of Bond Likely to be Made by the Court. Above "Supplement", Below Default Terminate---

[C] PROVIDED, however, that it is a condition precedent to recovery under this bond that written notice of any default claimed under the Material Contract be provided to Surety at the following address: Argo Surety, 20333 State Hwy 249, Suite 200, Houston, TX 77070.

[D] PROVIDED, further, that any suit by the Obligee under this bond must be instituted before the earlier of: (a) the expiration of one year from the date the Principal was obligated under the

[2] Yellow highlighting, [A] – [D], and yellow break line, added by Greg Arnold to show parallels with the bond form in the *Colorado Structures* case, and how the Court in this case might analyze the Argonaut bond consistent with the analysis in the *Colorado Structures* case. Notice the use of the word "otherwise" in the seventh line of [B]. The errors "referenced"[reference], third line in [B] and "th" [the], sixth line in [D], are original. The Argonaut performance bond, without the Dual Obligee Rider, consists of 429 words, contrasted with the ICW performance bond, which consisted of 368 words, based upon using the word count function in the Word program.

Material Contract to deliver the materials to the Obligee, or (b) the expiration of one year from the date any other default by the Principal under the Material Contract.[3] If the limitation set forth in this bond is void, prohibited by law or unenforceable for any reason, the minimum period of limitation available to sureties as a defense in the jurisdiction of th suit shall be applicable, and said period of limitation shall be deemed to have accrued and shall commence to run no later than the earlier of (y) the date the Principal was obligated under the Material Contract to deliver the materials to the Obligee or (z) the date of any other default by the Principal under the Material Contract; and

Provided, further that no right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein or its successor.

[3] On April 16, 2014, Judge Ronald B. Leighton provided his "Order On Defendant's Motion for Summary Judgment", ruling that the claim against the "performance bond" (page 1) was filed timely. "But, Unison's obligations under the contract did not end with delivery" (page 2). The Court went on to state "Indeed, it would not even be paid the last 10% of the price until its materials had undergone 'successful test'" (page 2).

Attachment A

Stellar J Corporation Expert Report

Figure 5

Dual Obligee Rider (Concurrent Execution):[4]

This Rider is executed concurrently with and shall be attached to and form a part of performance bond No. SUR0001957.

WHEREAS, on or about the 18th day of May, 2009, Unison Solutions, Inc. (hereinafter called the "Principal", entered into a written agreement with Applied Filter Technology, Inc. (hereinafter called the "Primary Obligee") for the construction of the Inlet Blower Package to Klickitat PUD, HW Hill Landfill Gas Project, Roosevelt, WA (hereinafter called the "Contract"); and

WHEREAS, Principal is required by the Contract to provide a performance bond and Primary Obligee has requested that Stellar J Corporation, 1363 Down River Drive, Woodland, WA 98874, be named as an additional obligee under the performance bond; and

WHEREAS, Principal and Argonaut Insurance Company (hereinafter referred to as "Surety") have agreed to execute and deliver this Rider in conjunction Performance Bond No. SUR0001957 (hereafter referred to as "Performance Bond")

NOW, THEREFORE, the undersigned hereby agree and stipulate that Stella J Corporation shall be added to said bond as a named obligee (hereinafter referred to as "Additional Obligee"), subject to the conditions set forth below:

1 The Surety shall not be liable under the Bond to the Primary Obligee, the Additional Obligee, or any of them, unless the Primary Obligee, the Additional Obligee, or any of them, shall make payments to the Principal (or in the case the Surety arranges for completion of the Contract, to the Surety) strictly in accordance with the terms of said Contract, as the payments and shall perform all other obligations to be performed under said Contract at the time and in the manner therein set forth.

[4] As opposed to insurance policies, where changes or additions are accomplished with "endorsements", "riders" are used for surety bonds. In this rider, Stellar J was added as a first party to whom Argonaut owed obligations as a surety to an obligee. The rider uses the words "performance bond" six times. In addition, it contains the word "perform" one time and the word "performed" one time. Taken as a whole, under the eight corners rule of contract interpretation, and Argonaut's chosen language in its manuscripted bond forms, the instrument issued by Argonaut was a performance bond.

2. The aggregate liability of the Surety under the Bond, to any or all of the obligees (Primary and Additional Obligees), as their interests may appear, is limited to the penal sum of the Bond; the Additional Obligee's rights hereunder are subject to the same defenses Principal and/or Surety have against the Primary Obligee, and the total liability of the Surety shall in no event exceed the amount recoverable from the Principal by the Primary Obligee under the Contract. At the Surety's election, and payment due under the performance bond may be made by joint check payable to one or more of the obligees.
3. The Surety may, at its option, make any payments under said Performance Bond by check issued jointly to all of the obligees.

Except as herein modified, the Bond shall be and remains in full force and effect. Signed this 22nd day of June, 2009.

Attachment A

Stellar J Corporation Expert Report

Figure 6

The Court is Expected to Interpret These Bond Forms As Follows:

Argonaut's Bond Language:[5]

[A] KNOW ALL MEN BY THESE PRESENTS; That Unison Solutions, Inc., 5451 Chavanelle Road, Dubuque, IA 52002, called the Principal, and Argonaut Insurance Company, an Illinois corporation, called the Surety, are held and firmly bound unto Applied Filter Technology, Inc., 19524 75th Avenue SE, Snohomish, WA 98296, called the Obligee, in the amount of Three Million Six hundred Seventy One Thousand One Hundred Thirteen & No/100 U.S. Dollars ($3,671,113.00), **[or three times this amount, plus Olympic Steam Ship damages]** for the payment whereof Principal and Surety bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, as provided herein.

[B] WHEREAS, Principal entered into that certain material contract with the Obligee **[Applied Filter Technology, Inc. and Stellar J Corporation]** dated May 18, 2009 for Inlet Blower Package to Klickitat UPD, HW Hill Landfill Gas Project, Roosevelt, WA, a copy of which is by referenced made a part hereof ("Material Contract").

NOW, THEREFORE, if Principal shall faithfully comply with all terms and conditions of said Material Contract, or if the Principal shall pay, indemnify, and hold harmless the Obligee **[Applied Filter Technology, Inc. and Stellar J Corporation]** from all direct damages sustained by the Obligee **[Applied Filter Technology, Inc. and Stellar J Corporation]**as a result of any default by the Principal under the Material Contract, then this obligation shall be void, **otherwise [emphasis added]**, to remain in full force and effect.

---Bifurcation of Bond Likely to be Made by the Court. Above "Supplement", Below Default Terminate---

[5] Red text added by Greg Arnold. Yellow highlighting, [A] – [D], and yellow break line, added by Greg Arnold to show parallels with the bond form in the Colorado Structures case. Notice the use of the word "otherwise" in the seventh line of [B]. The errors "referenced"[reference], third line in [B] and "th" [the], sixth line in [D], are original. The Argonaut performance bond, without the Dual Obligee Rider, consists of 429 words, contrasted with the ICW performance bond, which consisted of 368 words, based upon using the word count function in the Word program.

[C] PROVIDED, however, that it is a condition precedent to recovery under this bond that written notice of any default **[written notice of any default is not required pursuant to Washington law as enunciated in the *Colorado Structures* case. Also, any demands for repayment of monies paid by Stellar in supplementing Unison's Material Agreement would be analyzed under [A] and [B] above]** claimed under the Material Contract be provided to Surety at the following address: Argo Surety, 20333 State Hwy 249, Suite 200, Houston, TX 77070.

[D] PROVIDED, further, that any suit by the Obligee under this bond must be instituted before the earlier of: (a) the expiration of one year from the date the Principal was obligated under the Material Contract to deliver **[this is the surety's manuscripted bond form and does not contain a definition of the word "deliver", nor does it state anything about the timing for anything in connection with the word "deliver", and any ambiguity in a surety's own bond form should be construed against the surety. Also, the Court is likely to analyze parts [A] and [B] of this bond only]** the materials to the Obligee, or (b) the expiration of one year from the date any other default by the Principal under the Material Contract. If the limitation set forth in this bond is void, prohibited by law or unenforceable for any reason, the minimum period of limitation available to sureties as a defense in the jurisdiction of th suit shall be applicable, and said period of limitation shall be deemed to have accrued and shall commence to run no later than the earlier of (y) the date the Principal was obligated under the Material Contract to deliver **[same comments as above with respect to use of the word "deliver"]** the materials to the Obligee or (z) the date of any other default by the Principal under the Material Contract; and

Provided, further that no right of action shall accrue on this bond to or for the use of any person or corporation other than the Obligee named herein or its successor.

Attachment A

Stellar J Corporation Expert Report

Figure 7

Dual Obligee Rider (Concurrent Execution):[6]

This Rider is executed concurrently with and shall be attached to and form a part of performance bond No. SUR0001957.

WHEREAS, on or about the 18th day of May, 2009, Unison Solutions, Inc. (hereinafter called the "Principal", entered into a written agreement with Applied Filter Technology, Inc. (hereinafter called the "Primary Obligee") for the construction of the Inlet Blower Package to Klickitat PUD, HW Hill Landfill Gas Project, Roosevelt, WA (hereinafter called the "Contract"); and

WHEREAS, Principal is required by the Contract to provide a performance bond and Primary Obligee has requested that Stellar J Corporation, 1363 Down River Drive, Woodland, WA 98874, be named as an additional obligee under the performance bond; and

WHEREAS, Principal and Argonaut Insurance Company (hereinafter referred to as "Surety") have agreed to execute and deliver this Rider in conjunction Performance Bond No. SUR0001957 (hereafter referred to as "Performance Bond")

NOW, THEREFORE, the undersigned hereby agree and stipulate that Stella J Corporation shall be added to said bond as a named obligee (hereinafter referred to as "Additional Obligee"), subject to the conditions set forth below:

1. The Surety shall not be liable under the Bond to the Primary Obligee, the Additional Obligee, or any of them, unless the Primary Obligee, the Additional Obligee, or any of them, shall make payments to the Principal (or in the case the Surety arranges for completion of the Contract, to the Surety) strictly in accordance with the terms of said Contract, as the payments and shall perform all other obligations to be performed under said Contract at the time and in the manner therein set forth.

[6] Red text and underlining added by Greg Arnold to highlight how he expects the Court to analyze this Dual Obligee Rider. As opposed to insurance policies, where changes or additions are accomplished with "endorsements", "riders" are used for surety bonds. In this rider, Stellar J was added as a first party to whom Argonaut owed obligations as a surety to an obligee. The rider uses the words "performance bond" six times. In addition, it contains the word "perform" one time and the word "performed" one time. Taken as a whole, under the eight corners rule of contract interpretation, and Argonaut's chosen language in its manuscripted bond forms, the instrument issued by Argonaut was a performance bond.

2. The aggregate liability of the Surety under the Bond, to any or all of the obligees (Primary and Additional Obligees), as their interests may appear, is limited to the penal sum of the Bond **[except in cases of WIFCA violations, in which case damages can be trebled, plus *Olympic Steam Ship* damages for attorneys' fees, expert fees, *etc.*]**; the Additional Obligee's rights hereunder are subject to the same defenses Principal and/or Surety have against the Primary Obligee, and the total liability of the Surety shall in no event exceed the amount recoverable from the Principal by the Primary Obligee under the Contract. **[This ignores the fact that a first party claimant, such as an obligee, can obtain damages against a surety that exceed the amount recoverable from the principal by an obligee under the contract. This can happen in cases of WIFCA violations, in which case damages can be trebled, plus *Olympic Steam Ship* damages for attorneys' fees, expert fees, *etc.*]** At the Surety's election, and payment due under the performance bond may be made by joint check payable to one or more of the obligees.

3. The Surety may, at its option, make any payments under said Performance Bond by check issued jointly to all of the obligees.

Except as herein modified, the Bond shall be and remains in full force and effect. Signed this 22nd day of June, 2009.

Attachment A

Stellar J Corporation Expert Report

Figure 8

Argonaut Insurance Company

General Indemnity Agreement

July 27, 2009

[The General Indemnity Agreement contains 26 numbered paragraphs. For purposes of this litigation, some of these paragraphs are relevant in my expert analysis. These are as follows:]

Definitions

…

The term "Losses" shall mean any and all (a.) sums paid by Surety to claimants under the Bonds, (b.) sums required to be paid to claimants by Surety but not yet, in fact, paid by Surety, by reason of execution of such Bonds, (c.) **costs and expenses incurred in connection with investigating, paying or litigating any claim under the Bonds, including, but not limited to legal fees and expenses, technical and expert witness fees and expenses** [emphasis added by Greg Arnold] and (d.) all costs and expenses incurred in connection with enforcing the obligations of the Indemnitors under this Agreement including, but not limited to interest, legal fees and expenses and (e.) all accrued and unpaid premiums owing to Surety for the issuance, continuation or renewal of any Bonds and (f.) all other amounts payable to Surety according to the terms and conditions of this Agreement.

As an inducement to the Surety and in consideration of the Surety's execution or procurement of the Bond(s), the Surety's refraining from cancelling one or more Bond(s), and/or the Surety's assumption of one or more Bond(s) and for other good and valuable consideration, the receipt and sufficiency of which the Indemnitors hereby acknowledge, the Indemnitors hereby agree, for themselves, successors, and assigns, jointly and severally, as follows:

…

2. Indemnity. To indemnify, hold harmless and exonerate Surety from and against any and all Losses, as well as any other reasonable **expenses**[7] [emphasis added] that the Surety may incur or sustain as a result of or in connection with the furnishing, execution, renewal, continuation, or substitution of any Bond(s). Expenses include, but are not limited to: (a) the **cost incurred by reason of making an independent investigation in connection with any Bond(s)** [emphasis added] or this Agreement; (b) **the cost of procuring or attempting to procure the Surety's release from liability or a settlement under any Bond(s) upon or in anticipation of Losses, including the defense of any action brought in connection therewith** [emphasis added]; and (c) the cost incurred in bringing suit to enforce this Agreement against any of the Indemnitors. Payments of amounts due the Surety hereunder, including interest, shall be made immediately upon the Surety's demand. Vouchers, affidavits, or other **evidence of payment by the Surety shall be prima facie evidence of the Indemnitors' liability for any such Losses or other expenses.** [Emphasis added.][8]

3. Surety Reserves. The Surety may, in its sole discretion, establish a reserve to cover any actual or anticipated, liability, claim, suit, judgment, or Losses under any Bond. [Losses include "costs and expenses". See the third unnumbered paragraph under Definitions, as set forth above. Greg Arnold.] **In such event** [emphasis added by Greg Arnold][9], the Indemnitors will, immediately upon demand, deposit with the Surety a sum of money equal to such reserve, and any subsequent increase thereof, to be held by the Surety as collateral security on the Bond(s). Such funds will be used by the Surety to pay Losses or may be held by the Surety as collateral against potential future Losses. The Indemnitors hereby grant to the Surety a security interest in all money and other property now or hereafter delivered by such Indemnitors to the Surety for deposit in such reserve, and all income (if any) thereon. Any funds remaining after the Indemnitors' settlement or payment of all Losses will be returned to the Indemnitors within thirty (30) days from the date of the Indemnitors' settlement or payment of the Losses.

…

8. Default. The Indemnitors shall be in default of this Agreement if:…(c) Indemnitors fail to provide collateral in response to a proper request made by the Surety; ..and/or (e) Surety establishes reserves against Losses in connection with Bond(s) pursuant to Section 3 above.

…

[7] Stellar J is has not been made aware how the indemnitors have arranged for payment of any expenses incurred by Argo in this matter, and / or what reserves were posted to justify a collateral demand under the GIA.

[8] Argo had the right under the GIA to settle the Stellar J claim, with or without the consent of the Argo indemnitors.

[9] The establishment of a reserve is a condition precedent to Argo's demand for collateral. Stellar J has not been made aware of the establishment of reserves by Argo. Any amendment to the GIA must be by a writing, according to paragraph 16.

10. Surety's Rights to Releases or Bonds and Indemnitors Waiver.

This paragraph also addresses the rights of Argo to demand collateral "…to mitigate actual or potential Losses [including costs and fees, see Definitions, above] under any and all Bond(s) written in accordance with this Agreement."

11. The surety may execute or procure Bond(s) that guarantee the obligations or performance under one or more contracts (each a "Bonded Contract"). The Indemnitors shall be considered in default of a Bonded Contract if any of the following occur: (a) a declaration of default by any Bonded Contract owner;[10] (b) an actual breach or abandonment of the Bonded Contract;[11] and/or (c) an improper diversion of Bonded Contract funds or Indemnitors' assets to the detriment of the Bonded Contract obligations.

In the event of a default under a Bonded Contract, Indemnitors grant to Surety a security interest in all equipment, machinery, inventory, materials and all proceeds and products in connection with any Bonded Contract. This Agreement shall for all purposes constitute a Security Agreement and Financing Statement for the benefit of Surety in accordance with the Uniform Commercial Code ("UCC") and all similar statutes. In the event there is an act of default under any Bonded Contract, Indemnitors hereby irrevocably authorize Surety, without notice to any of the Indemnitors, to perfect the security interest granted herein by filing this Agreement or a copy or other reproduction of this Agreement.[12] Surety may add schedules or other documents to this agreement as necessary to perfects its rights. The failure to file or record this Agreement or any financing statement shall not release or excuse any of the obligations of Indemnitors under this Agreement. The Surety's exercise of any of its rights as a secured creditor under this Agreement shall not be a waiver of any of the Surety's legal or equitable rights or remedies, including the Surety's right of subrogation.

12. The obligee or beneficiary under certain Bonds(s) may make a demand for payment ("Demand") against the Bond(s). **When such Demand is made, the Surety must pay the amount of the Demand, not to exceed the penal sum of the Bond(s), as well as all necessary fees, within the time period required by the Demand**. [Emphasis added.][13] **Under such**

[10] This includes general contractor as an obligee.

[11] A principal would not want there to be a record of a declaration of default by any bonded contract owner, or a general contractor as obligee, or other status of obligee. This, by itself, would likely lead to a demand for collateral, failure to post which would lead to an argument by the surety under paragraph 8 that the indemnitors are considered in default of the indemnity agreement itself, and thus be at risk of receiving no other bonds from the surety and/or the surety demanding collateral.

[12] Stellar J has not been informed whether Argonaut in fact filed the GIA as a UCC-1 Financing Statement in one or more jurisdictions / states.

[13] Argonaut was aware of this obligation, but ignored it. Obligee Stellar J made such a demand, giving a time for response, but Argonaut did not meet that demand. "Stellar J. Corporation demands an acceptable cure plan delivered to Stellar J from Argos (sic) and/or Unison by close of business April 20, 2012. The cure plan must provide the date of installation of equipment needed to remediate this failed control system."

Bond(s), the Surety, [emphasis added] with the knowledge and consent of the Indemnitors, **has expressly waived all defenses to making such payment**. [Emphasis added.] If the Indemnitors receive notice from the Surety that a Demand has been made against the Bond(s) by the obligee or beneficiary, at least five (5) business days before payment of such Demand is due to the obligee, Indemnitors shall pay the Surety the full amount of the Demand, which amount shall not exceed the penal sum of the Bond, as well as all necessary fees. Such payment will be made by wire transfer or otherwise in immediately available funds to the bank account specified in the notice provided to the Indemnitors by the Surety.

The Indemnitors waive, to the fullest extent permitted by applicable law, each and every right which they may have to contest such payment. Failure to make payment to the Surety as herein provided shall cause the Indemnitors to be additionally liable for any and all **costs and expenses, including attorney's fees**, [emphasis added] incurred by the Surety in enforcing this Agreement, together with interest on unpaid amounts due the Surety, interest shall accrue, commencing the date the Surety pays the amount of the Demand, at the prime rate of interest in effect on December 31 of the previous calendar year as published in the Wall Street Journal. Indemnitors stipulate and agree that the Surety will suffer immediate irreparable harm and will have no adequate remedy at law should Indemnitors fail to perform this obligation, and therefore the Surety shall be entitled to specific performance of this obligation.

…

16. Amendment. This Agreement may be amended or terminated only by a **document executed by all parties** [emphasis added by Greg Arnold][14], or their respective successors or assigns.

…

[14] Stellar J is not aware of any document executed by all parties waiving the requirement that Argonaut first establish reserves before demanding collateral from its indemnitors. Sometimes this amendment can be addressed in a tender of defense to principal's / indemnitors' counsel or similar correspondence or agreement, but Stella J has not been made aware of any such document. Sometimes this can be addressed in correspondence to separate surety counsel, with an understanding that the surety will either be reimbursed by the indemnitors for fees paid by the surety company to separate surety counsel, or that the indemnitors will pay those fees directly. Stellar J has not been made aware of any such document that would amend the terms of the GIA. Accordingly, Stellar J assumes that Argo posted reserves.