WELCOME TO

PEARLMAN 2019

Pearlman 2019

Building Relationships – Keeping Them Strong

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On behalf of the Board of Directors and Sustaining Members of the Pearlman Association, I want to express our sincere appreciation to you for choosing to attend the Pearlman events this year. Whether you traveled across the country or across town, whether this is your first visit or your 25th, we have worked hard to make your time with us a rewarding and memorable experience and we hope we surpass your every expectation.

Pearlman is an organization designed, built and managed exclusively by company-side surety professionals. Its close, continuous access to the collective heartbeat of a large number of surety companies makes for a unique, targeted perspective on the needs, goals and challenges facing the industry – a perspective available to no other similarly situated organization. Our annual events draw from this special vantage point as we design our curriculum, training and recreational events.

As you take part in our events this year, please keep in mind that Pearlman has but one mission; to strengthen and enhance the talent, professionalism and career prospects of the surety professional. We will accomplish this mission through our scholarship distribution, our educational programs and our commitment to building industry relationships and keeping them strong.

Thank you, again, for joining us this year.

All the best –

R. Jeffrey Olson
Chairman/Director Pearlman Association

Special Recognition

The Pearlman would like to give special recognition to the folks who work tirelessly behind the scenes to make each Pearlman conference a reality.

Special thanks to **Lih Hudson** who truly does all the work. She spends hours upon hours making sure that every little detail is thought of and dealt with. Lih works tirelessly to make each conference the best in the industry and to ensure that everything runs smoothly. When you see her, please give her a heart-felt "thank you." She deserves it.

Special thanks also to **Christine Brakman**. Chris usually pulls all-nighters to put all the conference materials together, formatted correctly, and truly useable. We can't thank her enough for her hard work in preparing The Pearlman "packet" for printing. Thank you, Chris!

A big thanks to **David Stryjewski** for graciously volunteering his time to do the books and keeping the Pearlman finances in order.

Schedule of Events

Wednesday, September 4th

4:30-7:30 **Hospitality Reception –** Willows Lodge, Woodinville
Hosted by The Vertex Companies, Inc., Langley, LLP, Sage Associates, Inc., and The Hustead Law Firm

Hospitality Reception Entertainment
Hosted by Faux Law Group and Williams Kastner

Thursday, September 5th

7:00-8:00 **Registration and Breakfast –** Columbia Winery, Woodinville
Hosted by Alber Frank, PC, PCA Consulting Group, and Forcon International Corporation

All Day Coffee/Beverage Service
Hosted by Stewart Sokol & Larkin, LLC

8:00-8:15 **Welcome/Introductory Remarks**
R. Jeffrey Olson
Co-Chairs: Jan Sokol, Todd Braggins, Luis Aragon

8:15-9:00 **Co-Surety Issues; The Good, The Bad and The Ugly**
Mike Pipkin, Mary Jean Pethick, Andrew Torrance, Sunny Lee

9:00-9:45 **Completing Contracts with Surety's Own Accounts or Consultants**
Rebecca Glos, Douglas Dearie, Mark Degenaars, Todd Bauer

9:45-10:15 **Surety's Common Law Rights**
James Curran, Jason Stonefeld, Gina Shearer, Edward Rubacha, Jim Loewke

10:15-10:30 **Break**

10:30-11:15 **The Care and Feeding of Expert Witnesses**
Larry Rothstein, David Krebs, Charles Langfitt, Richard Tasker

11:15-12:00 **Future Prospects for Construction/Surety Bonds**
Scott Powers, David Hombach, John Kampschror, Guy Armfield

12:00-1:15 **Lunch**
Hosted by Wolkin Curran, LLP, Sage Consulting Group and Weinstein Radcliff Pipkin, LLP

1:15-2:00 **Privilege Issues in the Surety's Initial Investigation**
Amanda Miceli, Jonathan Cohen, William McConnell, Rachel Walsh

2:00-2:45 **Tech Talk**
Dennis O'Neill, Lin Heath, Todd Bauer, Kieran O'Connor, Greg Smith

2:45-3:00 **Break**

3:00-3:45 **Tendering A Completion Contractor**
Wayne Lambert, John McDevitt, Jenn Whritenour, Matt Holmes

3:45-4:30 **Financing the Principal and Protecting the Surety**
Adrian D'Arcy, Tom Vollbrecht, Bill Sanford, Pete Fascia, Ty Oksuzler

5:00 **Welcome Reception/Cocktails** – Columbia Winery, Woodinville
Hosted by Stewart, Sokol, and Larkin, LLC

6:00 **Dinner** – Columbia Winery, Woodinville
Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP and J.S. Held, LLC

7:15 **Hold 'Em Tournament** – Columbia Winery, Woodinville
Dealers Sponsored by Benchmark Consulting Services, LLC and Weinstein Radcliff Pipkin, LLP

Cocktails
Hosted by Krebs Farley, PLLC

Friday, September 6th

7:30-8:25 **Registration and Breakfast** – Columbia Winery, Woodinville
Hosted by Cashin Spinelli & Ferretti, LLC, and
Snow, Christensen & Martineau

All Day Coffee/Beverage Service
Hosted by Guardian Group, Inc.

Espresso Bar
Hosted by Partner Engineering and Science, Inc.

8:25-8:30 **Welcome/Program Introduction**
R. Jeffrey Olson, Jan Sokol, Todd Braggins, Luis Aragon

8:30-9:30 **An Underground Autopsy: Strategies for Analyzing, Presenting and Successfully Resolving Differing Site Condition Claims**
Ali Salamirad, Mike Timpane, Craig Sorensen, Steven Murow

9:30-10:00 **Testing and Inspections**
Jennifer Fiore, Rodney Tompkins, Luis Aragon, Jim Carlson

10:00-10:15 **Break**

10:15-11:00 **Show Me the Money**
Meredith Dishaw, Patrick Hustead, Mark Gamell, Paul Harmon, Mike Tomeo

11:00-11:30 **Serving Two Masters: The Ethical Risks of Joint Representation of the Contractor and Surety**
Thomas Windus, Samantha Canterino, Keith Langley, Eric Liberman

11:30-11:35 **Closing Comments**
R. Jeffrey Olson

11:35 **Lunch – On Your Own**

11:45 **Bus Service to/from Harbour Pointe Golf Club**
Hosted by Law Offices of Larry Rothstein
Bus leaves Willows Lodge at 11:45PM

1:00 **Sign In/Warm Up –** Harbour Pointe Golf Club

1:30 **Scramble Tournament – Shotgun Start**
Harbour Pointe Golf Club, 11817 Harbour Pointe Blvd, Mukilteo, WA 98275

Beverage Cart
Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP,
Benchmark Consulting Services, LLC, and The Sutor Group

7:00 **Dinner –** Harbour Pointe Golf Club
Hosted by Ward, Hocker & Thornton, PLLC,
Chiesa Shahinian & Giantomasi PC, and
Kerr Russell and Weber, PLC

Cocktails
Hosted by Stewart Sokol & Larkin, LLC

7:45 **Awards – Scholarships – Closing**

8:00 **Buses return to Columbia Winery and Willows Lodge**

Saturday, September 7th - "On Your Own"

We would like to extend our sincerest appreciation to our Sustaining Members and friends of Pearlman who graciously volunteered their time to coordinate and chaperone Saturday's "on your own" event.

For those of you who signed up for any of the elective event, you will have received by now an e-mail message from your respective "chaperone" alerting you to the logistics of your event.

Woodinville Wine Tour

Torre, Lentz, Gamell, Gary & Rittmaster,LLP
J.S. Held LLC
Law Offices of T. Scott Leo, P.C.
SMTD Law LLP
Jennings Haug Cunningham LLP

Program Co-Chairs

JAN D. SOKOL

Jan D. Sokol is one of the founders and the Managing Member of Stewart Sokol & Larkin, LLC. He represents prime contractors, subcontractors, real property managers, small corporations, sureties and fidelity insurers. His practice includes advising and organizing businesses, as well as the preparation of construction claims. He also has an extensive practice representing creditors in bankruptcy courts throughout the United States. Mr. Sokol handles complex corporate, commercial, construction and real property litigation, arbitrations and mediations.

Mr. Sokol is a frequent speaker at the Western States Surety Conference and the Pearlman addressing wide ranging topics in the construction and surety industry.

Oregon Super Lawyers Magazine listed Jan as one of the top lawyers in the state for the last eleven consecutive years: 2006 to 2016.

TODD R. BRAGGINS

Todd R. Braggins is Managing Partner of Ernstrom & Dreste, LLP, in Rochester, New York, and is licensed to practice in both New York and New Mexico. Mr. Braggins concentrates his practice in the fields of contract and commercial suretyship and construction law. In addition to Ernstrom & Dreste, LLP's Pearlman Sustaining Membership, Mr. Braggins is an active member of the Fidelity and Surety Law Committee ("FSLC") of the ABA's Tort Trial and Insurance Practice Section, formerly serving as a Vice-Chair, as well as a Co-Editor of the FSLC Newsletter. Mr. Braggins is also a member of the Surety Claims Institute, the National Bond Claims Association, the Attorney Advisory Council of the National Association of Surety Bond Producers, the Chicago, Atlanta and Philadelphia Surety Claims Associations, and the ABA's Forum on the Construction Industry. Mr. Braggins graduated with honors from Binghamton University and received his Juris Doctor from the Washington College of Law of The American University.

LUIS ARAGON

Luis Aragon is Surety Claim Counsel for Liberty Mutual Insurance Company. Prior to Liberty Mutual, Luis spent over two years as a surety attorney in the Seattle office of Watt Tieder Hoffar & Fitzgerald. Luis has a B.A. in History with Honors and a B.S. in

Biochemistry, both from the University of Washington. Luis also received his J.D. from the University of Washington.

Luis simply cannot find it in himself to leave Seattle. Outside of work, Luis has a wife who is a better lawyer than he is, and two amazing young daughters. When the ladies let him out of the house, he enjoys playing soccer. He is an exceptionally mediocre golfer.

Presenters/Biographies

We would like to thank each of our co-chairs and presenters for the significant time and talent that each of them have selflessly invested into the success of our educational programs.

LUIS ARAGON

Luis Aragon is Surety Claim Counsel for Liberty Mutual Insurance Company. Prior to Liberty Mutual, Luis spent over two years as a surety attorney in the Seattle office of Watt Tieder Hoffar & Fitzgerald. Luis has a B.A. in History with Honors and a B.S. in Biochemistry, both from the University of Washington. Luis also received his J.D. from the University of Washington.

Luis simply cannot find it in himself to leave Seattle. Outside of work, Luis has a wife who is a better lawyer than he is, and two amazing young daughters. When the ladies let him out of the house, he enjoys playing soccer. He is an exceptionally mediocre golfer.

GUY ARMFIELD

Guy Armfield is a Principal of Parker, Smith & Feek and a Vice President in the Surety Department. PS&F is a leader in providing construction risk management services to clients in the Pacific Northwest, including surety and insurance. Guy's current surety clients include companies with annual revenues ranging from $25 million to over $2 billion with operations in all 50 states.

Guy began his surety career with Safeco in 2001 as a contract surety underwriter. He held several positions of increasing responsibility, culminating as bond manager. In that position, he managed contractors with nationwide operations headquartered in Alaska, Washington, and Hawaii. Guy received his B.A. from the University of Washington's Michael G. Foster School of Business.

Guy is an active member of the National Association of Surety Bond Producers (NASBP), currently serving a three year term on the Board of Directors. He is an instructor within Parker, Smith & Feek's University Series, and is a frequent guest speaker within the construction and surety industries.

TODD M. BAUER

Todd M. Bauer is Executive Vice President of Guardian Group, Inc. and has more than 30 years of construction and general management experience. Todd received his Bachelor of Science degree from the University of Southern California and received his graduate degree

from the University of Texas at Austin. He is affiliated with numerous industry organizations. Todd assists numerous clients with claims investigation and settlement, forensic accounting, takeover and completion of defaulted contracts, bond claim analysis, affirmative claim preparation, delay claim analysis, scheduling, and accounting audits as well as provided litigation support and has acted as an expert witness. In addition, Mr. Bauer's expertise includes project management of schools, residential housing, airports, highways, underground conduit, hospitals, power plants, subdivisions, gas processing plants, prisons, landscaping, computer systems, manufacturing processes, as well as roofing, glazing and electrical projects. Mr. Bauer is also the President of Completion Contractors, Inc., Guardian's general contracting subsidiary, and holds a Commercial California Contractors "B" license. He is also licensed by The U.S. Treasury as a U.S. Customs Broker, and provides expertise in the investigation and resolution of U.S. Customs and FMC bond claims. Mr. Bauer has also acted as lead on Claim Department outsourcing and claims runoff assignments for surety companies and state's Departments of Insurance.

SAMANTHA CANTERINO

Samantha Canterino is presently employed as Claim Counsel in the Western Region of Travelers Bond & Specialty Insurance Claim. Prior to joining Travelers, Samantha was employed as a senior claims handler for a global specialty insurance and reinsurance company specializing in high exposure construction losses. While in private practice for a national insurance defense firm, Samantha handled matters on behalf of general contractors, subcontractors, and owners in disputes from inception to trial. Samantha is a graduate of Fordham University, *cum laude*, and New York Law School where she was the recipient of the Public Service Award for her continued service to City of New York as well as other local municipalities. Samantha is admitted to practice in the State of New York and the State of Washington.

JIM CARLSON

Jim Carlson, Technical Director of Owner's Representative and Surety Services, works out of Partner Engineering and Science, Inc.'s Santa Ana office. He is a Cal Poly Pomona and University of LaVerne graduate with a Bachelor of Science, a Master of Business Administration, and a Juris Doctorate. Mr. Carlson has over 15 years of experience in executive-level technical analysis of mechanical systems and controls, electrical and plumbing systems, and strategic planning. He has worked on public and private project scopes that range from minor repairs to large-scale and technically complex, both locally and internationally, including: military bases, industrial sites, heavy highway and civil design, residential and commercial tenant improvement.

SOMMER CLEMENT

Sommer B. Clement practices in the areas of construction and real estate transactions and litigation, civil litigation, and insurance defense. Sommer drafts contracts and provides risk management advice to companies involved in the development, design, construction, and sale of buildings and real estate. She also litigates civil disputes including complex multi-party litigation, construction defect, work site injury, products liability, automobile, premises, and personal injury claims.

Since 2003, she has represented numerous Washington real estate developers and contractors in disputes related to tower, commercial, condominium, apartment, conversion, and single-family construction. She has handled matters through mediation, jury trials, and appeals. She has also worked as a land use hearing examiner. Before earning her J.D., she worked at a mechanical and electrical engineering firm in Seattle.

Sommer is a Seattle-area native and enjoys bicycling and spending time in Central Washington.

Honors and Recognitions

Sommer was recognized as a Rising Star by *Washington Law and Politics* from 2002-2007 and in 2010. She has received an "AV" Preeminent rating from *Martindale-Hubbell*. This rating is given to attorneys who demonstrate the highest ethical standards and professional ability. She served as Chair of the Washington Defense Trial Lawyers Construction Section from 2013 to 2014.

Seminars/Speaking Engagements

Sommer is a frequent speaker on topics related to risk management for developers, contractors, and design professionals. Recent speaking engagements include:

- Co-Chair of “Preparing for Construction Defects in the Future,” The Seminar Group, Seattle, Washington, December 2018
- “The Current Status of Construction Defect Litigation,” The Seminar Group 25th Annual Washington Construction Law Conference, Seattle, Washington, September 2018
- “Project Update,” 2nd Annual Construction Project Challenges in Seattle, The Seminar Group, Seattle, Washington, December 2017
- “Risk Management for Condominium Development and Sale in Washington,” November 2017
- “Construction Defect Litigation, Today and Tomorrow,” The Seminar Group 24th Annual Washington Construction Law Conference, Seattle, Washington, September 2017

- “Construction Project Update,” Construction Project Challenges in Seattle Seminar, The Seminar Group, Seattle, Washington, December 2016
- “Forecasting the New World of Residential Construction Defect Litigation,” The Seminar Group 23rd Annual Washington Construction Law Conference, Seattle, Washington, September 2016
- “Wrap Policies: Unwrapping the Expectations and Realities,” West Coast Casualty Construction Defect Seminar, Anaheim, California, May 2016
- “Toolbox for Handling Emerging Construction Issues,” Washington Defense Trial Lawyers Annual Construction Law Update, Seattle, Washington, May 2016
- “AIA Contract Provisions That Can Keep You Out of Hot Water,” Society for Design Administration, Seattle Chapter, Seattle, Washington, March 2016
- “Yellow Brass Claims in Washington,” Washington Defense Trial Lawyers Annual Construction Law Update, Seattle, Washington, February 2013

JONATHAN COHEN

Jonathan is an experience attorney specializing in surety, construction, and commercial matters. He is the named principal at Jonathan P. Cohen, P.A. Jonathan routinely handles all phases of a dispute from pre-litigation to post-judgment collection activities in state court, federal court, and in arbitration. He is licensed to practice in Florida and Pennsylvania.

JAMES D. CURRAN

James D. Curran is a partner with Wolkin Curran, LLP, located in San Francisco and San Diego, California. He works with sureties in investigating and litigating commercial and contract surety claims, taking over and completing public and private works projects, resolving performance and payment bond claims, pursuing indemnitors, finding assets, and obtaining recoveries in state, federal, bankruptcy, and appellate courts.

ADRIAN D’ARCY

Adrian D’Arcy is a partner at Shields Mott LLP in New Orleans. Adrian’s practice focuses on construction and surety law. Adrian obtained an economics degree from University College Dublin in Ireland and graduated *cum laude* from Loyola Law School in New Orleans. Adrian now teaches construction law as an adjunct professor at Loyola Law School in New Orleans. Adrian regularly speaks at seminars on construction and surety matters. Away from the office, Adrian is a passionate supporter of youth soccer, coaching or managing his kid’s soccer teams for the last ten years.

DOUG DEARIE

Doug Dearie is a Vice President and Manager of Construction Services for Liberty Mutual Surety. He has 45 years of experience in construction management, claims consulting and surety claims management. Doug graduated with a Bachelor's of Science degree in Civil Engineering from Newark College of Engineering (NJIT).

MARK DEGENAARS

Mark Degenaars is the Managing Director of the Construction Services vertical with The Vertex Companies, Inc. He has been with VERTEX for over eight years with a primary focus as a consultant to the surety claims industry and private public developers. Mr. Degenaars brings over 20 years of project management, facility management, private/public development and construction experience to each assignment. Mr. Degenaars has successfully managed a large variety of projects ranging from various types of vertical construction to have highway/civil design projects. Mr. Degenaars has served as an expert and fact witness for a variety of projects. Prior to joining VERTEX, Mr. Degenaars owned and managed his own consulting firm for nearly a decade.

MEREDITH DISHAW

Meredith Dishaw is a Member in the Seattle office of Williams Kastner and the Co-Chair of the Construction and Surety Practice Teams. Ms. Dishaw is a construction and surety litigator who represents clients in state and federal courts as well as private arbitrations throughout the country. Her clients include public and private owners, contractors, sureties, architects and engineers and she works with them in all phases of the construction and bonding process from contract drafting and review to negotiation, trial and appeals. Ms. Dishaw's diverse background includes resolution of complex payment and performance bond claims, commercial and license disputes, and subrogation and recovery issues. Ms. Dishaw prosecutes affirmative construction claims to mitigation surety losses and defense extra-contractual claims including claims brought under the Washington Insurance Fair Conduct Act. Ms. Dishaw regularly writes and speaks on the topics of surety and insurance coverage. She recently was recognized by Super Lawyers as a 2019 Rising Star in Construction Litigation.

PETER FASCIA

Pete Fascia is a partner at Matson Driscoll & Damico in Philadelphia. His practice focuses mainly on the areas of: suretyship, fidelity claims, litigation support and tax issues. Pete obtained a dual major in accounting and business administration from Rutgers University, a law degree from the Temple University, and a Masters of Law in Taxation by splitting time at Temple University and Villanova University. He holds professional licenses as a Certified Public Accountant in New Jersey and Pennsylvania as well as being a licensed

attorney in New Jersey and Pennsylvania. Pete periodically speaks at seminars on surety and fidelity matters. Away from the office, Pete is an avid Philadelphia sports fan, coaches his younger son's hockey team while being the team manager for his older son's ice hockey team.

JENNIFER FIORE

As a principal in Dunlap Fiore, LLC, Ms. Fiore specializes in construction law, business law, litigation, public finance as well as Federal and State regulatory and administrative law matters. Ms. Fiore's practice encompasses the full breadth of private and public construction and surety law. She represents clients in the drafting and negotiation of contracts; the administration of project obligations; and the preparation, prosecution and defense of claims. She also has extensive experience in performance and payment guaranty-related matters, bonding, and indemnity issues giving her an experienced, educated perspective on all aspects of construction, and surety law. Ms. Fiore has represented contractors, owners, and sureties and has experience in contracting issues involving the Federal Acquisition Regulation. She has assisted clients with compliance of the Federal Contractor ethics rules in a wide variety of construction-related matters.

Ms. Fiore is a Vice-Chair of the Fidelity and Surety Law Committee of the Tort Trial and Insurance Practice Section of the American Bar Association, a member of American Bar Association, Construction Law Forum, the Louisiana Bar Association, the Pearlman Association and the National Bond Claims Association.

MARK S. GAMELL

Mark Gamell is a founding partner in the New York law firm of Torre, Lentz, Gamell, Gary & Rittmaster, LLP. Mark was previously a partner at Hart & Hume, LLP and Stockman Wallach Lentz and Gamell, LLP, and has practiced in the fields of fidelity, surety, construction litigation and related commercial insurance and bankruptcy law for over 30 years. A 1976 graduate of Dartmouth College and a 1979 graduate of Fordham University School of Law, Mark has served as a Vice-Chair of the ABA/TTIPS Fidelity & Surety Law Committee, co-chairman of its Bankruptcy Law Subcommittee, and has delivered papers and addresses at meetings of the committee through the years on surety, fidelity and bankruptcy law related subjects as well as contributed to several of the committee's publications. Mark has also addressed the ABA Forum on the Construction Industry, as well as other fidelity and surety industry professional organizations such as the Fidelity Law Association, the Surety And Fidelity Claims Institute, the National Bond Claim Association and the Pearlman Association. From 2009 to 2014, Mark served as Educational Program Director for The Pearlman Association, which is dedicated to developing the skills of surety industry professionals. He is admitted to practice in New York, as well as in all four U.S. District Courts in the State of New York, the U.S. Courts of Appeal for the Second, Third and Federal Circuits and the U.S. Court of International Trade.

REBECCA GLOS

Rebecca S. Glos is a partner in the Irvine, California office of WTHF. Rebecca has specialized in surety and construction law for the last 13 years, representing firm clients throughout the United States and internationally. Rebecca has tried cases in both state and federal courts, and in arbitration forums. Rebecca has experience with government contracts representing sureties and bond principals, and in their negotiations with branches of the federal government, including the United States Army Corps of Engineers ("USACE"). Rebecca has negotiated directly with the USACE in securing waivers and releases for sureties and settling affirmative claims. Most recently, in 2017-2018, Rebecca was a member of the trial team for the Plaintiff Kiewit Power Constructors Co. ("Kiewit") in a 12-day jury trial against the Los Angeles Department of Water and Power ("LADWP") in the United States District Court, Central District of California, which resulted in a jury's verdict of $45 million to Kiewit.

PAUL C. HARMON

In December 2007, Paul Harmon joined the Federal Way, WA Regional Claim Office having previously been admitted to the Washington State Bar. Paul is a 2007 graduate of the University of Oregon School of Law where he was the Executive Editor of the *Oregon Review of International Law.* Previously, Paul received his B.A. in Political Science with a Minor in Music from the University of California, San Diego. As an undergraduate, Paul was an exchange student at the University of Glasgow in Scotland.

LIN HEATH

Lin Heath is Principal in Charge of Engineering and Construction for Nicholson Professional Consulting. He has been a shareholder at Nicholson for 24 years. Prior to Nicholson , Lin worked for another surety consulting company , a family owned Heavy Highway contractor and a consulting engineering firm. He has 41 years of construction engineering experience.

Lin is a licensed professional engineer in 20 states, a licensed general contractor in Florida, a certified cost professional, construction contract administrator and a certified forensic claims consultant. He has extensive experience in a variety of construction means and methods, scheduling and cost analysis and has handled over 400 Surety related matters with loss single project loss exposures in excess of $150 million.

Lin also serves as an expert witness and has testified at the Federal Board of Contract Appeals, Federal and State courts on issues associated with scheduling, cost disputes, construction means and methods and the technical aspects of surety claims support.

MATTHEW D. HOLMES

Matthew D. Holmes is an Associate Attorney at Ernstrom & Dreste, LLP in Rochester, New York. Matt works with sureties, corporations, contractors, subcontractors, design professionals, and construction managers on a wide array of commercial, construction, and surety issues. His practice includes all aspects of contract review and negotiation, all phases of state and federal court litigation, including analysis of claims, preparation of pleadings, document discovery and depositions, motions, settlement negotiations, trial preparation, appeals, collections, and bankruptcy. Matt received his Juris Doctorate cum laude from Syracuse University College of Law. In law school, Matt competed on Syracuse's National Trial Team and completed an internship with the Honorable David E. Peebles, United States Magistrate Judge for the Northern District of New York.

DAVID R. HOMBACH

I graduated magna cum laude from the University of Puget Sound in Tacoma, WA in 1985 with a BS in Economics with a second major in Finance. My work history has been:

- Credit analyst for First National Bank of Englewood in Englewood, CO. January 1986 – July 1986
- Underwriting trainee with United Pacific Surety Managers from July 1986 through July 1988.
- HO underwriter from July 1988 to February 1991 with Reliance Surety
- Branch Underwriter with Reliance Surety from February 1991 to October 1996 in Seattle office with increasing levels of responsibility.
- Reliance Pacific Branch Manager from October 1996 to June of 2000 – covering business in Alaska and Hawaii.
- Travelers Bond HO Regional Underwriting Officer from June 2000 to May 2015. Responsibility for Travelers business in our Denver and Seattle Regional Offices – which includes the States of AK,HI, WA,OR, ID, MT, WY, CO, UT and parts of NV.
- Travelers Bond Chief Underwriting Officer – South Central Territory from June 2015 to December 2018. Responsibility for Travelers business in 16 offices in from Blue Bell, PA to San Antonio, Texas – states of PA, DE, MD,VA, NC, SC, TN, GA,FL,AL,MS,LA,TX and Puerto Rico.
- Travelers Bond Chief Underwriting Officer – West Territory. From October of 2018 to today… Responsibility for Travelers business in 16 offices from Seattle to New Orleans – states of AK, HI, WA, OR, ID, MT, WY, CO, UT, NV, AZ, NM, CA, TX, LA

- Professional designation: AFSB.

I am married and the father of five children and reside in Huntingdon Valley, PA. I will be relocating to Gig Harbor, WA in the summer of 2019.

PATRICK Q. HUSTEAD

Patrick Q. Hustead is the founder of The Hustead Law Firm in Denver, Colorado. He has a regional practice centered in the Rocky Mountain region. He is a founder of the ABA Fidelity and Surety Extra-Contractual Liability Committee and has represented sureties and insurers for over 30 years. He has tried many cases in the Rocky Mountains, on topics ranging from bad faith to brain injuries and construction defaults. He graduated from Boston College Law School, cum laude, and is admitted to practice in all courts in Colorado, Montana, Wyoming, Nebraska and the Dakotas.

Patrick has spoken in 18 states and the UK on a variety of insurance related topics. He has over 70 published opinions in six states and has penned over 20 pieces published by the ABA and DRI. He graduated from the University of Colorado Leeds School of Business (BS) 1981, attended the University of Paris at the Sorbonne (CP) 1984 and graduated cum laude from Boston College (JD), 1987.

JOHN KAMPSCHROR

John Kampschror is a Contract Underwriting Officer for Liberty Mutual Surety in Seattle WA.

John started with USF&G in 1988 as an underwriter in Charleston, WV. In 1994, he became Manager of the USF&G Oregon office. In 2004 he joined Safeco as the Oregon Manager and moved to Seattle in various Home Office

Contract Underwriting roles for Safeco and now Liberty Mutual. He works with offices in Washington, Alaska, Montana, Idaho and NJ.

John has a B.S. degree in finance from University of Montana.

DAVID J. KREBS

David J. Krebs is a member of Krebs Farley & Dry, with offices in Louisiana, Mississippi and Texas. Admitted to the bar in 1982, his practice has focused on Fidelity, Surety and Construction law for the last 35 years. He is ranked as a leading lawyer by Chambers & Partners, Best Lawyers in America, and Superlawyers. David received his B.A. cum laude from Tulane University in 1976, an M.A. with honors from the University of Tübingen in Germany in1979, and his J.D., Magna Cum Laude from Tulane University in 1982, where he

was also a member of the Tulane Law Review. A frequent speaker on fidelity and surety topics, David is active in the Fidelity and Surety Law Committee of the Torts, Trial and Insurance Practice Section of the ABA, and served as Chair of that committee in 2009-2010.

WAYNE D. LAMBERT

Wayne D. Lambert is the Regional Manager in Farmington, CT for the Northeast office of Cashin, Spinelli & Ferretti, LLC where he serves as a consultant to the Surety industry in Performance and Payment Bond claims and project completions. Prior to becoming a surety consultant, Mr. Lambert was a Senior Surety Counsel for Liberty Bond Services (now Liberty Mutual Surety); AVP of surety claims for Continental Insurance Company, a lawyer in private practice, and a Captain in the U.S. Army's Judge Advocate General's Corps. Mr. Lambert is a graduate of Georgetown University and the Western New England College School of Law. In his free time, Mr. Lambert sings with the Berkshire Mountain boys choir in Massachusetts.

CHARLES (CHUCK) LANGFITT

Chuck is a 2nd Vice President-Claim Counsel with the Travelers Insurance Companies. In his 35-year Surety career, Chuck has filled various positions of responsibility and, since 1998, he has led Travelers Western Regional Claim Office for the 13 Western States. In his current position, Chuck handles or provides management oversight for significant Surety claims in the Western United States, and, at times, in other regions, including Florida. Prior to joining the Surety Industry, Chuck was in private practice in Tacoma, Washington from November 1980 to June 1984 having been admitted to the Washington State Bar in October 1980. Chuck graduated from Gonzaga University School of Law with honors in 1980, and from the University of Oregon with a B.S. in History, in 1977.

Over the years, Chuck has participated at the Pearlman and other conferences. A representative sample follows:

- Co-Authored *Freedom of Contract Collides with Public Policy: A Trend Under the Miller Act of Invalidating Dispute Clauses* for the Spring 2016 Fidelity & Surety Law Committee Newsletter.
- Co-Chair of the Fidelity & Surety Law Committee 2013 Mid-Winter Meeting concerning *Construction Damages: An In-Depth Analysis*, serving as co-chair for the program and co-editor for the book of the same title.
- Co-Authored the article *Change Is Here: A Primer On the New A312-2010 Payment Bond Form* for the Winter 2011 Fidelity & Surety Law Committee Newsletter.

- Co-Author of Chapter 14 of the Law of Payment Bonds (2nd Ed.), *Payment Bond Claims Handling and the Law of Bad Faith*, presenting the chapter at the American Bar Association Spring Meeting in June 2011.

- Co-Author of Chapter 3 of the Law of Performance Bonds (2nd Ed.), *Performance Options Available to the Surety*, presenting the chapter at the American Bar Association Spring Meeting in May 2009.

KEITH A. LANGLEY

For 30 years of practice, Keith Langley has focused on understanding the client's business while seeking the earliest resolution of issues by starting with early comprehensive evaluation. He focuses his practice on complex workout, litigation, and bankruptcy matters. Keith is also experienced at counseling his clients on dispute avoidance. His trial experience includes serving as lead counsel on federal and state trials in Texas and other jurisdictions, as well as a successful record in arbitrations and appeals. Keith stays on the cutting edge of the latest technology in presenting evidence to the sophisticated jurors in today's courtrooms.

Keith's practice includes construction and surety law focusing on construction-related claims, lawsuits, mediations, and arbitrations. His experience in claims, trials, arbitrations, and mediations includes projects such as highways and bridges, public works projects, commercial and retail construction, industrial and warehouse facilities, health care facilities, power plants, pipelines, petrochemical plants, refineries, chemical plants, gas processing plants, schools, and multi-family housing.

He is a frequent author and speaker on a variety of litigation, bankruptcy, construction law, surety and fidelity topics. Keith is licensed in Texas, Florida, Arkansas, and Oklahoma.

SUNNY LEE

Sunny Lee is a partner at Bronster Fujichaku Robbins in Honolulu, Hawaii. Admitted to practice in Washington and Hawaii, he has a broad litigation background but focuses on Surety and Construction litigation. Sunny externed for the Honorable Kevin S. C. Chang, Magistrate, U.S. District Court for the District of Hawaii and clerked for Hawaii Supreme Court Justice Sabrina S. McKenna at the Circuit Court. He was previously in-house counsel for a title and escrow company before joining the firm in 2008. He received a B.A. from the University of Hawaii in 1999 and his J.D. from Seattle University in 2003. Sunny is also actively involved in several non-profit boards.

JAMES LOEWKE

Jim Loewke is CEO of Loewke Brill Consulting Group, Inc. a construction consulting firm located in Rochester, New York since 2002. Jim has been a licensed plumber since 1990 since joining the Local 13 Plumbers and Steamfitters Apprentice/journeyman program. He also studied HVAC Service & Controls program at Monroe Community College in Rochester, NY.

Jim went to work with his father Mike Loewke at E&L Piping from 1992-1998 from there he opened his own company Associated Mechanical Inc.in 1998-2001. He closed Associated Mechanical Inc. in 2001 to begin working as a consultant at Loewke Brill Consulting Group, Inc.

In 2003 Jim became President/Partner of Loewke Brill. In 2009 Jim developed 491 Elmgrove Park LLC a Real Estate Development Company. Jim Purchased and renovated over 26,000 square feet of commercial tenant space. In 2014 LB International Inc. was developed to provide the same services as offered in Loewke Brill Consulting Group, Inc. to international clients. In 2015 LBCG, Inc. dba LB Bonds & Insurance was developed a full service insurance brokerage that specializes in Contractor clientele. Jim also obtained his insurance brokerage license in 2015. Today Jim is sole owner of Loewke Brill Consulting Group, Inc., LB International Inc. LB Bonds & Insurance, and 491 Elmgrove Park LLC. Along with his education and experience this makes Jim well versed in within all forms of construction.

Outside of work Jim enjoys spending time with his wife of 13 years and his 4 daughters Abigail (12), Emma (11), Madelynn (8), and Sophia (6). They enjoy camping with family and friends, traveling and preparing for Halloween.

ERIC M. LIBERMAN

Education

- George Mason University School of Law, J.D., 2012, cum laude
- Miami University, B.A., Accounting with a Minor in Business Legal Studies

Bar Admissions

- Washington
- Virginia

Court Admissions

- Washington state courts
- Virginia state courts
- US District Court for the Eastern District of Washington
- US District Court for the Western District of Washington
- US District Court for the Eastern District of Virginia
- United States Court of Federal Claims

Memberships & Affiliations

- Washington State Bar Association
- Virginia Bar Association
- ABA Forum on the Construction Industry

Construction Litigation

Eric Liberman focuses his practice on construction litigation and government contracts. Eric has represented contractors, subcontractors, developers, sureties and insurance companies in all aspects of public and private construction projects.

Eric has represented clients in federal and state court cases, as well as GAO bid protests, and appeals before state and federal boards of contract appeals.

Eric has experience examining witnesses at trial, taking and defending depositions, drafting pleadings, dispositive motions and oppositions, and managing large scale e-discovery projects. Before earning his J.D, Eric worked for three years as a tax consultant and accountant.

Publications

- Know Your Title Insurance: How A Construction Lender Can Protect Its Interests When A Project Collapses.
- Guest Lecturer on International Commercial Arbitration at the George Mason University School of Law.

Representative Projects

- Obtained a $45,000,000 jury award for a Power Plant EPC contractor who accelerated construction to overcome delays caused by the Owner, a Municipal Corporation. Kiewit Power Constructors Co. v. City of Los Angeles, No. 2:16-cv-02590 (C.D. Cal. 2016)

- Successful bid protest at US Court of Federal Claims related to contract with Defense Information Systems Agency (DISA). Court issued permanent injunction stopping award. Level 3 Communications, LLC v. United States, 129 Fed. Cl. 487 (2016).

- Represented the EPC contractor on construction of Vogtle Nuclear Power Plants 3 and 4 in Waynesboro Georgia in litigation regarding regulatory and design changes exceeding $1.5 Billion, Georgia Power Co. v. Westinghouse Electric Company LLC et al., No. 12-167 (S.D. Georgia 2015).

- Favorable settlement of all claims in concurrent actions in the DC Superior Court and before the Civilian Board of Contract Appeals regarding renovation of fire damage at the Ronald Reagan Building and International Trade Center.

- Successfully represented intervener in a bid protest at the Maryland State Board of Contract Appeals and in the subsequent Petition for Judicial Review in the Circuit Court for Baltimore City regarding MDTA procurement to clean and paint the William Preston Lane, Jr. Memorial Bridge.

- Successfully represented intervenor in a bid protest at the FAA Office of Dispute Resolution (ODRA) related to a Controller Training services contract. Protest of CACI, 15-ODRA-00733 (2015).

BILL MCCONNELL

Bill McConnell is a co-founder and CEO of The Vertex Companies, Inc., a global forensic consulting, design engineering, environmental, and construction company that has completed nearly 50,000 projects since 1995. Vertex currently has over 20 offices and nearly 500 employee-owners. Bill earned a Bachelor of Science degree in Civil Engineering from the University of Maine, a Juris Doctor degree from the University of Denver, a Master of Science in Civil Engineering Degree from Columbia University, and he is working on his Doctor of Philosophy degree in Engineering and Applied Science from the University of Colorado. He is licensed professional engineer in many states. Bill has worked in the construction industry for nearly his entire life and has testified approximately 150 times as an expert on construction disputes, most notably for cost, allocation, scheduling, and standard of care opinions.

JOHN A. MCDEVITT

John A. McDevitt is the Regional Vice President for Global and Specialty Claims for Liberty Mutual Insurance Company. Prior to his current role, he was Senior Surety Counsel in the Northeast Region for Liberty Mutual Insurance Company, Bond Claims Counsel for Hanover Insurance Company, and represented contractor and subcontractors in private practice. He received a B.A. in History from Bates College in Lewiston, Maine, and a J.D. from Suffolk University Law School in Boston, Massachusetts. Although he can frequently be found worshipping #12 at his Tom Brady shrine, John is secretly a Seattle Seahawks fan and has a huge collection of Russell Wilson jerseys.

AMANDA MICELI

Amanda is an attorney in the surety and fidelity group at the law firm of Chiesa Shahinian & Giantomasi PC in West Orange, New Jersey. Amanda received her B.A. in philosophy from Franklin and Marshall College before graduating from Seton Hall Law School. Prior to joining Chiesa Shahinian & Giantomasi PC, Amanda was a law clerk in the United States District Court for the District of New Jersey.

STEVE MUROW

Steve Murow is the Founder and Chairman of DIRTONU, Inc. dba MUROW|CM and is an expert in **"forensic general engineering contracting and cost estimating"** specializing in DIRT – mass grading and excavation, street improvements, and underground utility construction. His career spans 40+ years in the public and private contracting industry. His expertise includes cost estimating and budgeting; project/construction management and contractor standard-of-care reviews; developing grading logistics, phasing analysis and sequencing of major earthwork projects; review and analysis of all phases of general engineering construction; public works contracting; job costing, change order review and billing procedures, and cost-to-complete. He has been retained as an expert over one hundred fifty times, been deposed on 55 occasions and has testified in court on twenty-six occasions.

KIERAN O'CONNOR

Kieran O'Connor is a Senior Project Manager at Beacon Consulting Group, Inc., a consulting firm that specializes in assessing and completing troubled construction projects for Surety Clients. He has spent over 7 years consulting on construction projects throughout the United States.

Kieran has demonstrated his effectiveness in performing construction management and oversight on troubled projects for Surety Clients, as well as assisting on matters related to complex surety bond default issues. Kieran's construction project experience is wide ranging and includes projects within the commercial, residential, education, marine,

municipal, and transportation sectors. Kieran has also provided expert testimony on several Surety Consulting files.

Kieran received a B.S. in Civil Engineering from the National University Ireland, in Galway.

Outside of work, Kieran's interests include travel and sports. He has been very active within the Irish Football Association of New York.

TY OKSUZLER

Ty Oksuzler is a Senior Consultant with JS Held, LLC. Mr. Oksuzler has served surety clients with cost to complete estimates, subcontractor ratifications, on-site construction monitoring and inspections, on-site construction management, relet bid procurement, processing of payment bond claims, dispute analysis and resolution, construction defect analyses, writing expert reports, and loss mitigation. Prior to becoming a surety consultant, Mr. Oksuzler accumulated 23 years of experience working for Texas based General Contractors as an estimator, project manager, chief estimator and VP of Operations. Mr. Oksuzler is a graduate of University of Texas at Austin (B.S. Civil Engineering). He resides in Houston, Texas with his wife and two young daughters.

DENNIS O'NEILL

Dennis O'Neill is the President of Beacon Consulting Group, Inc., a national construction consulting firm, which specializes in assessing troubled construction projects and managing all actions necessary to efficiently get work back on track. He has more than 20 years of experience working in the construction industry.

Dennis' expertise includes construction project management, estimating, consulting on complex surety bond claims and dispute resolution, and managing the turnaround of troubled projects. His background also includes providing expert testimony and litigation support in connection with construction claims, claims analysis, construction defects analysis, construction estimating, project funds control, and a wide range of project completion services. Dennis travels extensively for work and has a strong network of construction industry contacts throughout the United States. Beacon has consulted on projects in 32 states as well as several projects in Canada and Europe.

Dennis received a B.S. in Civil Engineering from the University of Maine, and M.S. in Real Estate Finance from New York University. A licensed construction supervisor, he has been a featured speaker at construction, surety, and fidelity related conferences for more than 10 years.

In his free time, Dennis coaches his children's hockey teams and continues to play ice hockey himself every week. Dennis is also a co-founder of Beacon Merchant, a General Contracting firm, and co-founder of Beacon Films, an independent film production company.

MARY JEAN PETHICK

Mary Jean Pethick leads Zurich North America's Surety Risk Solutions team of attorneys with responsibility for risk analysis, legal underwriting and training the Contract, International and Commercial Surety teams. She is a graduate of Rutgers University, cum laude, Phi Beta Kappa, and Georgetown University Law Center. She was formerly an associate at the law firm of Wolff & Samson specializing in surety law, and worked at Reliance Surety, Travelers Bond, and Arch Insurance providing legal advice to underwriters and handling complex surety claims. As Senior Counsel in the American Insurance Association's Law Department, she advocated for the surety industry concerning legislative and regulatory matters in the federal arena and the fifty states. Mary Jean currently serves as a Vice-Chair of the ABA TIPS Fidelity and Surety Law General Committee and as Zurich Surety's representative on the Surety and Fidelity Association of America's Corporate Counsel Advisory Committee and Government Affairs Advisory Committee. She is a past Vice-Chair of the American Bar Association's Fidelity & Surety Law Committee (FSLC). She has spoken at meetings of the American Bar Association's FSLC, the National Association of Surety Bond Producers, the Associated General Contractors of America, and other industry groups, as well as having written on various surety topics.

MIKE PIPKIN

Mike F. Pipkin is a Partner in the Dallas law firm of Weinstein Radcliff Pipkin LLP. He is a graduate of Abilene Christian University, B.B.A. 1986, and Southern Methodist University Dedman School of Law, J.D. 1989. Mike is a Past Chair of the ABA/TIPS Fidelity and Surety Law Committee and currently serves as one of eight attorneys in the USA on the National Association of Surety Bond Producers (NASBP) Attorney Advisory Council. In 2018, Mike was elected to serve on the Council for the American Bar Association's Tort Trial and Insurance Practice Section for a three-year term. Mike's election to Council is a reflection of his years of leadership within TIPS, including his continuing service as Co-Chair of the ABA/TIPS Book Publishing Editorial Board, his role as Co-Chair of the 2020 ABA/TIPS Section Conference, and his contributions to the ABA/TIPS Content Management and Finance Committees, and CLE Board. In 2016, Mike was elected to membership in the Federation of Defense & Corporate Counsel (FDCC), an organization comprised of leaders in the insurance and corporate defense bar. FDCC membership is selective and by invitation to those who have been judged by their peers to have achieved professional distinction.

SCOTT POWERS

Scott Powers' practice involves a broad range of commercial litigation matters with an emphasis on construction, surety, and insurance-related issues.

Licensed in Utah, Idaho, and Nevada, Scott has litigated disputes across the Intermountain West. He has successfully represented clients in a wide variety of legal matters including construction contract claims, defect claims, surety bond claims, mechanics lien claims, insurance coverage litigation, catastrophic injury claims, and class action lawsuits.

Prior to, and during, Scott's graduate and undergraduate studies, he worked in the construction industry. His experience working for multiple contractors, including union and non-union electrical contractors, commercial landscaping companies, and systems integration companies, provide insider expertise and knowledge to his construction litigation practice and allows him to more closely understand the unique needs of these industry clients.

Scott earned a B.S. from Brigham Young University in 2002 and received his J.D. from the University of Utah, S.J. Quinney College of Law in 2005.

LARRY A. ROTHSTEIN

Larry A. Rothstein has practiced surety and construction litigation for forty years. He has taken a dozen surety trials to jury verdict, winning all of them. In 2008, he was a featured participant in a mock surety bad faith trial presented at the ABA Surety and Fidelity Law mid-winter meeting. He has authored numerous articles on surety claims and recent developments and is a frequent presenter at numerous surety conferences.

Mr. Rothstein received his undergraduate degree from UCLA and J.D. from Southwestern University School of Law. He has been selected as a Super Lawyer® seven straight years. He practices in Westlake Village, CA.

EDWARD RUBACHA

Edward Rubacha is a partner with the Phoenix, Arizona law firm of Jennings, Haug & Cunningham, LLP., practicing in the firm's Surety and Construction Section. Ed has a B.S.E.E. from Purdue University, an M.B.A. from Arizona State University, and a J. D., cum laude, from Arizona State. Ed's practice includes representing sureties in all phases of bonding, including underwriting and claims litigation, including issues concerning bonding on Indian reservations. Ed represents sureties in Arizona, California, Colorado, and on reservation projects throughout the western United States. Ed is admitted to practice each of those states, in both state and federal court, and in a number of tribal courts. Ed has published a number of articles on the topic of bonding and contracting on the reservation and is a frequent speaker.

ALI SALAMIRAD

Ali Salamirad is the founding partner of SMTD Law LLP. Mr. Salamirad concentrates his practice in the areas of construction and surety law. For over twenty years, Mr. Salamirad has counseled sureties in a variety of complex litigation and transactional matters. Many of the nation's leading surety companies and general and specialty contractors trust Mr. Salamirad's guidance and counsel when dealing with the myriad of issues that arise in the construction industry.

Mr. Salamirad has successfully handled a wide range of cases on federal, state and private construction projects, including bid disputes and protests, subcontractor substitutions, labor claims, extra work disputes, differing site condition claims, delay, productivity and efficiency claims, default terminations, takeover and completion efforts, and surety financing arrangements.

WILLIAM SANFORD, III

William Sanford is responsible for handling complex contract surety claims of all types at The Hanover Insurance Group. William has over 11 years of direct experience as an in-house surety claims attorney, at Hanover and at Travelers. Mr. Sanford earned his JD from the University of Maine School of Law in 2000 and his BA from the University of New Hampshire in 1995. Mr. Sanford began practicing law in 2000, at a construction litigation firm in Providence, RI. Prior to moving to Hanover, Mr. Sanford worked as a construction litigator in Boston, representing general contractors, engineers and architects. He lives with his family in Rhode Island.

GINA D. SHEARER

Gina Shearer is a claims attorney at Merchants Bonding Company. Based out of Dallas, Texas, she handles a variety of contract and commercial bond claims across the United States. Prior to joining Merchants Bonding Company in 2019, she spent nearly a decade in private practice, most recently as a Senior Attorney at Clark Hill Strasburger. While in private practice, Gina devoted her practice primarily to construction and surety matters, with particular emphasis on bankruptcy, oil and gas plugging and abandonment obligations, payment and performance bond obligations, construction defect disputes, and enforcing rights against indemnitors. She also represented parties in complex commercial litigation in federal and state trial and appellate courts, as well as before tribunals and federal agencies.

Gina received a Bachelor of Science in Business Administration from the University of Texas at Dallas, *magna cum laude*, in 2007, and obtained her J.D. from Southern Methodist University in 2010. She regularly authors publications and presents at industry events on a variety of construction, surety, and bankruptcy topics.

GREGORY H. SMITH

Gregory H. Smith is a partner in the Orange County office of Booth, Mitchel & Strange LLP. Mr. Smith's practice focuses on business litigation matters and surety law matters in state and federal courts. Mr. Smith graduated from the University of California Berkeley in 2003 and obtained his law degree from Whittier Law School in 2005. He joined Booth, Mitchel & Strange LLP in 2012. Prior to joining the firm, Mr. Smith worked as an Equal Justice Works/AmeriCorps Attorney and later as a Staff Attorney at the Public Counsel Law Center where his practice focused on consumer litigation. He is an avid surfer and runner and lives in Laguna Beach California with his wife and daughter.

CRAIG SORENSEN

Mr. Craig A. Sorensen is a Construction Consultant and President of Nitro Associates Construction Consultants, in Pasadena, California. His consulting practice includes project planning, scheduling, cost analysis, and schedule delay impact analysis on private and government construction contracts. He established the consulting firm in 1992.

Mr. Sorensen studied Architecture (1979-1980) at Northern Virginia College and continued my studies at Montana State University towards a Bachelor of Arts degree in Architecture (1980-1983). He worked for Wexco Intl. Corp. (1983-1992) in the capacities of Junior Draftsman, Scheduling Engineer, Manager of Support Services, Senior Project Controls Manager, Senior Claims Manager, Vice President and, President - Consulting Operations Division.

He has been qualified as an expert in Court on Public Works bidding practices; Public and Private Projects on construction management, critical path method schedule analysis, schedule delay and related damage calculations, productivity and disruption damages, reasonable value of the work, and custom and practice concerning CPM scheduling, delay analysis, change order requests, change orders, methods of measuring inefficiency, and documenting delay claims. He has testified in the following jurisdictions and subject matter:

- United States Court of Federal Claims, Washington D.C. — Accepted

  Schedule analysis, delays, and delay-related damages

- United States District Court, California, Wyoming — Accepted

  Total cost, under-absorbed overhead, loss of efficiency, AIA contract documents custom and practice, cost plus agreements, and custom residential home building

- State of California Superior Court — Accepted

Public Works bidding practices, claims management and procedures, construction management, critical path method scheduling, schedule delay analysis, extended overhead, productivity, disruption, total cost method, reasonable value of the work, and prompt payment penalty calculations

- State of Montana District Court — Accepted

  Reasonable value of the work and labor inefficiency

- AAA, JAMS & OAH, California, Arizona — Accepted

  Critical path method schedule and delay analysis, extended overhead, productivity, disruption, force account / change in character, total cost method, and the practice of claims investigation when a demand on the performance bond is made

Mr. Sorensen has provided expert testimony as follows:

- Expert Testimony at Trial Court — 42 Occasions
- Expert Testimony at Arbitration — 56 Occasions
- Expert Testimony at Deposition — 133 Occasions
- Presentation of Expert Opinions Expected at Trial — 151 Mediations

Mr. Sorensen was an instructor for the Department of Engineering at the University of California, Los Angeles, Continuing Education Program from 1995 to 2002. He taught for UCLA in the Planning and Management Systems (CPM) class for the Professional Designation in Construction Management, a certified program. He continues to be a frequent speaker at Engineering and Construction Association meetings and conferences, as well as academically for Loyola School of Law, University of California, University of Southern California, California State University, and Lorman Educational Services. He is a member of the Association for the Advancement of Cost Engineering, the Engineering Contractors' Association and the Primavera Users Group.

JASON STONEFELD

Jason Stonefeld has been with Liberty Mutual since 2005. He is a life-long resident of the Pacific Northwest, but has yet to see Sasquatch.

RICHARD E. TASKER

Richard E. Tasker is President of Sage Associates, Inc., as well as Sage Consulting Associates, Inc. and Sage Contractor Services. He has been a Construction and Surety Consultant since the mid-1970's and has been involved with hundreds of contractor defaults and construction disputes. He began his career in the Northeast, working for a time in the Midwest and Rocky Mountain region, and for the past +15 years has resided in California. Mr. Tasker has represented most of the top 20 largest sureties and many smaller volume surety companies. He has been designated in many areas of construction including forensic schedule analysis, efficiency and productivity, construction accounting, procurement, means and methods, and standards of care. He is active and has often presented at industry functions including ABA, NBCA, SCI, NASBP, and WSSC, and is honored to see his many friends and speak again at the 2019 Pearlman.

MICHAEL J. TIMPANE

Mike Timpane is a partner with SMTD Law, LLP, and manages SMTD's Northern California office. Mike began his career in 1984 with the firm of Knecht, Haley, Lawrence and Smith, became a partner there in 1992, and co-founded the firm of Wolkin and Timpane, LLP in 1995. Mike joined SMTD Law in 2012. In his 34 years of practice, Mike has focused his practice on litigating surety and construction matters. He frequently writes and lectures on surety and construction topics, most recently co-authoring Chapter 3 of the 2018 Law of Performance Bonds, published by the ABA. Mike is also a highly experienced and sought-after neutral, with an active private mediation practice and as well being a member of the AAA Construction Arbitration and Construction Mediation panels. Mike was a member of the JAMS Global Engineering and Construction Group from 2008-2012.

MICHAEL TOMEO

Mr. Tomeo is a partner of Benchmark Consulting Services, LLC and manages its Irvine, California office. For nearly twenty-five years, Mr. Tomeo has been retained by multiple sureties, public agencies, general contractors and subcontractors to assist with various construction-related disputes. He has provided consulting services in the areas of surety, construction project management, alternative dispute resolution, as well as construction claim preparation and defense. Mr. Tomeo has been retained as a surety and damages expert and has defended and prepared multiple construction claims for project owners, sureties, general contractors and subcontractors. Mr. Tomeo also serves as a mediator and early neutral, and is a member of the American Arbitration Association's construction mediation and arbitration panels.

RODNEY J. TOMPKINS, JR.

Rodney J. Tompkins, Jr. is the Vice President of RJT Construction Consulting Services, Inc. Rodney manages the Southern California and Southwestern US region from RJT's Irvine, CA office. He graduated from University of San Diego with a B.A. Degree in Humanities, and Minor in Business. He received his J.D. from Lincoln Law School in Sacramento, CA and Post Graduate Construction Management certification at UC Berkeley. Rodney has served as President of Surety Claims Association of Los Angeles, as well as leadership committee roles within TTIPS and FSLC.

ANDREW W. TORRANCE

Andrew W. Torrance is Senior Surety Counsel at Liberty Mutual Surety. Mr. Torrance's experience includes 30 years in private practice as Litigation Counsel emphasizing Construction Law, Surety Defense, Insurance Defense and Commercial Law. He is licensed to practice in Washington and Alaska. He also was the CEO of a Seattle area Private Equity investment bank.

THOMAS J. VOLLBRECHT

Thomas J. Vollbrecht is a Shareholder in the Minneapolis MN law firm of Fabyanske Westra Hart and Thomson where his practice focuses on construction, fidelity and surety law. He is a graduate of St. John's University (MN) and Harvard Law School. Mr. Vollbrecht's practice is based in the Upper Midwest, but he represents clients in matters throughout the United States. He is a Fellow of the American College of Construction Lawyers and a Vice Chair of the ABA Fidelity and Surety Law Committee. When not practicing law, he enjoys spending time with his wife and daughters—something they sometimes enjoy, too.

RACHEL WALSH

Rachel joined Liberty Mutual Surety in 2015 as Claims Counsel for the Northeast Region. Before joining Liberty Mutual, she was an attorney at Krebs, Farley & Pelleteri, PLLC in New Orleans, Louisiana, where she focused her practice on construction litigation and surety law. Rachel graduated in 2004, cum laude, from Tulane University. In 2007, she earned her J.D., magna cum laude, from Loyola University New Orleans School of Law.

JENNIFER WHRITENOUR

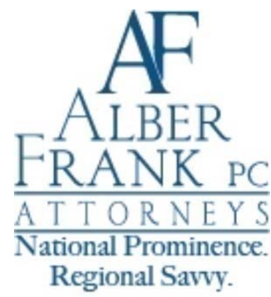
Jennifer Whritenour is a Claims Examiner at One Beacon Surety Group. She received her undergraduate degree from the University of Scranton and her Juris Doctorate from Seton Hall University School of Law.

THOMAS WINDUS

Tom Windus focuses his practice primarily in the area of surety and construction law. Tom has represented surety and construction clients for over thirty years in a variety of disputes involving litigation in both state and federal courts. Tom has extensive experience in state and federal courts involving trials as well as arbitration and mediation. Tom's undergraduate accounting degree gives him the ability help clients in the analysis of claims involving breach of contract, payment disputes, delay and disruption, labor productivity, contract interpretation and differing site conditions. Tom's practice has also involved representing commercial and surety clients in bankruptcy proceedings.

Professional Associations

- Washington State Bar Association
- King County Bar Association
- American Bar Association
  - Forum on the Construction Industry
  - Tort, Trial and Insurance Practice Section



Alber Frank, PSC is a regional surety, fidelity and construction law firm that is the product of relationships forged by years of trust and confidence between its attorneys and clients. To effectively serve the interests of our clients in matters of surety and fidelity law, construction law, insurance law, commercial law, bankruptcy law, and probate law, our attorneys hold licenses to practice in Arkansas, Indiana, Kentucky, Michigan and Ohio. Furthermore, by partnering with local counsel, we have been able to expand our geographic boundaries to represent our clients in Alabama, Colorado, Florida Minnesota, North Carolina, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, West Virginia and Washington D.C.

Please visit our website at www.alberfrank.com.

Benchmark Consulting Services, LLC is a full service construction consulting firm serving the Western United States from offices in Irvine, California, Las Vegas, Nevada and Phoenix, Arizona.

Benchmark's staff of construction industry experts consult our clients in the areas of surety, construction defect litigation, property and casualty evaluations, construction claims, scheduling, construction litigation support, construction monitoring/fund control, project management and quality assurance services.

Please visit our website at www.benchmark-consulting.com.

Berkeley Research Group offers professional experience and competence in fact-finding, claims/dispute analysis, and litigation support, along with technical expertise in engineering, architecture, construction management, public contracting, specifications and technical document development, schedule development and analysis, cost analysis, negotiations, and expert witness testimony. Our multidisciplinary team has a strong foundation in project management, scheduling, and accounting combined with deep industry experience.

BRG has worked extensively with our clients and their outside counsel to assess the allegations and facts at issue and develop sophisticated but efficient solutions.

Our experts are experienced in litigation and domestic and international arbitration, and include Professional Engineers, Project Management Professionals, AACE Certified Planning & Scheduling Professionals, Certified Public Accountants, Certified Fraud Examiners, forensic accountants, and industry leaders.

Please visit our website at www.brg-expert.com.

Since 1955, Booth, Mitchel & Strange LLP has provided exemplary legal service to businesses and individuals throughout California. With offices in Los Angeles, Orange County and San Diego, we are positioned to efficiently handle litigation and transactions throughout Southern California. In addition, over half of the firm's practicing lawyers are partners who have a personal stake in the quality of our work, the satisfaction of our clients in the results obtained and in the professionalism with which we represent them.

Rated AV by Martindale-Hubbell, Booth, Mitchel & Strange LLP handles private and commercial lawsuits and arbitrations involving tort, contract, environmental, construction, surety, commercial, employment, professional liability, landlord-tenant and real estate disputes. We represent both plaintiffs and defendants and have thereby developed a breath of insight that facilitates prompt and accurate analysis of our client's problem and an

ability to obtain the most favorable resolution in the most efficient and cost effective way.

We are also available to consult in the areas of commercial and construction contracting, real estate transactions, leasing, surety and employment.

Please visit our website at www.boothmitchel.com.

Bronster Fujichaku Robbins is recognized as one of the premier trial law firms in Hawaii, handling cases on all of the islands. We are an experienced litigation firm with an established track record of successful settlements, work outs, and trial verdicts in a wide variety of complex litigation, arbitrations and mediations. Our firm is strongly committed to serving the community through significant public and private *pro bono* work. Our philosophy is to obtain the best results possible for our clients through aggressive advocacy and efficient management practices.

Our areas of practice include commercial, business, surety and real property litigation; consumer protection law involving financial fraud, unfair or deceptive business practices; antitrust and competition law; litigation and advice to trustees and trust beneficiaries, including claims of breach of fiduciary duties; regulatory and administrative law before state and county agencies; environmental litigation; civil rights employment cases including discrimination, harassment, and wrongful discharge; and arbitration, mediation and other dispute resolution services.

Please visit our website at www.bfrhawaii.com.

Carney Badley Spellman works with a wide range of clients including, individuals, professionals, entrepreneurs, educators, closely-held or family businesses, franchises, as well as insurance companies, Fortune 500 companies and global industry leaders. They are in the private sector, public sector and governments. Our clients are forward thinkers, creative, collaborative and deliver high-quality products and business services to their markets. Our clients markets extend into almost every industry including, food and beverage, retail, professional services, arts, health care, education, manufacturing, technology, construction, surety, real estate and more. We partner with them so they can drive their journeys.

Please visit our website at www.carneylaw.com.

Cashin Spinelli & Ferretti, LLC is a multi-disciplinary firm providing consulting and construction management services to the Surety and construction industries. The Principals of Cashin Spinelli & Ferretti have more than 70 years of experience in providing expert advice and analysis to the nation's leading Surety companies. Drawing on the expertise of its staff of Professional Engineers, Architects, Attorneys, Certified Public Accountants, Field Inspectors and Claims experts, Cashin Spinelli & Ferretti is well poised to offer Surety consulting and litigation support services to the industry.

Operating from offices in: Hauppauge, New York (Long Island); Horsham, Pennsylvania (Philadelphia area); Farmington, Connecticut (Hartford area); Libertyville, Illinois (Chicago area); and Miami, Florida; Cashin Spinelli & Ferretti provides its services to all areas of the United States.

Please visit our website at www.csfllc.com.

Chiesa Shahinian & Giantomasi PC

Chiesa Shahinian & Giantomasi PC, with offices in New York, NY, West Orange, NJ and Trenton, NJ, is committed to teaming with our clients to achieve their objectives in an increasingly complex business environment. This goal is as important to us today as it was when our firm was founded in 1972.

Over the past four decades, CSG has expanded from eight to more than 130 members and associates, all of whom are dedicated to the legal profession and to the clients they serve. As our firm has grown, we have steadfastly maintained our commitment to excellence, offering businesses and individuals comprehensive legal representation in a cost-effective, efficient manner.

Our firm provides the high level of service found in the largest firms while fostering the type of personal relationships with the firm's clients often characteristic of small firms. We take pride in our reputation for excellence in all our areas of practice, including banking, bankruptcy & creditors' rights, construction, corporate & securities, employment, environmental law, ERISA & employee benefits, fidelity & surety, government & regulatory affairs, health law, intellectual property, internal investigations & monitoring, litigation, media & technology, private equity, product liability & toxic tort, public finance, real estate, renewable energy & sustainability, tax, trusts & estates, and white collar criminal investigations.

Please visit our website at www.csglaw.com.

CLARK HILL | Strasburger

Clark Hill | Strasburger has been at the forefront of the fidelity and surety industry for over fifty years. From the quiet days of the 1960's to the mercurial 1980's dealing with the banking and real estate crisis throughout the country, to the advent of electronic banking and mega-construction projects of the 1990's and 2000's, the lawyers in Clark Hill | Strasburger's Fidelity & Surety group have worked in partnership with our clients in every aspect of the industry.

Clark Hill | Strasburger's surety lawyers provide experienced representation in all facets of the surety industry. The group's lawyers have significant experience representing sureties in connection with all types of bonds, including performance, payment, probate, public officials, subdivision, and various other miscellaneous commercial surety bonds. Our lawyers have successfully handled countless complex contract surety claims, expertly guiding sureties through pre-default investigations and negotiations and completion of construction projects after default, including drafting and negotiating completion contracts, takeover agreements, ratification agreements, financing agreements, and other pertinent surety agreements. Our lawyers likewise have extensive experience handling complicated and varied commercial surety bond claims, from the initial investigation and analysis to conclusion. Our expertise and experience extends to protecting the surety's interests in bankruptcy proceedings, including pre-bankruptcy and post-filing negotiations of reorganization plans, conflicts regarding unpaid proceeds of bonded

contracts, negotiations regarding assumption of bonded obligations, and other issues affecting the surety in bankruptcy.

Please visit our website at www.clarkhillstrasburger.com.

The attorneys at Dunlap Fiore, LLC, represent surety clients throughout the United States and have extensive experience in all aspects of the construction industry including: default, project completion, disputes involving payment, defective work, defective design, delay claims, and claims for additional work. Our attorneys are actively involved in negotiations with project owners, creditors and financially troubled contractors during all stages of the construction process.

Our firm has a particular focus in federal contracting and issues involving the Federal Acquisition Regulation. Representing sureties for government contractors, we draw on decades of experience in resolving government contract controversies. Our approach to legal representation involves fully understanding the needs of our clients, followed by personalizing our representation to obtain quick, positive results.

Please visit our website at: www.dunlapfiore.com

The Ernstrom & Dreste, LLP law firm is proud to focus its practice on the surety and construction industries. Our experience and in-depth knowledge of surety and construction law is recognized locally, across New York State and even nationally. We serve clients across the country and around the globe. We are more than just a law firm; our industry knowledge helps us understand what is important to our clients. As leaders in surety and construction law, we are a team of accomplished professionals who understand the nature of both industries and the forces which shape those industries. Because the industries we serve are intertwined, our understanding of the surety industry means we can better serve our construction clients, and our knowledge of the construction industry means we can better serve our surety clients. We go the extra mile to make sure our clients are satisfied with the legal services we provide.

Please visit our website at www.ed-llp.com.

Fasano Acchione & Associates provides consulting services for a variety of clients in the construction and surety industries. The individuals at Fasano Acchione & Associates are accomplished professionals with expertise in surety, construction, engineering, project management, and dispute resolution including litigation support.

FA&A maintains offices in New York, NY, Philadelphia, PA, Mount Laurel, NJ, Seattle, WA, and Baltimore, MD. If you would like more information, please contact Vince Fasano at (856) 273-0777 or Tom Acchione at (212) 244-9588.

Please visit our website at www.fasanoacchione.com.

The Wild-Wild West is the home of Faux Law Group. Faux Law Group represents sureties in Nevada, Idaho and Utah regarding claims on public and private payment and performance bonds, subdivision bonds, commercial bonds, license bonds, DMV bonds, and miscellaneous bonds. Faux Law Group represents sureties in the recovery of losses through indemnity and subrogation actions. Our attorneys are actively involved in the local communities in order to better represent the interests of our surety clients.

Please visit our website at www.fauxlaw.com.

Forcon International is a multi-dimensional consulting and outsourcing firm that has provided services to the surety, fidelity, insurance and construction services industry for more than twenty-nine years. Our surety and construction services include books and records review, claim analysis, third party claims administration for sureties, bid procurement, estimating, project administration, scheduling and funds control. We are able to offer these broad ranges of services because FORCON is composed of senior claim management professionals, accountants, professional engineers and construction management executives. Forcon has acted as third party administrator dealing with bond claims and runoff services since its inception. The firm operates from six (6) offices located throughout the United States [FL, GA, MI, MD, PA, VA].

Please visit our website at www.forcon.com.

Global Construction Services, Inc., located in Redmond, Washington, has provided project management, claims consulting services and surety loss consulting to virtually the entire spectrum of the construction industry since 1972. Our construction experts have assisted owners and contractors alike with the preparation and updating of project schedules, change order pricing and negotiation, and time extension calculations. We have prepared and/or defended claims on behalf of general contractors, subcontractors, sureties, public owners, private owners, architects and engineers. We have extensive experience providing expert testimony at deposition, arbitration and trial. We have deftly handled surety losses through all phases of project completion as well as the resolution of related claims both asserted by and defended by the surety.

Please visit our website at www.consultgcsi.com.

Guardian Group, Inc. is a full-service consulting firm with offices nationwide specializing in surety claims, property and casualty claims, construction management and claims, construction defect claims, fidelity claims, construction risk management, expert witnessing and litigation support.

When you need expert construction and surety claims support, our distinguished twenty-five year track record yields confidence, unprecedented efficiency and results.

Guardian's management and staff consists of a unique combination of highly qualified engineers, architects, schedulers, project estimators, accountants, claims personnel and other professionals with expertise in all types of construction and surety bond claims. This knowledge, together with fully automated systems, provides our clients with expedient and cost effective claims resolutions.

Call on the one company engineered to exceed your expectations. Please learn more about Guardian Group, Inc.'s successful approach to consulting by visiting our website at www.guardiangroup.com.

Founded in 1979, JAMS is the largest private provider of mediation and arbitration services worldwide. With Resolution Centers nationwide and abroad, JAMS and its nearly 300 exclusive neutrals are responsible for resolving thousands of the world's important cases. JAMS may be reached at 800-352-5267.

JAMS neutrals are responsible for resolving a wide array of disputes in the construction industry, including matters involving breach of contract, defect, cost overrun, delay, disruption, acceleration, insurance coverage, surety, and engineering and design issues. The JAMS Global Engineering and Construction Group consists of neutrals who serve the industry through traditional ADR options such as mediation and arbitration, and through several innovative approaches to ADR such as Rapid Resolution, Initial Decision Maker, and Project Neutral functions. Further, JAMS neutrals understand the complexity of project financing and the demands of large infrastructure and other mega-projects and are uniquely qualified to serve on Dispute Review Boards and other institutional approaches to conflict resolution.

Please visit our website at www.jamsadr.com.

The surety, construction, and litigation firm of Jennings, Haug & Cunningham, LLP delivers effective courtroom representation, capable legal advice, and superior personal service to our clients in the construction and surety industries. Our experienced lawyers provide representation in a broad array of practice areas including construction law, surety/fidelity law, bankruptcy, Indian law, business law, and insurance defense.

What distinguishes our Firm is the quality of service and the consistent follow-through clients can expect from our attorneys and staff. We pride ourselves in providing timely, effective, and efficient legal services to our surety and contractor clients.

The firm serves businesses and individual clients throughout the state of Arizona, and we can accept cases in the southwest United States, California, New Mexico, Nevada and in

select bankruptcy actions nationwide.

Please visit our website at www.jhc.law.

J.S. Held is a leading consulting firm specializing in construction consulting, property damage assessment, surety services, project and program management, and environmental, health & safety services. Our organization is built upon three fundamental pillars: to provide high quality technical expertise; to deliver an unparalleled client experience; and to be a catalyst for change in our industry. Our commitment to these pillars positions us as a leading global consulting firm, respected for our exceptional success addressing complex construction and environmental matters in the world. Our team is a group of multi-talented professionals, bringing together years of technical field experience among all facets of projects including commercial, industrial, high rise, special structures, governmental, residential, and infrastructure. Our uncompromising commitment to our clients ensures our position as one of the most prominent consulting firms in our industry.

Please visit our website at www.jsheld.com.

Established in 1874, Kerr, Russell and Weber, PLC has evolved from a small practice in Detroit into a firm of committed, resourceful and respected lawyers with many talents and specialties. Our areas of practice include fidelity and surety. Kerr Russell represents sureties in a wide range of matters, including the handling of defaults; claims against performance bonds, payment bonds, probate bonds and other commercial bond forms; performance takeovers, tenders and subcontract ratifications; pursuit of indemnification; and all aspects of litigation. Our attorneys also include those whose specialties afford our surety practice access to a wide array of disciplines which are often beneficial to our services for surety clients, including corporate, tax, real estate, bankruptcy, and employment practices.

Please visit our website at www.kerr-russell.com.

Koeller, Nebeker, Carlson, Haluck, LLP (KNCH) prides itself in its handling of complex litigation matters. Our broad spectrum of practice areas includes litigation defense, business law, employment law, insurance coverage and bad faith, environmental law, and most types of general practice areas. Our clients range from small business owners and their insurance companies; to mid-sized commercial contractors, landlords and tenants; to large nationwide homebuilders and commercial builders.

Over the 30 years of our existence, we have also become a recognized authority in all areas of construction litigation and transactions, with a particular specialty in representing builders, developers and general contractors. From real estate acquisition, development and financing, to construction and business litigation for both residential and commercial projects, our breadth of experience and geographical coverage ensures that our clients' personal business and financial concerns are being represented every step of the way.

As a direct result of the faithful support of our clients and the dedicated service of our attorneys and staff, the firm has grown to over 80 attorneys, 200 employees, with offices in Irvine, San Diego, Sacramento, Las Vegas, Phoenix, Orlando and Austin. Indeed, since its inception in 1986, KNCH has formed a dynamic presence throughout the states of California, Arizona, Nevada and Florida and has recently extended its reach into Texas. We look forward to developing new client relationships while continuing to excel at serving the needs of existing clients by achieving the highest level of excellence.

Dedicated to service, and driving ahead with integrity and courage, we are the law firm you want on your side.

Please visit our website at www.knchlaw.com.

The nationally recognized attorneys of Krebs Farley & Dry, PLLC have litigated cases all over the United States. Our attorneys' skills show not only in the courtroom, but also in negotiation. The personal commitment and dedicated effort that our attorneys put forth

make a difference in every case we handle. We are smart, pragmatic and diligent. And we are dedicated to creatively pursuing the best solutions for our clients.

We understand the importance of prompt, correct, and concise responses; foreseeing and accounting for future contingencies in contract drafting; resolving disputes that can be amicably resolved; and positioning those matters that cannot be settled for a successful outcome in litigation. We do this while remaining cognizant that litigation often impacts business considerations beyond the case at hand. We also work closely with our clients in developing and operating within a litigation budget. Whether it be in negotiation, in mediation, in arbitration, in trial or on appeal, the attorneys at Krebs Farley & Dry, PLLC seek pragmatic solutions for our clients.

Please visit our website at www.kfplaw.com.

Langley, LLP is a Texas civil trial, commercial bankruptcy, and appellate firm that represents Fortune 500 and middle- market industry leaders in disputes throughout the United States. Our firm is made up of ambitious and smart lawyers who demonstrate passion and zeal in representation of the firm's clients. We help our clients solve their legal challenges through aggressive negotiation or litigation. Our areas of specialty include surety and construction, property insurance claims, commercial litigation, and commercial bankruptcy.

Our attorneys try cases, handle arbitrations, litigate, negotiate, analyze, and communicate. At the heart of the matter, for us it is all about understanding our clients' business and keeping our clients informed. We are strong believers in creating a plan for each matter designed to arrive at an efficient and effective resolution. Most cases in the United States settle, as do most of ours. When a case must be tried, our trial lawyers relish the opportunity – whether it is a two day trial to the bench or a sixteen week jury trial. Whether the amount in controversy is hundreds of millions of dollars or a small sum, our experience, communication skills, and use of cutting edge technology position us to achieve the winning result.

Please visit our website at www.l-llp.com.

The Law Office of Charles G. Evans has represented sureties in the last frontier of Alaska for more than forty years. From rebids and completion of defaulted contracts in remote locations, to bonded but busted roads, schools, hospitals, and dams, we solve problems with local knowledge and expertise. We know the environment. Our firm has a proven track record of limiting surety exposure and quickly capturing repayment for our clients. We combine personal service with innovative tech solutions and big firm capabilities to achieve results anywhere in Alaska.

Law Offices of John L. Fallat

Our firm has been representing fidelity and surety companies for over 20 years. We focus on problem solving, always attempting to resolve conflicts efficiently in a good-faith effort to avoid expensive, protracted litigation. However, we are certainly prepared to defend claims through the entire judicial process, including appeals. The size of our firm enables us to give personal attention to our clients' needs.

Please visit our website at www.fallat.com.

MDD is a world-class forensic accounting firm that specializes in economic damage quantification assessments. We have deep rooted and comprehensive expertise in matters related to the surety and construction industry.

Our experts speak over 30 languages and we have 42 offices on 4 continents. Our work spans more than 130 countries and 800 industries, and we frequently work with law firms,

government entities, multi-national corporations, small businesses, insurance companies and independent adjustment firms.

For more information please contact David Stryjewski or Peter Fascia at 215.238.1919 or visit us at mdd.com.

Manier & Herod, P.C. is located in Nashville, Tennessee and provides representation, counsel, and advocacy on behalf of sureties and fidelity insurers throughout the United States. Manier & Herod's attorneys are actively involved in the Fidelity and Surety Committee of the American Bar Association (ABA) and frequently address the ABA and other professional organizations on topics relevant to the fidelity and surety industries. Manier & Herod represents fidelity insurers and sureties in underwriting, pre-claim workouts, coverage analysis and litigation, contractor defaults including performance bond and payment bond claims, contractor bankruptcies, surety litigation, indemnity actions, and other matters and forums.

Please visit our website at www.manierherod.com.

Partner Engineering and Science, Inc. (Partner) offers full-service engineering, environmental and energy consulting and design services throughout the Americas, Europe, and around the globe. Our multi-disciplinary approach allows us to provide comprehensive surety consulting solutions, including claims management services and completion contracting, from initial due diligence and design to project close-out and expert witness litigation support. Our dedicated surety consulting team has over 20 years of domestic and international experience managing dozens of complex files and project sites. Backed by Partner's deep bench of registered professionals and specialists in diverse practices including forensic engineering, construction management, environmental consulting, and civil and structural engineering, the surety consulting team can perform a thorough and expeditious review of a distressed contracted project; interface with

subcontractors, vendors and other stakeholders; isolate causes and contributing factors; and recommend and/or execute a plan for resolution.

Please visit our website at www.partneresi.com.

PCA Consulting Group was formed in January 1989 for the purpose of providing the surety, insurance, legal and financial industries with cost effective technical services. With over 80 years of aggregate experience, the construction and engineering professionals of the PCA Consulting Group have served the surety and insurance industries throughout the majority of the continental United States and have been involved in matters requiring knowledge of every construction specialty.

PCA has adapted its experience and systems to meet the Surety's requirements. From evaluating the status and cost-to- complete projection for an individual project, to analyzing the fiscal and operating point-in-time cash position of an entire construction company, PCA has developed the systems, acquired the expertise, and retained the personnel to provide results in a timely and cost effective manner.

Please visit our website at www.pcacg.com.

For over 30 years, RJT Construction, Inc. has been dedicated to providing exceptional quality, experience, and professional services to the construction, surety, and legal industries. RJT operates as a full service consulting firm specializing in construction, surety, and related claims and litigation. RJT's typical services include: surety claims investigation and default analysis, completion obligations and oversight on behalf of surety, reporting, monitoring, payment bond analysis, claims preparation, claims analysis including support and defense, construction defect claims and litigation support, forensic investigation, scheduling analysis, and expert designation and testimony.

Please visit our website at www.rjtconstruction.com.

ROBINS KAPLAN LLP

Robins Kaplan LLP is among the nation's premier trial law firms, with more than 250 attorneys in eight major cities. Our attorneys litigate, mediate, and arbitrate client disputes, always at-the-ready for an ultimate courtroom battle. When huge forces are at play, major money is at stake, or rights are being trampled, we help clients cut through complexity, get to the heart of the problem, and win what matters most.

Our surety attorneys have combined over 100 years of experience in the evaluation, resolution and litigation of bond claims. This includes the handling of multi-project defaults to achieve a timely completion of open projects while mitigating losses and maximizing recovery efforts. Our surety attorneys also counsel clients on matters arising out of fiduciary bonds, litigation bonds, license and permit bonds, and other miscellaneous bond

matters, as well as provide necessary training and counsel on state regulations and Department of Insurance requirements.

Please visit our website at www.robinskaplan.com.

Robinson+Cole

Robinson+Cole is an Am Law 200 firm serving regional, national, and international clients from nine offices throughout the Northeast, Florida, and California. Our 200-plus lawyers and other professionals provide legal solutions to businesses, from start-ups to Fortune 100 companies and from nonprofits and educational institutions to municipalities and state government.

Through an understanding of our clients' industry, the nature and structure of their business, their level of risk tolerance, and their budget considerations, we tailor our legal strategy to align with their overall business needs. Where appropriate, alternative billing arrangements are made to provide clients with a greater degree of certainty about their legal costs. Robinson+Cole's varied practice areas include construction and surety; insurance and business litigation; land use, environmental and real estate; labor, employment and benefits; tax; and intellectual property and technology.

Please visit our website at www.rc.com.

Sage Associates is very pleased to be among the sponsoring firms of Pearlman. We have provided high quality, high value consulting services in the surety industry, as well as construction, banking, and insurance industries, for more than 30 years and our contacts within the construction community and with attorneys and mediators within the construction field is unmatched in the western United States.

The firm's employees and associates offer a broad mix of expertise and skills. Surety claims work is facilitated by knowledge, patience, focus, and relationships. We focus on our client's business and objectives, working hard to assist sureties "deliver on the promise"

and resolve claims. Cost to benefit is always a paramount consideration at Sage Associates as is a long term focus both in the assignment and with our relationship with our clients.

Please visit our website at www.sage-associates.com.

Sage Consulting Group provides consulting and expert witness services to the surety and construction industry on projects throughout the United States and Canada. Our expertise is focused on the heart of construction projects: time and money. The background of the Sage Team makes rapid and precise evaluation of costs to complete and project status possible. Sage's extensive background in construction claims and litigation is an asset when reviewing actual or potential defaults since troubled projects often have significant construction disputes. Favorable resolution of those disputes can be a significant source of salvage and reduce losses. Construction disputes arise out of the need by one of the parties to recover monetary damages. Sage focuses on first the areas of damage and then focuses on causation to narrow the research effort to the relevant areas of performance, resulting in a more cost-effective approach to claims assessment, development and defense.

Please visit our website at www.sageconsulting.com.

SMTD Law LLP is a boutique law firm specializing in construction, surety and business litigation. The Firm's attorneys are highly experienced in handling disputes unique to the construction and surety industries and they understand the rigors and challenges of litigation. The Firm handles matters for many of the world's leading sureties in all types of commercial and contract surety matters. Our attorneys frequently assist our surety clients with: defense of contract and commercial bond claims; analysis and prosecution of affirmative claims; preparation of transactional documents, including loan and financing

agreements; subdivision workouts with lenders and local entities; and handling complex indemnity and other salvage actions.

Please visit our website at www.smtdlaw.com.

Simon, Peragine, Smith & Redfearn, LLP has extensive experience in handling fidelity and surety related matters and litigation. Over the years, the firm's attorneys have handled numerous fidelity, contract surety, financial guarantee and miscellaneous bond and commercial surety matters.

The firm's attorneys who practice in the surety law field have been active participants in many professional associations, such as the Fidelity & Surety Committee of the Tort Trial Insurance Practice Section of the American Bar Association; the DRI Surety Committee; National Bond Claims Institute; Surety Claims Institute; and Louisiana Surety Association.

H. Bruce Shreves is the former Chair of the American Bar Association Fidelity & Surety Committee and the DRI Surety Committee; Jay Kern has served as a Vice-Chair of the

American Bar Association Fidelity and Surety Committee; Mr. Shreves, Mr. Kern and Denise Puente have delivered numerous papers and lectures before various ABA Committees, as well as DRI, National Bond Claims and Surety Claims Institute.

Mr. Shreves is currently the Chair of the Louisiana Fidelity, Surety & Construction Law Section of the Louisiana Bar Association. Mr. Shreves, Mr. Kern and Ms. Puente have been named by New Orleans Magazine as Best Lawyers in New Orleans in the area of construction/surety, and have been named as Louisiana Super Lawyers in the areas of construction and surety. They are contributing authors or editors to various ABA publications, including the Law of Payment Bonds; the Law of Performance Bond; and the Law of Suretyship.

Please visit our website at www.spsr-law.com.

Snow Christensen & Martineau traces its roots to Provo, Utah, and 1886, ten years before Utah became a state. One of its founders, George Sutherland, later became the only Utahan to serve on the United States Supreme Court. The firm now enjoys a complement of more than 55 attorneys (including a recently retired but still energetic federal magistrate judge) and a strong staff including more than 15 paralegals. With physical offices in Salt Lake City and St. George and virtual offices wherever needed, the Firm serves some of the Intermountain West's most vital and influential businesses and institutions. Snow, Christensen & Martineau benefits from an impressive history of service, growth and innovation in the legal community, and continues to build toward an equally impressive and significant future. The Firm is recognized for its preeminent trial work, but its attorneys are experienced in a broad spectrum of legal specialties, including complicated business transactions, patents, trademarks and other intellectual property. Many are recognized as among the best in their fields of practice, combining national expertise with personal service. The firm is committed to providing timely, superior legal services at a fair price. Its commitment to the practice of law is manifest in the general lackluster performance of most of its members on the golf course.

Please visit our website at www.scmlaw.com.

Stewart Sokol & Larkin LLC is a Pacific Northwest law firm. The firm enjoys a superior reputation for excellent, competitive and cost-effective legal services in construction and design law, commercial litigation, business and corporate law, insurance coverage and defense, bankruptcy, real estate, and surety and fidelity law.

The firm's Portland, Oregon location provides strong roots for its Pacific Northwest presence, and an ideal location from which it maintains its client base throughout Oregon, Idaho, Washington and Alaska. In addition to the firm's Pacific Northwest presence, Stewart Sokol & Larkin is a national firm, handling matters throughout the United States and its territories, including, Guam, Saipan and the Northern Mariana Islands. The firm's reach throughout various federal and state court systems continues to grow on a regular basis as our loyal clients bring it to more locales each year.

The firm's exceptional service is the product of a cohesive team of highly experienced professionals, each of whom plays a vital role in meeting our clients' needs.

Please visit our website at www.lawssl.com.

THE HUSTEAD LAW FIRM
A Professional Corporation

The Hustead Law Firm, A Professional Corporation, launched in 1996 when Patrick Q. Hustead left the partnership of one of Denver's largest law firms to create a dedicated litigation practice focused on the surety and insurance industry. Since that time, the Firm has grown into a dynamic mix of attorneys and technology that produces the results its clients deserve and expect. From complex surety matters to nuanced bad faith claims, the Firm delivers the firepower of a large firm with the personal attention of a small one.

Please visit our website at www.thlf.com.

Torre, Lentz, Gamell, Gary & Rittmaster, LLP is a boutique New York based law firm specializing in surety, fidelity and construction law and providing clients with the best features of small and large firms. TLGGR is able to provide this service by combining the seasoned legal talent and modern technology of a large firm with the personal attention, expertise and congeniality of a small firm. Our office is located in Jericho, Long Island, New York, which is within 30 minutes of Manhattan. While the firm's practice is located primarily in New York and New Jersey, TLGGR also has recently handled substantial matters in Connecticut, Pennsylvania, Delaware and Washington, D.C.

TLGGR handles all manner of commercial and business problems but in large measure specializes in counseling and litigation relating to (1) construction bonds, commercial surety bonds and other forms of suretyship, (2) construction contract and engineering disputes, (3) claims against project owners for wrongful termination and additional compensation, (4) financial institution bonds and other forms of fidelity or crime insurance, and (5) creditors' rights in bankruptcy. These matters involve us in a broad range of commercial problems, including workouts, bankruptcy proceedings, and insurance coverage analysis and litigation.

Please visit our website at www.tlggr.com.

Vertex is an international technical services firm that operates with urgency and produces exceptional value for our clients. VERTEX provides construction, environmental, energy, air quality, and engineering solutions. With over 20 domestic and international offices, along with unique teaming arrangements worldwide, we have the reach and relevant expertise to approach projects with remarkable efficiency gained through local knowledge. Our reputation for excellence, both in terms of timely results and quality service, spans the globe. It has earned us the trust of a prestigious client base that includes Fortune 100 companies and esteemed boutique firms in virtually every line of business.

Please visit our website at www.vertexeng.com.

For over a quarter of a century, the attorneys at Ward, Hocker & Thornton, PLLC (WHT) have diligently and competently served their clients and have provided them with the highest quality legal representation. With offices in Lexington and Louisville, WHT serves the entire state of Kentucky and has litigated cases in nearly all of its 120 counties.

Additionally, WHT often handles cases in the adjoining states of Indiana, Ohio, Tennessee and West Virginia.

WHT is a firm which generally represents the insurance industry and its insureds, the surety and fidelity industry, and the trucking industry. We also directly represent self-insured corporations (many of which are Fortune 500 companies) and various hospitals, health care providers and financial institutions. The net result is that our team of 30 lawyers has tremendous negotiation and litigation experience, having collectively handled thousands of cases encompassing several different areas of law, including: appellate practice, automobile/motor vehicle litigation, construction law, commercial and business litigation, extra-contractual/coverage issues, financial institution law, fire & casualty, governmental liability, healthcare professional liability, insurance defense, large loss subrogation, products liability defense, premises liability, surety & fidelity law, trucking & transportation litigation, and workers' compensation defense.

Our attorneys are licensed to practice in all courts in Kentucky, and in addition have attorneys licensed to practice in the states of Indiana, Ohio and Tennessee. WHT has been awarded the prestigious AV rating offered by LEXISNEXIS Martindale-Hubbell, and we are listed in the Best Directory of Recommended Insurance Attorneys and Adjustors.

Our goal is to provide you and your business with result-oriented legal services in an effective, cost-efficient manner. We at WHT welcome the opportunity to be of service to you and will aggressively work to achieve a successful outcome.

Please visit our website at www.whtlaw.com.

Watt, Tieder has one of the largest construction and surety law firms in the world, with practices that encompass all aspects of construction contracting and public procurement. Our practice groups include: domestic construction law, government contracts, international construction law and surety law. Watt, Tieder's work characteristically relates to major development and construction projects involving highways, airports and seaports, rail and subway systems, military bases, industrial plants, petrochemical facilities, electric generating plants, communication systems, and commercial and public facilities of all types in the United States and globally.

Watt, Tieder is one of the premier surety law firms in the country. We represent more than a dozen sureties in North America, acting as national, regional or public contract counsel for them. Our surety clients include industry leaders like Arch Insurance Company, Cincinnati Insurance Company, Hartford Fire Insurance Company, Liberty Mutual Insurance Company, RLI Corp., SureTec Insurance Company, Travelers Casualty and Surety Company and Zurich North America. In our thirty years of practicing surety law, Watt, Tieder has gained particular expertise in default terminations, affirmative construction claims, surety "abuse of discretion" cases, government contract disputes, surety bad faith claims and all forms of contract bond defaults.

With offices in Washington DC Metro; Irvine, California; Las Vegas, Nevada; Seattle, Washington; Chicago, Illinois; and Miami, Florida, we have a staff of over 50 legal professionals working throughout the United States, Canada, Europe, the Middle East, Asia, South America, Australia and Africa.

Watt, Tieder and its attorneys are annually recognized for accomplishments in construction and surety law, including top tier rankings in Chambers USA, the Legal 500 and US News-Best Lawyers.

Please visit our website at www.WattTieder.com.

Weinstein Radcliff Pipkin LLP is a Dallas, Texas–based commercial litigation law firm with extensive experience in commercial construction, surety, fidelity and professional liability coverage and defense, and labor and employment. As advocates, clients nationwide look to us as their go–to firm for litigation in Texas, Oklahoma, Arkansas, and elsewhere. As advisers, we provide an early, honest case assessment, offering creative solutions and establishing reasoned expectations that save time, money, and headaches. Our attorneys have extensive experience handling construction and surety cases involving contractor defaults, construction and design defects, impact and delay claims, and catastrophic loss. We also have considerable trial and litigation experience for fidelity and professional liability insurers, as well handling labor and employment cases involving corporate management, employee benefits, and non-compete agreements.

Please visit our website at www.weinrad.com.

Williams Kastner has been serving clients in the Northwest since 1929. With more than 90 attorneys in offices located throughout Washington and Oregon and affiliated offices in Shanghai, Beijing and Hong Kong, we offer global capabilities and vision with a local sensibility.

We are well known for our vast trial and litigation successes. Our deep bench of seasoned litigators have extensive trial experience in federal and state courts. In fact, over the course of the last three decades, Williams Kastner has tried (and won) more cases to jury verdict than any other firm in Washington.

The Construction Litigation & Surety Practice Team at Williams Kastner serves clients involved in all aspects of the construction industry, including general contractors, specialty subcontractors, owner/developers, architects, engineers, lending institutions, sureties and insurers. In the surety context, the Team handles the entire spectrum of issues, such as: analyzing and responding to default terminations and other performance bond claims; providing advice regarding complex bond claim investigations; addressing various project completion scenarios, including tenders, takeovers and financing the bond principal; defense of performance and payment bond claims under the Miller Act and state law, including discharge, exoneration and other surety-specific defenses; defense of extra-contractual claims by claimants, bond principals and indemnitors involving claims brought under the Washington Insurance Fair Conduct Act, the Consumer Protection Act and common law bad faith; prosecution of affirmative construction claims to mitigate surety losses; prosecution of indemnity and other salvage actions on behalf of sureties; resolving priority disputes between sureties, banks, trustees and public agencies; and defense of claims on miscellaneous bonds, including license bonds and public official bonds. When the situation warrants, the Team draws upon other practice areas within the firm to serve the needs of our construction industry clients. These practice areas often include: labor and employment, collections, bankruptcy, land use and real estate.

Please visit our website at www.williamskastner.com.

WOLKIN • CURRAN, LLP

Wolkin Curran specializes in surety, construction and insurance coverage litigation. With offices in both San Francisco and San Diego, Wolkin Curran's primary practice areas are in California and Nevada.

Wolkin Curran's surety and construction practice emphasizes the representation of sureties, general contractors, and public entities. Wolkin Curran investigates, negotiates, settles and litigates bond claims in trial, bankruptcy, and appellate courts. Wolkin Curran represents sureties in all aspects of commercial and contract suretyship, including takeover, completion, payment and creditor issues.

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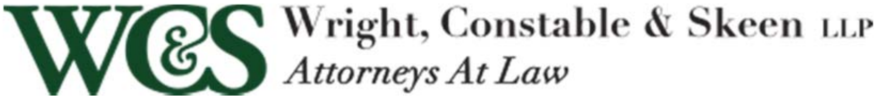

Wright, Constable & Skeen's Fidelity and Surety Law Group has over 100 years of combined surety and fidelity experience. WC&S lawyers represent sureties in federal and state courts at both the trial and appellate levels, before regulatory bodies, as well as in various forms of alternative dispute resolution, including mediation and arbitration. WC&S lawyers draw on experiences gained both from working within, and for, surety companies.

WC&S' experience and knowledge provide efficient representation for its clients throughout the Mid-Atlantic region, including handling complex surety cases with the federal government. WC&S' practice encompasses all aspects of performance bond claims, payment bond claims, bankruptcy, indemnity/subrogation, and commercial surety bonds. WC&S is an active participant in various legal and industry groups and associations, and its lawyers are leaders and speakers on a wide variety of important topics to the surety and fidelity industry. In addition, WC&S' lawyers are contributing authors or editors to various ABA and industry publications and books. WC&S has developed a national reputation in representing sureties in bankruptcy, authoring various papers and texts on the subject, and speaking at numerous conferences.

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Driving Directions

Willows Lodge to the Harbour Pointe Golf Club – 11817 Harbour Pointe Blvd, Mukilteo, WA

1.	Go right out of the parking lot onto NE 145th St/WA-202	1.7 mi
2.	Turn right onto NE 175th St/WA-202	0.2 mi
3.	Turn left onto 131st Ave NE/WA-202	0.3 mi
4.	Merge onto WA-522 W via the ramp on the left	0.8 mi
5.	Merge onto I-405 N toward Everett	6.7 mi
6.	Stay straight to go onto WA-525 N	4.3 mi
7.	Turn left onto Harbour Pointe Boulevard SW	1.7 mi
8.	End at 11817 Harbour Pointe Boulevard SW	

Harbour Pointe Golf Club to Willows Lodge - 14580 Northeast 145th Street, Woodinville, WA

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA-525	4.1 mi
3.	Take I-405 S toward I-405 S/Bellevue/Renton	6.8 mi
4.	Merge onto WA-522 E toward WA-202E/Monroe/Wenatchee	1.0 mi
5.	Take the WA-202 E exit toward Woodinville/Redmond	0.1 mi
6.	Merge onto 131st Ave NE/WA-202S toward Woodinville/Redmond	0.2 mi
7.	Take the 2nd right onto NE 175th St/WA-202	0.2 mi
8.	Turn left onto Woodinville Redmond Rd NE/WA-202	1.9 mi
9.	End at 14580 NE 145th St. Destination will be on the left.	

Harbour Pointe Golf Club to Marriott Redmond Town Center – 7401 164th Avenue NE, Redmond

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA-525	4.1 mi
3.	Take I-405 S toward I-405 S/Bellevue/Renton	11.9
4.	Take WA-908 E exit, exit 18, toward Redmond	0.7 mi
5.	Merge onto NE 85th Street	1.0 mi
6.	NE 85th St becomes Redmond Way	1.9 mi
7.	Turn right onto Cleveland Street	0.3 mi
8.	Turn right onto 164th Ave NE	0.05
9.	Enter next round-about and take the 3rd exit onto NE 76th St	0.09
10.	End at 7401 164th Avenue NE	

Harbour Pointe Golf Club to SeaTac Airport

1.	Start out going south on Harbour Pointe Blvd toward S Grove Dr	1.7 mi
2.	Turn right onto Mukilteo Speedway/WA 525	4.1 mi
3.	Merge onto I-5 S toward Seattle	30.1 mi
4.	Take the S 188th St exit, exit 152, toward Orillia Rd	0.2 mi
5.	Keep right to take the S 188th Street ramp	0.2 mi
6.	Turn right onto S 188th St	1.1 mi
7.	Turn right onto International Blvd/WA 99	1.0 mi
8.	End at Seattle-Tacoma International Airport. Airport is on the left.	0.8 mi

Willows Lodge to SeaTac Airport

1.	Head east on NE 145th St toward Sammamish River Trail.	0.1 mi
2.	At the traffic circle, continue straight to stay on NE 145th St	449 ft
3.	At the traffic circle, take the 1st exit onto Woodinville Redmond Rd NE	0.1 mi
4.	At the traffic circle, continue straight onto WA-202 E/Woodinville Redmond Rd NE	1.5 mi
5.	Turn right onto NE 124th St	2.5 mi
6.	Merge onto I-405 S via the ramp to Renton	20.5 mi
7.	Continue onto WA-518 W	0.9 mi
8.	Take the exit toward Sea-Tac Airport	0.8 mi
9.	Merge onto Airport Expressway	0.9 mi
10.	Slight right onto Departures Dr. Destination will be on the right	0.4 mi

Notes

Notes

SESSION 1

CO-SURETY ISSUES:

THE GOOD, THE BAD AND THE UGLY

Mike F. Pipkin | Weinstein Radcliff Pipkin LLP | Dallas, TX

Jennifer C. Ohn | Weinstein Radcliff Pipkin LLP | Dallas, TX

Mary Jean Pethick | Zurich North America | Owings Mills, MD

Andrew Torrance | Liberty Mutual Surety | Seattle, WA

Sunny Lee | Bronster Fujichaku Robbins | Honolulu, HI

PEARLMAN 2019

September 5-6, 2019

Columbia Winery | Woodinville, WA

CO-SURETYSHIP

Mike F. Pipkin
Jennifer C. Ohn

INTRODUCTION

Although the concept of co-suretyship dates back to the Magna Carta, as projects become larger and increasingly complex, co-surety arrangements have become more prevalent, leading to a greater need to spell out the relationship among co-sureties. Driving forces include, but are not, limited to "[i]ndustry consolidation, account resistance to industry consolidation, more restrictive reinsurance options, cost considerations, [and] desired retention levels . . .."[1] Reacting to such changes in market conditions has caused all major sureties to dramatically increase their capacity levels thereby making co-suretyship more common.[2]

Co-suretyship has many benefits. It is advantageous to owners, in that it can increase bidding competition and allow emerging and minority firms to submit bids.[3] Further, upon a principal's default, co-suretyship increases each surety's financial capacity and claims handling resources in order "to satisfy claims, finance the bond principal, and complete the project contract."[4] Co-suretyship also acts as "insurance" in the event a surety becomes insolvent, liquidated, or suffers significant capital impairment.[5]

Contract performance and payment bonds are flexible, in that they allow for multiple sureties to secure the underlying bond thereby creating co-suretyship.[6] Co-suretyship is the contractual relationship that is formed when multiple sureties agree to perform or bear part of the cost of performance on a bond.[7] Substantively, co-surety bonds are no different than a single-surety bond.[8] Generally, "each co-surety is bound to the obligee 'jointly and severally' unless the bond itself specifically states otherwise," which means "each of the sureties is liable to the obligee for the *full* penal sum of the bond."[9] Although the obligee may pursue any of the co-

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[1] Edward J. Reilly & J. Michael Franks, *Modern Co-Suretyship* (unpublished paper submitted to the Annual Meeting of Surety Claims Institute, June 23-25, 2004), at 1.

[2] See David J. Roth, *Joint Sureties for Larger Projects¸* CONSTRUCTION EXECUTIVE, November 5, 2014, at 2.

[3] See Devin Girardi, *Co-Surety in Contract Surety Bonds* (Surety & Fidelity Association of America White Paper 2018), at 1. The Surety & Fidelity Association of America ("SFAA") is a non-profit corporation whose member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is a licensed rating or advisory organization in all states and is designated by state insurance departments as a statistical agent for the reporting of premium and loss statistics for fidelity and surety bonds.

[4] *Id* at 2.

[5] *Id*.

[6] *Id.* at 1.

[7] See RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 53 (1996)

[8] See Girardi, *supra* note 3, at 1-2.

[9] *Id.* at 2.

sureties, the aggregate recovery from all of the secondary obligors may not exceed the maximum recovery that would have been available under the bond.[10]

Defining roles in co-suretyship in terms of indemnification, exoneration, reimbursement, subrogation, and contribution can be challenging, which has encouraged the use of agreements and documents related to co-surety arrangements. Co-Surety Side Agreements, such as the 1949 Co-Surety Agreement (the "1949 Agreement"), the Blanket Co-Surety Agreement (the "Blanket Agreement"), which is largely based on the 1949 Agreement, and the Participation Co-Surety Agreement (the "Participation Agreement") are commonly used to better define co-suretyship arrangements. However, issues with side agreements, such as addressing post-default claim administration, financial assistance and workout, and the underwriting authority of the lead surety, may arise, and side agreements should be modified to better address and prevent such issues.

This paper discusses the relationship among co-sureties, the principal, and the indemnitors as well as the rights of the co-sureties in order to provide background and context for prevailing issues in co-suretyship and how such issues may be addressed or prevented.

A. CREATION OF THE RELATIONSHIP AMONG CO-SURETIES, THE PRINCIPAL, AND THE INDEMNITORS

1. CONTRACTUAL CO-SURETY

Suretyship arises through contract, so the general principles of contract law apply. Thus, upon a principal's default, a surety is contractually obligated to perform. In a co-suretyship, multiple sureties are bound by the duty of the principal.[11] As such, upon a principal's default, the co-sureties are obligated to perform. A co-suretyship can be presumed even if separately executed documents are involved when there is more than one surety bound to the same obligation of the principal.[12] Thus, becoming co-sureties at different times by different instruments does not affect the co-suretyship relationship.

Co-suretyships typically arise under three fact scenarios.[13] The first instance is when multiple sureties jointly write a bond and are jointly and severally liable on the bond.[14] The

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[10] See RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 52 (1996) ("When there is more than one secondary obligor with respect to the same underlying obligation, each secondary obligor is liable to the obligee in accordance with the terms of its secondary obligation, provided that the obligee's aggregate recovery from all secondary obligors with respect to an underlying obligation may not exceed the amount of the underlying obligation plus any additional amounts recoverable pursuant to the terms of the secondary obligations.").

[11] Samuel J. Arena, Jr., Adam P. Friedman, Dennis J. Bartlett, and Dawn C. Stewart, *Ch. 2, Creation of the Relationship Among the Surety, the Principal, and the Indemnitors—Who and How, in* THE SURETY'S INDEMNITY AGREEMENT: LAW AND PRACTICE, 56-57 (Marilyn Klinger, George J. Bachrach, & Tracey L. Haley, eds., Am. Bar Ass'n, 2d ed. 2008).

[12] *Id*. at 56.

[13] *Id*.

[14] *Id*.

second instance involves a principal that is a joint venture composed of separate entities that are separately bonded.[15] In such an instance, the sureties must enter into an agreement to allocate the risk of loss proportionately.[16] However, when bonds are issued on behalf of the joint venture as a whole, the co-sureties remain jointly and severally liable.[17] The third instance is when a surety issues a payment bond on a project and another surety issues a release bond.[18]

Better understanding the contractual nature of co-suretyship can help in understanding the obligations co-sureties are bound by and the underlying principles of co-suretyship.

2. SUCCESSOR/PREDECESSOR SURETY

A successor surety is not necessarily a co-surety. When "two persons stand surety for the same debt, they may be required to share the loss, even when their liabilities originate in separate contracts, but if one of them in equity should bear the ultimate burden, the suretyship becomes successive."[19] In such instance, a successor surety terminates the liability of the predecessor surety for claims subsequent to the issuance of the successor bond. Conversely, the predecessor surety's liability stops for claims issued after the successor bond. The contracts and the circumstances of the case determine whether the relationship is that of a co-surety or a successor surety.[20] Contracts will typically dictate the successive nature of a co-suretyship. Additionally, if there are two successive sureties involved, to the extent that "the first of two successive sureties is forced to pay a debt for which both stand surety, he is subrogated to the creditor's rights upon the bond and may enforce it against the second surety."[21] Because a successive surety is markedly not a co-surety, significantly, there is no right to contribution in a successive relationship.[22]

In determining which surety is liable, the majority of courts have held that there is "a presumption that the loss occurred in the last term and places a burden upon the last surety to show that the loss occurred in previous terms."[23] For example, in *Century Indemnity Co. v. Fidelity & Deposit Co. of Md.,* 175 Ga. 834, 166 S.E. 235, 237 (1932), the Supreme Court of

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[15] *Id*. at 57.

[16] *Id*.

[17] *Id*.

[18] *Id*.

[19] Continental Casualty Co. v. Hartford Accident and Indemnity Co., 243 Cal. App. 2d 565, 566, 52 Cal. Rptr. 533 (Ct. App. 1966).

[20] *Id.*

[21] *Id.*

[22] Schram v. Werner, 32 N.Y.S. 995, 999 (Gen. Term 1895).

[23] United States v. Fid. & Deposit Co. of Md., 254 F.2d 836 (2d Cir. 1958) (citing Bruce v. United States, 17 How. 437, 442, 443, 15 L.Ed. 129; United States v. Honsman, 9 Cir., 70 F.581; Thurston County v. Chmelka, 138 Neb. 696, 294 N.W. 857, 132 A.L.R. 1077).

Georgia found that for successive sureties, "the liability of the one or the other of the surety companies must be determined by the time when the delinquency or default occurred."

Successor and predecessor liability are important concepts in defining the relationship among co-sureties, the principal, and the indemnitors, especially in regard to determining liability and whether the right of contribution applies, as discussed below.

B. THE RIGHTS OF CO-SURETIES

A surety generally has rights of indemnification, exoneration, reimbursement, subrogation, and contribution upon the principal's default. These rights are summarized briefly as follows:

- *Indemnification:* Under an indemnity agreement, a co-surety may be entitled to third-party beneficiary status and have the same right to recovery as the original surety.

- *Exoneration:* When a debtor is unable to fulfill its obligations, the surety becomes liable in accordance with the bond. However, a surety's right to exoneration compels the principal to honor its obligation to creditor(s).[24]

- *Reimbursement:* A surety is entitled to reimbursement when it must pay the creditor because the principal defaulted.

- *Subrogation:* If the principal's duty to the creditor is fully satisfied, then the surety is entitled to subrogation, which allows the surety to assert the creditor's rights against the principal as if the duty had not been discharged.

- *Contribution:* Contribution involves sharing the loss caused by the principal's default among the co-sureties. In co-suretyship, the right of contribution is particularly important because "[w]here contribution cannot be had from one or more of the co-sureties due to insolvency, non-residence, or other circumstances, each remaining co-surety must contribute a proportionate amount of the loss so caused."[25]

For purposes of contribution, each co-surety is a principal obligor to the extent of its contributive share and a secondary obligor as to the remainder of its duty.[26] A co-surety acting as a secondary obligor is entitled to the right of contribution against the principal obligor.[27] Therefore, to the extent a co-surety is in the position of an obligee and another is in the position

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[24] Borey v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania, 934 F.2d 30 (2d Cir. 1991)

[25] 16 SUMM. PA. JUR. 2D *Commercial Law* § 7:43 (2d ed.)

[26] See RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 55 (1996). ("(1) As between cosureties for the same underlying obligation, each cosurety is a principal obligor to the extent of its contributive share (§ 57), and a secondary obligor as to the remainder of its duty pursuant to its secondary obligation. (2) To the extent that, as between themselves, one cosurety is a secondary obligor and the other is a principal obligor, the former has rights of contribution against the latter. The rights of contribution are the same as the rights of a secondary obligor against a principal obligor as set forth in §§ 21- 31.").

[27] *Id*.

of a secondary obligor, "[w]hen a cosurety performs in excess of its contributive share, it has claims against two persons—the principal obligor and the other cosurety."[28] The non-performing co-surety may also have defenses it can raise against the performing co-surety.[29]

A co-surety's contributive share is typically the aggregate liability of the co-sureties to the obligee divided by the number of co-sureties.[30] However, the co-sureties may also set forth an express agreement as to contributive shares.[31] This is usually done in terms of the proportion of the total liability that each co-surety agrees to bear or in terms of the amount for which each co-surety agrees to be responsible in the event of the principal obligor's default.[32] Notably, a surety's right to contribution may also be waived.[33]

Understanding a co-surety's rights may entitle the co-surety recovery and may also allow co-sureties to raise proper defenses.

C. AGREEMENTS AND DOCUMENTS RELATED TO CO-SURETY ARRANGEMENTS

In recent years, the use of agreements and documents related to co-surety arrangements, such as the 1949 Agreement, the Blanket Agreement, and the Participation Agreement, has increased substantially. There are many variations of the documents in circulation, and it is possible that uniform form documents may emerge as a result.

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[28] *Id.* § 56 (citations omitted).

[29] *Id.* ("(1) As between cosureties, one cosurety is in the position of an obligee and the other cosurety is in the position of a secondary obligor to the extent that (a) the former cosurety has a claim against the principal obligor pursuant to §§ 21- 31; (b) that cosurety has a claim for contribution against the latter cosurety pursuant to § 55; and (c) the latter cosurety has a claim against the principal obligor pursuant to §§ 21- 31; (2) To the extent that, as between themselves, one cosurety is in the position of an obligee and the other is in the position of a secondary obligor, the suretyship defenses set forth in §§ 37- 49 are available to the latter cosurety.").

[30] *Id.* § 57 ("(1) Subject to subsection (2) and to any express or implied agreement between or among the cosureties, a cosurety's contributive share is the aggregate liability of the cosureties to the obligee divided by the number of cosureties. (2) When the terms of a cosurety's secondary obligation limit the cosurety's liability to an amount less than its contributive share determined pursuant to subsection (1), or the contribution that can be obtained from a cosurety is less than that amount, the contributive shares of the cosureties are reapportioned as follows: (a) When the secondary obligation of a cosurety limits the liability of that cosurety to an amount less than its contributive share determined pursuant to subsection (1), the contributive share of that cosurety is its maximum liability pursuant to the terms of the secondary obligation. The contributive shares of the other cosureties are recalculated by subtracting from the aggregate liability of the cosureties the contributive share of the secondary obligor whose obligation is so limited, and dividing by the number of cosureties whose obligations are not so limited. (b) When, because of insolvency, lack of personal jurisdiction, or other reasonable circumstances, the contribution obtained from a cosurety after reasonable collection efforts is less than that cosurety's contributive share, the contributive shares of the other cosureties as among themselves are recalculated pursuant to subsection (2)(a) as though the secondary obligation of the former cosurety limited its liability to the contribution obtained from that cosurety.").

[31] *Id.*

[32] *Id.*

[33] United States v. Immordino, 534 F.2d 1378, 1382 (10th Cir. 1976) (court held that provisions of guaranty agreement were sufficient to imply a waiver of the right to contribution).

Agreements and all documents related to co-surety arrangements should be construed together to define the rights and responsibilities of co-sureties in a co-suretyship. For example, in *National American Insurance Co. v. SCOR Reinsurance Co.,* 362 F.3d 1288 (10th Cir. 2004), the Tenth Circuit Court of Appeals held that an arbitration clause contained in a reinsurance treaty was to be construed together with an indemnity agreement that did not contain an arbitration clause.

1. INDEMNITY AGREEMENTS—SINGLE OR MULTIPLE

Common law principles ensure that all co-sureties are indemnified from the principal. So, even if the indemnity agreement does not define "surety" to include any co-sureties, a co-surety may still be entitled to third-party beneficiary status and the same right to recovery as the original surety.

However, many indemnity agreements expressly define "surety" to include any co-sureties, thereby enabling the co-surety to recover under another surety's indemnity agreement even if not specifically named therein.[34] Courts have enforced such provisions and held that such provisions to entitle co-sureties to recover from the principal on indemnity agreements to the same degree as the original surety."[35]

Generally, co-sureties often ask that the principal and indemnitors execute a single indemnity agreement. However, as a practical matter, co-suretyships formed on the basis of multiple executed indemnity agreements frequently occur, because the co-sureties elect to utilize their individual indemnity agreements with the principal rather than entering into a single, formal agreement with all co-sureties as signatories. Thus, when multiple indemnity agreements are involved, co-surety side agreements will generally fill any gaps or resolve any ambiguities in the documents.

2. CO-SURETY SIDE AGREEMENTS

The relationship among co-sureties, the principal, and the indemnitors necessitates co-surety side agreements, especially if the co-suretyship involves multiple indemnity agreements. While some sureties attempt to address issues and marginalize error through side letters and understandings, it is indisputably better practice to address issues through formal addenda.[36]

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[34] *See* Arena, et al., *supra* note 11, at 57.

[35] *Id*. at 93 (citing Commercial Ins. Co. of Newark v. Pacific-Peru Constr. Corp., 558 F.2d 948, 993 (9th Cir. 1977) (reinsurer was a third-party beneficiary to the Indemnity Agreement and court rejected principal's assertion of defenses which reinsurer could have initially raised against original surety to avoid payment, the court looked to RESTATEMENT (SECOND) OF CONTRACTS § 133 holding that "[a] beneficiary of an agreement is an intended third-party beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and…(b) the promise manifests an intention to give the beneficiary the benefit of the promised performance."); Westchester Fire Co. v. Campbell, 863 F. Supp. 32, 33 (D. Me. 1994), *aff'd,* 55 F.3d 32 (1st Cir. 1995). See also RESTATEMENT (SECOND) OF CONTRACTS § 302 (1981)).

[36] See Reilly & Franks, *supra* note 1, at 3.

The side agreements most commonly used to facilitate co-surety transactions are the 1949 Agreement, the Blanket Agreement, and the Participation Agreement. They are discussed in detail below.

(a) THE 1949 AGREEMENT

The 1949 Agreement is a bare bones recitation of the respective obligations and liabilities of the co-sureties under the bond.[37] It sets out that each party shall share in the premium and all collateral or indemnity, except reinsurance, in respective proportions.[38] It states each party is responsible for notifying other parties of a suit or claim. And, it states each party shall have the right "to make investigations and examinations concerned with the Bond and charge the costs thereof to all parties hereto in their respective proportions as set forth herein."[39]

However, the 1949 Agreement only anticipated the issuance of a single bond, it is silent on the pre-default workouts the lead surety may undertake, it does not address the possibility of financial assistance to the principal, it lacks post-default claims administration rights and procedures, and it does not provide the lead surety with the authority to issue new bonds on behalf of the principal. Thus, the 1949 Agreement presents issues that require resolution and input from all co-sureties, and as a result, the 1949 Agreement has more or less become inoperative.

(b) THE BLANKET AGREEMENT

The Blanket Agreement allows each surety the opportunity to accept or reject participation in any given bond. Like the 1949 Agreement, the Blanket Agreement is silent on the pre-default workouts the lead surety may take, it does not address the possibility of financial assistance to the principal, it lacks post-default claims administration rights and procedures, and it does not provide the lead surety with the authority to issue new bonds on behalf of the principal. This presents issues that require resolution and input from all co-sureties, and as a result, the Blanket Agreement has more or less become inoperative as well.

(c) THE PARTICIPATION AGREEMENT

In recent years, co-sureties have begun to use the Participation Agreement in lieu of the 1949 Agreement and the Blanket Agreement. The Participation Agreement allows for more flexibility and more clearly delineates co-sureties' respective rights and obligations, especially regarding pre-default workouts and post-default claims administration.

The Participation Agreement oftentimes affords the lead surety more discretion. Specifically, the Participation Agreement can allow the lead surety the authority to issue bonds at its own discretion up to the aggregate penal limit, subject to limitation as to covenant defaults,

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[37] A copy of the 1949 Agreement is included in the Appendix to this paper.

[38] See 1949 Agreement, ¶ 3.

[39] 1949 Agreement, ¶ 5.

withdrawal rights, and other factors. The Participation Agreement may also allow for an agency relationship, whereby the lead surety may implement all surety credit documents, including but not limited to security agreements, mortgages, and Uniform Commercial Code filings. The Participation Agreement may further grant the lead surety the power to resolve claims on behalf of the entire group. Co-sureties may be afforded the right of withdrawal upon specified conditions. And, the Participation Agreement may provide for dispute resolution.

(d) INDUSTRY-DEVELOPED BLANKET CO-SURETY SIDE AGREEMENTS

For many years, a working group within the SFAA, the Co-Surety Working Group, met to draft a co-surety agreement for account-based relationships. The Co-Surety Working Group worked to finalize a template, but the members did not reach a consensus on the terms of one form. As a result, two templates were ultimately completed and are posted on the SFAA website, copies of which are included in the Appendix to this paper. The chief difference between the templates involved the authorization of the lead surety's payment of a variety of costs that are not direct bond claims or bond obligations, but are payments made in an effort to avoid loss.

(e) KEY ELEMENTS OF CO-SURETY SIDE AGREEMENTS

Key elements that are usually addressed in co-surety side agreements include percentages of risk allocation, the lead surety's role in handling claims, and solvency issues. They are outlined below.

(i) PERCENTAGES OF RISK ALLOCATION

A co-surety side agreement typically sets forth the percentage of risk attributable to each co-surety. Generally, this is stated as a percentage of claims, demands, and losses under each said bond. Oftentimes, the share of the premium each co-surety receives is proportional to the percentage of risk the co-surety accepts. Setting forth each co-surety's risk allocation in a side agreement can help to avoid future disputes.

(ii) LEAD SURETY

Typically, in a co-suretyship, there is a lead surety to handle claims whose role is better defined in the co-surety side agreement. The lead surety has varying levels of authority under the 1949 Agreement, the Blanket Agreement, and the Participation Agreement. The lead surety assumes a "plurality or majority of the risk associated with the principal's potential default" and is tasked with taking lead in "underwriting new bonds, conducting pre-default workouts, providing financial assistance to the principal, and post-claims administration." [40] In order to better facilitate this, the lead surety may elect to modify side agreements accordingly. The lead surety can also help streamline communications between the owner and the co-sureties and prevent "administrative confusion, redundancy, and/or inconsistency among the parties."[41] Given

[40] J. Michael Franks, Matthew M. Horowitz, and Cynthia E. Rodgers-Waire, *Ch. 3, Documents and Agreements Related to the Indemnity Agreement, in* THE SURETY'S INDEMNITY AGREEMENT: LAW AND PRACTICE 172 (Marilyn Klinger, George J. Bachrach, & Tracey L. Haley, eds., Am. Bar Ass'n, 2d ed. 2008).

[41] See Girardi, *supra* note 3.

the lead surety's important role, it is good practice to outline the extent of its authority in a co-surety side agreement.

(iii) SOLVENCY ISSUES

There is always an ongoing risk that a co-surety, perhaps even the lead surety, becomes insolvent and is not able to pay claims or issue new bonds. Thus, to protect its interests, co-sureties often address potential insolvency issues in side agreements. Common potential solvency issues that are addressed include as follows: (1) whether the insolvent co-surety will assign its indemnity and other contract rights and/or any collateral it holds; (2) the manner in which it will recalculate percentage of risk among solvent co-sureties; (3) whether the agreement authorizes solvent co-sureties to issue new bonds; and (4) in the event the lead surety becomes unable to issue new bonds (i) whether a co-surety may issue new bonds on the insolvent co-surety's behalf through a fronting agreement; and (ii) whether a co-surety may enforce an insolvent surety's indemnity agreement.[42] Answering these questions early on allows for a smooth transition should a co-surety encounter solvency issues.

(f) ACCOMMODATION SURETY

An accommodation or gratuitous surety, as opposed to a compensated surety, assumes secondary liability on an obligation for the benefit of the principal rather than for its own profit.[43] An "accommodation surety usually undertakes the obligation as a personal favor for a friend or relative, the principal obligor, without investigation of the principal's financial condition."[44] As such, "it seldom prepares, or has any say in the preparation of its own contract." However, the law is very clear in that despite not being compensated, accommodation sureties are still entitled to reimbursement from the party primarily liable.[45]

Accommodation sureties benefit from the rule of *strictissimi juris*, which strictly construes the language of the suretyship contract and resolves any doubts as to language in the accommodation surety's favor.[46] The rule of *strictissimi juris* prescribes "that the surety has consented to be bound only within the express terms of the contract, and liability must be found within that contract or not at all."[47] Thus, "a surety's liability cannot be extended by implication or enlarged by construction beyond the terms of the agreement entered into."[48] Further, an

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[42] Franks, et al., *supra* note 41, at 174.

[43] 23 WILLISTON ON CONTRACTS § 61:5 (4th ed.); *see also* Chamberlain v. Marshall Auto & Truck Ctr., Inc., 293 Va. 238, 242, 798 S.E.2d 161, 163 (2017) (accommodation surety assumed secondary liability as a guarantor of a note, triggering a right to reimbursement).

[44] 23 WILLISTON ON CONTRACTS § 61:5 (4th ed.).

[45] See Chamberlain v. Marshall Auto & Truck Ctr., Inc., 293 Va. 238, 242, 798 S.E.2d 161, 163 (2017).

[46] 33 WASH. PRAC., WASH. CONSTRUCTION LAW MANUAL § 13:2 (2018-2019 ed.); *see also* Nat'l Bank of Washington v. Equity Inv'rs, 86 Wash. 2d 545, 555, 546 P.2d 440, 446 (1976) (discussing differences between accommodation and compensated sureties).

[47] 74 AM. JUR. 2D *Suretyship* § 26.

accommodation surety is permitted defenses, which a compensated surety cannot typically assert without showing injury.[49]

It is common for the situation to arise where the surety is neither purely an accommodation surety, nor a compensated surety; but rather, somewhere in between. In such cases, a court determination is necessary to assess the accommodation surety's liability.

(g) FRONTING CO-SURETY RELATIONSHIPS

A "fronting" co-surety lends support to the co-surety it is backing. Co-sureties generally enter into fronting agreements when a surety's principal performs work in a jurisdiction in which the existing surety is not authorized to issue bonds.[50] The existing surety then asks a surety who is authorized to issue bonds in that particular jurisdiction to enter into a fronting agreement, in which the existing surety indemnifies the fronting surety of any liability the fronting surety may sustain as a result of issuing bonds in that jurisdiction.[51] This renders them co-sureties and limits the risk of the fronting surety. In such instances, it is good practice to ensure that the principal acknowledges that its indemnity agreements with the existing surety also cover the "fronted bond."[52]

Understanding fronting co-surety relationships are increasingly important as fronting agreements are a way in which sureties increase capacity. Building a network of fronting agreements also provides a market advantage. For example, major sureties offer strategic fronting relationships in both foreign and domestic markets with regional offices as a selling point. Fronting relationships also allow a surety to issue bonds in greater percentages of developed countries. Offering such relationships in multiple countries can facilitate a surety emerging as a leading bond provider.

(h) THIRD-PARTY BENEFICIARY PROVISIONS

If so worded, an indemnity agreement may designate a co-surety as a third-party beneficiary. For example:

> If the Surety shall procure any other company or companies to execute or join with it in executing or reinsuring any Bond, this Agreement shall inure to the benefit of such other company or companies and its or their successors and assigns, so as to give it or them a direct right of action against the Indemnitors to enforce this Agreement, and in that event, the word "Surety," wherever used

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[48] *Id*.

[49] 23 WILLISTON ON CONTRACTS § 61:5 (4th ed.).

[50] See Franks, et al., *supra* note 41, at 174.

[51] *Id.*

[52] *Id.*

herein, shall be deemed to include such company or companies, as its or their respective interests may appear.[53]

A third-party beneficiary provision provides a co-surety and/or reinsurer with the same contractual rights available to the original surety.[54] As third-party beneficiaries, co-sureties have rights against indemnitors despite the lack of privity or even if its identity was unknown at the time of the execution of the Indemnity Agreement, so long as the co-surety was identifiable at the time of the performance.[55]

Recognizing the co-surety as a third-party beneficiary can assist in better defining the relationship among co-sureties, the principal, and the indemnitors.

D. THE GUIDING CLAIM PRINCIPLES

On February 5, 1957, the SFAA formed a subcommittee to promulgate the "Guiding Claim Principles." The 1979 Claims Guiding Principles were adopted by the SFAA on September 26, 1979.[56] The Guiding Claim Principles provide guidance as to co-suretyship as follows:

(a) Setting out the methods by which a surety shall notify other surety(ies) should it acquire knowledge of other surety(ies) with outstanding bond(s);

(b) Defining "Loss," "General Assets," "Specific Assets," and "Net Proceeds;"

(c) Setting out the methods by which the priority of a claim is to be determined;

(d) Mandating that the sureties work cooperatively and jointly to secure control of all General Assets of Contractor and third-party indemnitors;

(e) Advising when to file an indemnity agreement in the appropriate public office as a financing statement;

(f) Proscribing that recovery by a surety from a third-party indemnitor who is not an indemnitor of other sureties shall not be shared, and likewise, that collateral taken by a surety prior to execution of a bond(s) by the other sureties shall not be shared;

(g) Addressing payment of obligations not incurred;

(h) Outlining situations in which the Procedures do not apply; and

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[53] *See* James P. Diwik, Denise C. Puente, and Carol Z. Smith, *Ch. 5, The Surety's Enforcement of Its Rights of Reimbursement (Indemnity), in* THE SURETY'S INDEMNITY AGREEMENT: LAW AND PRACTICE 244 (Marilyn Klinger, George J. Bachrach, & Tracey L. Haley, eds., Am. Bar Ass'n, 2d ed. 2008).

[54] *Id.*

[55] *Id.*

[56] A copy of the Guiding Claim Principles is included in the Appendix.

(i) Reiterating that the Guiding Claim Procedures do not create any legal rights or obligations among the sureties.

E. ADVANTAGES AND DISADVANTAGES OF CO-SURETY SIDE AGREEMENTS AND PERSISTING ISSUES

Even with the implementation of a co-surety side agreement, on occasion, deficiencies and ambiguities persist. For example, as outlined in detail below, post-default claim administration resolution is not addressed in the 1949 Agreement, the Blanket Agreement is silent on investigation costs, and neither the 1949 Agreement nor the Blanket Agreement speak on financial assistance and workouts to the principal. The underwriting authority of the lead surety is also unclear.

1. POST-DEFAULT CLAIM ADMINISTRATION

Post-default, a claim must be investigated and paid, denied, or negotiated to an amicable resolution. The 1949 Agreement does not provide the lead surety with the express authority to resolve a claim. The lead surety's authority is limited to "investigations and examinations concerned with the Bond."[57] Thus, "[t]he lead surety must presumably elicit unanimous assent to its proposed claims disposition."[58] As a result, some sureties supplement with side letters and understandings.[59] However, it is better practice to address the desired text with "formal addenda."[60]

As with the 1949 Agreement, the Blanket Agreement allows co-sureties to investigate post-default claim administration. However, the Blanket Agreement is silent as to the allocation of investigative costs. The Blanket Agreement also does not contain language binding the co-sureties to the lead surety's decisions. This issue is easily resolved by stating that no surety has dispositive power over claims. In the alternative, the agreement could declare that the lead surety is granted authority to pay claims of a specified amount and/or that claim resolution is through majority vote.

In contrast, the Participation Agreement grants the lead surety broad powers in post-default claim administration. As a result, the Participation Agreement has been used with more frequency.

2. FINANCIAL ASSISTANCE AND WORKOUTS

The 1949 Agreement and the Blanket Agreement do not address financial assistance to the principal. However, in recent years, sureties have begun to allow financial assistance to the distressed principal to mitigate surety loss. This takes the form of "cash loans, forbearance from

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[57] 1949 Agreement, ¶ 5.

[58] Reilly & Franks, *supra* note 1, at 3.

[59] *Id.*

[60] *Id.*

collection rights, the extension of additional surety credit to provide the principal with an ongoing bonded work program, or some combination of the three."[61] Therefore, to address potential issues regarding financial assistance and workouts, the sureties may modify a 1949 Agreement or Blanket Agreement to provide financial assistance and workout. Oftentimes, this is done through majority vote. Alternatively, the sureties can execute a Participation Agreement, under which, assuming financing is permissible, lead sureties are granted an irrevocable appointment to act on behalf of the co-sureties to implement the documents. However, notably, none of the agreements allow the lead surety to extend additional surety credit to the principal as a form of financial assistance.

3. UNDERWRITING AUTHORITY OF THE LEAD SURETY

The lead surety's underwriting authority varies under the 1949 Agreement, the Blanket Agreement and the Participation Agreement. Under the 1949 Agreement and the Blanket Agreement, each party retains the right to accept or reject participation on a bond.[62] Conversely, the Participation Agreement, with limited exception, gives the lead surety the broad authority to issue bonds at its own discretion up to the aggregate penal limit. Granting lead sureties broader powers in underwriting bonds appears to be the prevailing trend. Understanding this trend and the driving factors behind it helps better assess the needs and progression of modern co-suretyship.

CONCLUSION

As co-suretyships become increasingly common, it is important to understand the rights and responsibilities of co-sureties in order to anticipate issues that may arise. Having insight on potential issues can also allow sureties to implement effective co-surety agreements and be more competitive in the market.

[61] *Id*. at 5.

APPENDIX

CO-SURETY AGREEMENT
(Revised March 15, 1949)

AGREEMENT by and between
and ....

....

....

....

....

WITNESSETH: The parties hereto having executed, or being about to execute, jointly, a certain obligation of suretyship, hereinafter called the BOND, in a penalty of

($) dollars,
dated , in behalf of
as Principal and in
favor of as Obligee, a copy of
which is or may be attached hereto, hereby mutually agree as follows:

1. The respective obligations and liabilities of the parties hereto for all claims, demands and losses under the Bond shall be limited, except as Section 6 hereof may extend such limits, to the following proportions:

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

In the case of
(Name of Company)
the proportion that $ bears to the penalty of the Bond.

2. The premium payable for the Bond, less the commission agreed to, shall be distributed among the parties hereto in their respective proportions as set forth herein.

3. Each party hereto shall share, according to its proportion as set forth herein, in all collateral or indemnity of whatever kind or nature, except reinsurance, held by any of the parties hereto, and in any recovery, right, recourse, or benefits as against any person, firm, or corporation, made by or accruing to any party hereto in connection with the Bond.

4. Any party hereto receiving notice of a suit or claim under the bond shall promptly give full information thereof to all the other parties hereto, in writing, to the respective home offices of such parties and each shall be liable, in its proportion as set forth herein, for all costs, expenses, counsel fees and charges of any kind, exclusive of compensation of salaried officers and employees, incurred on connection with the Bond.

5. The
shall have the right, and is hereby authorized, to make investigations and examinations concerned with the Bond and charge the costs thereof to all parties hereto in their respective proportions as set forth herein.

6. In case it shall be found impracticable to enforce this agreement against any party or parties hereto, by reason of insolvency or any other cause, the rights and obligations of such party or parties shall be shared by all other parties hereto in the proportion in which the amount of liability assumed by each bears to the aggregate of the amounts assumed by all parties hereto other than those against which the enforcement of this agreement is found to be impracticable.

IN WITNESS WHEREOF each of the parties hereto has caused this agreement to be signed by appropriate officers and their respective corporate seals to be hereunto affixed and duly attested this day of , 19 .

Attest:	………………………………………………
…………………………………………	By…………………………………………
Attest:	………………………………………………
…………………………………………	By…………………………………………
Attest:	………………………………………………
…………………………………………	By…………………………………………
Attest:	………………………………………………
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Attest: ……………………………………………

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Attest: ……………………………………………

………………………………………… By……………………………………...

INSTRUCTIONS

1. This form of agreement was devised for use in connection with unlimited co-surety bonds.
2. A separate form should be used with each bond.
3. Insert in Section 5 the name of the company which will service the risk.

GUIDING PRINCIPLES

FOR CONTRACT BOND CLAIMS

ADOPTED BY THE
SURETY ASSOCIATION OF AMERICA
CLAIMS ADVISORY COMMITTEE
SEPTEMBER 26, 1979

GUIDING CLAIM PROCEDURES

When two or more Sureties have executed separate bonds covering different construction or engineering contracts for the same Contractor, the following Guiding Claim Procedures shall be considered as a guide to such Sureties with respect to reaching an agreement among such Sureties:

Section 1. Whenever a Surety, while investigating a claim against a Contractor or a voluntary or involuntary default of a Contractor, acquires knowledge that other Surety(ies) have bond(s) outstanding on behalf of the Contractor, the investigating Surety:

(1) shall request the Contractor to give notice immediately to the other surety(ies) of the situation; or,

(2) if the Contractor refuses and after giving the Contractor notice of its intention to do so, may give notice to the other surety(ies).

Such notice to the other surety(ies) by the investigating surety shall not contain any information in violation of any confidential relationship between the investigating surety and the Contractor.

Section 2. Definitions: As used herein,

(a) "Loss" includes losses and allocated expenses paid or incurred excluding salaries of the employees of the respective Sureties.

(b) "General Assets" means all tangible and intangible property and rights to property of the Contractor, other than Specific Assets.

(c) "Specific Assets" means those assets described in Section 3, to which one Surety has superior or priority rights over other Sureties.

Section 2. continued

(d) "Net Proceeds", as used in Section 4, means gross proceeds less legal and other expense (excluding salaries of employees of Sureties) incurred in acquiring control and liquidating General Assets.

Section 3. As between the Sureties, and unless otherwise agreed, the surety on a particular job has a superior or priority claim or right to Specific Assets as follows:

(a) The proceeds of any contract shall be used in the following order of priority:

(1) to pay the costs of completing the Contract,

(2) to pay obligations incurred by the Contractor prior to default to suppliers of labor, material and services furnished for use in the performance of the contract; and

(3) to repay any indebtednesses or obligations of the contractor to the Surety,

(4) to be held as General Assets in accord with Section 4.

(b) All material ordered, purchased or manufactured specifically for such contract and paid for by the Contractor or the Surety shall be used by the Surety on that contract to complete the contract.

(c) The Surety on a bond covering a contract shall have a prior right to all equipment on the site of the contract at the time the first surety begins a claim investigation for use in the completion of said contract and any other contract secured by a bond executed by that Surety in favor of the Contractor.

Section 3. continued

(d) Any excess materials covered by (b) above and the equipment covered by (c) above shall be sold by the Surety having possession thereof. Prior lien holders on the equipment shall be paid to the extent of their lien and the balance of the proceeds from such sales shall be held by that surety and applied to its losses or expenses according to the priorities in Paragraph 3(a) above, except sub-paragraph 3(a)3.

Section 4. The Sureties concerned should cooperate and proceed jointly in the name of one or more of them, but for the benefit of all, to secure control of all General Assets of the Contractor, and third party indemnitors who indemnify all concerned sureties by taking title thereto, security interests therein, liens thereon or such other measures as they may jointly deem appropriate, subject to any prior liens, security interests or encumbrances thereon that may then be perfected.

Unless otherwise mutually agreed any General Assets or the proceeds therefrom should be held in trust for the benefit of all Sureties concerned. The net proceeds thereof, should be distributed among the Sureties in the ratio which the loss to each Surety bears to the aggregate of the losses of all Sureties. Such distribution shall be made from time to time as the Sureties may agree.

Section 5. Each Surety should consider the advisability of promptly filing of record its Indemnity Agreement from its contractor and/or third party indemnitors, in the appropriate public office provided for such recording in the juridiction where its bonded contract was or is being completed, so that it may be construed as a financing statement, under the law of such jurisdiction.

Section 6. Recovery by any Surety from a third party Indemnitor of one Surety, who is not an Indemnitor of other Sureties sustaining loss, shall not be shared with such other Sureties; and, collateral taken by a surety at any time prior to the execution of a bond or bonds by such surety shall not be shared with the other sureties.

Section 7. A Surety shall not be responsible to any other Surety on account of the application by Contractor of the proceeds of any contract to the payment of obligations not incurred on said contract when such application was made without the knowledge, direction or encouragement of the Surety(ies) who may have benefited therefrom.

Section 8. These Guiding Claim Procedures are not intended to apply in the following situations:

(a) The interests of any Surety that arise out of any bond or bonds it shall execute or commit itself to execute in behalf of any Contractor after such Surety shall have actual knowledge of loss incurred by another Surety arising from any bond previously executed in behalf of the Contractor.

(b) Where special circumstances exist which would make it unreasonable, impractible or unduly burdensome to apply them.

(c) Where reinsurers, cosureties or the Small Business Administration will not agree to such application.

(d) Where the contractor refuses to cooperate with the sureties in the implementation of these Guiding Claim Procedures.

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Section 9. As to Section 1. hereof these Guiding Claim Procedures do not create legal rights or obligations among any Sureties. As to Section 2. through 8. hereof, legal rights and obligations are created among sureties to the extent that such Sureties may expressly agree to be bound by those Sections with respect to any Contractor after their respective claim investigations have been made. Until such agreement is reduced to writing and executed by the concerned sureties, these Guiding Claim Procedures do not create legal rights or obligations among Sureties.

** TOTAL PAGE.07 **

THE SURETY ASSOCIATION OF AMERICA

GUIDING PRINCIPLES

FOR

CLAIMS HANDLING

The Surety Association of America recognizes that suretyship creates relationships among and between surety, principal and obligee which impose upon surety the obligation of good faith and fair dealing in claims handling. Thus, the Association recommends the Guiding Principles set forth below to member companies. Should there be any conflict between state, federal or local laws and these Guiding Principles, such law will prevail.

1) Surety shall promptly acknowledge communications relating to a claim.

2) Surety shall promptly undertake an appropriate investigation to determine its liability.

3) Surety shall promptly advise claimants of its position, based upon its investigation.

4) Surety shall promptly offer settlement of claims when liability has become reasonably clear.

5) Surety shall promptly provide the specific basis for denial of a claim.

6) Surety shall promote adherence to these Principles by its employees, attorneys and consultants.

(9/10/87)

GUIDING PRINCIPLES

FOR CONTRACT BOND CLAIMS

ADOPTED BY THE
SURETY ASSOCIATION OF AMERICA
CLAIMS ADVISORY COMMITTEE
SEPTEMBER 26, 1979

GUIDING CLAIM PROCEDURES

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(1) shall request the Contractor to give notice immediately to the other surety(ies) of the situation; or,

(2) if the Contractor refuses and after giving the Contractor notice of its intention to do so, may give notice to the other surety(ies).

Such notice to the other surety(ies) by the investigating surety shall not contain any information in violation of any confidential relationship between the investigating surety and the Contractor.

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(b) "General Assets" means all tangible and intangible property and rights to property of the Contractor, other than Specific Assets.

(c) "Specific Assets" means those assets described in Section 3, to which one Surety has superior or priority rights over other Sureties.

Section 2. continued

(d) "Net Proceeds", as used in Section 4, means gross proceeds less legal and other expense (excluding salaries of employees of Sureties) incurred in acquiring control and liquidating General Assets.

Section 3. As between the Sureties, and unless otherwise agreed, the surety on a particular job has a superior or priority claim or right to Specific Assets as follows:

(a) The proceeds of any contract shall be used in the following order of priority:

(1) to pay the costs of completing the Contract,

(2) to pay obligations incurred by the Contractor prior to default to suppliers of labor, material and services furnished for use in the performance of the contract; and

(3) to repay any indebtednesses or obligations of the contractor to the Surety,

(4) to be held as General Assets in accord with Section 4.

(b) All material ordered, purchased or manufactured specifically for such contract and paid for by the Contractor or the Surety shall be used by the Surety on that contract to complete the contract.

(c) The Surety on a bond covering a contract shall have a prior right to all equipment on the site of the contract at the time the first surety begins a claim investigation for use in the completion of said contract and any other contract secured by a bond executed by that Surety in favor of the Contractor.

Section 3. continued

(d) Any excess materials covered by (b) above and the equipment covered by (c) above shall be sold by the Surety having possession thereof. Prior lien holders on the equipment shall be paid to the extent of their lien and the balance of the proceeds from such sales shall be held by that surety and applied to its losses or expenses according to the priorities in Paragraph 3(a) above, except sub-paragraph 3(a)3.

Section 4. The Sureties concerned should cooperate and proceed jointly in the name of one or more of them, but for the benefit of all, to secure control of all General Assets of the Contractor, and third party indemnitors who indemnify all concerned sureties by taking title thereto, security interests therein, liens thereon or such other measures as they may jointly deem appropriate, subject to any prior liens, security interests or encumbrances thereon that may then be perfected.

Unless otherwise mutually agreed any General Assets or the proceeds therefrom should be held in trust for the benefit of all Sureties concerned. The net proceeds thereof, should be distributed among the Sureties in the ratio which the loss to each Surety bears to the aggregate of the losses of all Sureties. Such distribution shall be made from time to time as the Sureties may agree.

Section 5. Each Surety should consider the advisability of promptly filing of record its Indemnity Agreement from its contractor and/or third party indemnitors, in the appropriate public office provided for such recording in the jurisdiction where its bonded contract was or is being completed, so that it may be construed as a financing statement, under the law of such jurisdiction.

<u>Section 6.</u> Recovery by any Surety from a third party Indemnitor of one Surety, who is not an Indemnitor of other Sureties sustaining loss, shall not be shared with such other Sureties; and, collateral taken by a surety at any time prior to the execution of a bond or bonds by such surety shall not be shared with the other sureties.

<u>Section 7.</u> A Surety shall not be responsible to any other Surety on account of the application by Contractor of the proceeds of any contract to the payment of obligations not incurred on said contract when such application was made without the knowledge, direction or encouragement of the Surety(ies) who may have benefited therefrom.

<u>Section 8.</u> These Guiding Claim Procedures are not intended to apply in the following situations:

(a) The interests of any Surety that arise out of any bond or bonds it shall execute or commit itself to execute in behalf of any Contractor after such Surety shall have actual knowledge of loss incurred by another Surety arising from any bond previously executed in behalf of the Contractor.

(b) Where special circumstances exist which would make it unreasonable, impractible or unduly burdensome to apply them.

(c) Where reinsurers, cosureties or the Small Business Administration will not agree to such application.

(d) Where the contractor refuses to cooperate with the sureties in the implementation of these Guiding Claim Procedures.

Section 9. As to Section 1. hereof these Guiding Claim Procedures do not create legal rights or obligations among any Sureties. As to Section 2. through 8. hereof, legal rights and obligations are created among sureties to the extent that such Sureties may expressly agree to be bound by those Sections with respect to any Contractor after their respective claim investigations have been made. Until such agreement is reduced to writing and executed by the concerned sureties, these Guiding Claim Procedures do not create legal rights or obligations among Sureties.

GUIDING PRINCIPLES

CASUALTY - FIDELITY - FIRE - INLAND MARINE

FIRST-PARTY PROPERTY LOSSES AND CLAIMS

NOVEMBER 1, 1963

GUIDING PRINCIPLES

FOREWORD

Under practices predating these Guiding Principles, where an overlap in coverage existed between or among policies in the casualty, fire or inland marine classifications of insurance, each such classification participated as a group in the adjustment (subject to extent of available insurance and limiting conditions) without regard to the number of policies involved under each classification.

With the advent of multiple-line policies[1] which cross and re-cross jurisdictional lines, the Associations recommending these Guiding Principles have concluded that, excepting overlap between boiler-machinery policies with any other classification of insurance[2], it is no longer practical to group policies by "segments" of the industry; rather that each policy should contribute as an individual policy unless it be concurrent[3] with another policy or policies, in which instance such **group of concurrent policies** should contribute as if it were a single policy, subject to the Specific Principles and General Conditions contained herein.

However, retention of the classification concept is necessary to determine under which of the Principles certain overlaps are apportioned; namely, casualty, fidelity[4], fire, inland marine; casualty-casualty, fire-fire, inland-inland. For this purpose, and not to determine concurrent policies, the component coverages found in multiple-line policies should be identified on the basis of their traditional underwriting classification; i.e., the burglary and theft coverages of homeowners policies are casualty; the all-risk personal property coverage found in certain homeowners policies is inland marine.

[1] Wherever the term policy is used, it shall be construed to include fidelity bonds, certificates or certifications of insurance.

[2] See boiler-machinery Illustrative Problems, pages 17 to 27.

[3] See Definitions.

[4] Fidelity wherever used in these Guiding Principles shall not include surety or public official statutory or qualifying bonds.

GUIDING PRINCIPLES

for

OVERLAPPING INSURANCE COVERAGES

(Superseding All Guiding Principles of Prior Date)

THE PURPOSE

WHEREAS from time to time disputes arise in the adjustment and apportionment of losses and claims because of overlapping coverages, which disputes require litigation or arbitration, and

WHEREAS the occurrence of such disputes is against the interests of the insuring public and the companies, and

WHEREAS it is desirable to lay down certain Principles for the elimination of these disputes,

THEREFORE BE IT RESOLVED that the Association of Casualty and Surety Companies, the Inland Marine Underwriters Association, the National Automobile Underwriters Association, the National Board of Fire Underwriters, the National Bureau of Casualty Underwriters and the Surety Association of America recommend to their respective members and subscribers their concurrence in adopting the following Guiding Principles, effective as to losses and claims, other than losses and claims involving retrospective[1] rated policies, occurring on and after **November 1, 1963.**

Note: When retrospective rated boiler-machinery--fire policies overlap, these Guiding Principles do apply.

[1] See Definitions.

THE PLAN

These Principles provide for the equitable distribution of available insurance. As among insurance companies, the "other insurance" clause(s) which is (are) contained in a policy(ies) of insurance, and which may include an excess provision[1], shall be set aside and be inoperative to the extent that it is (they are) in conflict with the purpose of these Principles. Otherwise, these Principles will not change coverage or other conditions under any policy(ies) of insurance.

Further, the application of these Principles shall in no event operate to reduce recovery to the insured below that which would have been obtained under any policy or policies covering the risk.

[1] See Definitions.

PART I

THE PROCEDURE

Dealing with first-party property losses and claims, except those situations more specifically provided for in Part II (Specific Principles — casualty-casualty, fire-fire and inland-inland) and the General Conditions.

GENERAL PRINCIPLES

1. Insurance covering same property and same interest:

   A. Insurance covering a specifically described article or object, whether or not for an express amount, at a designated location[1] shall be primary to any other insurance.[2] (See Notes 1 and 2)

   B. Insurance covering a specifically described article or object, whether or not for an express amount, without designation of location shall be excess as to "1-A" but primary as to any other insurance.[2] (See Notes 1 and 2)

   C. Insurance covering a specifically described group or class of related articles or objects, whether or not for an express amount, at a designated location shall be excess as to "1-A" and "1-B" but primary as to any other insurance.[2] (See Notes 1 and 2)

   D. Insurance covering a specifically described group or class of related articles or objects, whether or not for an express amount, without designation of location shall be excess as to "1-A," "1-B" and "1-C" but primary as to any other insurance.[2] (See Notes 1 and 2)

   E. Insurance covering at a designated location and not specific as to an article or object or as to group or class of related articles or objects shall be excess as to "1-A," "1-B," "1-C" and "1-D" but primary as to any other insurance.[2] (See Notes 1 and 2)

   F. Insurance without designation of location and not specific as to an article or object or as to group or class of related articles or objects shall be excess to "1-A," "1-B," "1-C," "1-D" and "1-E."

      However, as between insurances without designation of location and not specific as to an article or object or as to group or class of related articles or objects, the policy for the more limited purpose[1] (other than peril) to which the insurance applies shall be primary.[2] (See Notes 1 and 2)

   G. Two or more policies providing coverage as set forth in "1-A" through "1-F," respectively, shall be contributing. Contribution shall be as follows:

      (1) Whether or not deductibles are involved, contribution shall be on the basis of the Limit of Liability Rule[3] except that, in the event there is an area of common coverage under two or more policies and separate coverage under any one or more such policies, the policy or policies affording separate coverage shall respond first to that loss it alone covers and the remainder of its limit of liability shall contribute to the common loss on the basis of the Limit of Liability Rule.

         (a) When one of the policies is subject to a deductible, the amount of loss in excess of the deductible will be considered as the common loss. The policy(ies) without a deductible shall first respond to the loss which it alone covers to the extent of its limit of liability, thereafter the remainder of its limit of liability will contribute with the other insurance to the common loss on the basis of the Limit of Liability Rule.

         (b) When two deductibles are involved, the amount of loss in excess of the higher deductible will be considered as the common loss. The differential between the higher and lower deductible shall be assessed to the limit of liability of the policy(ies) subject to the lower deductible The remainder of its limit of liability will contribute with the insurance subject to the higher deductible to the common loss on the basis of the Limit of Liability Rule. Where there are more than two deductibles, the same procedure shall apply.[2] (See Notes 1 and 2)

Note 1. In overlapping situations involving boiler-machinery policies, classifications "1-C," "1-D," "1-E" and "1-F" shall not consider other insurance primary. Therefore, losses will be apportioned in accordance with General Principle 1-G

Insurance effected on a specifically described article or object as defined in General Principles 1-A and 1-B shall be primary to the boiler-machinery policy. However, a building is not construed in overlapping situations involving boiler-machinery policies as a specifically described "article" or "object."

Note 2. In overlapping situations involving burglary policies the term "article" or "object," wherever used in these Principles, is not construed to include buildings or structures.

[1]See Definitions.
[2]See Illustrative Problems.
[3]See General Condition 2.

General Principles

2. Insurance covering same property and different interests:

   A. Bailee's customers insurance shall be primary to other insurance effected by the same named bailee-insured. (See General Condition 8)

   B. Insurance secured by a custodian covering property belonging to others shall be primary to any other insurance. Where there is more than one custodian, the insurance of the custodian in possession of the property shall be primary. (See General Condition 8)

   Note: Bankers and brokers blanket bonds, and fidelity, burglary, theft and jewelers block insurance providing coverage on property "held by the insured in any capacity whether or not the insured is liable for the loss thereof," or with equivalent verbiage, are not construed as insurance covering "different interests" and are not bailee's customers insurance or insurance secured by a custodian covering property belonging to others.

   Exceptions:

   General Principle (2-B) shall not apply:

   (1) when the custodian's insurance is afforded under a policy provision containing the words "property for which the insured is liable," "......may be liable," "......is legally liable," or equivalent verbiage;

   Note: For the purpose of these Guiding Principles the above verbiage is construed to provide liability coverage.

   (2) when the owner and custodian of the property have stipulated otherwise by written agreement prior to the loss.

   C. Contents policies insuring at the place of the loss and covering "employees'," "partners' " or "executives' " personal property, except in 2-B-(1) above, shall be primary to any off-premises coverage available under the employee's insurance. However, insurance covering a specifically described article or object, whether or not for an express amount, shall be primary.

   D. Coverage for property "used" or "worn" by the insured, for property of servants or guests, and insurance afforded by the "physical damage to property" coverage, shall be primary to any available insurance in the name of the owner of the involved property, except insurance covering a specifically described article or object, whether or not for an express amount, shall be primary.

   E. Installment-Sales or Deferred-Payment Merchandise Insurance:

   (1) Evidence of insurance issued by a vendor to a vendee under the provisions of a dual-interest policy specifically or generally describing the article or articles and their values individually or in total as invoiced under a conditional-sales contract shall be deemed to be insurance on specifically described property.

   (a) Above-described insurance shall be primary when overlapping with other contents policy(ies).

   (b) Above-described insurance shall contribute on the basis of the Limit of Liability Rule when overlapping with insurance expressly describing an article(s) or object(s) whether or not an express amount of insurance applies to each such article(s) or object(s).

   (2) When no such evidence of insurance has been issued, the dual-interest policy shall be deemed to be blanket floating insurance.

   (a) Above-described insurance shall be excess to other contents insurance in those cases where loss occurs at the location shown in the contents policy.

   (b) Above-described insurance shall contribute on the basis of the Limit of Liability Rule when overlapping with a floater policy. It is to be noted that the ten percent (10%) optional extension of the fire policy is floater coverage.[2]

[2]See Illustrative Problems.

GENERAL CONDITIONS

As to General Principles 1 and 2, and any additional Principles or amendments as may hereafter be adopted, it is AGREED that:

1. To provide the greatest recovery to the insured, the insurance declared to be excess or non-contributing under the governing Principle shall not include, in applying any coinsurance, average, or distribution clause(s) contained in any policy(ies), the value or loss on property covered under the insurance declared to be primary. However, it shall include any excess value not covered by the primary insurance and the loss unrecoverable under the primary insurance.

   When a coinsurance (not reduced rate contribution or average) clause is present in any or all policies, it shall be applied as if it were a reduced rate contribution or reduced rate average clause[2]. However, if by this procedure the insured collects less than he would collect under the terms of the coinsurance clause, the coinsurance clause shall be applied as such.

2. "Contribution," unless otherwise as specified in General Principle 1-G, shall be on the basis of the applicable limit of liability under each respective policy or group of concurrent policies as though no other insurance existed, and the limit separately determined under each policy or group of concurrent policies shall be the smallest of the following:

   (a) the amount of insurance,
   (b) the amount of loss, or
   (c) the amount payable after applying any policy limitation(s).

   The limits so determined of all policies or groups of concurrent policies herein declared contributing shall be added and, if the total amount exceeds the whole loss, each policy or group of concurrent policies shall pay such proportion of the loss as its limit bears to the sum of all the limits, but if the sum of the limits of liability is less than the whole loss, then each policy or group of concurrent policies shall pay its limit of liability. The determined liability of a group of concurrent policies shall be apportioned pro rata among the policies of the group.

3. Insurance covering property both scheduled and blanket, or both specific as to location and floating, shall be deemed to insure each item or portion separately, and the loss shall be apportioned in accordance with the Principle applying to each item or portion declared to be separately insured.

   In applying such Condition:

   A. Extensions of coverage in the name of the same insured, whether optional, those creating additional insurance, or based upon a percentage of the principal building or contents policy(ies), whether "permitted" or not, and without reference to inception date, shall be considered as excess to any specific coverage applying to the involved property. However, in the absence of specific insurance, the extensions shall be considered as:

      (1) Blanket insurance for on-premises losses.

         Examples:
         Private structures.
         Rental value.
         Additional living expenses.
         Improvements and betterments.
         Replacement cost coverage.
         Debris removal.

      (2) Floater insurance for off-premises losses.

         Examples:
         Contents while "elsewhere."
         Property removed for preservation from damage caused by the perils insured against.
         Livestock, farm and dairy produce while "elsewhere."

[1] See Definitions.

[2] See Illustrative Problems.

General Conditions

4. When the owner of a building is also the owner of the contents of the building and any overlapping coverage exists involving items of building equipment and fixtures essentially in the nature of **real** property, the building policy(ies) shall be primary.

   Examples: Covered under building policy(ies).
   Antennae and Towers—TV, detached—**not** affixed[1] to the building or to an outbuilding.
   Porandas—demountable screened enclosures.
   Readily removable equipment and fixtures that are included in the realty mortgage.
   Wall-to-wall carpeting only when included in the realty mortgage.

   Note: The building policy(ies) shall include, whether in position or stored on the premises, storm doors, storm sash, shades, blinds, wire screens, screen doors and awnings.

5. When the owner of a building is also the owner of the contents of the building and any overlapping coverage exists involving items of building equipment and fixtures essentially in the nature of **personal** property, the contents policy(ies) shall be primary, except when such items are included in the realty mortgage, in which event the policy(ies) covering building shall be primary.

   Examples: Covered under contents policy(ies).
   Antennae and Towers—TV, affixed[1] to the building or to an outbuilding.
   Fuel.
   Laundering machines whether or not attached to the realty.
   Portable air-conditioning and ventilating units.
   Refrigerators.
   Stoves.
   Wall-to-wall carpeting when not included in the realty mortgage.

6. Tenant's improvements and betterments insurance shall be primary to building insurance when the insured is owner and occupant of a co-operative apartment. However, the tenant's insurance shall first be made available to the loss on his own property and to property not otherwise insured.

7. The Principle specifically providing the basis of apportionment shall prevail over any Principle more general in scope.

8. Where a bailee's policy(ies) covers his own property, as well as property of others, the bailee's policy(ies) shall first be made available to the loss on the bailee's own property and to property not otherwise insured. Such claim or claims will be adjusted subject to all policy conditions affecting the adjustment, except that value and loss of otherwise insured property shall be deleted from the adjustment.

   A second statement of loss should then be prepared by the adjuster including all values and loss covered by the terms of the bailee's policy(ies) as written to determine the maximum liability under the policy.

   Distribution should then be made

   (a) to the loss on the bailee's own property and to the loss on otherwise uninsured interests,

   (b) to the otherwise insured interests for the difference, if any, up to the maximum liability under the bailee's insurance.

   While right of action under subrogation is retained by the bailors' insurers, the inclusion of the bailee insurer's name in any action against the bailee is contrary to the intent of these Principles.

   Claim filed by other insurers with the bailee insurers after payment or advance to owners shall be recognized to the same extent as if directly presented by the owner through the bailee in order to fulfill the purpose of these Principles, except where the bailee insurer may have certain facts in connection with a specific claim that justify reimbursement in a sum less than the amount paid by the bailor insurer.

9. Differences of opinion respecting the application or effect of these Principles shall be submitted for arbitration in the manner determined by the participating Associations. Payments of loss, or advances under loan agreements, or otherwise, shall be without prejudice to the rights of the insurers under these Principles.

[1]See Definitions.

ILLUSTRATIVE PROBLEMS

The following Illustrative Problems are for guidance purposes only and are not intended to limit the scope of the Principles.

General Principle 1-A

This applies to insurance written to cover an individual article or object, whether or not for an express amount, **at a designated location,** such as:

Neon Sign
Picture
Stained-Glass Window
Plate of Glass
Manuscript or Valuable Paper

Illustrative Problem (1) — $1,200 loss to a plate of glass.

Coverage

Casualty (glass) policy covers replacement cost of glass	**(Open)**
Fire and extended coverage insurance—	
Building (subject to 80% coinsurance clause)	$25,000.00

Property	**Value**	**Loss**
Plate of glass	$ 1,200.00	$1,200.00
Building (exclusive of plate of glass)	28,800.00	None
	$30,000.00	$1,200.00

Solution

Entire loss to plate of glass is assessed the casualty policy.

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Illustrative Problem (2) — $1,200 loss to a plate of glass and $200 boarding-up charge.

Coverage

Casualty (glass) policy covers replacement cost of glass	(Open)
Boarding-up charge	$75.00
Fire and extended coverage insurance — Building (subject to 80% coinsurance clause)	$25,000.00

Property	**Value**	**Loss**
Plate of glass	$ 1,200.00	$1,200.00
Boarding-up charge	—	200.00
Building (exclusive of plate of glass)	28,800.00	
	$30,000.00	$1,400.00

Solution

Casualty policy is primary insurance. However, policy has a $75.00 limitation on boarding-up charge. Therefore, claim under each type of insurance is:

Primary insurance — plate glass casualty policy

Plate of glass	$1,200.00
Boarding-up charge	75.00
	$1,275.00

Excess insurance — fire and extended coverage policy

Boarding-up charge ($200 less $75)	125.00
Total recovery	$1,400.00

Note: If metal stripping or obstruction removal is involved, the solution would parallel the above. Debris removal is charged under fire policy and is not to be confused with removal of obstruction.

General Principle 1-A

Illustrative Problem (3) — $100 loss to a neon sign.

Coverage

Inland marine neon sign policy subject to 100% coinsurance clause and $10 deductible clause	$125.00	
Fire insurance — Building (subject to 90% coinsurance clause)	$25,000.00	

Property

	Value	Loss
Neon sign	$ 150.00	$100.00
Building (exclusive of the neon sign)	30,000.00	None
	$30,150.00	$100.00

Solution

Primary insurance

Inland marine policy — application of 100% coinsurance clause $125.00/$150.00 of $100.00 or	$83.33
Less deductible	10.00
Claim under primary insurance	$73.33

Excess insurance

	Value	Loss
Building, including neon sign	$30,150.00	$100.00
Less value covered by the primary insurance	125.00[4]	
Less amount paid by the primary insurance		73.33[4]
Excess value and loss	$30,025.00	$ 26.67

Application of 90% coinsurance clause is $25,000.00/$27,022.50 (90% of $30,025.) of $26.67 or $24.67

Total claim under each policy is:

Inland policy	$73.33
Fire and extended coverage policy	24.67
Total claim	$98.00

[4]See General Condition 1.

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General Principle 1-B

This applies to insurance written to cover **an individual article or object**, whether or not for an express amount, without designation of location, such as:

Fur Coat
Diamond Ring
Camera
Animal
Bulldozer

Illustrative Problem (1) — Total loss to a fur coat (off-premises).

Coverage

Inland marine policy	
Scheduled fur floater	$ 500.00
Fire insurance — household contents form (10% applicable to property away from premises)	$5,000.00

Property

	Value	Loss
Fur coat	$500.00	$500.00

Solution

Entire loss to fur coat is assessed to inland marine policy.

General Principles 1-B - 1-E and General Condition 1

Illustrative Problem (2)

Coverage

Household contents policy		$5,000.00
Personal property floater or homeowners MIC 5		8,500.00
Unscheduled personal property	$7,500.00	
Scheduled property — picture	1,000.00	

No credit or pickup endorsement

Fire loss — on-premises

Property	Value	Loss
Picture	$ 1,500.00	$1,500.00
Unscheduled personal property	15,000.00	6,000.00
	$16,500.00	$7,500.00

Solution

Household contents policy insures all personal property at a designated location, whereas the personal property floater covers separately on unscheduled personal property and on scheduled property. Policies are not alike in coverage. Therefore, loss is distributed in accordance with Principles 1-B, 1-E and General Condition 1.

Primary insurance

Step 1 — Application of Principle 1-B

Personal property floater covering scheduled property without designation of location is primary to the household contents policy.

Recovery from scheduled property coverage is $1,000.00

Step 2 — Application of Principle 1-E

Household contents policy covering all personal property at a designated location is primary to the unscheduled personal property floater.

In accordance with General Condition 1, the amount not recovered from the scheduled personal property floater is assessed to the household contents policy.

Excess loss to scheduled property is $500.00

As the household contents policy insures at a designated location, it is primary to the unscheduled personal property floater coverage as respects loss sustained to unscheduled personal property. The household contents policy, therefore, is charged, in addition to the excess loss to scheduled personal property, with the loss to unscheduled personal property to the extent of the difference between $500. which has been paid on excess loss to scheduled property and the amount of its policy. Amount paid on unscheduled personal property is ($5,000.00 less $500.00 or) $4,500.00.

Total payment under household contents policy is:

Scheduled property	$ 500.00
Unscheduled personal property	4,500.00
	$5,000.00

Step 3 — Application of General Condition 1

"To provide the greatest recovery to the insured, the insurance declared to be excess or non-contributing under the governing Principle shall not include, xxx the value or loss on property covered under the insurance declared to be primary. However, it shall include only excess value not covered by the primary insurance and the loss unrecoverable under the primary insurance."

The amount of unscheduled personal property not recovered from the primary insurance is $1,500.00 ($6,000.00 less $4,500.00). This sum is assessed the unscheduled personal property floater.

Total claim under each policy is:

Household contents		
Scheduled property	$ 500.00	
Unscheduled personal property	4,500.00	$5,000.00
Personal property floater		
Scheduled property	$1,000.00	
Unscheduled personal property	1,500.00	2,500.00
		$7,500.00

General Principle 1-C

This applies to insurance written to cover a specifically described group or class of related articles or objects, whether or not for an express amount, **at a designated location**, such as:

Stained-Glass Windows
Silverware
Trophies
Antiques

Illustrative Problem (1) — Loss to antiques in dealer's premises.

Coverage

Inland marine — fine arts dealer's policy covering blanket on antiques	$ 5,000.00
Fire insurance — contents 90% coinsurance clause	20,000.00

Property

	Value	Loss
Antiques	$ 5,000.00	$1,500.00
Other contents	30,000.00	None
	$35,000.00	$1,500.00

Solution
Entire loss to antiques is assessed the inland marine policy.

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Illustrative Problem (2) — Loss to stained-glass windows and building.

Coverage

Inland marine fine arts policy covering stained-glass windows	$ 10,000.00
Fire and extended coverage insurance — Church building subject to an 80% coinsurance clause	100,000.00

Property

	Value	Loss
Stained-glass windows	$ 10,500.00	$10,500.00
Church building (other than stained-glass windows)	157,000.00	5,000.00
	$167,500.00	$15,500.00

Solution
Primary insurance — inland marine (fine arts policy)

Loss to stained-glass windows is assessed the inland marine policy to the extent of its policy limits.

Excess insurance — fire and extended coverage (building policy)
Balance of loss is assessed to the building policy as follows:

Building including stained-glass windows	$167,500.00	$15,500.00
Less value covered by the primary insurance	10,000.00[4]	
Less amount paid by the primary insurance		10,000.00[4]
Excess value and loss	$157,500.00	$ 5,500.00

Application of 80% coinsurance clause is:
$100,000.00/$126,000.00 (80% of $157,500.00) of $5,500.00 or $4,365.08

Claim under each policy is:

Inland marine policy	$10,000.00
Fire and extended coverage policy	4,365.08
Total claim	$14,365.08

[4]See General Condition 1.

General Principle 1-C

Illustrative Problem (3) — Loss to stock.

Coverage

Stock	$ 5,000.00 — no coinsurance
Contents	10,000.00 — no coinsurance

Property

Loss to stock	$ 1,000.00

Solution

Stock loss is less than the amount of specific stock coverage; therefore, entire loss assessed to the specific stock policy.

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Illustrative Problem (4) — Loss to stock.

Coverage

Stock	$ 5,000.00 — 80% coinsurance
Contents	10,000.00 — 80% coinsurance

Property

	Value	Loss
Stock	$ 10,000.00	$ 1,000.00
Furniture and fixtures	7,500.00	nil
	$ 17,500.00	$ 1,000.00

Solution

Primary insurance — stock

Application of 80% coinsurance clause under policy insuring specific on stock is:
$5,000.00/$8,000.00 of $1,000.00 or $625.00

Excess insurance — contents

	Value	Loss
Contents	$ 17,500.00	$ 1,000.00
Less value covered by the primary insurance	5,000.00	
Less amount paid under the primary insurance		625.00
Excess value and loss	$ 12,500.00	$ 375.00

80% coinsurance clause complied with. Entire excess loss assessed contents policy.

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General Principle 1-D

This applies to insurance written to cover a specifically described group or class of related articles or objects, whether or not for an express amount, **without designation of location** such as:

Stamp Collection
Tractors
Cattle or Animals

Illustrative Problem (1) — Loss to a stamp collection.

Coverage

Inland marine — scheduled floater policy covering stamp collection	$ 2,500.00
Fire policy — household contents form	10,000.00

Property

	Value	Loss
Stamp collection	$ 2,500.00	$2,500.00
Other contents	12,500.00	None
	$15,000.00	$2,500.00

Solution

Entire loss to stamp collection assessed the inland marine policy.

General Principle 1-D

Illustrative Problem (2) — Loss to builder's tools and equipment at the construction location.

Coverage

Inland marine — contractor's equipment floater	$ 5,000.00
Fire policy—builder's risk insuring at construction site (including builder's tools and equipment)	50,000.00

Property

	Value	Loss
Builder's tools and equipment	$5,000.00	$500.00

Solution

Entire loss assessed the inland marine contractor's equipment floater policy.

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General Principle 1-E

This applies to insurance written to cover at a designated location and not specific as to an "article" or "object" or as to a "group or class of related articles or objects" and shall be excess as to "1-A," "1-B," 1-C" and "1-D," but primary as to any other insurance.

Illustrative Problem (1)

Coverage

Household contents policy	$5,000.00
Personal property floater	7,500.00
No credit or pickup endorsement	
Fire loss — on-premises	$ 500.00

Solution

Entire loss assessed to the household contents policy.

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See General Principle 1-B — Illustrative Problem (2)

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General Principle 1-F

This applies to insurance without designation of location and not specific as to an "article" or "object" or as to "group or class of related articles or objects" and shall be excess to "1-A," "1-B," "1-C," "1-D" and "1-E," such as:

Floater Policies
Trip Transit
Tourist Baggage
Trip Travel
Sportman's
Certificate (covering contents of rental trailers or other similar type of coverages)
Armored Car

Illustrative Problem (1) — A fire loss to personal effects contained within a vehicle.

Coverage

Automobile policy — covering wearing apparel or personal effects	$ 100.00
Personal property floater — unscheduled personal property	5,000.00

Property

	Value	Loss
Personal effects	$ 90.00	$ 90.00

Solution

Entire loss assessed to the automobile policy.

(The coverage under the automobile policy is confined to personal effects while they are in or upon the automobile.)

For the purpose of this Principle a vehicle is considered as a specified location even though mobile.

General Principle 1-F

Illustrative Problem (2) — Fire loss to contents of a rental trailer.

Coverage

Inland marine — certificate covering contents of a rental trailer (subject to a $100.00 deductible clause)	$ 800.00
Fire policy — household contents	4,500.00
Off-premises	450.00

Property	**Value**	**Loss**
Contents of rental trailer	$2,500.00	$750.00

Solution

Inland marine certificate is primary insurance. However, same is subject to a $100.00 deductible clause and claim under each type of insurance is:

Primary insurance (inland marine)

Amount of loss	$750.00	
Less deductible	100.00	
Claim		$650.00

Excess insurance (fire)

Amount of loss	$750.00	
Less amount paid under primary insurance	650.00	
Claim		100.00
Total Claim		$750.00

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General Principle 1-G

Two or more insurances which are not concurrent but providing coverage as set forth in "1-A" through "1-F" shall contribute.

Illustrative Problem (1)

Coverage

Household contents or (homeowners 1, 2 or 4) —
 $5,000.00 on household and personal property
Personal property floater —
 $7,500.00 on unscheduled personal property
 No credit or pickup endorsement

Property

Fire loss to unscheduled personal property (off-premises) $100.00

Solution

The loss is covered under both policies. As loss is off-premises household contents coverage is limited to 10% of the insurance. The loss is distributed in accordance with Principle 1-G.

Household contents policy		**Limit of Liability**	**Pays**
Amount of policy	$5,000.00		
Off-premises coverage 10% or	500.00		
Loss	100.00		
Limit of liability		$100.00	$ 50.00
Personal property floater			
Coverage	$7,500.00		
Loss	100.00		
Limit of liability		100.00	50.00
		$200.00	$100.00

General Principle 1-G

Illustrative Problem (2)

Coverage

Homeowners MIC-5
- $15,000.00 on unscheduled personal property
- No credit or pickup endorsement

Personal property floater —
- $5,000.00 on unscheduled personal property
- No credit or pickup endorsement

Property

Fire loss to unscheduled personal property (on-premises) $500.00

Solution

Apportionment based on Principle 1-G.

		Limit of Liability	Pays
Homeowners MIC-5			
Coverage	$15,000.00		
Loss	500.00		
Limit of liability		$ 500.00	$250.00
Personal property floater			
Coverage	$ 5,000.00		
Loss	500.00		
Limit of liability		500.00	250.00
		$1,000.00	$500.00

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Illustrative Problem (3)

Coverage

Homeowners MIC-1, 2 or 4 —
- $7,500.00 on unscheduled personal property
- No credit or pickup endorsement

Household contents policy
- $5,000.00 on household and personal property

Fire loss — to unscheduled personal property (on-premises) $1,000.00

Solution

Apportionment based on Principle 1-G.

		Limit of Liability	Pays
Homeowners MIC-1, 2 or 4			
Coverage	$7,500.00		
Loss	1,000.00		
Limit of liability		$1,000.00	$ 500.00
Household contents			
Coverage	$5,000.00		
Loss	1,000.00		
Limit of liability		1,000.00	500.00
		$2,000.00	$1,000.00

General Principle 1-G

Illustrative Problem (4)

Coverage

Homeowners MIC-5
- $12,000.00 on unscheduled personal property
- $ 100.00 diminishing deductible
- No credit or pickup endorsement

Personal property floater
- $5,000.00 on unscheduled personal property
- No credit or pickup endorsement

Property

Loss to unscheduled personal property (on-premises) $450.00

Solution

Apportionment based on Principle 1-G.

Step 1 — Establish limits of liability for each of the separate coverages.

		Limit of Liability
Homeowners		
Coverage	$12,000.00	
Loss	450.00	
Claim — 125% of ($450.00 less [1]deductible of $100.00) $350.00 or	437.50	
([1]application of diminishing deductible establishes the deduction as $12.50 rather than $100.00)		
Limit of liability		$437.50
Personal property floater		
Coverage	$10,000.00	
Loss	450.00	
Limit of liability		450.00
		$887.50

Step 2 — Assess loss separately covered to insurance which alone affords coverage.

The [1]$12.50 deductible of the homeowners policy is assessed to the personal property floater.

Step 3 — Contribution to area of common coverage.

Loss to area of common coverage is $450.00 less $12.50 or $437.50.

The amount paid under the personal property floater to the area it alone covers is deducted from its limit of liability. The remaining limit of liability then contributes with the limit of liability of the homeowners policy to pay loss to area of common coverage.

	Limit of Liability	Pays
Homeowners	$437.50	$218.75
Personal property floater (remaining limit of liability $450.00 less $12.50)	437.50	218.75
	$875.00	$437.50

Total claim under each policy is:		
Homeowners —		
Share of area of common coverage loss		$218.75
Personal property floater —		
Deductible	$ 12.50	
Share of area of common coverage loss	218.75	231.25
		$450.00

General Principle 1-G

Illustrative Problem (5)

Coverage

Homeowners MIC-5
- $12,000.00 on unscheduled personal property
- $ 100.00 diminishing deductible
- No credit or pickup endorsement

Personal property floater
- $10,000.00 on unscheduled personal property
- $ 25.00 deductible
- No credit or pickup endorsement

Property

Loss to unscheduled personal property (on-premises) $450.00

Solution

Apportionment based on Principle 1-G.

Step 1 — Establish limits of liability for each of the separate coverages.

		Limit of Liability
Homeowners		
Coverage	$12,000.00	
Loss	450.00	
Claim — 125% of ($450.00 less deductible of $100.00) $350.00 or	437.50	
(application of diminishing deductible establishes the deduction as $12.50 rather than $100.00)		
Limit of liability		$ 437.50
Personal property floater		
Coverage	$10,000.00	
Loss	450.00	
Claim — $450.00 less $25.00 or	425.00	
Limit of liability		425.00
		$ 862.50

The amount of the lowest deductible ($12.50) represents a sum not insured under either policy.

Step 2 — Assess loss separately covered to insurance which alone affords coverage.

The difference between the highest and lowest deductible ($25.00 less $12.50) or $12.50 is assessed to the policy having the lowest deductible.

Step 3 — Contribution to area of common coverage.

The amount of $12.50 paid under the homeowners policy to area it alone covers is deducted from its limit of liability. The remaining limit of liability then contributes with the limit of liability of the personal property floater to pay loss to area of common coverage.

Loss in excess of the highest deductible or ($450.00 less $25.00) $425.00 is the loss to area of common coverage.

	Limit of Liability	Pays
Homeowners (remaining limit of liability $437.50 less $12.50)	$425.00	$212.50
Personal property floater	425.00	212.50
	$850.00	$425.00

Total claim under each policy is:		
Homeowners —		
Deductible	$ 12.50	
Share of area of common coverage loss	212.50	
		$225.00
Personal property floater —		
Share of area of common coverage loss		212.50
		$437.50

General Principle 1-G

Illustrative Problem (6)

Coverage

Homeowners MIC-5

$20,000.00 on unscheduled personal property
$ 250.00 limit on jewelry
$ 100.00 diminishing deductible
No credit or pickup endorsement

Personal property floater

$17,750.00 on unscheduled personal property
$ 250.00 limit on jewelry
$ 50.00 deductible
No credit or pickup endorsement

Property

Loss to jewelry $415.00

Solution

Apportionment based on Principle 1-G.

		Limit of Liability	Pays
Homeowners			
Coverage	$20,000.00		
Loss	415.00		
Claim—125% of ($415.00 less $100.00) $315.00 or	393.75		
Policy limit on jewelry	250.00		
Limit of liability		$ 250.00	$ 230.56
Personal property floater			
Coverage	$17,750.00		
Loss	415.00		
Policy limit on jewelry	250.00		
Application of deductible $250.00 less $50.00 or	200.00		
Limit of liability		200.00	184.44
		$ 450.00	$ 415.00

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Illustrative Problem (7)

Coverage

Homeowners

$25,000.00 on dwelling
No credit or pickup endorsement

Standard fire dwelling form

$10,000.00 on dwelling

Property

Loss to dwelling — $1,000.00

Solution

Apportionment based on Principle 1-G.

		Limit of Liability	Pays
Homeowners			
Coverage	$25,000.00		
Loss	1,000.00		
Limit of liability		$ 1,000.00	$ 500.00
Standard dwelling form			
Coverage	10,000.00		
Loss	1,000.00		
Limit of liability		$ 1,000.00	$ 500.00
		$ 2,000.00	$ 1,000.00

General Principle 1-G

Illustrative Problem (8) — Burglary loss involving premise damage to owner-occupied risk.

Coverage

Casualty			
Mercantile open stock policy	$ 15,000.00		
Fire policy subject to extended coverage and vandalism and malicious mischief endorsements			
Building and contents	$100,000.00		

Property	**Value**	**Loss**
Stock	$ 37,500.00	$1,000.00
Premise damage	87,500.00	500.00
	$125,000.00	$1,500.00

Step 1 — Establish limit of liability.

Mercantile open stock policy			**Limit of Liability**
Insurance		$ 15,000.00	
Loss —			
Stock	$ 1,000.00		
Premise damage	500.00	1,500.00	
Limit of liability			$1,500.00
Fire policy (E.C.E. and V. and M.M.)			
Insurance		$100,000.00	
Loss — premise damage		500.00	
(fire policy does not cover loss to stock)			
Limit of liability			$ 500.00
			$2,000.00

Step 2 — Loss separately covered assessed to policy which alone affords coverage.

Stock loss assessed the mercantile open stock policy which alone affords coverage and the remaining limit of liability participates with the fire policy (E.C.E. and V. and M.M.) to pay loss to area of common coverage.

Stock loss assessed mercantile open stock policy	$1,000.00

Step 3 — Contribution to area of common coverage on basis of available limits of liability.

Loss to area of common coverage is $500.00.

	Limit of Liability	Pays
Mercantile open stock policy (remaining limit of liability)	$ 500.00	$ 250.00
Fire policy (E.C.E. and V. and M.M.)	500.00	250.00
	$ 1,000.00	$ 500.00

Claim under each policy is:

Mercantile open stock policy		
Stock	$ 1,000.00	
Area of common coverage pays	250.00	
		$1,250.00
Fire policy (E.C.E. and V. and M.M.)		
Area of common coverage pays		250.00
		$1,500.00

General Principle 1-G

Illustrative Problem (9) — One policy subject to a deductible clause.

Coverage

"Fire Group"	$75,000.00	
"Boiler Group"	50,000.00	— $1,000.00 deductible clause

Property

Loss	$15,000.00

Solution

Step 1 — Establish limit of liability.

"Fire Group"		Limit of Liability
Insurance	$75,000.00	
Loss	15,000.00	
Limit of liability		$15,000.00
"Boiler Group"		
Insurance	50,000.00	
Loss	15,000.00	
Claim $15,000.00 less $1,000.00 or	14,000.00	14,000.00
Limit of liability		$29,000.00

Step 2 — Assess loss separately covered to policy which alone affords coverage.

The $1,000.00 uninsured under the "Boiler Group" is first assessed to the "Fire Group" which alone affords coverage and the remaining limit of liability participates with the "Fire Group" to pay loss to area of common coverage.

Step 3 — Contribution to area of common coverage on basis of available limits of liability.

Loss to area of common coverage is $14,000.00.

	Limit of Liability	Pays
"Fire Group" (remaining limit of liability)	$14,000.00	$ 7,000.00
"Boiler Group"	14,000.00	7,000.00
	$28,000.00	$14,000.00

Claim under each policy is:

"Fire Group"		
Deductible	$ 1,000.00	
Area of common coverage pays	7,000.00	
		$ 8,000.00
"Boiler Group"		
Area of common coverage pays		7,000.00
		$15,000.00

General Principle 1-G

Illustrative Problem (10) — One policy subject to a deductible clause.

Coverage

"Fire Group"	$500,000.00	
"Boiler Group"	50,000.00 — $5,000.00 deductible clause	

Property

Loss	$525,000.00

Solution

Step 1 — Establish limits of liability for each group.

		Limit of Liability
"Fire Group"		
Insurance	$500,000.00	
Loss	525,000.00	
Payable under policy limitations	500,000.00	
Limit of liability		$500,000.00
"Boiler Group"		
Insurance	50,000.00	
Loss	525,000.00	
Payable under policy limitations	50,000.00	
Limit of liability		$ 50,000.00

Step 2 — Assess loss separately covered to group which alone affords coverage.
The $5,000.00 deductible of the "Boiler Group" is assessed to the "Fire Group" which alone affords coverage. Its remaining limit of liability contributes with the "Boiler Group" to pay loss to area of common coverage.

Step 3 — Contribution to area of common coverage on basis of available limits of liability.
Loss to area of common coverage is $520,000.00 ($525,000.00 — $5,000.00)

	Limit of Liability	Pays
"Fire Group" (remaining limit of liability)	$495,000.00	$472,293.58
"Boiler Group"	50,000.00	47,706.42
	$545,000.00	$520,000.00

Summary of claim to each group is:

"Fire Group"		
Deductible	$ 5,000.00	
Share of loss to area of common coverage	472,293.58	$477,293.58
"Boiler Group"		
Share of loss to area of common coverage		47,706.42
		$525,000.00

General Principle 1-G

Illustrative Problem (11) — Each group subject to a deductible clause.

Coverage

"Fire Group"	$75,000.00	— $ 200.00 deductible clause
"Boiler Group"	50,000.00	— $1,000.00 deductible clause

Property

Loss	$15,000.00

Solution

Step 1 — Establish limit of liability.

		Limit of Liability
"Fire Group"		
Insurance	$75,000.00	
Loss	15,000.00	
Claim $15,000.00 less $200.00 or	14,800.00	
Limit of liability		$14,800.00
"Boiler Group"		
Insurance	$50,000.00	
Loss	15,000.00	
Claim $15,000.00 less $1,000.00 or	14,000.00	
Limit of liability		14,000.00
		$28,800.00

Step 2 — Assess loss separately covered to policy which alone affords coverage.

The difference between the highest and lowest deductibles is assessed to the "Fire Group" which alone affords coverage and the remaining limit of liability participates with the "Boiler Group" to pay loss to area of common coverage.

Step 3 — Contribution to area of common coverage on basis of available limits of liability.

Loss to area of common coverage is $14,000.00

	Limit of Liability	Pays
"Fire Group" (remaining limit of liability)	$14,000.00	$ 7,000.00
"Boiler Group"	14,000.00	7,000.00
	$28,000.00	$14,000.00

Claim under each policy is:

"Fire Group"		
Differential between the highest and lowest deductible — $1,000.00 less $200.00 or	$ 800.00	
Area of common coverage pays	7,000.00	
		$ 7,800.00
"Boiler Group"		
Area of common coverage pays		7,000.00
		$14,800.00

Note: Lowest deductible assumed by insured.

General Principle 1-G

Illustrative Problem (12) — Time element loss.

Coverage

"Fire Group"	$761,000.00 — 80% coinsurance clause
"Boiler Group"	(Valued Form) $3,000.00 daily indemnity
	Commencement of liability — 1st Midnight
	Limit of loss $100,000.00

Other considerations — Time of occurrence 12:01 A.M.; plant operates twenty-four hours per day; occurrence causes 100% shutdown of operations.

Business Interruption		**Value**	**Loss**
Value		$1,128,055.00	
Period of suspension			
80 hours or 3⅓ days			
1st 24-hour period	$5,198.00		
2nd 24-hour period	5,198.00		
3rd 24-hour period	5,198.00		
4th 8-hour period	1,732.66		$17,326.66

Step No. 1 — Establish respective limits of liability.

"Fire Group"		**Limit of Liability**
Insurance	$761,000.00	
Loss	17,326.66	
Application of 80% coinsurance clause — $761,000.00/$902,444.00 of $17,326.66	14,610.97	$14,610.97

"Boiler Group"	**Limit of Liability**	
Insurance — $3,000.00/day from 1st Midnight		
1st 24-hour period — 12:01 A.M. — 12:00 Mdnt —	no coverage	
2nd 24-hour period — 12:00 Mdnt — 12:00 Mdnt —	$3,000.00	
3rd 24-hour period — 12:00 Mdnt — 12:00 Mdnt —	3,000.00	
4th 8-hour period — 12:00 Mdnt — 8:00 A.M. —	1,000.00	
		$ 7,000.00
	Total	$21,610.97

Step 2 — Assess part of loss separately covered to policy which alone affords coverage.

Loss for first 24-hour period assessed to "Fire Group" — $5,198.00

"Fire Group" remaining limit $9,412.97 ($14,610.97 — $5,198.00) available for contribution in area of common coverage.

Step 3 — Contribution to area of common coverage on basis of available limits of liability.

Loss to area of common coverage is ($17,326.66 — $5,198.00) $12,128.66

	Limit of Liability	**Loss**
"Fire Group" (remaining limit)	$ 9,412.97	$ 6,955.88
"Boiler Group" limit	7,000.00	5,172.78
	$16,412.97	$12,128.66

Claim under each policy is:

"Fire Group"		
1st 24-hour period	$ 5,198.00	
Contribution to area of common coverage	6,955.88	
		$12,153.88
"Boiler Group"		
Contribution to area of common coverage		5,172.78
	Insured recovers	$17,326.66

Note: Example not intended to imply that loss under "Valued Form" of boiler-machinery policy must necessarily be adjusted on an "hourly" basis.

General Principle 1-G

Illustrative Problem (13) — Time element loss.

Coverage

"Fire Group" $761,000.00 — 80% coinsurance clause
"Boiler Group" Valued U and O — daily indemnity $5,500.00
Liability commences 1st Mdnt; limit loss $550,000.00

Other considerations — Time of occurrence 12:01 A.M.; plant operates twenty-four hours per day; occurrence causes 100% shutdown of operations.

Property

Business interruption		**Value**	**Loss**
Value		$1,128,055.00	
Period of suspension			
80 hours or 3⅓ days			
1st 24-hour period	$5,198.00		
2nd 24-hour period	5,198.00		
3rd 24-hour period	5,198.00		
4th 8-hour period	1,732.66		
			$17,326.66

Step 1 — Establish respective limits of liability.

"Fire Group"		**Limit of Liability**
Insurance	$761,000.00	
Loss	17,326.66	
Application 80% coinsurance clause		
$761,000.00/$902,444.00 of $17,326.66		$14,610.97
"Boiler Group"		
Insurance — $5,500.00/day from 1st Midnight		
1st 24-hour period — 12:01 A.M. — 12:00 Mdnt —	no coverage	
2nd 24-hour period — 12:00 Mdnt — 12:00 Mdnt —	$5,500.00	
3rd 24-hour period — 12:00 Mdnt — 12:00 Mdnt —	5,500.00	
4th 8-hour period — 12:00 Mdnt — 8:00 A.M. —	1,833.33	
		$12,833.33
	Total	$27,444.30

Step 2 — Assess loss separately covered to policy which alone affords coverage.

Loss for first 24-hour period assessed "Fire Group" — $5,198.00

"Fire Group" remaining limit $9,412.97 ($14,610.97 — $5,198.00) available for contribution in area of common coverage.

Step 3 — Contribution to area of common coverage basis of available limits of liability.

Loss to area of common coverage is ($17,326.66 — $5,198.00) $12,128.66

	Limit of Liability	**Pays**
"Fire Group" (remaining limit)	$ 9,412.97	$ 5,131.94
"Boiler Group" limit	12,833.33	6,996.72
	$22,246.30	$12,128.66

Claim under each policy is:

"Fire Group"		
1st 24-hour period	$5,198.00	
Contribution to area of common coverage	5,131.94	
		$10,329.94
"Boiler Group"		
Contribution to area of common coverage		6,996.72
	Insured recovers	$17,326.66

Note: Example not intended to imply that loss under "Valued Form" of boiler-machinery policy must necessarily be adjusted on an "hourly" basis.

General Principle 1-G

Illustrative Problem (14) — Boiler-machinery — fire overlap
Fire policies coverage is non-concurrent

Coverage

"Fire Group"

Building	$ 50,000.00
Building and contents	75,000.00
	$125,000.00

"Boiler Group"

Amount of Insurance	$100,000.00

Property

	Value	Loss
Building	$ 90,000.00	$15,000.00
Contents	75,000.00	5,000.00
	$165,000.00	$20,000.00

Solution

Step 1 — Establish limits of liability of each group for contribution purposes.
The liability of the "Fire Group" policies is determined by order of precedence as established by General Principles 1-A through 1-G.

			Limit of Liability
"Fire Group"			
Building policy — primary insurance in accordance with Principle 1-A and Specific Principles — Fire-Fire.			
Entire building loss would be assessed to specific insurance			$15,000.00
Building and contents policy — excess insurance in accordance with General Condition 1.			
Building and contents value and loss	$165,000.00	$20,000.00	
Less value covered by primary insurance (building)	50,000.00		
Less amount assessed to primary insurance		$15,000.00	
Excess value and loss	$115,000.00	$ 5,000.00	
Limit of liability			$ 5,000.00
"Fire Group" limit of liability			$20,000.00
"Boiler Group"			
Amount of insurance		$100,000.00	
Loss		20,000.00	
Limit of liability			$20,000.00
			$40,000.00

Step 2 — Distribution of loss to each group.

	Limit of Liability	Pays
"Fire Group"	$20,000.00	$10,000.00
"Boiler Group"	20,000.00	10,000.00
	$40,000.00	$20,000.00

Distribution of the Fire Group's share of loss to their policy or group of concurrent policies —

	Limit of Liability	Pays
Building policy	$15,000.00	$ 7,500.00
Building and contents policy	5,000.00	2,500.00
	$20,000.00	$10,000.00

General Principle 1-G

Illustrative Problem (15) — Boiler-machinery overlap
Fire policies coverage is non-concurrent

Coverage

"Fire Group"

Building	$ 50,000.00
Building and contents	75,000.00
	$125,000.00

"Boiler Group"

Amount of insurance — (subject to $1,000.00 deductible clause)	$100,000.00

Property	Value	Loss
Building	$ 90,000.00	$15,000.00
Contents	75,000.00	5,000.00
	$165,000.00	$20,000.00

Solution

Step 1 — Establish limits of liability of each group for contribution purposes.

The liability of the "Fire Group" policies is determined by order of precedence as established by General Principles 1-A through 1-G.

"Fire Group"			Limit of Liability
Building policy — primary insurance in accordance with Principle 1-A and Specific Principles — Fire-Fire			
Entire loss would be assessed to specific insurance			$15,000.00
Building and contents policy — excess insurance in accordance with General Condition 1.			
Building and contents value and loss	$165,000.00	$20,000.00	
Less value covered by primary insurance (building)	50,000.00		
Less amount assessed to primary insurance		15,000.00	
Excess value and loss	$115,000.00	$ 5,000.00	
Limit of liability			$ 5,000.00
"Fire Group" limit of liability			$20,000.00
"Boiler Group"			
Amount of insurance	$100,000.00		
Loss	20,000.00		
Claim $20,000.00 less $1,000.00 or $19,000.00			$19,000.00
Limit of liability			$39,000.00

Step 2 — Assess loss separately covered to group which alone affords coverage.

The $1,000.00 not insured under the "Boiler-Machinery Group" is first paid by the "Fire Group" which alone affords coverage. The remaining limit of liability of the "Fire Group" contributes with the "Boiler Group" to pay loss to area of common coverage.

The amount of $1,000.00 is assessed to the "Fire Group."

CONTINUED

Step 3 — Contribution to area of common coverage on basis of available limits of liability.
Loss to area of common coverage is $20,000.00 less $1,000.00 or $19,000.00

	Limit of Liability	Pays
"Fire Group" (remaining limit of liability)	$19,000.00	$ 9,500.00
"Boiler Group"	19,000.00	9,500.00
	$38,000.00	$19,000.00

Claim under each group is:
"Fire Group"

Amount of deductible	$ 1,000.00	
Area of common coverage	9,500.00	
	$10,500.00	$10,500.00

Distribution of the Fire Group's share of loss to their policy or group of concurrent policies —

	Limit of Liability	Pays
Building policy	$15,000.00	$ 7,875.00
Building and contents	5,000.00	2,625.00
	$20,000.00	$10,500.00

"Boiler Group"

Area of common coverage	$ 9,500.00
	$20,000.00

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Illustrative Problem (16) — Boiler-machinery — fire overlap
Fire policies coverage is non-concurrent

Coverage

"Fire Group"

Building	$ 50,000.00	— 80% coinsurance
Building and contents	75,000.00	— 80% coinsurance
	$125,000.00	

"Boiler Group"

Amount of insurance $100,000.00

Property

	Value	Loss
Building	$ 90,000.00	$15,000.00
Contents	75,000.00	5,000.00
	$165,000.00	$20,000.00

Solution

Step 1 — Establish limits of liability of each group for contribution purposes.
The liability of the "Fire Group" policies is determined by order of precedence as established by General Principles 1-A through 1-G.

CONTINUED

			Limit of Liability
"Fire Group"			
Building policy — primary insurance in accordance with Principle 1-A and Specific Principles — Fire-Fire.			
Under application of 80% coinsurance clause, limit of liability would be: $50,000.00/$72,000.00 of $15,000.00 or			$10,416.67
Building and contents — excess insurance in accordance with General Condition 1.			
Building and contents value and loss	$165,000.00	$20,000.00	
Less value covered by primary insurance (building)	50,000.00		
Less amount assessed to primary insurance		10,416.67	
Excess value and loss	$115,000.00	$ 9,583.33	
Under application of 80% coinsurance clause, limit of liability would be: $75,000.00/$92,000.00 of $9,583.33 or			$ 7,812.50
"Fire Group" limit of liability			$18,229.17
"Boiler Group"			
Amount of insurance		$100,000.00	
Loss		20,000.00	
Limit of liability			$20,000.00
			$38,229.17

Step 2 — Distribution of loss to each group.

	Limit of Liability	Pays
"Fire Group"	$18,229.17	$ 9,536.78
"Boiler Group"	20,000.00	10,463.22
	$38,229.17	$20,000.00

Distribution of the Fire Group's share of loss to their policy or group of concurrent policies —

	Limit of Liability	Pays
Building policy	$10,416.67	$ 5,449.59
Building and contents policy	7,812.50	4,087.19
	$18,229.17	$ 9,536.78

General Principle 1-G

Illustrative Problem (17) — Boiler-machinery — fire overlap
Boiler-machinery policy subject to a deductible
Fire policies coverage is non-concurrent

Coverage
"Fire Group"

Building	$ 50,000.00—80% coinsurance
Building and contents	75,000.00—80% coinsurance
	$125,000.00

"Boiler Group"

Amount of insurance .... $100,000.00—$1,000.00 deductible

Property	**Value**	**Loss**
Building	$ 90,000.00	$15,000.00
Contents	75,000.00	5,000.00
	$165,000.00	$20,000.00

Solution

Step 1 — Establish limits of liability of each group for contribution purposes.
The liability of the "Fire Group" policies is determined in order of precedence as established by General Principles 1-A through 1-G.

			Limit of Liability
"Fire Group"			
Building policy — pri· ıary insurance in accordance with Principle 1-A and Specific Principles — Fire-Fire.			
Under application of 80% coinsurance clause, limit of liability would be: $50,000.00/$72,000.00 of $15,000.00			$10,416.67
Building and contents — excess insurance in accordance with General Condition 1.			
Building and contents value and loss	$165,000.00	$20,000.00	
Less value covered by primary insurance (building)	50,000.00		
Less amount assessed to primary insurance		10,416.67	
Excess value and loss	$115,000.00	$ 9,583.33	
Under application of 80% coinsurance clause, limit of liability would be: $75,000.00/$92,000.00 of $9,583.33 or			$ 7,812.50
"Fire Group" limit of liability			$18,229.17

"Boiler Group"

Amount of insurance	$100,000.00	
Loss	20,000.00	
Claim $20,000.00 less $1,000.00 or	19,000.00	
Limit of liability		$19,000.00
		$37,229.17

Step 2 — Assess loss separately covered to group which alone affords coverage.

The $1,000.00 not insured under the "Boiler-Machinery Group" is first paid by the "Fire Group" which alone affords coverage. The remaining limit of liability of the "Fire Group" contributes with the "Boiler Group" to pay loss to area of common coverage.

The amount of $1,000.00 is assessed to the "Fire Group."

CONTINUED

Step 3 — Contribution to area of common coverage basis on available limits of liability.
Loss to area of common coverage is:
$20,000.00 less $1,000.00 or $19,000.00

	Limit of Liability	Pays
"Fire Group" (remaining limit of liability)	$17,229.17	$ 9,035.65
"Boiler Group"	19,000.00	9,964.35
	$36,229.17	$19,000.00

Claim under each group is:
"Fire Group"

Amount of deductible	$ 1,000.00	
Area of common coverage	9,035.65	
	$10,035.65	$10,035.65

Distribution of the Fire Group's share of the loss to their policy or group of concurrent policies —

	Limit of Liability	Pays
Building policy	$10,416.67	$ 5,734.66
Building and contents policy	7,812.50	4,300.99
	$18,229.17	$10,035.65

"Boiler Group"

Area of common coverage	$ 9,964.35
	$20,000.00

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Illustrative Problem (18) Fire-Fire coverage.

Coverage

A. Stock	$30,000.00
B. Contents, including improvements and betterments	20,000.00
C. Contents, exclusive of improvements and betterments	10,000.00
	$60,000.00

No coinsurance clause under any policy.

Property

	Value	Loss
Stock	$60,000.00	$ 5,000.00
Furniture and fixtures	10,000.00	1,000.00
Improvements and betterments	2,500.00	500.00
	$72,500.00	$ 6,500.00

Solution

Primary insurance — Policy A

Stock loss is assessed to specific insurance in accordance with Principle 1-C.

Excess insurance — Policies B and C

Loss to property other than stock is distributed according to Principle 1-G-(1).

CONTINUED

Step 1 — Establish limit of liability.

Policy B, including improvements and betterments		**Limit of Liability**
Insurance	$20,000.00	
Loss	1,500.00	
Limit of liability		$ 1,500.00
Policy C, excluding improvements and betterments		
Insurance	10,000.00	
Loss	1,000.00	
Limit of liability		1,000.00
		$ 2,500.00

Step 2 — Assess loss separately covered to policy which alone affords coverage.

Improvements and betterments loss is first assessed to Policy B which alone affords coverage and the remaining limit of liability participates with Policy C to pay loss to area of common coverage.

Improvements and betterments loss assessed Policy B.

Step 3 — Contribution to area of common coverage on basis of available limits of liability.

Loss to area of common coverage — $1,000.00

	Limit of Liability	**Pays**
Policy B (remaining limit of liability)	$1,000.00	$ 500.00
Policy C	1,000.00	500.00
	$2,000.00	$1,000.00

Total claim to each policy is:

Policy A		
Stock		$5,000.00
Policy B		
Improvements and betterments	$ 500.00	
Contents, other than stock and improvements and betterments	$ 500.00	$1,000.00
Policy C		
Contents, other than stock and improvements and betterments		500.00
		$6,500.00

General Principle 2-E

Installment-Sales or Deferred-Payment
Merchandise Insurance:

Illustrative Problem (1)

Coverage
Inland marine
Policy issued to vendor.

Installment-sales floater (dual-interest.)
$30,000.00 on the interest of the insured and of purchasers in merchandise sold by the insured under a deferred-payment or conditional-sales agreement.

Evidence of insurance issued by vendor to vendee.

Fire insurance
Policy issued to purchaser —
$5,000.00 on household furniture.

Property, location and cause.

Property damaged or destroyed	— Refrigerator which had been purchased under a conditional-sales agreement
Amount of loss	— $250.00
Location of loss	— Purchaser's residence
Cause of loss	— Fire

Solution

Distribution of loss is based on subdivision (1)-(a) of General Principle 2-E.
The loss is assessed to the installment-sales floater policy as primary coverage.

Note: With coverages outlined above the result would be the same in an "on-premises" or "off-premises" situation.

General Principle 2-E

Illustrative Problem (2)

Coverage
Inland marine
Policy issued to vendor.

Installment-sales floater (dual-interest.)

$30,000.00 on the interest of the insured and of purchasers in merchandise sold by the insured under a deferred-payment or conditional-sales agreement.

Certificate of insurance issued by vendor to vendee.

Fire insurance
Policy issued to purchaser —
$1,500.00 on tractor (Farm Form)

Property, location and cause.

Property damaged or destroyed	— Tractor which had been purchased under a conditional-sales agreement
Amount of loss	— $2,500.00
Location of loss	— Purchaser's farm
Cause of loss	— Fire

Solution

Distribution of loss is based on subdivision (1)-(b) of General Principle 2-E which provides loss be divided in accordance with the Limit of Liability Rule (General Condition 2).

		Limit of Liability	Pays
Inland marine			
Coverage	$30,000.00		
Loss	2,500.00		
Limit of liability		$2,500.00	$1,562.50
Fire insurance			
Coverage	1,500.00		
Loss	2,500.00		
Limit of liability		1,500.00	937.50
		$4,000.00	$2,500.00

Note: With coverages outlined above the result would be the same in an "on-premises" or "off-premises" situation.

General Principle 2-E

Illustrative Problem (3)

Coverage
Inland marine
Policy issued to vendor.

Installment-sales floater (dual-interest).

$30,000.00 on the interest of the insured and of purchasers in merchandise sold by the insured under a deferred-payment or conditional-sales agreement.

No evidence of insurance issued by vendor to vendee.

Fire insurance — homeowners MIC 1 or 2
Policy issued to purchaser —
$8,000.00 on unscheduled personal property.

Property, location and cause.

Property damaged or destroyed	—	Television set which had been purchased under conditional-sales agreement.
Amount of loss	—	$500.00
Location of loss	—	Purchaser's residence
Cause of loss	—	Fire

Solution

Distribution of loss is based on subdivision (2)-(a) of General Principle 2-E.

Loss is assessed to the homeowners policy as primary coverage.

General Principle 2-E

Illustrative Problem (4)

Coverage
Inland marine
Policy issued to vendor.

Installment-sales floater (dual-interest).

$30,000.00 on the interest of the insured and of purchasers in merchandise sold by the insured under a deferred-payment or conditional-sales agreement.

No evidence of insurance issued by vendor to vendee.

Fire insurance — homeowners MIC 5
Policy issued to purchaser —
$15,000.00 on unscheduled personal property xxx while in all situations anywhere in the world. (10% of the limit of liability for coverage C for unscheduled personal property ordinarily situated throughout the year at residences other than the described dwelling.)

Property, location and cause.

Property damaged or destroyed	—	Riding power lawn mower which had been purchased under a conditional-sales agreement.
Amount of loss	—	$500.00
Location of loss	—	Purchaser's secondary residence
Cause of loss	—	Fire

Solution

Distribution of loss is based on subdivision (2)-(b) of General Principle 2-E, which provides loss be divided in accordance with the Limit of Liability Rule (General Conditon 2).

		Limit of Liability	Pays
Inland marine			
Coverage	$30,000.00		
Loss	500.00		
Limit of liability		$ 500.00	$250.00
Fire insurance — homeowners MIC 5			
Coverage — secondary residence	1,500.00		
Loss	500.00		
Limit of liability		500.00	250.00
		$1,000.00	$500.00

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General Condition 1
See General Principle 1-B — Illustrative Problem (2).

PART II

SPECIFIC PRINCIPLES
CASUALTY - CASUALTY

Overlap of first-party property coverage situations occurring between or among casualty coverages only are to be resolved in accordance with General Principles 1-A through 1-G; 2-A through 2-E; General Conditions and Definitions.

PART II

SPECIFIC PRINCIPLES
FIRE - FIRE

Overlap of first-party coverage situations occurring between or among fire coverages only are to be resolved in accordance with General Principles 1-A through 1-G; 2-A through 2-E; General Conditions; Specific Principles and Definitions.

Explanatory Notes and Examples

Under overlapping situations between fire-fire coverages:

1. A building is construed to be an object.
2. The following are construed to be a group of related articles or objects and come within the provisions of General Principle 1-C or 1-D:
   (a) stock (merchandise),
   (b) machinery,
   (c) furniture and fixtures,
   (d) improvements and betterments.
3. Coverage on any combination of the above in 1 or 2 and coverage on CONTENTS or on personal property are not construed to be coverage on a group of related articles or objects, but come within the provisions of General Principle 1-E or 1-F.

PART II

SPECIFIC PRINCIPLES
INLAND - INLAND

Overlap of first-party coverage situations occurring between or among inland coverages only are to be resolved in accordance with General Principles 1-A through 1-G; 2-A through 2-E; General Conditions; Specific Principles and Definitions, subject to the following specific exceptions:

1. Policies issued to common or contract carriers covering their legal liability for cargo shall be deemed to insure independently of any policy issued to a shipper, consignee, owner or agent to the same extent as if no other insurance existed, subject, nevertheless, to pro rata contributions from and with other similar policies issued to the carrier.

2. Overlapping insurance shall be deemed to exist in the case of termination, by expiration or cancellation, of a motor truck cargo liability policy with Interstate Commerce Commission and State Endorsement(s) expiring subsequent thereto, and a succeeding motor truck cargo liability policy whose ICC and State Endorsement(s) attach upon the termination dates of the endorsement(s) attached to the succeeded policy. In the case of such overlapping insurance between a succeeded insurer's unexpired ICC and State Endorsement(s) and a succeeding insurer's ICC and State Endorsement(s) whether issued or not: It is agreed that the succeeding insurer shall assume any liability under ICC or State Endorsement(s) from the date of attachment of the succeeding policy but not in excess of the limits stated in the ICC or State Endorsement(s).

3. Overlapping insurance shall be deemed to exist whenever insured loss or damage may have occurred during continuous coverage under successive policies of two or more companies and the date of loss cannot be determined but may be presumed to have been during the existence of such policies, the loss shall be prorated between the companies on the basis of time each company was at risk prior to discovery of loss, the total of such time in no case to exceed thirty-six months nor to extend in the case of missing property beyond the time the property was last seen nor in the case of damage beyond the time the property was last known to be in sound condition.

4. When a furriers customers policy has been extended to cover excess legal liability and the amount charged the bailor for storage or services and insurance was predicated on the declared valuation stated in the receipt issued by the furrier for the article lost or damaged, the bailor's insurer shall accept in final settlement the amount of the loss or damage not exceeding such declared valuation, unless such loss or damage was due to unauthorized use or disposition of the article by the bailee.

   When one bailee sends property to another bailee, insurance covering the bailee in possession of the property at the time of the loss is to be considered primary in relation to the first bailee's insurance. The measure of liability under the insurance declared to be primary shall be determined as follows notwithstanding any limitation of subsequently determined excess liability stated in the original bailee's contract of bailment with the owner or agent:

   A. If a receipt shall have been issued by the bailee in custody, with a declared valuation, or stated limitation of liability, the measure of liability shall be such declared valuation, or stated limitation, but in no event exceeding the actual cash value of the property.

   B. If a receipt shall have been issued by the bailee in custody with no declared valuation, or no stated limitation of liability, or if no receipt shall have been issued, the measure of liability shall be the actual cash value of the property, unless there is in effect a signed contract or other agreement in writing between the parties specifically providing for a lesser liability between the parties.[5]

CONTINUED

[5]See Examples.

EXAMPLES — Specific Principle 4

(Inland-Inland)

Example 1. A coat worth $3,000 is stored by "A" with the furrier who issues a fur storage receipt with a declared value of $500. "B" asks the furrier to manufacture a coat like "A's". The furrier agrees, and without "A's" knowledge or consent removes her coat from the storage vault to his workroom where it is used as a model, and while there it is stolen. This is an unauthorized use of the coat, and the furrier should be liable for the full value.

Example 2. The same coat is stored under a $500 receipt, and without "A's" knowledge or consent, the furrier removes the coat from the storage vault for display or exhibition and, while on a form in the store or window, it is stolen. This is an unauthorized use of the coat and the furrier should be liable for full value.

Example 3. The same coat is stored under a $500 receipt, and repairs are ordered and agreed upon. The receipt bears a statement: "All work done on our premises." The coat, without the knowledge of "A," is sent to another and independent contractor where the work is to be done. It is damaged by fire on these premises and is a total loss. This is an unauthorized use of the coat and the furrier should be liable for the full value for such a breach of contract.

Example 4. Assuming the same bailment, the furrier, being in financial difficulties, takes the coat to a pawnbroker, where it is pledged for a loan. "A" should recover damages (i.e., cost of replevin, et cetera) up to the full value from the furrier for such unauthorized use or disposition of the property.

Note: Where the personal property insurer does not control the right of recovery against the furrier, due to insufficient insurance, and a recovery is made by the owner in excess of the receipt valuation, the property insurer should refund to the excess liability insurer such amount as it has received in excess of the receipt valuation.

DEFINITIONS
of
Insurance Terms for the Purpose of these Guiding Principles

AFFIXED — A television aerial or antenna is affixed to the building or outbuilding when substantially attached with the weight of the antenna borne principally by the building.

BLANKET — (Casualty) — When a policy covers at a stated location and any number of other unstated or non-scheduled locations as well, it is said to be "blanket."

(Fire and Inland Marine) — When a single amount of insurance covers several unrelated items, the policy is said to be written "blanket."

Example

One amount of insurance covering two or more buildings or a building and its contents.

CONCURRENT POLICIES — Concurrent policies are those insuring the same interest and the identical property involved in the loss or claim, which divide the risk of a specific major hazard between or among policies or companies, even though policy dates and amounts vary and certain policies contain reduced rate contribution, average, coinsurance, or deductible clauses, while others do not.

Examples

Two or more standard fire policies.
Two or more contractors installment floaters.
Two or more furriers customers policies.
Two or more mercantile theft policies.

A policy(ies) providing coverage under more than one underwriting classification; i.e., casualty--fidelity--fire--inland marine or multiple-line, shall **not** be considered concurrent to policy(ies) limited to one classification.

Examples

A standard fire policy and a homeowners or MIC.
A boiler-machinery and a fire policy.
A special multi-peril motel policy and a mercantile theft policy.

EXCESS PROVISION — A provision in a policy which stipulates that the policy is liable only after other insurance, covering the risk, has been exhausted — not to be confused with "pure excess" insurance. However, depositors forgery insurance which by its terms is primary to employee dishonesty coverage shall remain so.

FLOATER POLICY (FLOATING) — A policy under the terms of which protection follows movable property, covering it wherever it may be.

Example

A policy on tourist's baggage.

LIMIT OF LIABILITY RULE — As described in **General Condition 2.**

LIMITED PURPOSE — A policy(ies) is said to be for a more limited purpose when it is designed to provide coverage for a specific exposure as contrary to one which includes that exposure and other exposures as well.

Example

A trip transit policy is a more limited purpose policy than a household furniture policy with off-premises coverage.

LOCATION — A site specifically defined in the policy.

OVERLAPPING — When two or more types of insurance cover the same risk, the insurance is said to be "overlapping."

RETROSPECTIVE RATING — A plan under which the final premium for a risk is adjusted on basis of its own loss experience during the policy period.

ASSOCIATION OF CASUALTY AND SURETY COMPANIES

110 William Street .... New York, N. Y. 10038
315 Montgomery Street .... San Francisco, Cal. 94104
837 Washington Building .... Washington, D. C. 20005
120 South LaSalle Street .... Chicago, Illinois 60603

INLAND MARINE UNDERWRITERS ASSOCIATION

161 William Street .... New York, New York 10038

NATIONAL AUTOMOBILE UNDERWRITERS ASSOCIATION

125 Maiden Lane .... New York, N. Y. 10038
360 Pine Street .... San Francisco, Cal. 94104
Railway Exchange Building .... Denver, Colorado 80202
175 West Jackson Boulevard .... Chicago, Illinois 60604
650 Trust Company of Georgia Building .... Atlanta, Georgia 30303

NATIONAL BOARD OF FIRE UNDERWRITERS

85 John Street .... New York, N. Y. 10038
465 California Street .... San Francisco, Cal. 94104
222 West Adams Street .... Chicago, Illinois 60606

NATIONAL BUREAU OF CASUALTY UNDERWRITERS

125 Maiden Lane .... New York, N. Y. 10038
315 Montgomery Street .... San Francisco, Cal. 94104
1627 Peachtree Street, N. E. .... Atlanta, Georgia 30309
1920 Field Building, 135 So. LaSalle Street .... Chicago, Illinois 60603
Casco Bank Building .... Portland, Maine 04101
404 International Life Building .... Austin, Texas 78701

SURETY ASSOCIATION OF AMERICA

110 William Street .... New York, N. Y. 10038

GUIDING PRINCIPLES

for

OVERLAPPING INSURANCE COVERAGES

(Superseding All Guiding Principles of Prior Date)

THE PURPOSE

WHEREAS from time to time disputes arise in the adjustment and apportionment of losses and claims because of overlapping coverages, which disputes require litigation or arbitration, and

WHEREAS the occurrence of such disputes is against the interests of the insuring public and the companies, and

WHEREAS it is desirable to lay down certain Principles for the elimination of these disputes,

THEREFORE BE IT RESOLVED that the Association of Casualty and Surety Companies, the Inland Marine Underwriters Association, the National Automobile Underwriters Association, the National Board of Fire Underwriters, the National Bureau of Casualty Underwriters and the Surety Association of America recommend to their respective members and subscribers their concurrence in adopting the following Guiding Principles, effective as to losses and claims, other than losses and claims involving retrospective[1] rated policies, occurring on and after **November 1, 1963.**

Note: When retrospective rated boiler-machinery--fire policies overlap, these Guiding Principles **do** apply.

[1] See Definitions.

2-1

The Surety Association of America

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Senior Statistician

Surety Department
DENNIS E. WINE
Vice President

August 20, 1987

TO THE MEMBERS OF THE BOARD OF DIRECTORS:

Re: Claims Advisory Committee
Guiding Principles

Gentlemen:

At the request of a new member of the Claims Advisory Committee, the Guiding Principles previously approved by the Board at its meeting of May 7, 1987 have been reconsidered.

The original three-man sub-committee of the Advisory Committee, with the participation of a representative of the member company requesting reconsideration of the Guiding Principles, met on June 24 and modified the original proposal. By mail vote the Claims Advisory Committee accepted the amended version.

The new version is attached for consideration by the Board of Directors. The preamble to the Guiding Principles now makes reference to the fact that the Principles are not intended to replace or supplant existing regulations. In the attached copy, the new material is underscored. The six Principles have not been changed from those previously considered by the Board.

This item will appear on the Agenda for the Board's meeting of September 10.

Very truly yours,

Robin V. Weldy

RVW:poh
Enclosure

THE SURETY ASSOCIATION OF AMERICA

GUIDING PRINCIPLES

FOR

CLAIMS HANDLING

The Surety Association of America recognizes that suretyship creates relationships among and between surety, principal and obligee which impose upon surety the obligation of good faith and fair dealing in claims handling. Thus, the Association recommends the Guiding Principles set forth below to member companies. <u>Should there be any conflict between state, federal or local laws and these Guiding Principles, such law will prevail</u>.

1) Surety shall promptly acknowledge communications relating to a claim.

2) Surety shall promptly undertake an appropriate investigation to determine its liability.

3) Surety shall promptly advise claimants of its position, based upon its investigation.

4) Surety shall promptly offer settlement of claims when liability has become reasonably clear.

5) Surety shall promptly provide the specific basis for denial of a claim.

6) Surety shall promote adherence to these Principles by its employees, attorneys and consultants.

2-1

Insurers as Innocent Bystanders

SUMMARY: The California and Minnesota high courts have ruled that anyone can sue an insurer for almost any delay in handling a claim. Some lawyers say litigants could now win huge sums for minor injuries. The U.S. Supreme Court seems to disapprove.

A 16-year-old boy living near Los Angeles borrowed his older brother's car to drive to school. He drove into a telephone pole instead, injuring a passenger, who sued. There was a problem: The young driver did not have auto insurance. Neither did the brother, age 20, a student at a college near San Francisco but visiting at home when the accident occurred.

The brothers' father did have $50,000 worth of liability insurance on two cars he and his wife owned, but he did not list the two sons on the policy because that would have raised the premiums substantially.

The parents' insurance policy contained another clause, extending coverage to any accident involving a car owned by a nonresident of the household and not regularly driven by household members. The clause seemed designed to apply to rental cars. But the teenager argued that his brother was technically a "nonresident" of the household. Ergo, said the youth, the brother's car was covered by the parents' policy.

The parents' insurance company denied coverage and tried to get a court ruling to that effect. It also turned down a demand by the injured passenger's lawyer to settle the case for the parents' $50,000 policy limits. Nonetheless, the company provided the youth with a lawyer. The court eventually decided the policy covered the accident. Later, a jury awarded the passenger $125,000, which the insurer paid in full.

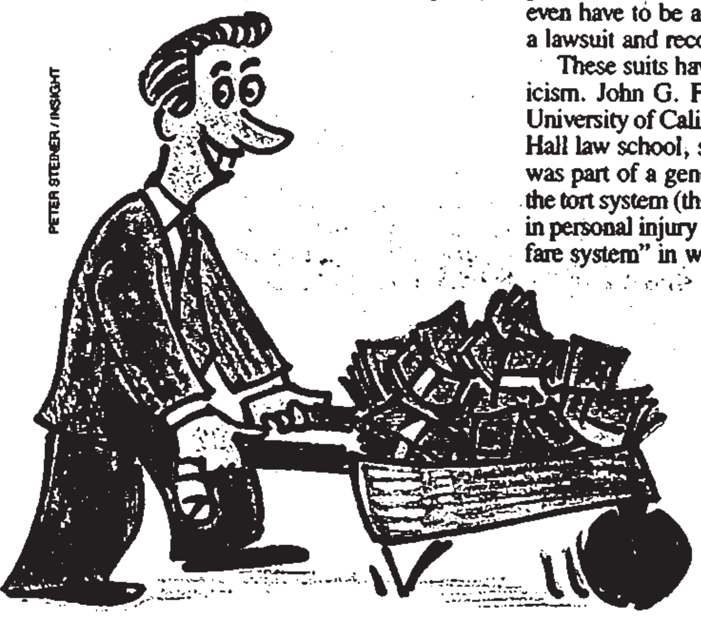
All seemed well that ended well. But now the teenager plans to sue his parents' insurance company. What for? For putting him through the emotional distress of waiting on tenterhooks while the firm dithered over whether to provide coverage. A lawyer representing the youth argues the company acted in bad faith for failing to settle the case with reasonable speed.

This story is true, part of the annals of a new kind of lawsuit that flourishes in California, Minnesota and one or two other states. These states, like virtually every other, have statutes on their books dating from the 1940s that make it an unfair practice for an insurance company to fail to settle a case with reasonable promptness once an insured's liability becomes reasonably clear.

None of these statutes, which are all based on models drafted by the National Association of Insurance Commissioners, explicitly gives private parties any particular rights. They are supposed to be part of the states' general insurance regulatory schemes, with state officials enforcing them via fines or other sanctions. Most state courts have rejected the idea that individuals should be able to sue under them.

Nonetheless, the California Supreme Court in 1979 and a Minnesota appellate court in 1985 ruled that anyone who claims injury from an insurance company's unfair practices — and that "anyone" does not even have to be a policyholder — can file a lawsuit and recover damages.

These suits have engendered much criticism. John G. Fleming, professor at the University of California at Berkeley's Boalt Hall law school, says the California ruling was part of a general trend toward turning the tort system (the liability rules that apply in personal injury cases) "into a social welfare system" in which anyone claiming an injury, no matter whose fault or how trivial, can collect from an insurance company, even if not his own.


PETER STEINER / INSIGHT

The trend toward such suits actually began decades ago, in response to what most observers agree was — and still is, say some — a real problem: insurance companies that refused or lagged in paying claims for spurious reasons. Disability insurers ignored policyholders' claims sometimes, adding emotional injuries to physical ones. Accident insurers refused to settle cases for the policy limits, leading to later judgments for vaster amounts that had to be made up out of the policyholder's own pocket.

So courts in practically every state have allowed holders of insurance policies to collect damages over a carrier's "bad faith" refusal to honor policy terms. Besides recovering out-of-pocket losses, the usual remedy in a breach of contract suit, the injured policyholder can usually get punitive damages as well. The latter, which can run into the millions of dollars, are designed to punish wrongdoers.

From this, it has been just a small philosophical jump in states such as California to letting people not party to the insurance contract sue over settlement delays. "There's a concept in some states that the injured victim, not the policyholder, is the real beneficiary of the insurance contract," says Stephen Sugarman, a colleague of Fleming's at Boalt Hall.

Lawyers who represent insurers say the new legal theories have occasionally led to absurdly large verdicts for minor defalcations and delays in settling cases. "Theoretically, it's possible for someone to lose the underlying case and still win a suit against the insurance company for refusing to offer a reasonable settlement," says Los Angeles lawyer Timothy L. Walker.

Victim advocates insist these cases are rare, however, and that higher courts routinely overturn or reduce punitive damage awards. "You know the plaintiff deserves it if the award survives all the appeals," says William M. Shernoff, a lawyer in Claremont, Calif., whose firm, Shernoff & Levine, handles about 300 to 400 bad faith cases a year against insurance companies.

But such suits may diminish if the U.S. Supreme Court continues a current trend. On April 6, it ruled 9-0 in a case from Mississippi that bad faith claims related to employer-provided insurance benefits cannot be tried under state law but only under federal pension plan laws, which do not provide for punitive damages. The court also agreed recently to review another case from Mississippi challenging the whole concept of large punitive damages as violating the Eighth Amendment's ban on excessive fines. With no prospect of winning punitive damages, many claimants and their lawyers may well decide bad faith suits are not worth the trouble of filing.

— Charlotte Low

BLANKET CO-SURETY SIDE AGREEMENT

This Agreement is entered into between and among _______________, _________________, _______________, and ____________________ (hereinafter individually "Surety" or collectively the "Sureties") effective on the ______ day of ________, 20__ (the "Effective Date"). In consideration for the following covenants, the sufficiency of which is hereby acknowledged, the Sureties hereby covenant and agree as follows:

ARTICLE 1
Definitions

1.1 In addition to the capitalized terms defined elsewhere in this Agreement, the following terms when utilized in this Agreement, unless the context otherwise requires, shall have the meanings indicated in this Article, which meanings shall be equally applicable to both the singular and plural forms of such terms:

"Indemnity Agreement" means any agreement of indemnity received by any Surety from or relating to any Principal.

"Lead Surety" means _________________________________ or the replacement Surety if said replacement is so named in accordance with the provisions hereof.

"Loss" means, for any Surety, any payment or expense, exclusive of compensation of salaried employees and overhead expenses, incurred by such Surety arising out of or relating to any Program Bond, the enforcement of any Indemnity Agreement relating to any Program Bond or this Agreement, including but not limited to: payment under the Program Bond or any other payment, cost, damages, liabilities, judgment and/or expense incurred in connection with claims, potential claims, settlements and/or demands, penalties, interest, court costs, experts' fees, consultants' fees, and attorney's fees, including but not limited to those payments, costs and fees incurred defending and adjusting Program Bond claims or preventing or diminishing liability under the Program Bond or attempting to do so, attempting to cancel or obtain release of the Program Bond, pursuing rights of indemnification, subrogation, and/or recoveries from third parties, realizing upon any shared collateral, or in obtaining and collecting on any judgment obtained against any Principal arising out of or related to any Program Bond.

"Person" means any entity, whether an individual, business trust, corporation, general partnership, limited partnership, limited liability company, joint-stock company, trust, estate, unincorporated organization, business association, firm, joint venture, or any other form of business or professional entity or governmental entity.

"Principal" or "Principals" means ______________________ and any of its affiliates and subsidiaries, direct or indirect, whether in existence now or created at any time in the future, or any joint ventures or any special purpose entity in which one or more of them are involved and for which a Program Bond is issued and/or any Person for which a Program Bond is issued at the request of one or more of them.

"Program Bond" means any surety bond, undertaking, guarantee, stipulation or other obligatory instrument executed by all the Sureties on behalf of any one or more of the Principals, for work domiciled within the United States of America or any of its territories, Puerto Rico, or Canada, or for the United States of America or any agency thereof wherever located, on or after the Effective Date of this Agreement, together with bid bonds and consents of surety executed by any Surety in reasonable anticipation of the execution of any such surety bonds and undertakings and any final bonds issued for which such bid bonds or consents of surety were executed.

"**Other Bond**" means any surety bonds, undertakings, guarantees, stipulations or other obligatory instruments executed by any one or more of the Sureties on behalf of any one or more of the Principals which is not a Program Bond and is therefore excluded from this Agreement.

1.2 Terms Generally. The words "hereof" and other words of similar import refer to this Agreement. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms. All references to any Surety shall be deemed to mean and include their present or future direct or indirect parent companies, any of their respective present or future direct or indirect affiliates or subsidiaries and any of the aforementioned entities' successors or assigns.

ARTICLE 2
Incorporated Recitals

2.1 From time to time in the past, some or all of the Sureties may have issued Other Bonds on behalf of one or more of the Principals. This Agreement is not intended to alter the proportionate share of liability of any Surety with respect to any such Other Bonds. Subsequent to the Effective Date, the Sureties hereto may execute, jointly, Program Bonds for any one or more of the Principals. This Agreement is intended to establish the proportionate share of liability of the Sureties with respect to such Program Bonds in the event that such proportionate share of liability is not otherwise expressly set forth in such Program Bonds. Subsequent to the Effective Date, one or more of the Sureties may also decide to issue Other Bonds which will not be executed by all of the Sureties and as to which such Sureties may undertake a share of liability thereunder solely or separately or with one or more of the other Sureties who are signatories to this Agreement, but in an amount different than the proportions governing Program Bonds as may be set forth in such Other Bonds. Notwithstanding anything to the contrary above, any and all Other Bonds shall not be subject to any of the terms and conditions of this Agreement unless all Sureties that executed such Other Bonds agree in writing, in which case this Agreement shall apply as to such Sureties with respect to such Other Bonds.

2.2 The Sureties desire to document their respective rights and obligations to each other arising out of the Program Bonds.

ARTICLE 3
Covenants

3.1 For all Program Bonds, the respective obligations and liabilities of the Sureties among themselves for all Loss arising out of or relating to each Program Bond shall be, except as otherwise modified herein or as expressly set forth in such Program Bond, in the amount established by applying the following proportions to such Loss incurred by any Surety:

	_____% of the penalty of each Program Bond
	_____% of the penalty of each Program Bond
	_____% of the penalty of each Program Bond
	_____% of the penalty of each Program Bond

3.2 Each Surety shall be responsible for billing and collecting premiums and paying commissions for its respective share of any Program Bond.

3.3 Except as may be otherwise provided herein or agreed in writing by the Sureties, each of the Sureties shall be entitled to retain for its sole and exclusive benefit all collateral of whatever kind or nature held by such Surety in connection with any Program Bond or Other Bond, and in any recovery, right, recourse or benefit made by or accruing to any of the Sureties in connection with any Program Bond as against any Person. Each Surety retains, and may act independently in connection with, any collateral, indemnity, right, recourse or benefit not received or obtained in connection with any Program Bond and shall have no obligation to share with any other Surety with respect to any recovery obtained from such collateral, indemnity, right, recourse or benefit.

3.4 Any of the Sureties receiving notice or otherwise learning of a claim or suit under any Program Bond which they believe will likely give rise to a Loss shall promptly give full information thereof to the other Sureties, in the manner set forth in paragraph 3.19 below. Each Surety will give the other Sureties access to all documents and information in its possession related to such claims or suits related to any Program Bond.

3.5 The party designated from time to time as Lead Surety as provided hereunder shall have the right and obligation to make investigations and examinations of all claims or other matters related to the Program Bonds and, consistent with the Action Plan described in paragraph 3.7, shall respond to all such claims, defend all suits under the Program Bonds in consultation with all Sureties, engage counsel, consultants and such professionals as it deems appropriate, conditioned on receiving confirmation from all Sureties that there are no conflicts of interest, act on behalf of all of the Sureties in matters relating to the Program Bonds, keep each other Surety reasonably informed with respect to claims, and charge the other Sureties for their respective percentages, as set forth in paragraph 3.1 above, of the Loss incurred in doing so. All Sureties shall endeavor to conduct an expeditious search and notify the Lead Surety within five days of notification of the proposed retention of counsel or other professionals as to whether there is a conflict related to such proposed retention. The Lead Surety may also, consistent with the Action Plan described in paragraph 3.7, tender defense of all claims asserted against each of the Sureties to counsel engaged by the Principal, except that such authority shall not apply to any claim alleging bad faith or extra-contractual damages against any Surety. Moreover, notwithstanding the foregoing, each Surety reserves the right, at its own expense, to opt out of any such tender, in which event it shall bear its own expenses regarding the charges of any separate counsel and/or experts it may retain without any right of reimbursement or contribution from the other Sureties toward such expenses. The Lead Surety agrees to keep the other Sureties fully informed of the substance of its investigations and examinations and of its responses to claims and defense of suits under the Program Bond. The Lead Surety further agrees that its responses to claims shall be consistent with any response time requirements that may be applicable and imposed by law or regulation.

If any of the Sureties desires to change the designation of Lead Surety, any Surety may give written notice to the other Sureties, and authorized representatives of the Sureties shall, within five (5) business days of receipt of the notice, meet in person or by conference call and attempt to reach a unanimous agreement. If a unanimous resolution is not achieved, the Lead Surety will be changed only by the affirmative vote of Sureties holding greater than 50% of the proportionate shares of liability for Loss as set forth in paragraph 3.1a and agreement of at least 2 of the Sureties.

3.6 Each of the Sureties other than the Lead Surety shall have the right, but not the obligation, at its sole discretion, to conduct its own investigations or examinations of matters related to a Program Bond. Notwithstanding the broad definition of Loss hereunder, such other Surety shall not be entitled to reimbursement under this Agreement for the costs or expenses it incurs in such separate investigations or examinations. Nonetheless, it shall retain any right it may have to reimbursement from the Principal or others for such costs or expenses. Any Surety may at any time request a meeting or conference call among the parties hereto to discuss issues related to Program Bonds, the Principal, or any project for which a Program Bond was issued.

3.7 If the Lead Surety concludes that the Sureties will likely incur Loss on a Program Bond, it shall prepare a proposed action plan to address the Sureties' obligations

and rights in connection with such Program Bond(s) (hereafter referred to as the "Action Plan" including any changes or amendments made from time to time). The Lead Surety may incur expenses and make necessary Loss payments to preserve the status quo and the Sureties' options until an Action Plan is approved in accordance with the provisions hereof, all to be reimbursed in accordance with the percentages of participation set forth in paragraph 3.1. If the Lead Surety contemplates advancing any funds to a Principal in order to maintain the status quo, written notice must be provided to all Sureties prior to the advancement of any such funds. Expenses to be reimbursed shall not include salaried employees of any Surety unless otherwise agreed by the parties. As promptly as possible, the Lead Surety shall circulate to the other Sureties its proposed Action Plan and any reports or other documents relevant to an evaluation of the Action Plan. Promptly following receipt of the proposed Action Plan, the Sureties will meet, in person or by telephone, to discuss the proposed Action Plan, any modifications to the plan proposed by any Surety and any other issues related to the Program Bond. The Sureties will attempt in good faith to agree to action plans that are fair and equitable to each Surety. If there is no agreement to the Action Plan, the Sureties will agree to as many components of the Action Plan as they can and recess the meeting or conference call. The representative of each Surety will consult promptly with management of his or her company about any components on which there was no agreement, and the meeting or conference call shall attempt to reconvene not more than three (3) business days after the initial meeting or conference call. If there is still no agreement on the disputed issues, the Sureties agree to promptly select a mediator reasonably acceptable to all Sureties with prior experience in managing surety claims to promptly conduct a non-binding mediation. Should that mediation be unsuccessful, the disputed issues will be determined by a majority vote of the Sureties based on the percentage of participation set forth in paragraph 3.1. If a majority vote based on percentages cannot be achieved, the good faith decision of the Lead Surety on the issues not agreed to shall be the basis upon which claims decisions will be made on an interim basis, and the other Sureties shall contribute their respective shares of the resulting Loss in the percentages set forth in paragraph 3.1 above. Notwithstanding the above, without the agreement of sureties representing at least 50% of the proportionate shares of liability for Loss as set forth in paragraph 3.1, and agreement of at least 2 of the Sureties, the Lead Surety may not agree to provide financing to a Principal or agree to an Action Plan that might waive the bond penalty on any Program Bond. Should any Surety wish to challenge whether the contributions which they were required to make hereunder were, under the circumstances, not the product of good faith claims handling by the Lead Surety, such Surety, after payment in accordance with the terms hereof, shall be entitled to submit to binding arbitration pursuant to paragraph 3.14 hereof the issue of whether its obligation to pay hereunder was caused by the bad faith claims handling of the Lead Surety.

It is understood and agreed that the Action Plan may likely be revised and updated throughout the time there exists any Loss or potential Loss on a Program Bond. Further, the Action Plan and the comments and consents provided by any of the Sureties to the Lead Surety or each other may be communicated in an e-mail and incorporated by reference in to the Action Plan. It is also understood and agreed that the Action Plan may include authority granted the Lead Surety to commit, on behalf of all Sureties, to the

payment and settlement of certain expenses, claims and disputes without the prior consent of the other Sureties.

3.8 The Sureties contemplate and agree that they will have a common interest in connection with engaging counsel and other professionals relating to the defense of claims and the enforcement of rights against Principals and third parties and intend that all communications between them and counsel or between them regarding advice and communications with counsel relating to the Program Bonds and any rights or obligations arising out of their execution, including, but not limited to, loss mitigation, recovery actions and strategy, shall remain confidential and protected from disclosure to any third party by applicable privileges and immunities and that communications between and among them shall not constitute a waiver of any such privilege or immunity.

3.9. Consistent with the approved plan of action implemented in accordance with the terms hereof, the Lead Surety is authorized to settle and pay all Losses to meet or otherwise resolve disputes or potential disputes relating to the Sureties' obligations on the Program Bonds; to seek salvage or recoveries on behalf of all Sureties to offset Losses on the Program Bonds; and to pursue, settle and resolve any affirmative claims on behalf of all Sureties with respect to such Losses. The Lead Surety shall act as the disclosed agent of the Sureties in connection with the administration, settlement and payment of claims with respect to Program Bonds and enforcement of rights against third parties with respect to Program Bonds, including, but not limited to, subrogation and indemnity rights. All settlements and actions taken by Lead Surety in good faith with respect to such activities shall be binding upon the Sureties, except that Lead Surety may not bind other Sureties with respect to settlement of such other Surety's claims under its Indemnity Agreement without its consent.

3.10a Recoveries, other than from collateral not taken jointly on behalf of the Sureties, arising out of or in connection with any Program Bond shall be used to reimburse each Surety sustaining Loss in proportion to each Surety's net Loss with respect to such Program Bond. Any Surety may decline to take part in any particular recovery activities in connection with any Program Bond. Such Surety shall not share in the recovery from that activity or the recovery costs incurred after receipt by the Lead Surety of notice from the Surety declining to participate in the recovery activity.

3.10b In the absence of a written agreement to the contrary, there shall be no sharing of collateral and collateral obtained by any Surety shall not be considered for purposes of calculating net Loss for purposes of sharing or allocating any recovery.

3.10c Any recovery arising out of or related to Other Bonds by any Surety against any Person who signed an Indemnity Agreement in favor of such Surety shall not be shared with any other Surety. With respect to Program Bonds, all Indemnity Agreements executed by any Person shall be deemed for the benefit of all Sureties with respect to Loss arising out of or related to Program Bonds to the extent such Indemnity Agreements allow for such interpretations.

3.10d Recoveries from reinsurers shall not be shared and shall not be considered when allocating Loss or recoveries.

3.11 The Lead Surety shall provide periodic accountings, but in no event less than quarterly, of Losses paid under the Program Bonds. The other Sureties shall pay their respective shares of each payment or group of payments, in the percentages set forth in paragraph 3.1 above, within within the time required under the applicable Program Bond not to exceed 15 business days of receipt of a written request for payment from the Lead Surety. For payments in excess of $___________, the Lead Surety may request that the other Sureties pay their respective shares of the payment in advance. For the purposes of this paragraph 3.11, an itemized statement in the form of a letter or spreadsheet, showing payments and receipts will be deemed a satisfactory accounting for the purpose of Loss reimbursements. Upon reasonable notice, Lead Surety will give the other Sureties access to all documents and information in its possession related to any accounting provided pursuant to this paragraph.

3.12 Sureties agree any Loss arising out of or relating to the handling of any claim with respect to any Program Bond, together with any costs, damages or payment obligation incurred arising out of any claims asserting bad faith claim handling or other extra-contractual allegations arising out of execution of any Program Bond, excluding only (i) damages arising out of the willful, dishonest conduct of a Surety or one of its employees; or (ii) arising out of the grossly negligent failure of Lead Surety to timely respond to a pleading, resulting in a default judgment where liability would otherwise not have existed; or (iii) damages arising from Lead Surety's refusal or failure to comply reasonably with the terms of the action plan to the extent such an action plan was agreed upon by the Sureties pursuant to paragraph 3.7 hereof, will be allocated between and paid by the Sureties in accordance with their respective percentage allocation of such Loss as set forth in paragraph 3.1a

3.13 A discharge or release of any of the Sureties by the Obligee or any beneficiary of any Program Bond shall not affect the right of the other Sureties to contribution pursuant to this Agreement unless the other Sureties consented to such discharge or release and agreed that it would extend to obligations under this Agreement.

3.14 All claims and disputes between or among any or all of the Sureties arising under or relating to this Agreement are to be settled by binding arbitration in the City of New York, State of New York or another location mutually agreeable to the parties. The arbitration shall be conducted on a confidential basis pursuant to the Commercial Arbitration Rules of the American Arbitration Association, as modified by the provisions of this paragraph 3.14, or as otherwise agreed by all of the Sureties in writing. The arbitration panel shall consist of current or former surety claims managers, not currently or previously affiliated with any party to the dispute. Each side to the dispute shall select one arbitrator, regardless of the number or percentage interest of the Sureties constituting each side. An additional arbitrator shall be selected by the initial arbitrators so selected by the parties. The arbitrators shall endeavor to enforce the Agreement as written. Any decision or award as a result of any such arbitration

proceeding shall be in writing and shall provide an explanation for all conclusions of law and fact, and shall include the assessment of costs, expenses, and reasonable attorneys' fees in favor of the prevailing party. For purposes of determining which party is the prevailing party, the arbitrators shall consider the position asserted by the respective parties and the determination rendered for purposes of assessing whether the determination rendered is most closely in line with the position asserted by each party, and the arbitrators may equitably apportion the award of such fees and costs based upon the total amount in controversy, the claims made, defenses raised, and the findings for or against each party. Notwithstanding the foregoing, if a written offer of compromise made by a party more than thirty (30) days prior to commencement of hearings in the arbitration is not accepted by the adverse party within thirty (30) days after receipt and the party not accepting such offer fails to obtain a more favorable ruling, the non-accepting party shall not be entitled to recover its costs, expenses and reasonable attorneys' fees relating to the arbitration (even if it is the prevailing party) and shall be obligated to pay the costs, expenses and reasonable attorneys' fees incurred by the offering party from the date of such offer forward, and the arbitrators shall retain jurisdiction and alter their award within thirty (30) days after its entry should such modification be appropriate in order give full force and effect to this paragraph. No disclosure to the arbitrators of any offer of compromise shall be allowed or required, unless a modification of the award is sought within thirty (30) days of entry of the award, and failure to disclose such offer of compromise before the entry of the award shall not be deemed a waiver or otherwise operate to prejudice the position of the offering party. The offer of compromise shall not be deemed an admission or be evidence of anything other than its significance with respect to allocation of costs, expenses and attorneys' fees.

3.15 If it is impracticable to enforce this Agreement against one or more of the Sureties (hereinafter a Defaulting Surety or Sureties), by reason of rehabilitation, liquidation, insolvency or any other similar cause, the rights and obligations of such Defaulting Surety or Sureties with respect to or arising out of Program Bonds shall be shared by the other Sureties in the proportion which the amount of liability assumed by each bears to the aggregate of the amounts assumed by all Sureties other than the Defaulting Surety or Sureties with respect to Program Bonds. This provision does not release the Defaulting Surety or Sureties from any of its or their obligations under any Program Bond or this Agreement, and each of the other Sureties shall have a right of contribution from such Defaulting Surety or Sureties and any right of setoff allowed by law. A Defaulting Surety or Sureties shall not be considered a Surety for purposes of participating in decisions as set forth in paragraph 3.7 above.

3.16 If a Surety seeking contribution is insolvent and/or has been placed under supervision, rehabilitation or liquidation by any insurance department of any state, the other Sureties may set off debts which are not directly related to the rights and obligations of such Surety with respect to the Program Bonds, subject to adjustment once all liability and Loss under or arising out of the Program Bonds has been fully and finally resolved and determined.

3.17 If the Sureties desire to change the proportions of assumption of liability for any particular bond in the future for whatever reason, a separate and specific Co-Surety Agreement may be entered into which, if executed, would supersede this Agreement with respect to that bond.

3.18 This Agreement may be terminated by any Surety giving 30 calendar days notice to all other Sureties to this Agreement in the manner set forth in Article 3.19, but said Agreement will remain in full force and effect for all Program Bonds executed prior to the effective date of termination. The effective date of termination shall be 30 calendar days after the receipt of the termination notice by all other Sureties to this Agreement. In the event that a bid bond is executed prior to the effective date of termination with respect to a pre-authorized Program Bond, the terminating Surety shall be obligated to participate as co-surety with respect to any final bond issued relating to such bid in the proportion specified in paragraph 3.1a hereof if the Principal is awarded the contract and final bonds are required, and this Agreement shall apply with respect thereto.

3.19 All demands, notices or other communications shall be given in writing and may be given by any method of delivery that provides evidence or confirmation of receipt, including personal delivery, express courier (such as Federal Express), electronic mail for which read receipt or acknowledgment is obtained or delivery and review may otherwise be demonstrated, and prepaid certified or registered mail with return receipt requested. Notices shall be deemed to have been given and received on the date of actual receipt or, if any of the following dates is applicable, then on such date: on the Business Day actually sent, read, and receipt is obtained or receipt is otherwise acknowledged if sent by electronic mail; or one (1) Business Day after sending if sent via express courier. Any Surety may change the address or electronic mail address to which notices are to be sent by giving written notice of its new address or electronic mail address. Unless notified in writing of a change of address, any notice sent to Sureties at the address set forth below shall be deemed received by the Sureties within the applicable time frame set forth above. Notice furnished by e-mail shall only be effective if and when receipt is acknowledged or for which delivery and review may be otherwise proven.

All notices made or required to be given pursuant to this Agreement shall be in writing and shall be addressed as follows:

_______: ________________________________
____
Attn: ___________________________
E-mail address:_________________

_______: ________________________________
____
Attn: ___________________________
E-mail address:_________________

_______: ________________________________
____

Attn: ___________________________
E-mail address:_________________

________:	________________________________
____
Attn: __________________________
E-mail address:_________________

3.20 No Surety shall be deemed to be the drafter of any particular provision or provisions of this Agreement nor shall any part of this Agreement be construed against any Surety on the basis of its identity as the drafter of any part of this Agreement. This Agreement shall be construed as a contract negotiated at arm's length, and any special rules of construction applicable to contracts of adhesion or insurance contracts shall not apply.

3.21 Lead Surety is not acting as a fiduciary in any capacity. In entering this agreement all Sureties expressly agree that Lead Surety is not assuming the role or liability of a fiduciary and expressly waive any claims against Lead Surety its directors, supervisors, officers, employees, or agents and/or employees for damages, loss, injury and/or liability, direct or indirect, resulting from any actual or alleged breach of fiduciary duty.

3.22 This Agreement shall be governed by and construed in accordance with the laws of the State of New York **[or insert such other state as is desired]** without regard to such state's conflicts of laws rules. Each of the Sureties hereby submits to the exclusive jurisdiction of (a) The United States District Court for the Southern District of New York or, if such court does not have jurisdiction, (b) New York State Supreme Court, Commercial Division, in the County of New York regarding enforcement of the arbitration clause and any arbitration award rendered with respect to the subject matter hereof**.** The Sureties hereby irrevocably and unconditionally submit to the jurisdiction of said courts for such purposes. In any action, suit or other proceeding the Sureties hereby irrevocably and unconditionally waive and agree not to assert by way of motion, as a defense or otherwise, any claims that they are not subject to the jurisdiction of the above courts for such purposes, that such action or suit is brought in an inconvenient forum or that the venue of such action, suit or other proceeding is improper.

3.23 No arbitration with respect to any dispute, claim or controversy arising out of or relating to this Agreement may be commenced until the matter has been submitted to mediation. Any Surety may commence mediation by providing to the other Sureties a written notice requesting mediation, setting forth the subject of the dispute and the relief requested. The Sureties will cooperate with each other in selecting a mediator and in scheduling the mediation proceedings. The Sureties covenant that they will participate in the mediation in good faith, and that they will share equally in its costs. All offers, promises, conduct and statements, whether oral or written, made in the course of the mediation by any of the parties, their agents, employees, experts and attorneys, and by the

mediator are confidential, privileged and inadmissible for any purpose, including impeachment, in any litigation or other proceeding involving the parties, provided that evidence that is otherwise admissible or discoverable shall not be rendered inadmissible or non-discoverable as a result of its use in the mediation. No Surety may commence an arbitration with respect to the matters submitted to mediation until after the completion of mediation, it being understood that mediation is a condition precedent thereto; provided, however, that nothing herein shall preclude commencement of arbitration or litigation to the extent doing so is required in order to prevent the running of any statute of limitations. In the event mediation is unsuccessful or 90 days after the date of notice of the written request for mediation, whichever occurs first, arbitration proceedings as provided herein may be commenced. Mediation may continue after the commencement of arbitration if the parties so desire.

3.24 If any provision of this Agreement is held or determined to be illegal, invalid or unenforceable under any present or future law: (a) such provision will be fully severable; (b) this Agreement will be construed and enforced as if such illegal, invalid or unenforceable provision had never comprised a part hereof; (c) the remaining provisions of this Agreement will remain in full force and effect and will not be affected by the illegal, invalid or unenforceable provision or by its severance here from; and (d) in lieu of such illegal, invalid or unenforceable provision, there will be added automatically as a part of this Agreement a legal, valid and enforceable provision as similar in terms to such illegal, invalid or unenforceable provision as may be possible.

3.25 This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original as against any Surety whose signature appears thereon and all of which together constitute one and the same instrument. Faxed or electronically transmitted signatures to this Agreement shall be considered valid and original signatures for all purposes.

3.26 Neither failure nor delay on the part of any Surety to exercise any right, remedy, power or privilege provided for herein, or by statute or at law or in equity shall operate as waiver thereof, nor shall any single or partial exercise of any right, remedy, power or privilege preclude any other or future exercise thereof, or the exercise of any other right, remedy, power or privilege.

3.27 The terms and provisions of this Agreement are intended solely for the benefit of the Sureties and their respective successors and permitted assigns, and are not intended to confer third party beneficiary rights upon any other person.

3.28 This Agreement may not be amended except in writing, signed by the Sureties. This Agreement contains the entire understanding between the Sureties regarding the subject matter hereof, and supersedes all prior written or oral agreements, representations, warranties, negotiations or understandings.

3.29 This Agreement shall be binding upon the Sureties, and their respective successors and assigns.

In Witness Whereof, each of the Sureties has caused this Agreement to be signed by authorized officer s of the Surety.

Witness:	Name of Surety
____________________________	By:____________________________
Witness:	Name of Surety
____________________________	By:____________________________
Witness:	Name of Surety
____________________________	By:____________________________
Witness:	Name of Surety
____________________________	By:____________________________

BLANKET CO-SURETY AGREEMENT

THIS Blanket Co-Surety Agreement ("Agreement") is entered into by and between **[Insert name of Co-Surety 1]**, for itself and on behalf of any of its affiliates and subsidiaries that execute or procure the execution of any Program Bonds (as hereafter defined), (individually and collectively referred to as "**Co-Surety 1**"), **[Insert name of Co-Surety 2]**, for itself and on behalf of any of its affiliates and subsidiaries that execute or procure the execution of any Program Bonds, (individually and collectively referred to as "**Co-Surety 2**"), and **[Insert name of Co-Surety 3]**, for itself and on behalf of any of its affiliates and subsidiaries that execute or procure the execution of any Program Bonds, (individually and collectively referred to as "**Co-Surety 3**") (Co-Surety 1, Co-Surety 2, and Co-Surety 3 each a "Party" and together the "Parties").

WHEREAS, all of the Parties have executed or procured, or expect to execute or procure Program Bonds, as defined below, for, on behalf of, in the name of, or at the request of any of the Principals, as defined below; and

WHEREAS, such Program Bonds will be in various amounts in favor of various obligees and covering various obligations, and each Party shall be liable under the Program Bonds pursuant to the terms of such Program Bonds; and

WHEREAS, the Parties desire to document their respective rights and obligations to each other in connection with the Program Bonds,

NOW, THEREFORE, the Parties hereby agree as follows:

1. Definitions:

"Claim" means all claims, potential claims, demands, suits, actions, or proceedings in connection with any Program Bonds, including but not limited to affirmative claims brought by a Principal, or by the Parties as subrogees and/or assignees of a Principal.

"Customer" means [Insert Customer Entities] and any of their present or future direct or indirect parent companies, subsidiaries and affiliates and all of their respective heirs, administrators, executors, successors and assigns.

"Loss" means all payments or expenses, exclusive of compensation of salaried employees and overhead expenses, incurred by any of the Parties in connection with any Program Bonds, any Claim or any indemnity agreement supporting a Program Bond (subject to the terms of Paragraph 6), including but not limited to: payment of Program Bond proceeds or any other payment, cost, damage or expense in connection with a Program Bond or a Claim, any penalties, interest, court costs, experts' fees, consultants' fees, and attorneys' fees, including but not limited to those fees incurred defending and adjusting Claims, pursuing rights of indemnification or subrogation, pursuing recoveries from obligees or third parties, or in obtaining and collecting on any decision, award or judgment obtained arising from or related to a Program Bond or any indemnity agreement supporting a Program Bond.

"**Other Bonds**" means obligations of suretyship, undertakings, guarantees, stipulations or other obligatory instruments executed or procured by or on behalf of at least one, but not all, of the Parties, as sureties, for, on behalf of, in the name of, or at the request of any one or more Principals.

"Principals" mean Customer and any present or future joint venture, special purpose entity, co-venture, consortium, partnership, trust, association, limited liability company or other legal entity in which Customer has or may acquire an interest, whether in existence now or created at any time in the future; and any other person or entity for, on behalf of, or in the name of which any Program Bonds may be issued at the request of any of the aforementioned.

"Program Bonds" means (i) all obligations of suretyship, undertakings, guarantees, stipulations or other obligatory instruments executed or procured by or on behalf of all of the Parties, as sureties, for, on behalf of, in the name of, or at the request of any one or more Principals, and (ii) any Other Bonds (as defined above) that all of the Parties agree in writing shall be treated as a Program Bond under this Agreement.

2. This Agreement covers all Program Bonds executed or procured by the Parties from an effective date of __________ until the Agreement terminates.

3. The respective obligations and liabilities of the Parties hereto among themselves for any Loss shall be limited, except as may otherwise be set forth in this Agreement, to the percentage of participation for each Party, by applying the following proportions to such Loss incurred by any Party:

Co-Surety 1 ____%

Co-Surety 2 ____%

Co-Surety 3 ____%

Each Party hereto shall be liable in such proportion for all Loss incurred in connection with any Program Bond. Except as may otherwise be set forth in this Agreement, in no event will any Party be required to contribute more than its percentage of participation set forth above.

4. It is understood and agreed that each Party hereto retains the right to individually accept or reject participation on any proposed Program Bond, in which case the Parties choosing to participate in such proposed Program Bond may choose but are not required to execute a separate and specific co-surety agreement with respect to that proposed Program Bond.

5. Each Party hereto shall be responsible for billing and collecting premiums and paying commissions for its respective share of each Program Bond.

6. Each Party hereto shall share, according to its proportion as set forth in Paragraph 3, in all indemnity of whatever kind or nature and in any recovery, right, recourse or benefit made by or

accruing to any Party hereto in connection with any Program Bond, except collateral and/or reinsurance, held by any of the Parties hereto. Any collateral and/or reinsurance of whatever kind or nature held or obtained by any Party, any proceeds from collateral and/or reinsurance, or any recovery, right, recourse, or benefit with respect to any collateral and/or reinsurance of whatever kind or nature is for the sole and exclusive benefit of the Party that holds or obtains such collateral and/or reinsurance and shall not be shared with any other Party.

7. All indemnity agreements executed by Principal, and/or any other person or entity applicable to such Program Bonds shall be deemed for the benefit of all Parties with respect to Loss to the extent such indemnity agreements allow for such interpretation; provided however any recovery arising out of or related to any such indemnity agreements with respect to Other Bonds which are not Program Bonds under this Agreement or with respect to persons or entities who are not Principals under this Agreement shall not be shared with any other Party and shall not be considered when allocating Loss or recoveries under this Agreement, except that no recoveries shall be allocated or paid to any Party after that Party has been made whole from any and all Loss incurred by such Party.

8. Any Party hereto receiving notice or otherwise learning of a Claim under any Program Bond shall promptly give full information thereof to Co-Surety 1, in writing, which shall in turn give full information thereof to all other Parties to this Agreement, in the manner set forth in Paragraph 23 below, except where there is correspondence clearly showing a copy has previously been sent to those Parties. Each Party will give the other Parties access to all non-proprietary documents and information in its possession related to such Claims in connection with any Program Bond.

9. Co-Surety 1 is designated as the lead surety for the Program Bonds and shall have the right and obligation, and is hereby authorized, to conduct investigations and examinations of any and all Claims or other matters (including indemnity-related matters pursuant to Paragraph 7 hereof) in connection with any Program Bonds, to respond to, prosecute, defend, tender defense to a Principal (except with respect to Claims alleging bad faith, extra-contractual damages, and/or any other allegation that may preclude such tender unless otherwise agreed by the Parties), engage outside counsel, consultants and other professionals it deems appropriate (subject to Co-Surety 1 providing the other Parties with notice of such engagement(s) and not receiving timely written advice from any Party that it has a conflict of interest with any such professionals), and act on behalf of all Parties in consultation with them in connection with any Claims or other matters, to keep the Parties reasonably informed, and to charge the Parties pursuant to Paragraph 3 the Loss incurred in doing so. Notwithstanding the foregoing, each Party reserves the right to opt out of any tender. Co-Surety 2 and Co-Surety 3 each have the right, but not the obligation, to conduct their own investigations or examinations of any Claims or other matters in connection with any Program Bonds in their sole discretion and at their own cost and expense. Notwithstanding the broad definition of Loss under this Agreement, neither Co-Surety 2 nor Co-Surety 3 shall be entitled to contribution or reimbursement under this Agreement or otherwise from any other Party for any Loss they incur in connection with their own investigations or examinations in connection with any Program Bonds, however, they shall retain any right they may have or acquire to reimbursement or contribution from the Principal or others for any such Loss. Co-Surety 2 and Co-Surety 3 agree to keep the other Parties fully

informed of the substance of their own investigations, examinations, determinations and actions in connection with any Claims or other matters concerning any Program Bonds.

10. In the event any Party hereto makes any payments pursuant to this Agreement in connection with any Program Bond in excess of its proportion set forth in Paragraph 3, then such Party shall have the right of reimbursement from the other Parties hereto in an amount equal to such excess, but in no event will any Party hereto be required to contribute more than its respective proportion set forth in Paragraph 3 except as provided in Paragraph 14.

11. If, after a good faith effort by the Parties to resolve any dispute that arises out of or relates to this Agreement, the Parties are unable to reach agreement, any Party may submit the dispute to an arbitration panel located in the County of New York, State of New York, or another location mutually agreeable to the Parties. The arbitration panel shall consist of former employees of insurance companies, consulting firms, law firms, and construction related businesses who had experience and responsibility for matters that concerned surety products and/or the surety industry not currently or previously affiliated with any party to the dispute. Each side to the dispute shall select one arbitrator, regardless of the number or percentage interest of the Parties constituting each side. An additional arbitrator shall be selected by the initial arbitrators so selected by the Parties. The arbitrators shall endeavor to enforce the Agreement as written. Any decision or award as a result of any such arbitration proceeding shall be in writing and shall provide an explanation for all conclusions of law and fact, and shall include the assessment of costs, expenses, and reasonable attorneys' fees in favor of the prevailing party/parties at the discretion of the arbitrators, though the arbitrators may equitably apportion the award of such fees and costs based upon the total amount in controversy, the claims made, defenses raised, and the findings for or against each party. However, if an adverse party to an award or decision failed to accept a written offer of compromise prior to the commencement of the hearing and the award or decision is not more favorable than the offer of compromise, then the adverse party is not entitled to recovery of any costs, expense and/or fees and is obligated to pay the costs, expenses and fees incurred by the offering party after the date of the offer. No disclosure to the arbitrators of any offer of compromise shall be allowed or required, unless a modification of the award is sought within thirty (30) days of entry of the award, and failure to disclose such offer of compromise before the entry of the award shall not be deemed a waiver or otherwise operate to prejudice the position of the offering party. The offer of compromise shall not be deemed an admission or be evidence of anything other than its significance with respect to allocation of costs, expenses, and reasonable attorneys' fees.

12. No Party hereto may set-off debts from other Parties seeking contribution pursuant to this Agreement which are not directly related to the rights and obligations of the Parties with respect to any Program Bond.

13. The Parties contemplate and agree that they will have a common interest in connection with engaging counsel and other professionals relating to the defense of claims and the enforcement of rights against Principals and third parties and intend that all communications between them and counsel or between them regarding advice and communications with counsel relating to the Program Bonds and any rights or obligations arising out of their execution, including, but not limited to, Loss mitigation, recovery actions and strategy, shall remain

confidential and protected from disclosure to any third party by applicable privileges and immunities and that communications between and among them shall not constitute a waiver of any such privilege or immunity.

14. In case it shall be found impracticable to enforce this agreement against any Party or Parties hereto by reason of insolvency or any other cause, each solvent Party hereto shall share the rights and obligations concerned herewith in the proportion in which the amount of liability originally assumed by each solvent Party bears to the aggregate of the amounts originally assumed by all the solvent Parties.

15. If the percentage of participation or proportions of assumption of liability of any Party or Parties change for any Program Bond for whatever reason, a separate and specific co-surety agreement or an amendment to this Agreement will be entered into which will supersede this Agreement with respect to that Program Bond.

16. This Agreement may be terminated by any Party giving thirty (30) days advance written notice to all other Parties by Certified Mail, but said Agreement will remain in full force and effect for all Program Bonds provided, or which the Parties committed to provide, prior to the effective date of termination of this Agreement.

17. This Agreement shall bind not only the undersigned Parties but also their respective successors and assigns, as the case may be.

18. This Agreement and the rights and obligations of the Parties under this Agreement shall be governed by the laws of the State of New York without regard to any conflicts of laws principles.

19. This Agreement is strictly for the benefit of the Parties hereto and they expressly declare that they do not intend to confer any rights or benefit of whatsoever kind or nature upon any third party not referenced herein.

20. A discharge or release from liability of any Party by the beneficiary or obligee of any Program Bond shall not affect the rights of any other Party to contribution from the discharged or released Party pursuant to this Agreement, unless the other Party consented to the discharge or release, or unless the discharge or release legally terminates in full all obligations and liability of the other Party under such Program Bond.

21. Neither failure nor delay on the part of any Party to exercise any right, remedy, power or privilege provided for herein, or by statute or at law or in equity, shall operate as a waiver thereof, nor shall any single or partial exercise of any right, remedy, power or privilege preclude any other or future exercise thereof, or the exercise of any other right, remedy, power or privilege.

22. The provisions of this Agreement are severable, and if any clause or provision shall be held invalid and unenforceable, in whole or in part, then such invalidity or unenforceability shall affect only such clause or provision, or part thereof.

23. All demands, notices or communications made or required to be given pursuant to this Agreement shall be in writing and may be given by any method of delivery that provides evidence or confirmation of receipt, including personal delivery, express courier, electronic mail for which read receipt or acknowledgment is obtained or delivery and review may otherwise be demonstrated, and prepaid certified or registered mail with return receipt requested. Such demands, notices or communications shall be addressed as follows:

Co-Surety 1: ______________________________
____
Attention: ____________________
with a copy to: [EMAIL]

Co-Surety 2: ______________________________
____
Attention: ____________________
with a copy to: [EMAIL]

Co-Surety 3: ______________________________
____
Attention: ____________________
with a copy to: [EMAIL]

or to such other address that any Party may hereafter provide in writing to the other Parties.

24. No Party shall be deemed to be the drafter of any particular provision or provisions of this Agreement nor shall any part of this Agreement be construed against any Party on the basis of its identity as the drafter of any part of this Agreement. This Agreement shall be construed as a contract negotiated at arm's length, and any special rules of construction applicable to contracts of adhesion or insurance contracts shall not apply.

25. This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original as against any Party whose signature appears thereon and all of which together constitute one and the same instrument. Scanned, digital or facsimile signatures to this Agreement shall be considered valid and original signatures for all purposes.

26. No waiver of any provision of this Agreement shall constitute or imply a further or contingent waiver. Each Party shall be entitled to enforce all terms of this Agreement regardless of any prior waivers unless made in writing and signed by all Parties to this Agreement.

27. This Agreement may not be amended except by a writing signed by all Parties to this Agreement. This Agreement constitutes the entire understanding and agreement among the Parties regarding the subject matter hereof and supersedes all previous understandings, agreements, representations, warranties and/or negotiations, oral or written, with respect thereto.

28. The words "hereof" and other words of similar import refer to this Agreement. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms. Any collective defined term and any defined term used in the plural or singular will be taken to encompass all members of the relevant class. Any defined term used in the singular proceeded by "any" will be taken to indicate any number of the members of the relevant class.

IN WITNESS WHEREOF, each of the Parties hereto has caused this Agreement to be signed by their respective duly authorized corporate officers and their respective corporate seals to be hereunto affixed and duly attested this ____ day of __________________, 20___.

[Insert name of Co-Surety 1]	Attest/Witness
By:____________________________	____________________________
(Signature)	*(Signature)*
____________________________	____________________________
(Print Name and Title)	*(Print Name and Title)*

[Insert name of Co-Surety 2]	Attest/Witness
By:____________________________	____________________________
(Signature)	*(Signature)*
____________________________	____________________________
(Print Name and Title)	*(Print Name and Title)*

[Insert name of Co-Surety 3]	Attest/Witness
By:____________________________	____________________________
(Signature)	*(Signature)*
____________________________	____________________________
(Print Name and Title)	*(Print Name and Title)*

SESSION 2

THINKING OUTSIDE THE BOX:
UTILIZING A SURETY'S OWN ACCOUNT OR CONSULTANT TO COMPLETE A DEFAULTED PROJECT

Rebecca S. Glos | Watt, Tieder, Hoffar & Fitzgerald, LLP | Irvine, CA

Douglas Dearie | Liberty Mutual Surety | Seattle, WA

Todd Bauer | Guardian Group, Inc. | Torrance, CA

Mark Degenaars | The Vertex Companies, Inc. | Irvine, CA

PEARLMAN 2019

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Columbia Winery | Woodinville, WA

THINKING OUTSIDE THE BOX: UTILIZING A SURETY'S OWN ACCOUNT OR CONSULTANT TO COMPLETE A DEFAULTED PROJECT

By Rebecca S. Glos, Doug Dearie, Todd Bauer, and Mark Degenaars

I. INTRODUCTION

It is the reality of every surety – a bond principal who does not, or cannot, perform. When a default happens, the surety's first thoughts are to determine the remaining scope of work, and, if default is proper, examine its various options to mitigate damages in the event of looming deadlines and/or liquidated damages. If the elected remedy is to takeover and complete the bonded project, the next decision is to select the most appropriate contractor to complete the work.

While the more commonly used options consist of issuing a solicitation for bids or possibly financing the defaulted bond principal, some less utilized options include the surety using: (1) one of its own accounts; or (2) the consultant who has been assisting with the bond claims, whether they be in the form of payment bond claims or demands for performance made by the obligee. On the surface, both options appear to be attractive given the pre-existing familiarity with the surety as compared to hiring an unknown contractor partially based on a competitive bid price. Familiarity with a contractor can often result in side-stepping, or, in some cases, altogether eliminating delays that would normally occur if the surety were to find a contractor in an open market. As with anything, however, even using a contractor with whom the surety is already familiar (whether it be through an account or a consultant) has its risks and disadvantages, all of which should be thoroughly vetted before a surety makes its decision.

The purpose of this paper is to examine the various ways a surety using its own account or consultant to complete a defaulted project can be a benefit, but also how it can be risky. Both completion options may potentially save weeks or months of time that would have otherwise been used for competitive bidding. Nevertheless, even using a surety's own account or consultant does not mean that obtaining the best possible price is no longer a goal. For all jobs, regardless of who is used to complete the work, sureties should negotiate the best pricing structure possible.

As will be discussed below, sureties need to strike a balance between supporting their own accounts or consultants but, at the same time, maintaining an arm's length distance to not compromise a pre-existing relationship or give off the appearance of impropriety. If both can be accomplished, it may be possible to avoid even greater harm. With every decision, however, the surety is racing against the clock to avoid incurring additional fees and costs. As the adage goes, time is money.

II. USING OWN ACCOUNT AS COMPLETION CONTRACTOR

A. Positive Aspects

With the current economic upturn (and, therefore, many more opportunities for contractors than in years past), finding a qualified, available, and economical contractor in a short period of time may be challenging. This is especially true if the completion contract includes terms requiring the completion contractor to assume liability for work already in place. In such situations, using an account that the surety already has a relationship with may often be viewed as an attractive option. As will be shown below, the advantages of using an existing account to complete the remaining work arise from the pre-existing relationship that has already been formed with the surety.

First, using an existing account would allow the surety to give work back to its own clients. If the project is completed in a successful manner, this would contribute to the account's overall net worth which, in effect, could potentially strengthen the relationship. This is especially true if the account is in its nascent stages. Not only is trust created between the contractor and surety to allow the project to continue without the surety having to competitively bid the project, but a positive completion experience would provide the surety with more confidence in the account which could, in turn, allow the surety to feel more comfortable and security issuing further bonds in the future.

Second, every surety's primary concern after a default is finding a replacement contractor as quickly as possible to avoid accruing delay damages. Unless the surety already knows of a contractor who is qualified, available, and willing to step in to complete the work, the process of finding a replacement contractor can be time-consuming as the project may need to be re-bid. Using an existing contractor may save time as the surety already has a pre-existing relationship with the contractor, a direct line of communication, and knowledge regarding the contractor's character, capacity, and capital through the underwriting process. This could potentially save weeks or months that would have otherwise been spent putting together a request for proposal and reviewing bids.

Finally, due to the existing relationship, the account could possibly provide a more attractive contract price than an unknown contractor. Knowing that the successful completion could increase its chances for further bonding in the future, and that the surety's underwriters have access to the contractor's work in progress ("WIP") reports and can track how much profit the contractor is making on its bonded jobs, the account may be willing to complete the work at a lower cost than another contractor who has no incentive to lower its price. A surety working with its own account allows for pre-existing trust and transparency. This may be especially handy in a period of economic downturn when the lack of new work, coupled with low backlogs, may drive desperate contractors to bid projects at or below cost with the hope of buying out projects or earning additional profit through change orders, all of which could end disastrously for the surety. This may all be avoided if the surety hires a contractor that the surety is already familiar with and maintains a certain degree of comfort and confidence.

B. <u>Negative Aspects</u>

Notwithstanding the advantages, using an existing account as a completion contractor may have its own risks. Ironically, the disadvantages and risks stem from the very same pre-existing relationship with the surety which forms the basis for the advantages and benefits.

First and foremost, because of the close relationship between the parties, the account may believe it can influence the decision of claims representatives that a completion contractor would otherwise not be able to do. For instance, if an ordinary completion contractor submitted a claim for additional or change order work, the claims representative overseeing the completion process (with the help of his/her consultant) would make his/her decision without any thought given to how the decision would affect the relationship from a bonding perspective. However, if the contractor is also an existing account of the surety, there is a risk that it could use its role and influence as the "client" to sway the claim decision in its favor. Alternatively, *not* giving the account preferential treatment and treating them like any other contractor (ie. at arm's length) could potentially threaten or harm the relationship if the account had an expectation of more favorable treatment. In short, using an existing account could potentially create a conflict of interests.

Second, using an existing account could possibly lead to pricing issues if the account is looking for greater flexibility. For instance, the account may expect the surety to be more lenient on pricing or contract terms when, ordinarily, the surety would impose the same on any other completion contractor. Sureties should be aware that indemnitors may use this argument as a defense against indemnity if they sense that completion costs were inflated in any way. In other words, if a surety agrees to certain pricing demands made by an existing account, indemnitors may argue that the surety did not, in fact, mitigate its damages and, instead, could have obtained a better contract price through competitive bidding.

Third, granting certain favors to an account, especially during the bidding process, may cause problems if the surety intends to tender the completion contractor to the owner. In an ordinary situation, the surety's general goal is to find a replacement contractor who can bid on the project as similarly as the defaulting principal so that the surety can bind the contractor to the same, original terms. If the surety modifies the original terms because of pressure exerted by the account, the owner may not be willing to accept a tender since the completion terms do not match the original contract terms. This is just another reason why sureties, when using their own accounts to complete work on a defaulted project, should make every effort to maintain as much of an arm's length distance as possible.

Finally, using an existing account to complete a project may leave the surety without bonding because *it* is the surety for the completion contractor. In a typical completion setting, the surety enters into a completion agreement with a contractor and requires the completion contractor to provide, among other things, bonding to guarantee

the contractor's: (1) completion of all remaining work; and (2) payment to its subcontractors and suppliers. The completion contractor, then, turns to its own surety to provide such bonding. This allows the surety to shift the exposure for completing the remaining work onto another entity.

If the completion contractor is an existing account, however, the surety, then, is *already* issuing bonds on the contractor's behalf. It would not make sense for the surety to issue a bond on behalf of the completion contractor just to guarantee to *itself* that *it*, as the surety, will complete the project and/or pay subcontractors if the completion contractor does not. In this situation, the surety has no other entity to shift the exposure onto. Besides leaving the surety in a potentially vulnerable position, this may also create problems if the owner is requiring that a surety (other than the surety that issued the original bond) guarantee completion of the remaining work.

Finally, a disadvantage to using an account to complete a defaulted project is that a negative experience could lead to a "ripple effect." A contractor defaulting on a bonded project could be the result of a myriad of reasons: drastic financial changes due to the economy, expansion into a new geographic area, or rapid over-expansion. However, there is also the possibility that the contractor failed because of unforeseen changes in job site conditions. If that is the case, the surety takes on additional exposure by placing one of its *own* accounts on a project that has already failed once. If the account is in a precarious financial position, defaulting on a project that has already experienced problems with another contractor may push the contractor over the edge. All too often, a contractor is unable to prevent poor performance on one project from negatively affecting other, ongoing projects. This could prove disastrous for the surety who is bonding such other, ongoing projects.

As demonstrated above, using a surety's own account to complete work on a defaulted project has its upsides and downsides. The most prudent thing for a surety to do, before rendering a decision, is to examine each factor closely to determine whether it is worth taking on such risk for the sole purpose of saving time and/or money.

III. USING CONSULTANT AS COMPLETION CONTRACTOR

A. Positive Aspects

The greatest advantage to using a consultant's construction division to complete a defaulted project is the time it could potentially save. Rather than re-bidding the project to contractors who may be unfamiliar with the project, the consultant has, most likely, already become well-acquainted with the overall project (and, especially, the scope of outstanding work) through the claims process. A quick re-start of the project, as opposed to a prolonged bidding process, would also place the surety on good terms with the owner who is aiming for as smooth and timely of a transition as possible.

In addition to saving time, using a consultant could also result in the surety saving money. Because it has already been negotiating with the subcontractors on the claims side, the consultant may have been able to develop a positive relationship and, therefore, convince the same subcontractors to remain on the project and simply have their subcontracts ratified by the surety. This could have a positive impact on the consultant's overall pricing. Hiring the consultant to "oversee" a defaulted project typically seen in situations where a majority of the work has already been completed (less than $100,000 of remaining work) and the consultant's role is primarily to provide insurance and the proper contractor's license.

Finally, using the consultant to complete the remaining work can be advantageous because the pre-existing trust and relationship with the surety allows the consultant to act as a second pair of eyes for the surety. In dealing with the owner to close out the project, the surety relies heavily on the participation and involvement of the completion contractor. If the completion contractor has already been retained by the surety to represent its interests (during the takeover process or in resolving payment bond claims), the surety has greater trust that the contractor has the surety's best interests in mind. This is compared to a contractor hired through the open market who may feel less (if any) sense of loyalty to the surety. The surety should keep in mind, however, that retaining a consultant as a completion contractor also destroys any privilege because, unlike the relationship between a client and consultant, there is no privilege between a surety and its completion contractor. Therefore, any communications exchanged between a surety and the consultant *after* the consultant becomes the completion contractor are no longer privileged.

B. Negative Aspects

One drawback to using a consultant to complete work on a defaulted project is that it may not necessarily be a costs-saving mechanism. Typically, a completion contract is on a time and material basis which is reputedly the most expensive pricing structure. Nevertheless, this would be the case with *any* contractor and, therefore, the problem is not isolated to consultants.

Another problem is that using a consultant could potentially give the appearance of a conflict of interest. Because its primary goal is to limit the amount of damages for which it must indemnify the surety, an indemnitor may argue that everything the consultant did on the file was aimed at ultimately being awarded the completion contract. In other words, an indemnitor may argue that the consultant's goal was more self-serving rather than assisting the surety in mitigating its (and, therefore, the indemnitors') overall loss. For this reason, some sureties have internal policies forbidding them from using their own consultants as completion contractors simply to avoid even the perception of impropriety to prevent indemnitors from using such an argument as a defense against indemnity.

Finally, a significant concern with using a consultant as a completion contractor is that a negative experience could potentially damage an otherwise healthy relationship. In most completion contracts, a surety will include a defense and indemnity clause so that the surety is shielded from liability. This may create tension when the completion contractor is the consultant and the surety is still expecting the same level of protection. This is especially true if the consultant is not providing a bond to guarantee its performance like a regular contractor would be required to do.

IV. <u>CONCLUSION</u>

In conclusion, there is no concrete answer as to whether using an account or consultant as a completion contractor is a better option than finding a contractor in the open market. Each situation must be examined on a case-by-case basis with the objective being to mitigate damages as much as possible. Regardless of what it decides, the surety should endeavor to treat everybody the same, not display any unfair bias, and always make reasonable efforts to mitigate damages for everyone. Sometimes the situation dictates the options available, thereby making completion through a surety's account or consultant the best mitigation option.

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SESSION 3

THE SURETY'S COMMON LAW RIGHTS

James D. Curran | Wolkin • Curran, LLP | San Francisco, CA

Edward Rubacha | Jennings Haug Cunningham, LLP | Phoenix, AZ

Jason Stonefeld | Liberty Mutual Surety | Seattle, WA

Gina Shearer | Merchants Bonding Company | Dallas, TX

Jim Loewke | Loewke Brill Consulting Group | Rochester, NY

PEARLMAN 2019

September 5-6, 2019

Columbia Winery | Woodinville, WA

The Surety's Common Law Rights

WOLKIN & CURRAN, LLP
James D. Curran

JENNINGS HAUG CUNNINGHAM, LLP
Edward Rubacha

Jason Stonefeld
LIBERTY MUTUAL INSURANCE

Gina Shearer
MERCHANTS BONDING COMPANY

I. INTRODUCTION

A surety's rights *vis a vis* owners and claimants are governed primarily by the language of the performance and payment bonds, and, in the instance of public works, the governing statutes and codes requiring those bonds. A surety's rights *vis a vis* its principal and indemnitors are most often governed by the terms of a General Agreement of Indemnity ("GAI"). Numerous papers and authorities are available on these foregoing rights, all dependent on form, contract and statute.

A surety also has a plethora of rights that spring from the common law; equitable subrogation being the preeminent right. In addition, a surety has common law rights of indemnity, exoneration, and contribution. *Liberty Mut. Ins. Co. v. Aventura Eng'g & Const. Corp.*, 534 F. Supp. 2d 1290 (S.D. Fla. 2008)(recognizing four common law rights available if a surety is called on to discharge an obligation of one of its principals: subrogation; common law indemnity; exoneration; and contribution). One additional right, *quia timet*--although arguably more of a remedy than a right--also springs from the common law via equity.

This paper will discuss the surety's somewhat lesser-known common law rights and provide the bases that allow the surety to take advantage of these common law rights when the standard indemnity agreement language falls short or in the absence of such an agreement. This paper also will identify the potential shortfalls in the scopes of these rights and discuss the relevance to the surety.

II. THE SURETY'S COMMON LAW RIGHT OF EQUITABLE SUBROGATION

There is no more powerful common law right--as powerful as any GAI clause--than equitable subrogation. No GIA is needed; only performance or payment by the surety under its bonds. Equitable subrogation provides the surety the right to unpaid contract funds, which right has long been recognized in the triumvirate of decisions: *Prairie State Bank v. United States*, 164 U.S. 227, 17 S.Ct. 142 (1896)[1], *Henningsen v. United*

[1] Even before *Prairie State*, the United States Supreme Court stated, "[t]he right of subrogation is not founded on contract but '[i]t is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties.' " *Memphis & Little Rock R.R. Co. v. Dow,* 120 U.S. 287, 301–02, 7 S.Ct. 482 (1887).

States Fid. & Guar. Co., 208 U.S. 404, 28 S.Ct. 389 (1908) and, more recently, although now itself more than fifty years old[2], *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S. Ct. 232 (1962), wherein, besides providing a clever name for this illustrious organization, the Supreme Court held:

> Thus the same equitable rules as to subrogation and property interests in a retained fund were held to exist whether a surety completes a contract or whether, though not called upon to complete the contract, it pays the laborers and materialmen. These two cases [*Prairie State* and *Henningsen*] therefore, together with other cases that have followed them, establish the surety's right to subrogation in such a fund whether its bond be for performance or payment.

Pearlman, 371 U.S. at 139, 83 S. Ct. at 236.

The right of equitable subrogation confers on the surety the mantle of the "best of secured creditors." *U.S. v. Munsey Trust Co. of Washington, D.C.*, 332 U.S. 234, 240 (1947) ("[O]ne whose own appropriation and payment of money is necessary to create a fund for general creditors is not a general creditor . . . . In fact, he [the payor] is the best secured of creditors; his security is his own justified refusal to pay what he owes until he is paid what is due him."); *see also*, *Am. Sur. Co. of New York v. Bethlehem Nat. Bank of Bethlehem, Pa.*, 314 U.S. 314, 317, 62 S. Ct. 226, 228 (1941)("The surety is a special kind of secured creditor. For its claim against the principal is secured by its right of subrogation to the remedies of the creditor which it has been compelled to pay.").

In a recent decision a bankruptcy court questioned the continuing applicability of *Pearlman* because it was decided under the Bankruptcy Act. *In re Glenbrook Group, Inc.*, 552 B.R. 735 (Bankr. N.D. Ill. 2016). Nevertheless, the court conceded and stated, "a finding that something is property of the estate does not mean a debtor has a greater right to the property, only that the property comes into the estate." *Glenbrook Group*, 552 B.R. at 738. The court then ordered the trustee to hold the funds "pending a determination of [the surety's] interest. *Id.* at 741; accord, *In re Kappa Dev. & Gen. Contracting Inc.*, 2017 WL 4990438, at *3 (Bankr. S.D. Miss. 2017)(property held by the debtor subject to an interest of another entity comes into the estate subject to that interest and "[i]t is for the bankruptcy court to sort out competing property interests"); and *In re Kappa Dev. and General Contracting, Inc.*, 2019 WL 2867110, at *8 (Bankr. S.D. Miss. July 2, 2019) ("Most bankruptcy courts have held that *Pearlman* survives the enactment of the Code. . . . This Court agrees." . . . "The right of a surety to retainage is superior to a creditor's security interest in accounts receivable, general intangibles, and account proceeds regardless of when the creditor's security interest was perfected.")

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[2] Decided when Armen Shahinian and George Bacharach were just budding lawyers.

Equitable subrogation allows the surety to step into the shoes of the obligee, payment bond claimants it has paid, and the shoes of the principal. *Nat'l Shawmut Bank of Boston v. New Amsterdam Cas. Co.*, 411 F.2d 843, 845 (1st Cir. 1969), on reh'g, (1st Cir. 1969)(on default of the contractor, equitable subrogation places performing surety into three sets of shoes: "the shoes of the contractor insofar as there are receivables due it; in the shoes of laborers and material men who have been paid by the surety- who may have had liens; and, not least, in the shoes of the government, for whom the job was completed."); accord, *XL Specialty Ins. Co. v. Commonwealth, Dept. of Transp.*, 269 Va. 362, 369, 611 S.E.2d 356, 360 (2005)(when a principal defaults on a contract guaranteed by a performance or payment bond and the surety performs on the bonds, equitable subrogation grants the surety certain rights running between the surety, principal, and obligor, and allows the surety to enforce such rights and duties); *Hartford Fire Ins. Co. v. United States*, 108 Fed. Cl. 525, 532 (2012)(performance bond surety succeeds to the contractual rights of both the defaulted contractor and the government itself).

These rights include the right to retained funds and also the following: the right to recover from the government for violations of its stakeholder duties, *Nat'l Am. Ins. Co. v. United States*, 72 Fed.Cl. 451, 458 (2006)(equitable subrogation allows a surety to recover from the government when the government abuses its discretion in disbursing earned progress payments); the right to setoff under the common obligee theory, *Hartford Fire Ins. Co. v. United States*, 108 Fed. Cl. 525, 532 (2012)(equitable subrogation includes government's set-off right under other contracts and under the same contract, citing *Johnson v. All–State Constr., Inc.*, 329 F.3d 848, 852 (Fed.Cir.2003); the right to enforce a subcontractor's performance bond, *U.S. ex rel. Wesco Distribution, Inc. v. Liberty Mut. Ins. Co.*, 921 F.3d 744, 748 (8th Cir. 2019)(surety is subrogated to the principal's contract rights vis-a-vis a subcontractor such as Electric and, if the subcontractor defaults, its surety); and the right to enforce a paid payment bond claimant's mechanic's lien against an owner's property, *Golden Eagle Ins. Co. v. First Nationwide Fin. Corp.*, 26 Cal.App.4th 160, 172, 31 Cal.Rptr. 2d 815, 823 (1994)(surety may enforce a subrogated mechanics' lien claim when doing so would lead to such an inequitable result) and stop notice rights, *Leatherby Ins. Co. v. City of Tustin*, 76 Cal.App.3d 678, 685, 143 Cal.Rptr. 153, 157 (1977)(surety subrogated to position of stop notice claimants it paid under payment bond and to whatever rights they had in funds withheld pursuant to stop notices filed). In addition, there is no need to file a UCC to secure rights over secured creditors in contract funds, *Interfirst Bank Dallas, N.A. v. U.S. Fid. & Guar. Co.*, 774 S.W.2d 391, 398 (Tex. App. 1989) ("The overwhelming and essentially unanimous post-UCC decisions have held that the interest of a surety . . . continues to be superior to the claim of a contract assignee, such as [a] bank"); citing numerous decisions such as *National Shawmut Bank*; accord *In re Kappa Dev.*, 2019 WL 2867110, at *6 (Bankr. S.D. Miss. 2019)("surety's right of equitable subrogation relates back to the date the bond

was issued" and "is not governed by the priority rules of the Uniform Commercial Code").

There are authorities, however, to the contrary, and the surety wishing to take advantage of equitable subrogation, in the numerous scenarios the surety may face, should be aware of these authorities. Compare *Insurance Co. of the West v. United States*, 243 F.3d 1367, 1371 (Fed. Cir. 2001)("It is well-established that a surety who discharges a contractor's obligation to pay subcontractors is subrogated only to the rights of the subcontractor. Such a surety does not step into the shoes of the contractor and has no enforceable rights against the government"), with *Nat'l Am. Ins. Co. v. United States*, 498 F.3d 1301, 1307 (Fed. Cir. 2007)(payment bond surety that discharges a contractor's obligation to pay a subcontractor is equitably subrogated to the rights of both the contractor and the subcontractor). Under certain scenarios, courts have restricted the performing surety's right to equitable subrogation to instances of "complete" performance. See, *e.g.*, *Colonial Sur. Co. v. United States*, 108 Fed. Cl. 622, 638-39 (2013)(surety's right to equitable subrogation does not attach under its performance bond until surety discharges its performance bond obligations by taking over the contract and completing performance and "threshold requirement for asserting the doctrine of equitable subrogation under a payment bond is proof that the surety has paid 'all of the outstanding claims owed by [the contractor]' "). By understanding how such cases were decided and when they apply, a performing surety can cite the pertinent and controlling authorities that support the performing surety's rights under equitable subrogation to prevail over competing cases.

In summary, over fifty years after *Pearlman*, the surety's common law right of equitable subrogation still provides the surety that has paid under its bonds the status of "the best of secured creditors." This powerful right allows the performing surety to prevail over the obligee, UCC-secured creditors, trustees in bankruptcy, and the principal.

III. THE SURETY'S COMMON LAW RIGHT OF INDEMNITY

A. The Elements of Common Law Indemnity

There are numerous statements in cases outlining when common law indemnity should operate. See, *e.g.*, *Fireman's Fund Ins. Co. v. Haslam*, 29 Cal. App. 4th 1347, 1353, 35 Cal.Rptr. 2d 135, 139 (1994)("The duty to indemnify may arise and indemnity may be allowed when in equity and good conscience the burden of a judgment should be lifted from a person seeking indemnity to one from whom indemnity is sought."); *Houdaille Indus., Inc. v. Edwards*, 374 So. 2d 490, 492–93 (Fla. 1979)("Indemnity is a right which inures to one who discharges a duty owed by him, but which, as between himself and another, should have been discharged by the other and is allowable only where the whole fault is in the one against whom indemnity is sought."). This language applies to

the surety-principal relationship, when the surety discharges its duty and, as between the surety and the principal, it is the principal that should have "discharged the duty."

The surety's right to indemnity is well established at common law, *see, e.g.*, *Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp.*, 534 F. Supp. 2d 1290, 1303 (S.D. Fla. 2008), 4 Phillip L. Bruner & Patrick J. O'Connor, Jr., *Bruner & O'Connor On Construction Law* § 12:97 (August 2017) ("By the 15th century, the surety's four fundamental equitable rights were well-recognized: exoneration, indemnity, subrogation, and contribution") (citation omitted). Because the majority of cases discussing and analyzing common law indemnity arise in the tort realm rather than the contract realm, whether the surety successfully can assert a claim for common law indemnity, either in the absence of a signed indemnity agreement or concurrently with its action on the indemnity agreement, depends on the jurisdiction.

For example, in a recent unreported decision in Colorado, *Liberty Mut. Ins. Co. v. Milender White Constr. Co.*, 2017 WL 6361418 (D. Colo. 2017), the surety had a written indemnity agreement but was faced with a situation that arguably was not addressed therein: whether the principal and indemnitors could be liable to indemnify the surety against allegations of bad faith. The district court cited the Restatement (Second) of Torts § 886B, as follows:

> [i]f two persons are liable in tort to a third person for the same harm and one of them discharges the liability of both, he is entitled to indemnity from the other if the other would be unjustly enriched at his expense by the discharge of the liability." The Restatement sets forth several instances in which indemnity is granted under this principle, including in relevant part: (1) where "[t]he indemnitee acted pursuant to directions of the indemnitor and reasonably believed the directions to be lawful; (2) "[t]he indemnitee was induced to act by a misrepresentation on the part of the indemnitor, upon which [the indemnitee] justifiably relied"; (3) "[t]he indemnitor...performed defective work upon land or buildings as a result of which both were liable to the third person, and the indemnitee innocently or negligently failed to discover the defects"; and (4) "[t]he indemnitor was under a duty to the indemnitee to protect him against the liability to the third person." *Id.* The underlying basis for indemnity is the presupposition that the indemnitee is not in *pari delicto* with the indemnitor. *Id.* at comments a, c ("[t]he unexpressed premise has been that indemnity should be granted in any factual situation in which, as between the parties themselves, it is just and fair that the indemnitor should bear the total responsibility, rather than to leave it on the indemnitee or to divide it proportionately between the parties by contribution"). See *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. First National Bank of Little Rock, Arkansas*, 774 F.2d 909, 917 (8th Cir. 1985)

> (summarizing the examples in Restatement (Second) of Torts § 886B as follows: "In all of these situations, the indemnitee is liable as a matter of law but the loss is primarily caused by the indemnitor, not the indemnitee").

Milender White, 2017 WL 6361418, at *16. A review of this language shows the difficulty of deriving the surety's right to indemnification under the common law from the standard tort-related elements of common law indemnity. Additionally, whether the surety can simply assert its right of common law indemnity or whether it must show the absence of a written indemnity agreement -- or that the GAI does not address the factual situation as in *Milender* White -- depends on the particular jurisdiction the surety finds itself in.

For example, in a recent decision by the Southern District of Mississippi district court, a surety was entitled to common law indemnity under Mississippi law when it showed only: "(1) that it was legally liable to a third party, (2) that it paid under compulsion, and (3) that the amount it paid was reasonable." *Travelers Cas. & Sur. Co. of Am. v. Dirtworks, Inc. of Vicksburg*, 375 F. Supp. 3d 680, 685 (S.D. Miss. 2019). In a decision under Texas law, the Seventh Circuit in *Kaiser Aluminum & Chem. Sales, Inc. v. PPG Indus., Inc.*, 42 F.3d 1147 (7th Cir. 1994), noted that although common law indemnity is applied only in a few narrow situations, the surety scenario is one of those situations:

> The situations in which an action for common law indemnity may be maintained under Texas law are "extremely limited." *Cypress Creek Utility Serv. Co. v. Muller*, 640 S.W.2d 860, 864 (Tex.1982). Texas common law indemnity principles may only be invoked in the contexts of agency or surety, *American Alloy Steel, Inc. v. Armco, Inc.*, 777 S.W.2d 173, 175 (Tex.App.1989), or in two special classes of tort-based actions: (1) in product liability cases to protect an innocent retailer in the chain of distribution of the defective product, *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 432 (Tex.1984), and (2) in negligence actions to protect a defendant whose liability is vicarious in nature, *Aviation Office of America, Inc. v. Alexander & Alexander, Inc.*, 751 S.W.2d 179, 180 (Tex.1988).

Kaiser Aluminum, 42 F.3d at 1152 (applying Texas law).

New York courts have no issue allowing a surety both contractual and common law indemnity: "[n]othing in [a contractual indemnification] clause is inconsistent with [an indemnitee's] right to common-law indemnity and there is no reason why the right to common-law indemnity and contractual indemnity should not coexist." *Hunt v. Werner Spitz Const. Co., Inc.*, 152 A.D.2d 936, 543 N.Y.S.2d 814, 815 (1989), citing *Aetna Cas. & Sur. Co. v. Lumbermens Mut. Cas. Co.*, 136 A.D.2d 246, 248, 527 N.Y.S.2d 143, *lv. denied* 73 N.Y.2d 701, 535 N.Y.S.2d 595, 532 N.E.2d 101). Under New York law, where

payment by one person is compelled, which another should have made, a contract to reimburse or indemnify is implied by law. *Colonial Sur. Co. v. A&R Capital Associates*, 2017 WL 1229732, at *5 (E.D.N.Y. Mar. 31, 2017), citing *First Indem. of Am. Ins. Co. v. Shinas*, 2009 WL 3154282, at *10 (S.D.N.Y. Sept. 30, 2009) (citing *McDermott v. City of New York*, 50 N.Y.2d 211, 216-17, 428 N.Y.S.2d 643, 406 N.E.2d 460 (1980)); *Westbank Contracting Inc. v. Rondout Valley Cent. Sch. Dist.*, 46 A.D.3d 1187, 1189, 847 N.Y.S.2d 780, 782 (3rd Dep't 2007). Similarly, New Mexico appears to uphold the surety's right to common law indemnity. See, *e.g.*, *Pedroza v. Lomas Auto Mall, Inc.*, 716 F. Supp. 2d 1031, 1046–47 (D.N.M. 2010), judgment vacated on other grounds, 2013 WL 4446770 (D.N.M.2013)(where the surety, Western Surety, issued a motor vehicle dealer bond on behalf of the principal, Loma Auto Mall, "Western Surety has established, as a matter of law, that it is entitled to traditional indemnification against Lomas Auto Mall").

A number of jurisdictions hold the opposite. See, *e.g.*, *Charlotte Motor Speedway, Inc. v. Tindall Corp.*, 195 N.C. App. 296, 672 S.E.2d 691 (2009) (there "can be no implied contract where there is an express contract between the parties in reference to the same subject matter," in case where the parties executed an express indemnification provision that, by its terms, did not cover the losses for which plaintiff sought indemnification); *Nguyen v. Lumbermens Mut. Cas. Co.*, 261 Ga. App. 553, 556, 583 S.E.2d 220, 224 (2003) (where surety's duty to pay stemmed from its contractual obligation as a surety, common law indemnity principles did not apply); *Cincinnati Ins. Co. v. Savarino Const. Corp.*, 2011 WL 1068022, *22 (S.D. Ohio Mar. 21, 2011) (dismissing common law indemnification claim as duplicative where parties entered into express indemnification agreement); accord *Developers Sur. & Indem. Co. v. Renew Maint. & Constr., Inc.*, 2018 WL 6185999, at *5 (S.D. Ala. Oct. 5, 2018); *Fireman's Fund Ins. Co. v. Nizdil*, 709 F. Supp. 975, 976 (D. Or. 1989) ("The written Indemnity Agreements signed by defendant supercedes any common law right to indemnity."); *Quilico v. Union Oil Co.*, 58 Ill.App.3d 87, 374 N.E.2d 219, 226 (1978) (as a general rule, under Illinois law, an indemnity agreement renders unavailable common law theories of "implied indemnity."); Bruner & O'Connor, § 10:103, "[w]here a written agreement exists, the surety's indemnity rights will be determined by the contract rather than by common-law indemnity principles."

As reasoned by the Western District of Pennsylvania court in *Fidelity Nat. Title Ins. Co. v. B&G Abstractors, Inc.*, 2015 WL 6472216, *10 (W.D. Penn. Oct. 27, 2015):

> [I]n certain circumstances, such as when there is some question about whether a contract exists or whether certain issues are covered by the contract, it might make sense to allow a plaintiff to pursue common law remedies alongside a claim for breach of contract. It does not, however, make sense when, as here, there is no dispute that the parties' Agreement covers the issue of indemnity. Under such circumstances, Plaintiff's claim must live or die under the terms of the Agreement, the terms of which the parties agreed would govern any disputes between them.

However, it should be noted that the analysis is not as black and white as the issue first appears when a written indemnity agreement exists. When the written indemnity agreement "requires more precise language than what it contains to evidence that the Parties' contracted, or intended to contract," such as whether the indemnitors would be required to indemnify the surety for such causes of action as bad faith, courts may find the indemnity agreement does not preclude common law indemnity. *Milender White*, *supra,* (where court finds indemnity agreement does not address the nature of the indemnity sought, "common law indemnity may serve to protect the interest of the surety where the contractual agreement is silent as to the question").

Aside from the "written contract-no equity" jurisdictions, other jurisdiction, such as New Jersey, require a "special relationship" be shown before common law indemnity is allowed and the surety-principal relationship, apparently, is not all that "special:"

> Case law clearly requires that there be a special relationship between the parties or that the party seeking indemnification must be "[a] person who, without personal fault, has become subject to tort liability for the unauthorized and wrongful conduct of another, [and] is entitled to indemnity from the other for expenditures properly made in the discharge of such liability." *Adler's Quality Bakery, Inc. v. Gasateria, Inc.*, 32 N.J. 55, 80, 159 A.2d 97, (N.J.1960) (citing Restatement of Restitution § 96 (1937)); *Ramos*, 103 N.J. at 189, 510 A.2d at 1158.
>
> In the case at bar, by its own admission, Western's liability to Hudson did not arise in tort, but instead, from its contractual liability as a surety. . . . Furthermore, there are no facts pleaded giving rise to the type of special relationship that might otherwise support an indemnification theory. Once again, Western has cited no case law that supports an exception to these prerequisites to application of the doctrine of common-law indemnity. Furthermore, the Court's research reveals no New Jersey cases that support application of common-law indemnity to the factual allegations in the complaints. Consequently, Count I of Western's complaints are dismissed for failure to state a claim to the extent it seeks recovery from the Defendants under a theory of common-law indemnity.

W. Sur. Co. v. Sandoval, 2010 WL 3745895, at *4–5 (Bankr. D.N.J. Sept. 17, 2010)

Finally, presuming the court allows the surety the right to common law indemnity, whether in addition to a written GAI or not, the surety must then show that under the particular state's elements of common law indemnity, the surety meets those elements. For example, in *Great Am. Ins. Co. v. Wade-Trim/Associates, Inc.*, 952 F.2d 403 (6th Cir. 1992), Great American sought common law indemnification via a third-party complaint from the project architect and testing engineer in a complaint by the public entity against the performance bond, alleging the principal negligently installed a sewer system where installed pipes cracked and portions of the roadway settled. In finding as

a matter of law the surety had no such claim, the Michigan court first noted the elements:

> Generally, indemnity is available only if the party seeking it is not actively negligent. *Langley v. Harris Corp.*, 413 Mich. 592, 601, 321 N.W.2d 662 (1982). As Harte's surety, Great American liability is coextensive with Harte's liability. *See Indemnity Insurance Co. of North American v. Otis Elevator Co.*, 315 Mich. 393, 24 N.W.2d 104 (1946); *Ackron Contracting Co., v. Oakland County*, 108 Mich.App. 767, 310 N.W.2d 874 (1981).

Great Am. Ins. Co. v. Wade-Trim, 952 F.2d at 4. The court then found GAIC was unable to assert a cause of action for common law indemnity:

> Great American claims to have a cause for common law indemnity. In determining whether a party stated a cause of action common law indemnity, Michigan courts look to the primary plaintiff's complaint. *Hill v. Sullivan Co.*, 86 Mich.App. 693, 696–697, 273 N.W.2d 527 (1978), *Peeples v. Detroit*, 99 Mich.App. 285, 293, 297 N.W.2d 839 (1980). If the complaint alleges only "active" negligence or fault, the defendant is not entitled to common law indemnity. *Id.* The primary complaint in the present case alleges active fault, not vicarious or derivative liability, against Harte and Great American. Consequently, Great American is not entitled to common law indemnification.

Id.

B. Against what parties potentially does the surety have common law indemnity rights and are such rights subject to certain common law defenses?

Using any of the above-referenced compendiums of common law indemnity elements, it should be clear that the principal is the party that is liable primarily for performance of the contract, along with the surety that issued the bond securing that performance, both liable to the owner/obligee. As outlined previously, the elements can be applied to the surety-principal relationship as both the principal and the surety are liable for performance, a "duty" as it were--the principal under the contract and the surety under the bond--to the same third-party.

The same cannot be said under the common law definition of indemnity as applied to individual indemnitors, those that typically sign a GAI. Individual indemnitors would not be liable for the performance that the principal agreed to. As to these potential defendants, the surety would have a difficult time convincing a court applying strictly the requirements for common law indemnity that, absent a GAI, such indemnitors would be liable to the surety under the common law.

There appears to be a dearth of caselaw limiting the surety's common law indemnity to the principal alone. Most often, the surety's indemnity complaint simply names all indemnitor defendants without discriminating as to which defendants are liable under which theory. Compare, *e.g.*, *Travelers Cas. & Sur. Co. of Am. v. Dirtworks, Inc. of Vicksburg*, 375 F. Supp. 3d 680, 685–86 (S.D. Miss. 2019) (finding surety stated

claim for common law indemnity against all defendants; motion to dismiss denied) with *Developers Sur. & Indem. Co. v. Ne. Fin. Mgmt. Corp.*, 2011 WL 4424065, at *1 (Mass. Super. 2011)(count for common law indemnity against principal only).

Common law indemnity, besides potentially limited to the principal, is also limited to situations where the surety has acted reasonably and under an express duty to act. In comparison, indemnity under a GAI typically allows the surety to settle claims on its own, to pay claims in settlement, and to have such payments binding on those parties to the GAI. Common law indemnity allows no such luxuries. See, *e.g.*, *Travelers Cas. & Sur. Co. of Am. v. James*, 2016 WL 9306254, at *6 (N.D. Tex.2016)("Common-law principles such as reasonableness of the settlement and a requirement of potential liability do not apply where the indemnity contract expressly gives the surety the right to settle claims without an adjudication. . . . The doctrines of unclean hands, acquiescence, negligence, and failure to act equitably all assume that Travelers owed a duty to the indemnitors to act reasonably, but the Indemnity Agreement expressly allows Travelers to handle claims at its sole discretion. Similarly, the defense of mitigation does not apply because Travelers was within its rights under the right-to-settle clause to settle or pay claims in full at its discretion, whether or not this it was reasonable to do so."); *RLI Ins. Co. v. John H. Hampshire, Inc.*, 461 F. Supp. 2d 364, 369 (D. Md. 2006)(surety's claim for common law indemnity dismissed as not ripe; surety had not yet paid any amounts under its bond).

In summary, a surety can rely on its right of common law indemnity against the principal, often in addition to its rights under the GAI or in instances where the GAI might be inapplicable or unenforceable. The surety wishing to pursue its common law right of indemnity should examine the jurisdiction in which the action would be brought to ensure the viability of such a cause of action under that particular jurisdiction's laws. The surety should also realize that its rights most likely would apply only to the principal, not other individual indemnitors. The surety should also realize the right may be limited based on the surety's conduct and not presume that its actions, although condoned by the standard language of a GAI, would not provide a defense to an action for common law indemnity.

IV. THE SURETY'S COMMON LAW RIGHT OF EXONERATION

A. Exoneration by the principal.

As defined by *Black's Law Dictionary*, exoneration is

> 4. The equitable right of a surety — confirmed by statute in many states — to proceed to compel the principal debtor to satisfy the obligation, as when, even though the surety would have a right of reimbursement, it would be inequitable for the surety to be compelled to perform if the principal debtor can satisfy the obligation.

Black's Law Dictionary (11th ed. 2019). Indeed, the second definition of exoneration in *Black's*, "[t]he removal of a burden, charge, responsibility, or duty," applies when the principal is required to perform, or to pay the obligation, before the surety does. *Id.*

As further outlined in Restatement (Third) of Suretyship & Guaranty § 21 (1996), Comment 2, "the principal obligor owes the [surety] a duty to perform the underlying obligation at the time the performance is due." However, if the principal refuses to perform, "it is inequitable for the [surety] to be compelled to suffer the inconvenience and temporary loss that performance [under the bond] will entail. Thus, if the principal obligor has no defense to its duty of performance, the [surety] is entitled to appropriate relief protecting its interests. The right to such relief is sometimes called the right of exoneration." *Id.*

The prior Restatement (First) of Security § 112 said it simpler and better: "The surety is entitled to equitable relief ***without alleging any particular reason for fearing that he will not be reimbursed in the event of payment***. The right to such equitable relief is called the right of exoneration." Restatement (First) of Security § 112 (1941) (emphasis added); accord *Finkelstein v. Keith Fabrics, Inc.*, 278 F.2d 635, 640 (5th Cir. 1960) (under "ordinary principles of suretyship, there is an automatic duty of exoneration . . . on the part of the principal to the surety").

As noted by one court, of all the surety's common law remedies, only exoneration operates before any payment by the surety[3]:

> The remedies of reimbursement, contribution and subrogation are only available after the surety has paid or discharged the principal's obligation and not before. However, even before any payment by the surety and after maturity of the debt, the right of exoneration enables a surety to commence an equitable action to compel the principal to discharge his obligation.

In re Israel's Estate, 64 Misc. 2d 1035, 1039, 315 N.Y.S.2d 453, 459 (Sur. 1970). Similarly, in *Morley Const. Co. v. Maryland Cas. Co.*, 90 F.2d 976, 977 (8th Cir. 1937), cert. denied, 302 U.S. 748, 58 S.Ct. 266 (1937):

> As a complaint in an action at law, such a petition would be premature; the plaintiff having paid nothing, may not yet call for indemnity. * * * In equity, however, the rule is otherwise; before paying the debt a surety may call upon the principal to exonerate him by discharging it; he is not obliged to make inroads into his own resources when the loss must in the end fall upon the principal.

Morley Const. Co., 90 F.2d at 977.

Therefore, the common law right of exoneration entitles the surety to require that the principal pay a bonded obligation that has matured before the surety expends its

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[3] See, *post*, discussion of *quia timet*.

own resources to perform. *Admiral Oriental Line v. United States*, 86 F.2d 201, 204 (2d Cir. 1936) ("before paying the debt a surety may call upon the principal to exonerate him by discharging it; he is not obliged to make inroads into his own resources when the loss must in the end fall upon the principal"); *accord Filner v. Shapiro,* 633 F.2d 139, 142 (2d Cir. 1980); *Glades County v. Detroit Fidelity & Surety Co.*, 57 F.2d 449, 451 (5th Cir. 1932) ("As between the surety and the principal there arises without payment by the surety and without his having even been sued an equity of exoneration."); *The Surety's Indemnity Agreement, Law and Practice* 7-8 (Marilyn Klinger et al., eds., American Bar Association 2002) ("The right or doctrine of exoneration springs from the recognition that it is the principal's obligation to perform the duties of its contract prior to and in a fashion to avoid a loss to the surety.").

The common law right of exoneration is, however, an equitable remedy, subject to those jurisdictions holding that in the presence of an adequate legal remedy, equity will not operate. See, *e.g.*, *Far West Ins. Co. v. J. Metro Excavating, Inc.*, 2008 WL 859182, *13 (N.D. Ind. 2008) (finding a common law claim for exoneration moot where a written indemnity agreement provided the surety with contractual rights regarding future losses). The courts further restrict application of the remedy to those instances where the obligation bonded by the surety has matured or is "due." See, *e.g.*, *Borey v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania*, 934 F.2d 30, 32 (2d Cir. 1991) ("It is the surety's right, <u>after the principal's debt has matured</u>, to compel the principal to honor its obligation to the creditor." citing *Filner v. Shapiro*, 633 F.2d 139, 142 (2d Cir.1980)); accord *Colonial Sur. Co. v. A&R Capital Associates*, 2017 WL 1229732, at *7 (E.D.N.Y. 2017); *Hanover Ins. Group v. Singles Roofing Co., Inc.*, 2012 WL 2368328, at *6 (N.D. Ill. 2012)(in addition to alleging the existence of a debt that is or will become due, a plaintiff surety must also allege that it "is or will become liable for the debt, and that absent equitable relief, the surety will be prejudiced because it will be forced to advance money to the creditor").

B. Exoneration of the bond by acts of the obligee

Alternatively, once again citing *Black's Law Dictionary*, this time the second definition, exoneration is also "The removal of a burden, charge, responsibility, or duty." *Id.* Although not necessarily a right, more commonly applied as a defense, it can be said the surety and/or its bond can be exonerated by acts of the obligee.

V. <u>THE SURETY'S COMMON LAW RIGHT OF *QUIA TIMET*</u>

Quia timet is the right of a surety to demand that the principal place the surety "in funds" when there are reasonable grounds to believe that the surety will suffer a loss in the future because the principal is likely to default on its primary obligation to the creditor. *Borey v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pennsylvania*, 934 F.2d 30, 32 (2d Cir. 1991) citing *New Orleans v. Gaines's Adm'r.*, 131 U.S. 191, 212, 9 S.Ct. 745, 752,

(1889) and *Morley Constr. Co. v. Maryland Casualty Co.*, 90 F.2d 976, 977–78 (8th Cir.), cert. denied, 302 U.S. 748, 58 S.Ct. 266 (1937). In a more recent decision, *Fid. & Deposit Co. of Maryland v. Edward E. Gillen Co.*, 926 F.3d 318, 322–23 (7th Cir. 2019), the Seventh Circuit provided the history and use of *quia timet* as follows:

> A surety's equitable right to *quia timet* relief is closely related to its right to exoneration, and the two concepts are often muddled. Curtis A. Jennings, Quia Timet: *A Remedy for the Fearful Surety*, 20 Forum 685, 687 (1984); *see also,* Walter W. Downs, *Quia Timet as a Preventer of Anticipated Mischief*, 1956 ABA Sec. Ins. Negl. & Comp. L. Proc. 173, 174-75 (1956) ("[*Q*]*uia timet* has from ancient times been considered as a separate remedy applicable where exoneration is not appropriate."). . . . "[B]efore the underlying obligation is due," a surety may use *quia timet* "to demand that the principal obligor provide adequate assurance of the principal's performance."
>
> Given the versatility of bills *quia timet* and their breadth of applications, the remedies available are correspondingly varied. Story, *supra*, § 826 (explaining chancellors could adapt "their relief to the precise nature of the particular case, and the remedial justice required by it"); *see also,* Restatement (Third) of Suretyship & Guaranty § 21 cmt. k (Mar. 2019 supp.) ("The relief granted, when exoneration or *quia timet* rights are asserted, depends on the facts of the particular case."). Courts may appoint receivers, enjoin actions, order a defendant to pay money into the court, or otherwise provide security to the plaintiff. 1 Wait, *supra,* at n.7, at 657–61. Injunctive relief is only one option available to a court of equity considering a bill *quia timet*. Bispham, *supra*, § 568; *see also, Borey*, 934 F.2d at 33 (distinguishing between preliminary injunctions and *quia timet* as a "final remedy").
>
> With the lack of formal causes of action in courts of equity, *see* Charles Herman Kinnane, First Book on Anglo-American Law § 220 (2d ed. 1952), the term *quia timet* (as used in the context of suretyship) took on a dual meaning. Courts and commentators have used the term to refer to the surety's common law right to assurance of the principal's future performance and also to the various equitable remedies available in such scenarios. *See, e.g., Borey*, 934 F.2d at 32 (describing *quia timet* as the surety's "right" to demand security from its principal and also as a "procedural device"); Walter W. Downs, *Quia Timet as a Preventer of Anticipated Mischief*, 1956 ABA Sec. Ins. Negl. & Comp. L. Proc. 173, 173 (1956) ("What is *quia timet*? Is it a principle of equity or is it a form of relief?"); John Norton Pomeroy, A Treatise on Equity Jurisprudence §§ 1393, 1394 (Spencer W. Symons ed., 5th ed. 1941) (describing "bills *quia timet*" as remedies for declaring or establishing another legal or equitable right).

Fid. & Deposit Co. of Maryland v. Edward E. Gillen Co., 926 F.3d at 322–23.

As the Second Circuit in *Borey* reasoned:

> Because *quia timet* and exoneration arise from a common substantive nucleus, they share common, though analytically distinct, defenses. When, for example, the principal has a defense against the surety, but not against

> the creditor, the surety may not maintain an action for *quia timet* or exoneration relief. As the Restatement of Security puts it: "Where the suretyship exists, it is the duty of the principal to the surety to satisfy the surety's obligation by performing his own duty to the creditor, in the absence of a defense between himself and the surety. . . . " Restatement of Security § 103 (1941). On the other hand, fraud on the part of the creditor gives the principal a defense to the primary obligation, and this defense may also be asserted by the surety. Because the surety may avoid liability by asserting this defense, he has no right to *quia timet* or exoneration. *See* L. Simpson, *Suretyship* § 46, at 201; Restatement of Security § 112 comment d (1941); *see also*, Restatement of Security § 118 (1941) (surety not entitled to equitable relief against principal if surety undertook its obligation with knowledge of the fraud by the creditor).

Borey, 934 F.2d at 32–33.

Quia timet survives in today's courts. For example, in a recent decision, *Travelers Cas. & Sur. Co. of Am. v. Dirtworks, Inc. of Vicksburg*, 375 F. Supp. 3d 680, 686 (S.D. Miss. 2019), the court affirmed the continued availability of the remedy, at least in Mississippi:

> Finally, turning to Travelers' claim for *quia timet*, Defendants' argument concerning the lack of recent Mississippi caselaw on the matter does not establish that such a claim is not viable. Indeed, a federal district court in Mississippi granted *quia timet* relief in 2013. *See Renpetco II, LLC v. Arinder*, 3:13CV240-HTW-LRA, 2013 WL 12108217, at *2 (S.D. Miss. Dec. 30, 2013). "It is well settled that a surety may, before payment of the debt by him, exhibit his bill in equity *quia timet* to compel the principal to pay the debt or perform the obligation." *Graham v. Thornton*, 9 So. 292, 293 (Miss. 1891). Under such bills, a party is entitled to relief even before injury or loss. *Lee v. Griffin*, 31 Miss. 632, 635 (Miss. Err. & App. 1856).
>
> Writing in 1856, the Mississippi High Court of Errors and Appeals further expounded upon the purpose of bills *quia timet* and the manner in which resultant relief is carried out:
>
>> Bills *quia timet*, are allowed to sureties only against their debtors or creditors. If they have any apprehension of loss or injury from the delay of the creditors to enforce payment of the debt against the principal debtor, they may file a bill of this sort to compel the debtor to discharge the debt or other obligation for which surety is responsible, or may compel the creditor to sue the principal, and collect from him the debt in discharge of the surety. But then, in this case, the surety is compellable to deposit the money in court for the payment of the creditor; and it is, in fact, but an indirect subrogation to the rights of the creditor, upon the virtual payment of the debt by such a deposit.
>
> *Id.* at 636. Travelers' allegations satisfy the pleading requirements for *quia timet* relief. Defendants' concerns analogizing such relief to a preliminary injunction are unavailing. Defendants do not point to any Mississippi court decisions calling into question the continued viability of *quia timet*

> claims, and, as already established, Travelers' Third Amended Complaint does not seek preliminary injunctive relief from this Court.

Dirtworks, 375 F. Supp. 3d at 686; see also *Developers Sur. & Indem. Co. v. DKSL, LLC*, 2018 WL 1177918, at *6 (D. Haw. 2018) (granting the surety's request for *quia timet* relief because the surety had set reserves and the applicable indemnity agreement language required the indemnitors to deposit security with the surety).

Other courts follow the maxim *aequitas non supplet ea quae in manu orantis esse possunt* ("equity does not provide for those things that may be in the hand of an applicant"). *Fid. & Deposit Co. of Maryland v. Edward E. Gillen Co.*, 926 F.3d 318, 327 (7th Cir. 2019). In affirming the grant of the principal's motion for summary judgment on *quia timet*, the Seventh Circuit held, "[a]fter negotiating for specific collateralization and indemnification rights, suing on that indemnity agreement, and then settling its breach of contract claims, Fidelity cannot now use this ancient equitable doctrine to get additional relief. Gillen is entitled to summary judgment." Another court, this time the Northern District of Alabama, denied the surety's motion for summary judgment on *quia timet* because the surety already had paid the amounts under its bond. *Hanover Ins. Co. v. Hudak & Dawson Const.*, 946 F. Supp. 2d 1208, 1224 (N.D. Ala. 2013)("Plaintiff's right of *quia timet* is moot because Plaintiff has already made payments under the bonds").

In summary, the surety's common law right (or remedy) of *quia timet* is alive and well. However, as with common law indemnity, and exoneration, some courts find that if a GAI exists, equity will not operate and *quia timet* being an equitable remedy, such relief will be denied. Further, some courts distinguish between those instances where the surety has paid claims, denying *quia timet* relief, and those where the surety anticipates but has not yet paid claims. The surety should review the particular jurisdiction/court in which it will file for *quia timet* relief to determine the court's predilection to granting such relief. In the absence of controlling authority, pray for the relief and cite the authorities such as *Dirtworks* and *Borey*.

VI. THE SURETY'S COMMON LAW RIGHT OF CONTRIBUTION

In general, "[t]he doctrine of contribution rests upon the broad principle of justice that, where one has discharged a debt or obligation which others were equally bound with him to discharge and thus removed a common burden, the others who have received a benefit ought in conscience to refund to him a ratable proportion. It depends rather upon principles of equity than upon contract." *Assets Realization Co. v. Am. Bonding Co. of Baltimore*, 88 Ohio St. 216, 253, 102 N.E. 719, 726 (1913)[4]; *see also*, *BMO*

[4] The Eight Circuit noted in *Assets Realization* that "[t]he case of *Deering v. Earl of Winchelsea*, 2 Bos. & Pul. 270, an English case decided in 1787, seems to be the leading case on the doctrine of contribution among sureties." *Assets Realization Co.*, 88 Ohio St. at 254, 102 N.E. at 726. Apparently, contribution among co-sureties has been recognized for a long time.

Harris Bank, N.A. v. European Motor Works, 372 Wis. 2d 656, 668, 889 N.W.2d 165, 171 (2016) ("A right to contribution may be based on an express contract, or, in the absence of an express contract, may "arise by operation of law to rectify an inequity resulting when a co-obligor pays more than a fair share of a common obligation"; citing *Kafka v. Pope*, 194 Wis.2d 234, 242, 533 N.W.2d 491 (1995)).

> As to sureties,
> the doctrine of contribution has its origin in the relation of cosureties and is not founded upon the contract of suretyship; that it is an equity which springs up at the time the relation of cosureties is entered into and ripens into a cause of action when one surety pays more than his portion of the debt. It equalizes burdens and recognizes and enforces the reasonable expectations of cosureties, because it is just and right in good morals, and not because of any supposed promise between them. This equity having once arisen between cosureties, this reasonable expectation that each will bear his share of the burden is, as it were, a vested right in each and remains for his protection until he is released of all his liability in excess of his ratable share of the burden.

Assets Realization Co., 88 Ohio St. at 253–54, 102 N.E. at 726; accord *Gross v. Davis*, 87 Tenn. 226, 11 S.W. 92, 93 (1889)("It is well settled that one surety may have contribution from [any] co-sureties only when, and to the extent that, [the one surety] may have paid more than [the] ratable proportion of their joint liability."); *Jones v. Berkley*, 12 Ohio Supp. 82 (1942) ("[C]ontribution is a right which a person has who has been compelled to pay what another should pay in part. This principle of contribution exists in many fields of law, but we find its most common application in the field of suretyship, requiring a surety to relieve his cosureties of an unjust proportion of the common burden.").

To be eligible for contribution, the paying surety must be a "co-surety," that is, liable to the same party for the same debt or obligation with one or more other sureties. As defined by the 8th Circuit Court of Appeals in *U.S. Fid. & Guar. Co. v. Naylor*, 237 F. 314 (8th Cir. 1916):

> The test of cosuretyship is a common liability to the same party or parties for the same debt or duty. Such cosuretyship may arise out of the same writing or transaction, or out of several writings or transactions, at the same time, or at different times. It entitles the cosurety who has paid more than his just proportion of the common liability to contribution from his fellow cosureties who have paid less than their just proportion.

Id. The liability "may arise at the same time or at different times, out of the same writing or out of many writings. A common interest and a common burden alone are required to create the relation, and to enable the co-surety who has paid more than his due proportion to claim contribution from those who have paid less than their just

proportion of the common liability." *Naylor*, 237 F. at 316; *Callison v. Glick*, 826 S.E.2d 310, 317 (Va. 2019)("a cosurety relationship exists when there are multiple sureties, and "as between themselves, each should perform part of its secondary obligation or bear part of the cost of performance"; citing Restatement (Third) of Suretyship and Guaranty § 53(2)).

Before the merger of law and equity, courts distinguished, in situations involving co-sureties, between suits at law and suits in equity. "In actions at law, where some of the cosureties liable to contribute are insolvent, have died or are beyond the jurisdiction of the court, the solvent sureties within its jurisdiction are liable for their respective aliquot parts only of the amount all the sureties on their particular bond should contribute." *Naylor*, 237 F. at 315. "But in suits in equity, where some of the sureties on a bond are insolvent, have died, or are beyond the jurisdiction of the court, the solvent sureties on that bond are liable to contribute and pay, not only their aliquot parts of the contribution due from the sureties on that bond, but also the parts attributable to their cosureties on the bond who are insolvent, have died, or are beyond the jurisdiction of the court. They are liable for the entire contribution due from all the sureties on their bond." *Id.*; *accord Smith v. Mason*, 44 Neb. 610, 63 N.W. 41, 43 (1895)(contribution must be based upon the number of solvent cosureties; insolvent ones are to be excluded with the burden distributed equally between those who are solvent.

Co-suretyship does not apply, and therefore, no right of contribution exists, where several surety companies are bound by separate instruments, albeit on account of the same principal, but each surety, by its bond, limits its liability, in the event of default on the part of the principal, to such proportion of the total loss sustained by the obligee as the penalty named in its bond bears to the total amount of the bonds furnished by the principal to the obligee. In this instance, because the suretyship of each company is a separate and distinct transaction "the relation of cosuretyship among them does not arise, nor does the right of contribution exist. *Assets Realization Co.*, 102 N.E. at 719.

Similarly, a sub-surety has no contribution rights as against the prime surety because there is no co-surety relationship. See, *e.g.*, *State Nat'l Ins. Co., Inc. v. Washington Int'l Ins. Co.*, 304 F. Supp. 3d 827, 836 (D. Neb. 2018)(subcontractor's surety not entitled to contribution from prime's surety for payment to subcontractor's unpaid supplier despite prime's breach of payment directive signed by prime contractor to pay surety's funds control account); *see also, Porto Venezia Condo. Ass'n, Inc. v. WB Fort Lauderdale, LLC*, 2012 WL 12838283, at *3 (S.D. Fla. 2012) (noting Florida law limits equitable contribution to the surety and guarantor context, developer not entitled to contribution from general contractor which did not agree to be a co-obligor and cooperating to construct the project did not make the parties co-obligors).

There are no recent decisions involving sureties and the rights of equitable contribution. The majority of recent decisions involve multiple insurance companies, *Scottsdale Ins. Co. v. Century Sur. Co.*, 182 Cal. App. 4th 1023, 1031, 105 Cal.Rptr. 3d 896, 902 (2010) ("In the insurance context, the right to contribution arises when several insurers are obligated to indemnify or defend the same loss or claim, and one insurer has paid more than its share of the loss or defended the action without any participation by the others."); and *Fireman's Fund Ins. Co. v. U.S. Fid. & Guar. Co.*, 2010 WL 1959148, at *5 (D. Or. 2010) (Fireman's Fund not entitled to equitable contribution because when it made payment, defendant insurers not obligated for any claim given limitations period had run; as a matter of law plaintiff was not making a payment for defendants' benefit). However, the right still exists and if a surety finds itself a co-surety and makes any payment in excess of what it deems its fair share, that surety should consider bringing a claim for equitable contribution.

VII. CONCLUSION

The surety's common law rights of equitable subrogation, common law indemnity, exoneration, *quia timet*, and contribution provide a powerful arsenal of rights in addition to those found in the standard, well-drafted GAI used by today's sureties. A proper understanding of the principles and concepts discussed in this paper will hopefully help the surety obtain—and perfect—its common law rights in addition to those provided by the general agreement of indemnity or in absence thereof. Modern courts continue to recognize these rights, established in favor of sureties centuries ago and reported in cases from the late 1800's to today. Recognition, however, does not necessarily mean enforcement, as jurisdictions vary on whether the existence of a written indemnity agreement precludes the use by sureties of certain of these common law rights, all of which spring from equity. The prudent surety ensures that a valid and enforceable GAI exists with all the rights and remedies appurtenant thereto. But such prudence can be supported by resort to the surety's common law rights in the appropriate circumstances and in those jurisdictions that recognize the use of these powerful remedies by the surety.

SESSION 4

THE CARE AND FEEDING OF EXPERT WITNESSES

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THE CARE AND FEEDING OF EXPERT WITNESSES

By Larry A. Rothstein

1. Work Product Privilege Protection for Consultants and Experts Under California Law

The identities and opinions of experts retained by counsel *solely* as a consultant to help evaluate the case or prepare for trial and *not* as a trial witness are entitled to qualified work product protection as well as derivative materials created by such consultants such as diagrams, reports and communications to the lawyer. *Williamson v. Sup. Ct. (Shell Oil Company)* (1978) 21 Cal.3d 829, 834, 148 Cal.Rptr. 39, 42.

This includes not even having to disclose the *identity* of the expert. This protection encourages experts to serve as consultants knowing that they will not be subject to subpoenas, depositions, etc. *Williamson, supra.*

Attorney opinions are absolutely protected by the work product privilege. C.C.P. §2018.030(a). However, all other work product, including consultants' reports, etc. are subject to qualified work product protection. The Court may order disclosure if it determines that "denial of discovery will unfairly prejudice the party seeking discovery in preparing that party's claim or defense or will result in an injustice." C.C.P. §2018.030(b).

Reports previously rendered in a consultant capacity do not automatically lose work product protection even after the consultant has been identified as a testifying expert in an expert witness disclosure statement. Reports rendered to assist the lawyer in such matters of preparation of pleadings, discovery, manner of proof and cross-examination of opposing expert witnesses remain protected because they are often "reflective of the mental processes of the lawyer under whose direction the expert works." *National Steel Products Company v. Sup. Ct. (Rosen)* (1985) 164 Cal.App.3d 476, 489, 210 Cal.Rptr. 535, 543. The advice and the report given by the expert in a consulting capacity on trial preparation, etc. remains subject to conditional work product protection. However, the trial court may conduct an *in camera* review to separate that from other discoverable information. *DeLuca v. State Fish Company, Inc.* (2013) 217 Cal.App.4th 671, 690, 158 Cal.Rptr.3d 761, 775.

However, as stated above, disclosure may be ordered where denial of discovery would "unfairly prejudice" the party or will result in an "injustice." C.C.P. 2018.030(b)

Here the exception could well swallow up the rule. If the expert's prior report(s) as a consultant contains information that could be used for *potential impeachment* purposes, "a court [must] *weigh carefully* the power of impeachment as a valuable tool in the process of truth ascertainment against the benefits of protecting the privilege of 'work

product.'" *Jasper Construction, Inc. v. Foothill Junior College District of Santa Clara County* (1979) 91 Cal.App.3d 1, 17, 153 Cal.Rptr. 767, 776. (Emphasis added) (Disapproved on other grounds in *Los Angeles Unified School District v. Great American Insurance Company* (2010) 49 Cal.4th 939, 753, 112 Cal.Rptr.3d 230, 240.

It is therefore of paramount importance that, notwithstanding the qualified privilege, a written report of the then-consultant/now-expert witness must be such that the expert does not contradict his or her prior statements made in the capacity of consultant.

It is likely that one's opponent will try to claim "potential impeachment" in order to get at the expert's earlier "advisory" reports.

"If the lawyer instructs the expert whom they plan to call at trial only to report orally, then there is no report to turn over. However, opposing counsel is likely to argue that the standard of care for any responsible expert would have been to prepare a written report.

My view is that written reports from consultants which do not contain opinions are often valuable. For example, in a construction defect case, the consultant can prepare a scope of repairs and a cost estimate without assigning culpability. Those opinions are not likely to change if the consultant is later designated as an expert. In any event, it is always paramount for the lawyer to closely circumscribe precisely what he or she wants and expects from their consultant or expert. I have seen on too many occasions where the consultant/expert, if left to his or her own devices, will venture far a stream from the issues in the case or needs of the client and its counsel.

The work product protection for a consultant ceases once "it becomes reasonably certain the expert will give his or her professional opinion as a witness on a material matter in dispute." This is often long before the person is actually designated as an expert in the case which occurs fifty (50) days prior to trial. C.C.P. §2034.230(b); *Deluca v. State Fish* Co., *Inc.* (2013) 217 Cal.App.4th 671, 689-690; 158 Cal.Rptr.3d 761, 775. The point where it is reasonably certain the expert will testify is a "bright line" with work product protection before but not after. *Williamson v. Sup. Ct. (Shell Oil Co.)* (1978) 21 Cal.App. 829, 834-835; 148 Cal.Rptr. 39, 42-43.

Sharing with others information otherwise entitled to qualified work product protection does not waive the privilege unless the circumstances are *inconsistent* with safeguarding the privacy of the attorney's trial preparation. *Raytheon Co. v. Sup. Ct. (Renault)* (1989) 208 Cal.App.3d 683, 689, 256 Cal.Rptr. 425, 429.

Work product protection is not lost by the attorney delivering copies of consulting reports to experts retained by the attorney or in discussions relating to the retention of the expert, even if the expert is not subsequently retained. *Shadow Traffic Network v. Sup. Ct. (Metro Traffic Control, Inc.)* (1994) 24 Cal.App.4th 1067, 1079; 29 Cal.Rptr.2d 693, 699.

Where parties collaborate on creating or obtaining work product, waiver of the protection by one of them does not bar the other from asserting it. All holders of the

work product privilege must consent to waiver of the privilege. *Arminta v. Sup. Ct. (James Jones Co.)* (2002) 101 Cal.App.4th 525, 532, 124 Cal.Rptr.2d 273, 278. One party's willingness to waive the work product privilege for test results by an expert jointly retained with a co-party does not affect the co-party's right to prevent disclosure of the results.

To rule on claims of work product protection, it is often necessary for the trial judge to conduct an *in camera* inspection of the report(s) in question and make the following determinations:

- If the report reflects in whole or in part the attorney's impressions, conclusions, opinions or theories, that information is absolutely protected and cannot even be reviewed *in camera.* Evidence Code §915(a).

- As to those portions not absolutely privileged, was the report made by an expert designated as a trial witness (that is, fully discoverable) or was it merely advisory to the attorney. If only advisory, it is conditionally privileged and cannot be discovered absent "unfair prejudice," to the party seeking discovery.

- Third, as to advisory reports, does good cause for discovery outweigh the policies supporting work product protection? That is, could the report serve as possible impeachment of the expert's testimony at trial. *National Steel Products Co. v. Sup. Ct. (Rosen)* 1985 164 Cal.App.3d 476, 489-492.

2. <u>Disclosure Requirements Under Fed. Rules of Evidence 702, 703 and 705</u>

Unless otherwise provided by court order or stipulation, each party must disclose the identity of expert witnesses whom it expects to use at trial to present evidence and, as to certain of these experts, a written report, prepared and signed by the expert, containing a complete statement of all opinions to be expressed and the basis and reasons, and certain other information. FRCP 26(a)(2)(A), (B).

As to experts not required to submit a written report, a disclosure of the subject matter on which the expert will testify and a summary of the facts or opinions to which the expert is expected to testify is required. FRCP 26(a)(2)(C)

Each expert who may be called to give opinion evidence at trial under FRE 702, 703 or 705 must be identified. Disclosure is not limited to experts who will be called on direct examination. Those who may be called to rebut or impeach opposing experts must also be identified. However, experts who will be called solely for rebuttal purposes may be identified within 30 days after the opposing party’s disclosures. FRCP 26(a)(2)(D)(ii)

Parties are generally not required to identify experts acting solely as consultants (i.e. non-testifying experts) or to disclose their reports. Their reports and the facts or opinions known to them are discoverable only under “exceptional circumstances.” FRCP 26(b)(4)(D)(ii)

A single individual may serve as both a testifying expert and a non-testifying consultant, but discovery is permitted for everything except materials generated or considered by the individual solely in his or her role as a non-testifying consultant. *Sara Lee Corp. v. Kraft Foods, Inc.* (ND IL 2011) 273 FRD 416, 419-420

Any ambiguity regarding the capacity of the individual is resolved in favor of the party seeking discovery. *In Re: Comm'l. Money Ctr., Inc. Equipment Lease Litig.* (ND OH 2008) 248 FRD 532, 538

The test for discoverability is whether the documents reviewed or generated by the expert are germane to the subject matter on which the expert will testify. *South Yuba River Citizens League v. National Marine Fisheries Service* (ED CA 2009) 257 FRD 607, 614

Designating experts as trial witnesses and discovery of their reports waives any work product protection for their opinions. Therefore, even if the party designating the expert decides not to call the expert to testify, any other party may do so. "The practical effect of a Rule 26(b)(2) designation is . . . to bring an expert and his report within the universe of material that is discoverable by all parties and, generally, admissible at trial. *Penn Nat'l Ins. Co. v. HNI Corp.* (MD PA 2007) 245 F.3d 190, 193

However, drafts of any expert witness report or disclosure required under Rule 26(a)(2) are protected as attorney work product "regardless of the form in which the draft is recorded" (i.e. , oral, written, electronic or otherwise). FRCP 26(b)(4)(B)

If the expert has prepared notes or drafts documents reflecting communications with persons other than attorneys (i.e. communications with other experts) there is no work product protection under FRCP 26(b)(4)(B) *Republic of Ecuador v. Mackay* (9th Cir. 2014) 742 F.3d 860, 870-871.

Communications in any form between a party's attorney and an expert who is required to provide an expert witness report (i.e., retained or specially employed experts) under Rule 26(a)(2)(B) are protected as qualified attorney work product subject to certain exceptions. FRCP 26(b)(4) Nevertheless, it makes sense to be cautious in communications (particularly written communications) with testifying experts.

Certain attorney expert communications are not protected as attorney work product:

- The amount an expert witness is being paid for his/her services is discoverable because it may suggest bias. FRCP 26(b)(4)(C)(i)
- Compensation for the study and testimony provided and any additional benefit to the expert (e.g. promise of further work in the event of a successful result) and extends to compensation for work done by any person or organization associated with the expert. Adv. Comm. Note to 2010 amendment to FRCP 26(b)(4)

Thus, it is fair game to ask a testifying expert by whom and how he/she is being paid (e.g. whether fees are secured by a lien on recovery, etc.) Similarly, the expert may be asked about income from other sources of employment.

There is no work product protection for communications identifying facts or data provided by the attorney and relied upon by the expert in forming the opinions he/she expresses. FRCP 26(b)(4)(C)(iii) However, discovery is allowed only as to communications identifying the facts or data provided by counsel, not communications regarding their relevancy or importance. Adv. Comm. Note to 2010 Amendment to FRCP 26(b)(4)

There is no work product protection for communications identifying assumptions made by the attorney and relied upon by the expert in forming the opinions expressed. For example, an attorney tells the expert to assume the truth of certain testimony or evidence or the correctness of another expert's conclusions. FRCP 26(b)(4)(C)(iii)

The identification requirement contained in FRCP 26(a)(2)(A) applies to a broader range of experts than does the written report requirement in rule 26 (a)(2)(B). While all persons giving expert testimony must be identified, a party must provide full and signed written reports only for experts who are:

- Retained or especially employed to provide expert testimony at trial of the action, or
- Employed by a party and whose duties regularly involve giving expert testimony (so-called "in-house" experts). Rule 26(a)(2)(B)

"Retained" or "specially employed" experts are those engaged by a party to provide expert opinion testimony on its behalf at trial. These experts must provide a signed expert witness report under Rule 26(a)(2)(B).

Unretained experts are persons who may be asked their expert opinion testimony at trial but who are not engaged or employed by a party to testify. These include:

- Treating physicians
- Police officers
- Government investigators
- General contractors
- Auto accident investigators
- Employees who do not regularly provide expert testimony

In contrast to retained experts who have no prior connection to the facts given rise to the litigation, unretained experts are those persons with recipient knowledge who happen to be an expert. The unretained expert is "an actor with regard to the occurrences from which the tapestry of the lawsuit was woven," with the opinion testimony rising not from enlistment as an expert but from "ground-level involvement in

the events giving rise to the litigation." *Downey v. Bob's Discount Furniture Holdings, Inc.* (1st Cir. 2011) 633 F.3d 1, 6

Even as to unretained experts, parties have an obligation to (a) identify them as testifying experts under Rule 26(a)(2)(A) and (b) disclose the subject matter of their expected testimony together with the summary of the facts and opinions to which they will testify. This is the so-called "expert report light," which is prepared by counsel (not the unretained expert) and involves considerably less than the detailed reports required from the retained experts.

3. Requirements For Experts' Reports

The report must be prepared by the expert – not the attorney for the party making the disclosure. FRCP 26(a)(2)(B) However, it is not improper for the attorney to provide assistance to the expert in preparing the report. *Marek v. Moore* (D KS 1997) 171 FRD 298, 302

The report must be in writing and signed by the expert. FRCP 26(a)(2)(B)

Each report must contain all of the following:

- A complete statement of all opinions to be expressed at trial and the bases for each opinion;
- The facts or data considered in forming the opinion;
- Any exhibits to be used as a summary of or support for the opinions;
- The qualifications of the expert;
- All publications authored by the expert within the preceding 10 years;
- A listing of other cases in which the witness testified as an expert (at trial or deposition) during the past 4 years;
- The compensation to be paid to the expert.

Note that the disclosure is not limited to matters supporting the expert's opinion, it must include facts or data *considered* by the witness informing his/her opinion. This may include matters harmful to the party's position.

Note further that an expert may be asked during deposition about testimony given in other litigation beyond the 4 year period specified in FRCP 26(a)(2)(B). Adv. Comm. Notes to 1993 Amendments to FRCP 26(a)(2)(B)(v).

For unretained experts (such as police officers or treating physicians), counsel must disclose the subject matter of the expected expert testimony and summarize in writing the facts and opinions to be attested by the experts who are not required to file expert reports. FRCP 26(a)(2)(C)

The disclosures and reports described above are to be made when the court directs. Absent a court order or stipulation, such disclosures are due 90 days before trial (or the day the case is to be ready for trial). FRCP 26(a)(2)(D)(i)

If the expert evidence is intended solely to rebut evidence of another's expert, the disclosures are due within 30 days after the other party's disclosure. FRCP 26(a)(2)(D)(ii)

The discovery requirements described above do not apply to experts engaged solely to consult with the party or counsel and who are not expected to testify at trial. The opposing party may not, by interrogatories or deposition, discover facts known or opinions held by such a consultant absent exceptional circumstances. FRCP 26(b)(4)(D)

However, one such "exceptional circumstance" applies where a person was originally designated as a testifying expert but later re-designated as non-testifying.

4. Expert opinion under FRE702 and *Daubert v. Merrell Dow Pharmaceuticals, Inc.* (1993) 509 U.S. 579, 113 S.Ct. 2786

The critical distinction between lay testimony, admissible under FRE 701 and expert testimony, admissible under FRE 702, is that lay testimony must be based on firsthand knowledge, while expert testimony may be based on hypothetical facts and hearsay so long as it has "a reliable basis in the knowledge and experience of the expert's discipline." *Daubert*, s*upra*, 509 US at 592; 113 S.Ct. at 2796

Daubert and its progeny as well as the FRE assigned to the trial judge the task of insuring that an expert's testimony both rests on a reliable foundation and is relevant to the task at hand. The test for reliability is the soundness of the expert's methodology, not the accuracy of the conclusions. Reliable testimony must also be helpful, and the trial judge may exclude testimony that falls short of achieving either end. *Stilwell v. Smith & Nephew, Inc.* (9th Cir. 2007) 482 F.3d 1187, 1192

The trial court's general gate keeping role established under FRE702 and *Daubert* applies not only to testimony based on scientific knowledge but also to testimony based on technical and other specialized knowledge. *Kumho Tire Co., Ltd. v. Carmichael* (1999) 526 U.S. 137, 147-148, 119 S.Ct. 1167, 1174.

In all cases where expert testimony is offered, the trial judge must find that the testimony is "properly grounded, well reasoned and not speculative before it can be admitted." CFRE 702, Adv. Comm. Notes (2000)

The author wishes to acknowledge Weil & Brown, *Civ. Pro. Before Trial* (TRG 2019) (as to California materials referenced herein) and Schwarzer, Tashima & Wagstaffe, *Cal. Prac. Guide: Fed. Civ. Pro. Before Trial* (TRG 2018) (as to the Federal materials).

SESSION 5

THE CRYSTAL BALL PANEL:
WHAT DOES THE FUTURE HOLD FOR
SURETIES AND CONTRACTORS

Scott C. Powers | Snow, Christensen & Martineau | Salt Lake City, UT

David Hombach | Travelers Bond & Specialty Insurance | Huntingdon Valley, PA

John Kampschror | Liberty Mutual Surety | Seattle, WA

Guy Armfield | Parker, Smith, Feek | Bellevue, WA

PEARLMAN 2019

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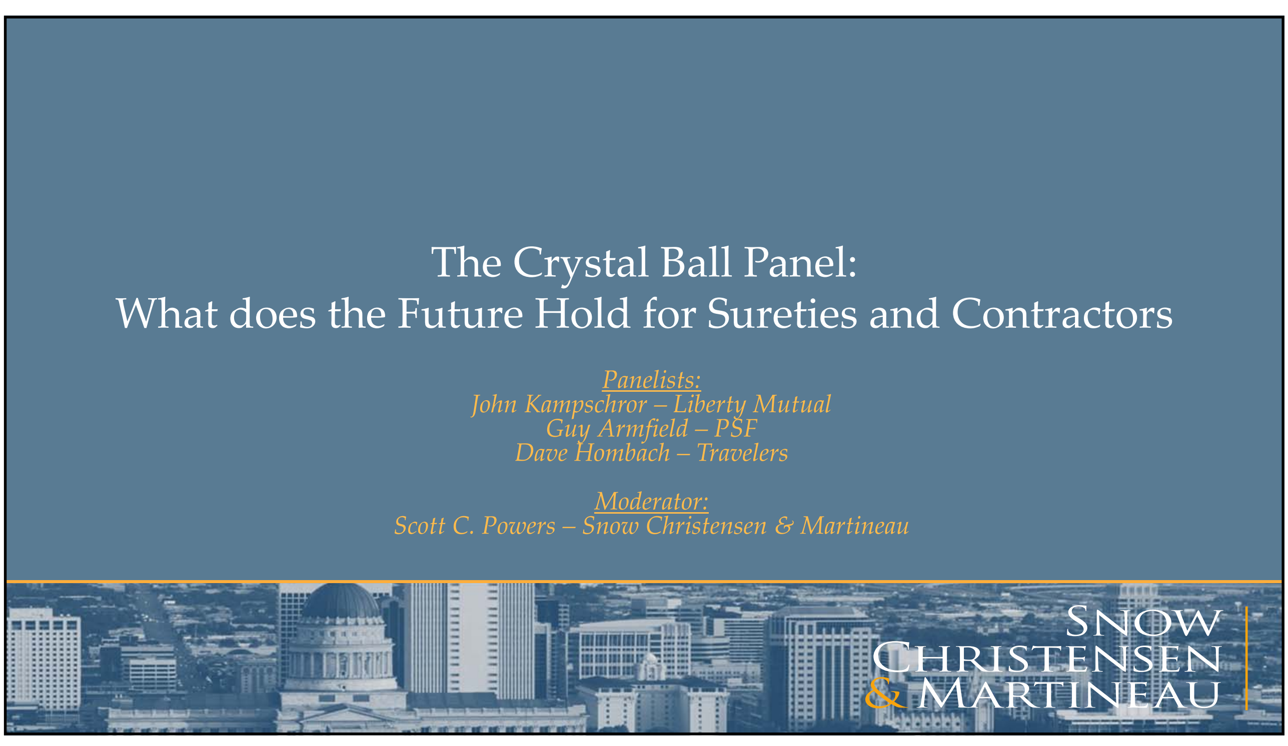
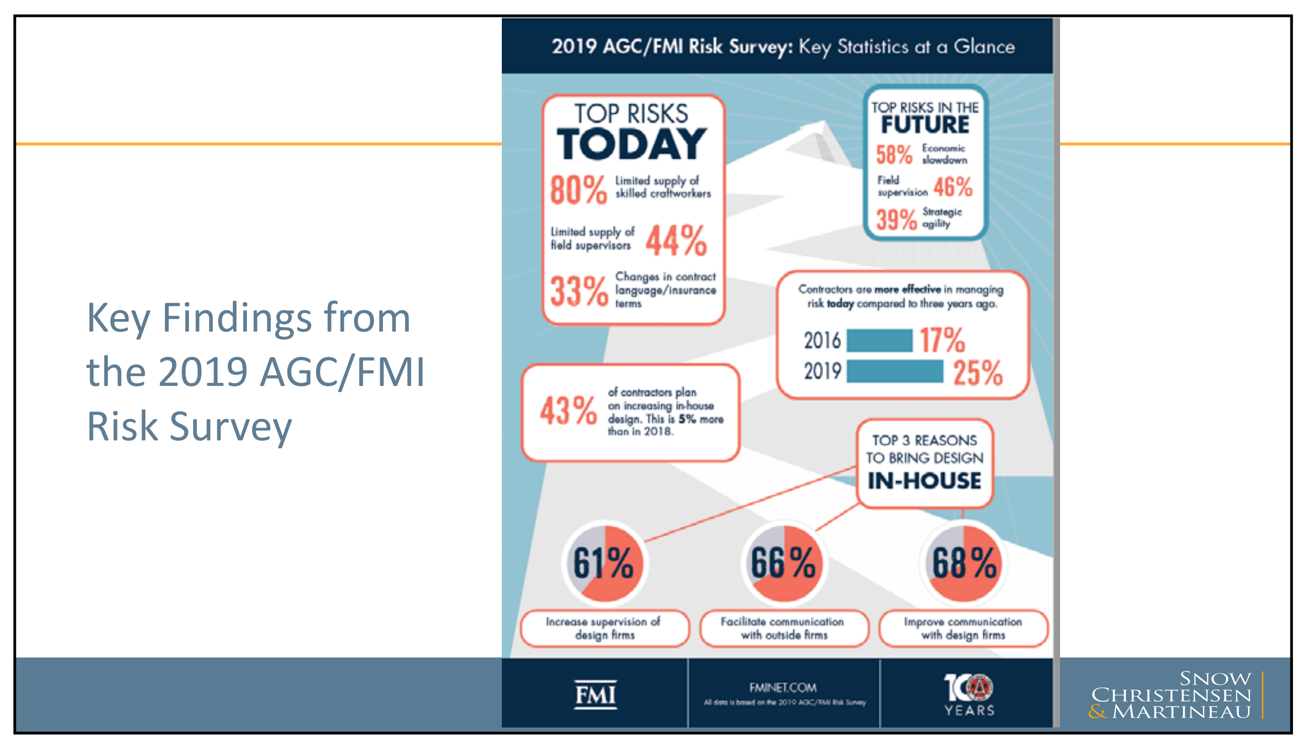


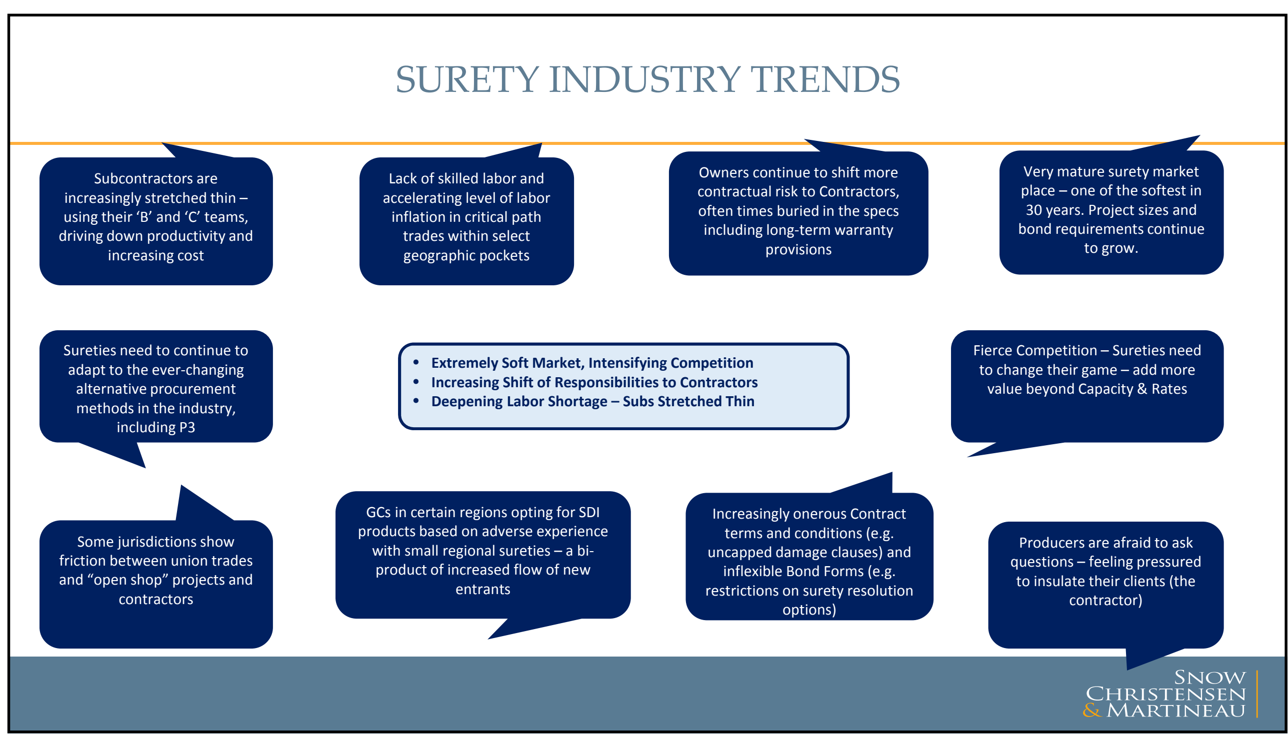
CURRENT STATUS OF THE INDUSTRY

- Industry is quite profitable
- Claims severity is high
- Money and demand are driving industry to do things that might not be a good idea.
- Other concerns:
  - reinsurers,
  - sub-guard policies, co-sureties

Despite Strong Economic Growth, Construction Sector Faces Challenges
Subcontractors
SKILLED LABOR ISN'T CHEAP
CHEAP LABOR ISN'T SKILLED
RISK
YOURS!
CONTRACTOR/ SUBCONTRACTOR TEAMWORK
CON TRACT
Subcontractors stretched thin, driving down productivity and increasing cost
Lack of skilled labor and accelerating costs in critical trades shrinks profitability
Shifting of Risk to Contractors – Increasingly onerous Contract terms and conditions
Rapidly Fluctuating and Escalating Materials Prices
Risk of Subcontractor Default, especially in times of recovery
SNOW CHRISTENSEN & MARTINEAU



Key Findings from the 2019 AGC/FMI Risk Survey
2019 AGC/FMI Risk Survey: Key Statistics at a Glance
TOP RISKS TODAY
80% Limited supply of skilled craftworkers
Limited supply of field supervisors 44%
33% Changes in contract language/insurance terms
TOP RISKS IN THE FUTURE
58% Economic slowdown
Field supervision 46%
39% Strategic agility
Contractors are more effective in managing risk today compared to three years ago.
2016 17%
2019 25%
43% of contractors plan on increasing in-house design. This is 5% more than in 2018.
TOP 3 REASONS TO BRING DESIGN IN-HOUSE
61% Increase supervision of design firms
66% Facilitate communication with outside firms
68% Improve communication with design firms
FMI
FMINET.COM
100 YEARS
SNOW CHRISTENSEN & MARTINEAU



WHAT DO THE NEXT 3-5 YEARS LOOK LIKE?

- We anticipate a slowing, but metrics appear optimistic.
- Sureties and contractors have already made adjustments after the great recession
  - Sureties and contractors are more sophisticated
  - Better staffed
  - Better equipped financially
  - We use data better
  - Less overextension
- Underwriting is doing a better job
  - File info is more accurate
  - Better subcontractor pre-qualifications (which historically has been a huge cause of defaults)
- Don't see much of a change in claim activity, and don't anticipate a significant up-tick
  - Contractors are making good money
  - Contractors have manageable back logs
  - In general, we're dealing with better operators with more information
- Challenges remain

WHAT DO THE NEXT 3-5 YEARS LOOK LIKE?

- *Results of the Associated General Contractors of America* ***(AGC)-Sage Construction and Real Estate Survey*** *were released on January 2nd! The study finds that* ***Construction executives remain optimistic*** *about the market for 2019, but with continuing worries about finding qualified workers. Both the optimism about the backlog and the worry about worker availability exist in* ***all regions****,* ***project categories*** *and* ***types of contractors****.*

- *Here are some key* ***highlights*** *from the study:*

- Contractors expect growth in **ALL Sectors**

- Most Construction firms plan to **add staff** in 2019
  - **79 percent** of the firms plan to increase headcount in 2019, up from 75 percent of respondents in 2018
  - Firms are also **raising pay** and **investing in training**
- Over **75%** of the firms are struggling with **Workforce Shortages**
- Contractors continue to **embrace innovation**
  - Firms are using a variety of methods to **reduce onsite worktime**, including lean construction, BIM or other virtual construction techniques, or offsite fabrication. In addition, there is increasing investment in **labor-saving equipment**, including drones, robots, 3-D printers, and laser- or GPS-guided equipment.
  - **IT investment** is also increasing and evolving

WHAT IS THE EFFECT OF TECHNOLOGY IN THE INDUSTRY AND HOW WILL IT AFFECT IT?

- Drones
  - Land Surveys
  - Building Inspections/Progress Monitoring
  - Promotional Visual Material
  - Monitoring On-site Activities
  - Security Surveillance
  - Mapping/3d Modeling
- AI and Automated Equipment.
  - AI being used to assess budget and assist in building information modeling (which is useful after construction as well).
  - Already using GPS to assist in construction (excavation, survey points, etc.)
  - Komatsu recently purchased 1000 drones, with the intent of sing them to control robotic construction vehicles with an eye toward a fully automated construction site.
- Speed

DO SURETIES NEED TO MAKE ADJUSTMENTS?

- Underwriting needs to reflect changes in industry
  - Underwriting has to adapt to the environment as it changes
  - Underwriting Issues
    - Contract review - Erroneous contracts and Long Warranties
    - Bond forms
- Claims side has to change and become more responsive because private sector doesn't want our product. Perceived non-responsiveness of our product was the motivator for subguard.
  - Exxon, Amazon, etc. built big projects, but they are not bonded.
  - Our industry could be bigger, but potential customers do not think surety industry is responsive
- Surety industry may need to come up with a faster product that clients like, which hopefully avoids the bad aspects of subguard

DO WE NEED TO MAKE ADJUSTMENTS?

- Public v. Private –
  - Can sureties market to private industry?

  - Will public entities try and circumvent bonding requirements?
  - Will enough bad experiences to move public away from our product?

EFFECT OF INTERNATIONAL MARKET

- Canada and UK – these big losses will modify the market.
  - Carrillon Loss in UK
  - Bondfield Bankruptcy in Canada
- Should sureties go outside US?

CONCLUSION

- Most in the construction and surety industries are very confident about the rest of 2019 and 2020.
  - Some think that it will see a downward trend beginning in 2020 and through 2021, with the growth cycle to start again in 2022
  - There are still $1Billion in unfilled jobs; there is a lot of pent up work still to be performed

SESSION 6

PRIVILEGE ISSUES IN THE SURETY'S INITIAL CLAIM INVESTIGATION

Rachel Walsh | Liberty Mutual Surety | King of Prussia, PA

Amanda Miceli | Chiesa Shahinian & Giantomasi PC | West Orange, NJ

Jonathan Cohen | Jonathan P. Cohen, P.A. | Fort Lauderdale, FL

William McConnell | The Vertex Companies, Inc. | Denver, CO

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Privilege Issues in the Surety's Initial Claim Investigation

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Introduction

As a general matter, when investigating a surety claim, events may unfold rapidly and the parties do not always consider the prospect of litigation. However, the surety should, from the outset of a claim, hold itself responsible for documenting its file in a manner which adequately protects the surety from unnecessarily disclosing confidential documents in the future. To preserve the surety's legitimate right to withhold certain communications and documentation during the discovery process, it will need to bear this very fact in mind while creating them.

A surety may be specifically served with discovery requesting those communications which occurred during the claim investigation phase. Even if the claim investigation file is deemed relevant and therefore probably discoverable, many of these documents may warrant protection under various privileges, including attorney-client and common interest privileges and the work-product doctrine. However, the applicability of privilege is determined on a case-by-case basis and is subject to the facts and circumstances surrounding the subject document or communication.

This paper is intended to cover the broadest contours of the attorney-client privilege, work product protection and related topics of common interest and joint defense. Given the potential sensitivity of the materials typically at issue, it is important for a surety to maintain an awareness of the relevant thresholds of discoverability both before and after litigation is reasonably anticipated. Simply assuming that communication between an attorney and his or her client will be privileged and/or protected as work product, risks disclosure which may otherwise have been avoided.

Attorney-Client Privilege

The attorney-client privilege protects confidential communications between an attorney and client regarding legal advice. *See, e.g., United States v. Philip Morris*, 2004 U.S.Dist. Lexis 27026 at pp. 10-13 (D.D.C. 2004). The protection is therefore applicable to surety professionals and their outside counsel. The rationale for the attorney-client privilege rests on core principles such as the following: (1) intimacy of the attorney-client relationship; (2) confidentiality within that intimate relationship; and (3) the necessity of communications within that intimate relationship. More succinctly put, the United States Supreme Court emphasized that the basis for this privilege is so clients feel safe in fully disclosing pertinent facts to their lawyers. *Upjohn Co. v. United States*, 449 U.S. 383, 393 (1981).

Generally, the elements of the attorney-client privilege are: (1) a confidential communication; (2) made for the purpose of facilitating the rendition of professional legal services; (3) between or amongst the client, lawyer, and their representatives; and (4) the privilege has not been waived. *Curlee v. United Parcel Serv., Inc. (Ohio)*, No.

3:13-cv-344-P, 2014 WL 4262036, at *4 (N.D. Tex. Aug. 29, 2014). However, there are applicable state-by-state variations of these requirements. For example, New York modifies these elements as follows: (1) a communication between client and counsel that (2) was intended to be and was in fact kept confidential, and (3) was made for the purpose of obtaining or providing legal advice. *In re County of Erie,* 473 F.3d 413, 419 (2d Cir. 2007); *see also United States v. Mejia,* 655 F.3d 126, 132 (2d Cir. 2011).

Regardless of the jurisdictional distinction in elements, when a surety engages outside counsel to handle a claim made, or in anticipation of a claim being made, communications between the surety and its attorneys concerning the claim or anticipated claim will, as a general rule, be afforded protection pursuant to the attorney-client privilege. This is relatively easy to establish because outside counsel was presumably retained for legal advice in connection with the claim, even though outside counsel sometimes serves an investigative function. However, courts are less willing to extend these generalities to investigative work of consultants.

Even though a surety consultant's participation in a claim investigation and analysis may be very similar to that of outside counsel, often collaborating with in-house and outside counsel to analyze the legal issues that arise in the context of the facts, it can be much more difficult to protect communications between the consultant and in-house or outside counsel under the attorney-client privilege. Surety consultants are often hired very early in the investigative phase of a claim or potential claim, which in and of itself may weigh heavily against the applicability of the privilege. Generally speaking, the hurdle to applicability of the attorney-client privilege to communications involving a consultant is establishing that the consultant was retained to assist the surety's in-house or outside counsel in providing legal advice and/or that the purpose of the communication at issue was the rendition of legal advice.

Although this distinction is not always easily comprehended, the following two cases are instructive. Where the surety employed both consultants and lawyers to perform its investigation, the court ruled that the documents created by the investigative team were not privileged (nor work product). *Levingston v. Allis-Chambers Corp*., 109 F.R.D. 546 (S.D. Miss. 1985). Although the documents at issue were either authored or received by the surety's attorneys, representatives, and consultants, the court determined the individuals were hired to determine the status and completion costs of the bonded projects and not in anticipation of litigation. By contrast, in a breach of performance bond action, a surety successfully withheld from discovery handwritten comments prepared by one of its consultants on the grounds that the consultant was a non-testifying expert whose comments were intended to assist the surety in preparing for mediation. *Aetna Casualty & Surety Co. v. Manshul Construction Corp*., 2001 WL 484438 (S.D.N.Y. May 7, 2001).

The perhaps more challenging way to protect these communications is to apply the attorney-client privilege by arguing the consultant is acting as an agent for the surety and communicating with in-house or outside counsel. Likewise, the privilege may also apply when the consultant is acting as an agent of outside counsel when communicating with the surety. However, this application is somewhat rare. As one court explained, the attorney-client privilege applies to an attorney's agent only if the agent is providing aid that is *necessary* in order for the attorney to render legal advice. *Scott v. Chipotle Mexican Grill, Inc.*, 103 F. Supp. 3d 542, 546 (S.D.N.Y. 2015). Put differently, fact finders will likely not fall within this protection.

In sum, to be protected by the attorney-client privilege it is essential that the purpose behind the creation of the communication is obtaining or rendering legal advice. As such, if the consultant is engaged merely to provide a factual synopsis of the events leading up to, contributing to, and/or resulting from the claim, the end materials communicated by the consultant arguably fall outside the scope of the privilege, even though the consultant's material is delivered directly to counsel.

Work Product

In the surety investigation context, withholding of otherwise discoverable documentation on the basis of work product is a two-fold consideration. Put succinctly, either the document was prepared by counsel (or the surety) or was prepared by a consultant or party in anticipation of litigation to validate it not being produced.

The *attorney* work-product doctrine has its origins in the opinion of the United States Supreme Court (and the court of appeals) in *Hickman v. Taylor*, where the Supreme Court stated that, "[p]roper presentation of a client's case demands that ... [the attorney] assemble information, sift what he considers to be relevant from the irrelevant facts, prepare his legal theories and plan his strategy without undue and needless interference." 329 U.S. 495, 510-11 (1947). In sum, the work product doctrine addresses the scope of confidentiality of memoranda, correspondence, notes, interviews, beliefs and mental impressions of or by counsel. As a result, the work product doctrine generally provides sureties and their attorneys with a wider swath to contend that documents and/or communications prepared by or for consultants are not discoverable.

The application of the work product doctrine to surety consultants primarily turns on whether the documents prepared by or for the consultant were actually prepared "in anticipation of litigation." When a consultant is retained can have a significant influence on this determination. When a consultant is retained early in a surety's investigation, there very well may be no basis to anticipate litigation at that time and, hence, no basis to claim the privilege. However, even as to documents prepared by the consultant after litigation is anticipated, there remains an issue of whether the documents and/or communications at issue were part of the ordinary course

of business of the surety or were prepared "in anticipation of litigation." While this line of demarcation is often gray, a review of federal precedent is helpful, if not instructive.

Claims of work product protection in federal court are governed by the principles set forth in Federal Rule of Civil Procedure 26(b)(3), which reads in pertinent part:

> a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative (including the other party's attorney, consultant, surety, indemnitor, insurer, or agent).

Thus, a party must anticipate litigation at the time the documents were drafted for these protections to apply. Materials or documents drafted in the ordinary course of business are not protected and the burden is on the party withholding discovery to show that the documents should be afforded work-product immunity. As a consequence, to determine whether the protection is applicable, the court must determine when the document was created, and why it was created. Because a surety investigates claims in the ordinary course of its business, the boundary between discoverable documents and protected work product is not always clear.

Joint Defense/Common Interest

More often than not, a surety will be asked to produce its claim files, or its investigative files, concerning the principal and the claim at issue. The principal will be asked to produce all written communications with the surety. The surety and the principal may also be subject to depositions concerning communications between the parties. There are also circumstances where the surety is asked through discovery to disclose possibly privileged documents which have been shared with brokers, reinsurers, co-insurers or co-sureties. When faced with such discovery and with arguments that privilege has been waived as a result of information exchanges, the surety should consider the applicability of the joint defense privilege, also sometimes referred to as the common interest doctrine.

The Federal Rules of Evidence provide that the principles of common law, as interpreted by the courts, govern rules of privilege. *See* Fed. R. Evid. 501. Thus, federal courts develop rules of privilege, including joint defense privilege, on a case-by-case basis. In the most general context, the common interest privilege protects communications between a lawyer and two or more clients regarding a matter of common interest. *In re* Sealed Case, 29 F.3d 715, 719 (D.C. Cir. 1994); *In re Auclair*, 961 F.2d 65, 69-70 (5th Cir. 1992). More commonly applicable to sureties, this common interest rule can also be used were multiple parties are represented by multiple counsel so long as the parties share a common interest in a legal matter. *United States v. Schwimmer*, 882 F.2d 237, 243-44 (2d Cir. 1989); *Walsh v. Northrop Grumman*

Corp., 165 F.R.D. 16, 18 (E.D.N.Y. 1996). The joint defense or common interest rule protects the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon and undertaken by the parties and their respective counsel. *Schwimmer*, 882 F.2d at 243-44; *United States v. Bay State Ambulance and Hosp. Rental Serv*., 874 F.2d 20, 28 (1st Cir. 1989); *Country Life Ins. Co. v. St. Paul Surplus Lines Ins. Co*., No. 03-1224, 2005 U.S. Dist. LEXIS 39691, at *18 (C.D. Ill. Jan. 31, 2005); *United States v. United Techs. Corp*., 979 F. Supp. 108, 111 (D. Conn. 1997). Thus, this allows a party to assert the attorney-client privilege to protect statements made not only to his or her own attorney, but also statements made to an attorney for a codefendant for a common purpose related to the defense of both defendants. *United States v. Evans*, 113 F.3d 1457, 1467 (7th Cir. 1997); *Country Life Ins. Co*., 2005 U.S. Dist. LEXIS 39691 at *17-18.

Under the appropriate circumstances, the joint defense privilege or common interest doctrine could provide a legal basis for the surety to withhold disclosure of confidential documentation. However, the surety should also consider whether it can, or should, memorialize any joint defense arrangement in a contract, agreement or simply by way of letter with the principal, or, in some cases, the obligee. A typical joint defense letter agreement, may include language such as the following:

> This letter constitutes a joint defense agreement relating to the aforementioned defense. Related communications between the Surety and Obligee/Principal, as well as documents and information prepared by and/or exchanged between them for this joint-defense endeavor, shall be subject to the joint defense privilege. The aforementioned joint defense endeavor is subject to Principal's/Obligee's and the Surety's reservation of their respective rights and defenses with respect to each other and the Principal/Obligee, including but not limited to the Surety's separate suretyship defenses.

By arranging for a joint defense agreement as early as possible, the surety may maximize its potential to withhold otherwise discoverable communications and documentations with its principal or obligee.

<u>Three Related Practical Tips</u>

Relevancy: As the aforementioned privileges and doctrines are a means to protect otherwise relevant and therefore discoverable material, a surety should first ask whether the discovery request will result in relevant material to the facts and claims asserted in any matter. While relevancy is a broad concept, it does not necessarily follow that a surety is required to disclose every document that relates to a principal or claim. For example, sureties have successfully asserted relevancy as a basis to protect their files

related to underwriting, reserves, and reinsurance in performance bond disputes where no surety-specific defenses have been asserted.

Defining the Scope of Outside Counsel and Consultants: If materials are determined to be relevant, the surety will likely be in the best position to preserve any work product or privilege protection over documents created by its counsel or consultants where the surety remains the primary fact finder during an investigation. Attorneys and consultants should maintain a well-developed scope of work that involves providing legal advice or claims analysis in preparation for anticipated litigation.

Instituting Document Protocols: When documents are exchanged, instituting protocols of copying counsel on the distribution of these documents will better the chances of protection. Similarly, by labelling documents prepared by outside counsel or consultants as "work product" or "drafted in anticipation of litigation," lower level associates participating in large document reviews will be more likely to understand the authors of the documents and therefore safeguard against inadvertent disclosure.

Conclusion

Claims investigations involving counsel and consultants often include communications relating to his or her understanding of the facts, opinions of relevant law, and recommendations. Often, claim notes or other claim file materials reference all or portions of such communications or may include documents prepared by counsel or consultants. Due to their sensitive nature, it is important to be aware of what materials may ultimately be discoverable. Though the work product protection and the attorney-client privilege are generally understood to limit discovery of certain materials, the devil is in the details. Instituting document protocols early on can dramatically reduce subsequent discovery motions and therefore litigations expense.

BIOGRAPHIES

Rachel Walsh: Rachel joined Liberty Mutual Surety in 2015 as Claims Counsel for the Northeast Region. Before joining Liberty Mutual, she was an attorney at Krebs, Farley & Pelleteri, PLLC in New Orleans, Louisiana, where she focused her practice on construction litigation and surety law. Rachel graduated in 2004, cum laude, from Tulane University. In 2007, she earned her J.D., magna cum laude, from Loyola University New Orleans School of Law.

Amanda Miceli: Amanda is an attorney in the surety and fidelity group at the law firm of Chiesa Shahinian & Giantomasi PC in West Orange, New Jersey. Amanda received her B.A. in philosophy from Franklin and Marshall College before graduating from Seton Hall Law School. Prior to joining Chiesa Shahinian & Giantomasi PC, Amanda was a law clerk in the United States District Court for the District of New Jersey.

Jonathan Cohen: Jonathan is an experienced attorney specializing in surety, construction, and commercial matters. He is the named principal at Jonathan P. Cohen, P.A. Jonathan routinely handles all phases of a dispute from pre-litigation to post-judgment collection activities in state court, federal court, and in arbitration. He is licensed to practice in Florida and Pennsylvania.

William J. McConnell: Bill is a co-founder and the CEO of The Vertex Companies, Inc. Bill is an expert witness for large and complex domestic and international construction disputes. He has testified approximately 160 times, most notably for damages, allocation, scheduling, productivity, and standard of care opinions. He is a frequent presenter at many construction, engineering, and law conferences each year.

SESSION 7

CONSTRUCTION TECH TALK PANEL

LATEST CONSTRUCTION TECHNOLOGIES

Todd M. Bauer | Guardian Group, Inc. | Torrance, CA

Kieran O'Connor | Beacon Consulting Group, Inc. | New York, NY

Dennis O'Neill | Beacon Consulting Group, Inc. | Medford, MA

Lin Heath | Nicholson Consulting | Leander, TX

Gregory H. Smith | Booth, Mitchel & Strange, LLP | Orange, CA

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Construction Tech Talk Panel
Latest Construction Technologies

By:

- Todd M. Bauer - Guardian Group, Inc.
- Kieran O'Connor & Dennis O'Neill - Beacon Consulting Group, Inc.
- Lin Heath - Autonomous Machinery
- Gregory H. Smith – Booth Mitchel & Strange

Introduction

The surety industry stands to gain invaluable benefits from the use of new technologies in construction. The primary objective in surety consulting is loss prevention, or minimization, and the use of new technology can play a role in that objective. This being the case, it is important for claim personnel, consultants, and counsel to educate themselves on new technology and quickly understand their benefits and limitations. Here, we will discuss three areas that are currently being utilized: (1) drones; (2) infrared roof and building scanning; and (3) autonomous machinery.

Drones: By Todd M. Bauer, Guardian Group, Inc.

Overview of the Technology

A drone or Unmanned Aerial Vehicle (UAV) is an unmanned platform whose operation is controlled remotely via a wireless or tethered signal. Although this technology may seem like a recent development over the last couple of decades, drones can be traced back to the late 1800s. Nikola Tesla was testing drone watercraft, piloted by radio waves, as early as 1860. During the 1960s and the Vietnam war, unmanned aircraft saw huge developments in the technology by the military with the use of the Ryan Firebee and Lightning Bug platforms, which were the forerunners of the Predator and Reaper platforms currently in use by the military. Drone technology gradually made inroads into other areas, including Search and Rescue (SAR) and law enforcement. Eventually, the technology became affordable and portable for the commercial and consumer markets, especially with advancements in Wi-Fi communication. Drones, specifically UAVs, can be either fixed wing or rotary, although the quadcopter tends to be the most common because it’s vertical take-off and landing capabilities mean smaller operational bases and the hover ability to remain on station while offering a 360-degree view.

Uses in the Construction and Insurance Industries

While the initial commercial applications of drones were largely photography and videography, various industries including the insurance and construction industries are now embracing drone technology because of "force multiplier"—something that increases the production and or efficiency of a process—advantages.

Today, the insurance industry uses drones for loss analysis and claim disposition on everything from crop damage claims to catastrophic loss, such as hurricane, wildfire, tornadic

events, floods, earthquakes, etc. Meanwhile, the construction industry uses drones for program compliance documentation, inspections—especially membrane roof moisture studies—, project management showing progress against schedules and marketing by showing clients real time status of the project.

Benefits

<u>Accessibility and Safety</u>

The greatest advantage of drone technology is greater accessibility and safety, which results in reducing the costs associated with performing a specific task. Often project sites have conditions that are very dangerous. For example, uncleared land with lack of access roads and natural obstacles present problems for survey teams to gather accurate data for which to develop meaningful information regarding design impacts and constructability. Bridges and other structures require special rigging and equipment when surveying and inspecting the structural integrity. A collapsed roof may not be able to be adequately surveyed because it is unsafe to get on top of. Previously, these types of conditions required expensive and time-consuming measures to safely address and the data would be speculative while being presented with several disclaimers based on the inability to accurately or reasonably assess. Because the UAV is operated remotely from a safe area, there is greater flexibility on gathering information.

<u>Perspective and Quality Control During Construction Activities</u>

Nearly every subdivision and land plat are shown in what is known as "plan view"—a bird's eye view of the project. Before drone technology, the only way to verify that the project complied with the plans was to rent an aircraft, either fixed wing or rotary wing, to review the project from the air and record with cameras. Drone technology, combined with mapping programs, can compare the as-built conditions to what was permitted and approved. Drones can be inexpensively deployed at any stage of project construction to determine status or to routinely monitor progress. Contractors can also use drone technology for compliance programs with respect to Maintenance and Protection of Traffic or Erosion and Sediment issues. By using a drone to periodically document these measures, contractors can quickly address areas of non-compliance and correct them as needed—particularly after storm events, which often cause failures in these programs. Progress documentation for various projects like stream restorations, subdivision and infrastructure improvements—such as stormwater management—, or bridges using time lapse photography can show an accurate record of a project's progress over time and

its collateral impacts. Drones can be used to quickly assess the amount of equipment on a project as well as access issues and site conditions such as excessive mud.

Technology Stacking

The ability to merge technology on a drone platform is rapidly expanding. Using GPS mapping technologies like Drone Deploy and LIDAR, accurate surveys of areas can be developed in half the time traditional surveys take and the added elevated point allows for 3D modeling of an area on CAD programs. Forward Looking Infrared (FLIR) cameras are used to inspect roofs or solar panels and is another area where technology is being stacked with the drone platform. Many commercial drones in development are coming standard with mounting adapters that allow these technology modifications to be quickly installed or changed out depending on the drone mission. Artificial Intelligence (AI), and the ability of drones to communicate data with other information, is rapidly developing too. Using LIDAR and AI equipped drones, it is possible for the drones to direct robotic earth moving equipment to grade certain areas in real time. One downside to technology stacking is that utilizing additional technologies like LIDAR require special calibration or infrared thermology, all which require specialized training to use and interpret the data. While online training is good, there is no substitute for actual experience using these technologies.

Pitfalls

Regulations

Drones are heavily regulated. The FAA requires commercial drone operators to be licensed and to know the airspace in which they are operating. Where and when you can operate a drone is of major concern. Drones are prohibited in restricted airspace deemed no fly zones including military bases, airports, protected wilderness areas and parks, and government buildings with elevated security measures such as courthouses, etc. It is incumbent on the drone operator to verify the airspace he or she will be operating in prior to flying—although most operating systems now lock up operation before entering restricted areas. Airspace is also a fluid factor as airspace may be restricted by military exercises or commercial events like sporting events so it is necessary to check all updates. Companies can apply for a Certificate of Exemption to alleviate the impact of certain restrictions. However, FAA Review of these certificates is often lengthy and not a priority. Additionally, the regulations for drone operation and registration are constantly evolving. The FAA is constantly updating the regulations—almost

monthly and usually in response to drone incidents where a drone interfered with other aircraft or over concerns for citizen's privacy—and it is up to the operator to stay current on the regulatory developments. Fines and penalties for non-compliance can be substantial.

Currently, FAA Regulations restrict drone use to an altitude of 400 feet Above Ground Level (AGL), with some exceptions, and the operator must maintain unaided visual contact with the platform ("VisCon"). With smaller drones in low contrast backgrounds, the VisCon requirement can severely limit the area of operations.

Other Limitations

Drones, like any mechanical device, are limited by their own technology and the abilities of their operators. Like Tesla's car, the biggest limitation of UAV operation is battery life, which limits flight time and range of the operation. There are many factors that can impact the battery life and the drone's ability to loiter on-station or fly a pre-determined waypoint, including the weight of the drone and payload, air temperature, altitude, humidity, battery heat, wind, ground effect, etc.

Weather, lightning, and environment are other major limitations to drone operations. Cameras on drones do not see through heavy foliage, so in a heavily canopied wooded area there may not be useful data garnered from a drone fly over. The outdoors is not the only place drones face issues as most do not perform well indoors. Most UAVs have a fail-safe that in the event of broken communication, the drone climbs to 60 feet and returns to home which uses a GPS sensor—rendered mostly useless indoors.

There are also limitations on the technology stacking. For instance, in the previously mentioned example of the drone sending elevation data to robotic earth moving equipment, the AI cannot distinguish a truck from the ground, it simply sees a "high spot" that needs to be knocked down and will send the equipment there to perform that function.

Infrared Roof and Building Scanning: By Kieran O'Connor & Dennis O'Neill, Beacon Consulting Group, Inc.

Overview of the Technology

Technological advancements in image capturing have been rapidly enhanced over the past years. While the major usage of this technology seems to have been reserved for millennial entertainment, there are several practical uses within the construction field. Cameras are now

capable of capturing incredibly detailed images and are generally lightweight enough to be conveniently used on a chaotic construction site. Armed with this new technology, the construction and surety fields both stand to gain major advantages that will undoubtedly affect the bottom line.

Infrared Scanning and Building Scanning Technology are used to capture existing conditions of a project at a particular moment in time. Infrared Scanning is used on roof projects to identify where there may be potential for leaks and or pockets of moisture that are not easily identifiable with the naked eye. When a thermal roof survey is performed, a contractor will typically walk the roof using a hand-held infrared camera that can capture and measure the thermal energy radiating off the surface of the roof. The colors that appear on each image correspond to a sliding color scale that a trained surveyor utilizes to interpret surface temperatures. Scanned areas with images that indicate moisture presence—images will have white/red spots indicating the hottest temperatures—are typically where the potential leaks are.

Infrared Scanning

The benefits of this technology are vast and diverse. Infrared Surveys are typically very quick. It does not take a surveyor long to walk the span of a roof and the thermal images are instantly available. This whole process is not invasive as the roof does not have to be physically disturbed for the survey to work. The thermal imaging can detect problems that cannot be visually identified with ease. Pockets of moisture may not typically be obvious or will give a poor representation to the extent of the leak. The results from the survey will make it easier for a contractor to plan accordingly, saving time and money for eventual completion down the line.

While the technology is deficient in some areas, most of the issues can be resolved through common sense and proper planning. The benefits of using it, if implemented correctly, will outweigh the negatives in the long term. Ironically, the decreasing costs of thermal cameras are a hidden disadvantage to their use. The cheapness of the cameras means that more untrained amateurs can sell their survey services to unsuspecting developers. Infrared scanning requires training and experience. Incorrect conclusions will end up costing the developer more in dollars and lawsuits. Even basic training of these cameras is not enough, as a surveyor must not only know how to use the device, but also put it into context of the construction techniques and materials in use on the project. There is no governing body that determines licensed practitioners at this point, making it easier for dishonest subcontractors to take advantage.

Building Scanning

Building scanning is where a laser scanner will either sit on a tripod—typically interior—or a high caliber camera within a drone—typically building exterior—to capture data points of the building under surveillance. For interior use, the laser will scan a vertical line, pivot slightly, and then scan another vertical line. This process is repeated until the scanner has captured the entire 360° space. If the device is set up correctly, it will record the surface of every single item in the room no matter what the material. Every object that is scanned by the laser is also surveyed. Typically, the data captured by the scanner is then used in conjunction with design software, like AutoCAD, to create an up-to-date 3D model of the existing conditions.

Building scanning possesses superior advantages given the complexity of the technology. In combination with a modeling program, scanning technology is applicable to all 2D and 3D surfaces. This allows designers to view their projects from different angles, revealing different perspectives. The scanning can also be performed in a short amount of time but will yield both a massive and precise volume of data collected. The models generated from the scans can greatly reduce the amount of rework performed on a project. For example, detailed surveys can identify conduit clashing and imperfections in the floors. As is typical in construction, identification and preventative planning for problems will always save the project time and money on the bottom line.

Most of the disadvantages associated with the technology are inherent. The large data sets generated from the scans require some post-processing analysis to produce something workable for designers. While the scanning is very precise, it is difficult to extract the edges of objects from indistinct data clouds. This leaves out a certain degree of accuracy around the perimeter of some objects. As is common with any new and rapidly expanding technology, it is difficult to stay current with each advancement made with building scanning. Aspects of the technology become quickly outdated in favor of the new streamlined version. Finally, the startup cost for the hard and software is very expensive. The cameras themselves can cost several thousands of dollars on top of the sophisticated software and training required to operate them. It is important for project managers to determine whether renting or buying scanning technology is beneficial for their company.

<u>Automation</u>: By Lin Heath, Nichols Consulting

Overview of the Technology

At first blush, the unique features of the work site seem to limit the general applicability of the 'digital revolution' to the messy field of construction.[1] However, such a casual generalization, so we are told, flies in the face of recent technological trends. The hopes of improving both quality and safety standards while diminishing labor costs continue to motivate an active community of researchers, designers, engineers, tech enthusiasts, and business leaders across the globe to envision new alternatives for a booming industry that continues to face poor labor market conditions.[2] This section will focus on only three developments: the application of artificial intelligence and related IT technologies to (1) bricklaying; (2) on-site welding; and (3) road maintenance and repair.

Automated Brick Laying (SAM)

Over the past few years, discussions concerning robots on-site, including automated bricklayers most notably, have stirred the public imagination. The first of these technologies to reach market, the SAM100, short for Semi-Automated Mason, is reportedly the "first commercially available bricklaying robot for onsite masonry construction."[3] Estimates vary, but Construction Robotics, the patent-holder and manufacturer of SAM100, claims that their robot guarantees a 50%+ gain in labor savings, which also translates into higher yields in productivity. According to the manufacturer, productivity by SAM100 is 3-5x that of present-day conventional methods with a masonry crew. SAM100 also promises to mitigate on-site injury risk of workers by a considerable factor due to the robot's reduction of 80% of the human lifting normally involved in the process of laying bricks.

In recent years, the market viability of automated bricklaying has inspired a new generation of sophisticated applications. In 2017, Wayne Grayson, an industry reporter for Equipment World, revealed that the industry giant Caterpillar would develop a combined robotic bricklayer/3D Home Printer in collaboration with an Australian company, Fastbrick Robotics,

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[1] Between 2005 and 2015, the construction world saw only an average year-over-year growth of 4%, marking it as one of the most tech-averse industries in the modern economy. *See* McKinsey report, "5 Ways Robotics Will Disrupt the Construction Industry in 2019," roboticsbusinessreview.com.

[2] According to a Robotic Industries Association report by Tanya M. Anandan, "the global construction market for robotics is expected to more than double to $166 billion by 2023" in response to a supply shortage in knowledgeable and experienced workers.

[3] *See* construction-robotics.com.

which had already developed the Hadrian X, an automated bricklayer that can reportedly lay 1,000 standard-size house bricks per hour.[4] The incorporation of onsite 3D printing technology, working alongside the automated bricklayer, would rely upon software that would generate a 3D model for the robot. The bricklayer would then receive the generated schematics and, according to the developer Fastbrick Robotics, print out the "structure course by course just like a 3D printer, including all cutting and routing of the bricks for electrical and plumbing services so the finished structure is ready for first fixing within days."[5]

In spite of these promises, however, the construction industry remains hesitant to purchase expensive capital equipment in the case of the automated bricklayer. A Digital Trends industry report found that the SAM100—the first marketed technology of its kind—still hovered around $500,000 as of 2017.[6] Prohibitive costs, and the need to retrain masons to incorporate this sophisticated piece of capital equipment onto the work-site, likely means that this robot mason—the most viable of its kind, to be sure—will not be stealing any jobs any time soon, much less "revolutionizing" how bricklaying is done. Most surprising of all, there are presently little to no industry feasibility studies on the incorporation of advanced AI and robotic technologies into the contemporary construction workplace as of 2019.[7]

Automated Pipe Welding

Automated pipe welding is another specialized field of construction that expects a reorientation towards labor-cost saving robotics. Since the early 1960s, automated welding was applied to the controlled environment of heavy industrial manufacturing.[8] Since the emergence of commercially viable automated welding units around the early-to-mid 1970s, advanced metallurgical technologies involving robotics have been reapplied for small-scale, localized tasks that offer high-degree precision in the assembly of high-tech consumer electronics and other similar goods of the late-20th century. Despite these promising spin-offs, industrial applications of automated welding still remain tightly bound to the controlled environment of industrial

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[4] *See* equipmentworld.com.
[5] *See* fbr.com.au.
[6] *See* digitaltrends.com.
[7] A search of feasibility studies as to cost of retraining, the liability issues, the human-tech interface problems, etc. yielded no results. It is still a novel piece of technology.
[8] Ghobakhloo and Khaksar, Robotic Welding Technology, 6-7 (2014).

manufacturing.[9] Only in more recent years have innovators tried to free these technologies from their factory settings for efficient uses on on-site construction jobs.

Sensing an opportunity, Welbot Technology has led the way by recently applying their patent-pending Adaptive Robotic Control (ARC) technology to an easily programmable adaptive robot prototype that they plan to develop for on-site construction use in the coming years. Boasting a user-friendly interface that allegedly takes two minutes to program, ARC provides an Auto-Weldpath Generation for the six-axis robot arm, after the operator pre-selects the target, allowing the SMARTScan feature to refine an approximated path after taking into account the particular contours of the gap itself.[10] Supporting algorithms for the Auto-Weldpath Generation will employ a 3D Welding Wing Weave to fulfil the complex requirement along the programmable welding pathway, limiting the margin of error beyond even the steadiest hand of an expert professional welder. Beyond this initial phase, the ARC also comes equipped with a Gap Compensation feature that re-scans the last layer welded before undertaking a new application cycle. This ensures a smooth and consistent surface of the weld itself. In an industry where the supply of skilled and experienced welders remained limited, as Robotics Tomorrow—an online robotics trade magazine—reports, an alternative to an expensive labor source may incentivize future manufacturers to follow Welbot's footsteps in innovating a viable unit for use in the field of construction.[11] Until Welbot obtains its patent, however, the industry will have to wait and further speculate as to its usefulness as a viable alternative to an experienced tradesperson.

Automated Road Repair

Perhaps no specialized field of construction has anticipated the gains of automation like road repair work, especially the patching up of surface damage and the filling of cracks and pot-holes along the nation's crumbling infrastructure. At the cusp of the digital revolution, about seven years ago, Jonathan Holmes and his colleagues at Georgia Tech Research Institute (GTRI) developed a paving robot prototype known as the Automated Road Repair System that made use of an array of LEDs underneath a moving vehicle. These sensors would hook up to computer software program that mapped out road surface damage over highways and roads as the vehicle passed over. Developed under the auspices of the Georgia DOT, this automated road repair

[9] *Id.* at 9.
[10] *See* welbot-tech.com.
[11] *See* roboticstommorrow.com.

vehicle not only mapped out the extent of the surface damage within a reported 100 milliseconds of taking the first picture, but also relayed this data to a series of 12 nozzles that would eject sealant into the cracks themselves. As of its last press release in 2012, however, the directors of this GTRI project have remained curiously silent over the project's development in general, given the lingering technical issues, the most notorious capping the system's overall efficiency at three miles per hour.[12]

While many of these eye-opening projects often fail to transition from a theoretical design phase to a ready-for-market condition, this has not stalled innovative applications in machine visualization processing technologies or adaptive robotics among those who wish to automate road repair in the twenty-first century. Most recently, team leaders at Dahir Insaat, a Turkish architecture and design company known for its futuristic design concepts, have envisioned a new kind of fully automated module to the back of a manned vehicle that would employ sophisticated AI-algorithms to "drive around cutting potholes out of the road in neat squares, vacuuming up the debris and then plugging it with a ready-made plug of exactly the right size."[13] Despite its stunning marketing appeal and the press the firm received, Dahir Insaat's innovative design is not entering an untapped market, but merely provides a titillating vision of the first fully automated machine of its kind. For over five years, pavers have instead settled for more modest technologies—the marketed "pothole killer" by U.S. manufacturer Patch Management, for instance, has provided a feasible operator-dependent alternative to Dahir Insaat's evocative design, a cost-effective solution to a large work crew that nonetheless costs up to $130,000 for a three-month contract alone as of 2014.[14]

Conclusion

While new emerging technologies certainly will transform the construction work site in the coming decades, a sense of sober realism is also in order as the surety industry tries to figure out how to incorporate the more viable technologies into their present-day business practices. During the panel discussion, the panelists will discuss their specific experiences working with the above technologies and the unique situations that arise in the context of surety claims handling.

[12] *See* PCWorld: Georgia Tech's Automated Road Repair System Fills in Pesky Cracks.
[13] *See* iconsofinfrastructure.com.
[14] Gizmodo.com (This Utility Truck Can Exterminate a Pothole Every 120 Seconds.").

SESSION 8

BEING A GOOD WINGMAN:
TENDERING "MR. OR MRS. RIGHT" TO THE BOND OBLIGEE TO COMPLETE THE PROJECT

Wayne Lambert | Cashin Spinelli & Ferretti, LLC | Avon, CT

John McDevitt | Liberty Mutual Surety | Weston, MA

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BEING A GOOD WINGMAN: TENDERING "MR. OR MRS. RIGHT" TO THE BOND OBLIGEE TO COMPLETE THE PROJECT

I INTRODUCTION

Getting out of a conversation that you had to be a part of can be tricky. Leaving early, saying the wrong thing, or not listening and responding to your partner can land you in hot water. Fortunately, for every conversation that you do not want to be a part of, there is likely someone else who will step in and handle it for you. Finding "Mr. or Mrs. Right" to replace you in the conversation is just like the Performance Bond Surety's tender option, but it comes with a number of factors to consider.

The Performance Bond Surety's tender of a contractor to the Bond Obligee for completion of a project after a Principal's default has been the subject of many papers and conference presentations in the past. The unique aspect of this paper is that this is the only completion option in the Surety's toolkit that will be discussed herein. This paper will explore the intricacies of the tender process and address those issues that have either been superficially addressed previously or not covered at all.

More than a decade ago, an Obligee's acceptance of a tendered completion contractor for completion of a defaulted project seldom occurred, particularly by the federal government. Today it seems to be the most prevalent completion option. Sureties tend to prefer the tender option, particularly if they can buy out of their performance bond obligations by tendering a check and "closing the file." Obligees are more accepting of the tender option than in years past. Even though the Surety's satisfaction of its performance bond obligations through the tender option is more prevalent today, it does not mean the process occurs smoothly in all circumstances. However, there are several actions that the Surety can take to make the transition for project completion from its defaulted Principal to a tendered completion contractor as seamless as possible.

II WHAT THE FAR SAYS ABOUT THE TENDERING PROCESS

Familiar to the federal government under 48 C.F.R (the "FAR") Subparts 49.2, 49.3 and 49.4 are terminations of contracts for convenience and for default. Not covered specifically at all in the FAR is the concept of the Surety's tender of a contractor to complete a terminated contract. However, Contracting Officers are granted wide latitude and discretion in carrying out their warranted duties.

Although the level of discretion possessed by contracting officers is not specifically defined in the termination subparts of the FAR, case law frequently cites to the wide latitude and discretion afforded to contracting officers. For instance, the United States Court of Federal Claims found in *Phoenix Management, Inc. v. United States*, 127 Fed. Cl. 358 (June 30, 2016) that contracting officers are entitled to exercise discretion upon a broad range of issues facing them in the procurement process (*citing Impresa Construzioni Geom. Comenico Garufi v. United States*, 238 F.3d 1324 (Fed. Cir. 2001) and *American Telephone & Telegraph Co. v. United*

States, 307 F.3d 1374 (Fed. Cir. 2002)). In the termination process, contracting officers are afforded considerable latitude and broad discretion in making the termination decision.[1]

The FAR does provide that "courses of action, *among others*, are available to the contracting officer in lieu of termination for default *when in the Government's interest*." [FAR 49.402-4] [Emphasis added.] Two of those courses of actions described in the FAR are:

> FAR 49.402-4(a) Permit the contactor, the surety, or the guarantor, to continue performance of the contract under a revised delivery schedule.
>
> FAR 49.402-4(b) Permit the contractor to continue performance of the contract by means of a subcontract or other business arrangement with an acceptable third party, provided the rights of the Government are adequately preserved.

Even though the above provisions apply to contracts that have not been terminated, they do highlight examples of the discretion available to the contracting officer to consider when in the Government's interest.

More specifically to the tender issue, is FAR 49.405 which states:

> If the surety does not arrange for completion of the contract, the contracting officer normally will arrange for completion of the work by awarding a new contract based on the same plans and specifications. The new contract may be the result of sealed bidding *or any other appropriate contracting method or procedure.* The contracting officer shall exercise reasonable diligence to obtain the lowest price available for completion [emphasis added].

This provision applies specifically in the situation where the surety has not arranged for completion. However, all of the above provisions can be used to try to convince a reluctant federal contracting officer that the tendering by the Surety to the Government of a completion contractor (thus, an "other appropriate contracting method or procedure") provides the Government "the lowest price available for completion" (in the tendering situation the completion contractor would be at no additional cost to the Government) and thus, this option would be "in the Government's interest" and within the sound discretion of the contracting officer.

Within the past several years, the above arguments have become increasingly unnecessary because the federal government has become much more accepting of the tendering process than it had been previously.

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[1] Securiforce International America, LLC v. United States, 125 Fed. Cl. 749, 782 (Fed. Cl. 2016). The court in *Securiforce* further stated that because of the broad discretion that is vested in the contracting officer, a contractor challenging the contracting officer's termination decision carries a high burden of proof to show that the decision was an abuse of discretion. To prove an abuse of discretion, a contractor must show that the contracting officer's decision to terminate was arbitrary and capricious. The applicable standard of proof to show an abuse of discretion is by clear and convincing evidence. *Id.* at 782-783. Clear and convincing evidence is evidence that establishes for the fact finder a very high probability that the facts asserted are true or exist. (Citing Connecticut Judicial Branch Civil Jury Instruction No. 3.2-2.)

III TYPICAL PERFORMANCE BOND PROVISIONS

Several performance bond forms explicitly provide for the tendering by a Surety of a completion contractor to the Obligee.

The 1984 version of the AIA Document 312 Performance Bond form provides the following in Section 4:

> When the Owner has satisfied the conditions of Paragraph 3, the Surety shall promptly and at the Surety's expense take one of the following actions:
>
> 4.3 Obtain bids or negotiated proposals from qualified contractors acceptable to the Owner for a contract for performance and completion of the Construction Contract, arrange for a contract to be prepared for execution by the Owner and a contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract . . .

Section 5.3 of the 2010 version of the AIA Document 312 Performance Bond contains the exact same language.

The 1970 version of the AIA Document 311 Performance Bond contains similar language to the AIA Document 312 Performance Bond:

> Obtain a bid or bids for completing the Contract in accordance with its terms and conditions, and upon determination by Surety of the lowest responsible bidder, or, if the Owner elects, upon determination by the Owner and the Surety jointly of the lowest responsible bidder, arrange for a contract between such bidder and Owner…

Case law firmly establishes the Surety's right to enforce its tender option under the AIA A311, AIA A312-1984, and AIA A312-2010 bonds. For example, in *St. Paul Fire & Marine Ins. Co. v City of Green River, Wyo.*, the Surety successfully removed itself from further performance obligations on the ground that the Obligee prohibited the surety from exercising its rights to perform or to participate in the selection of a completion contractor for a water treatment plant.[2] Additionally, in *St. Paul Fire & Marine Ins. Co. v VDE Corp.*, the court upheld the Surety's summary judgment discharging it from liability on an AIA A312 bond when the Obligee prevented the Surety from exercising its right to determine the means of completing the contract.[3] Finally, before a performance bond can even be triggered in most jurisdictions, the Obligee must comply with the conditions precedent contained in the bond, which includes allowing the Surety to complete the project itself or hire others to do so.[4]

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[2] 6 F. App'x. 828, 829 (10th Cir. 2001).
[3] 603 F.3d 119, 123-125 (1st Cir. 2010).
[4] Elm Haven Const. Ltd. P'ship v Neri Const. LLC, 376 F3d 96, 101 (2nd Cir. 2004).

The 1988 version of the Associated General Contractors of America, AGC Document NO. 606 provides the following in Section 4.2:

> OBTAIN NEW CONTRACTORS. Obtain a bid or bids formally, informally or negotiated for completing the Subcontract in accordance with its terms and conditions, and upon determination by the Surety of the lowest responsible bidder, or negotiated proposal, or, if the Obligee elects, upon determination by the Obligee and Surety jointly of the lowest responsible bidder, or negotiated proposal, arrange for a contract between such party and the Obligee. . . .

Variations of this bond form are frequently used by general contractors for the subcontractor performance bonds they require their subs to produce, however, there is typically a provision in said bonds that the subcontractor's surety must produce replacement bonds furnished by the tendered contractor.

The above bonds provide a specific option for the Surety of the defaulted and terminated principal to tender a contractor to the Obligee for completion of the project. Prevalent, however, are the defeasance or "faithful performance" type bonds that do not specifically address the tender option. Key among these bonds is the Miller Act performance bond that provides:

> The above obligation [i.e. – the obligation of being firmly bound to the Government up to the penal sum of the bond] is void if the Principal – (a)(1) Performs and fulfills all the undertaking, covenants, terms, conditions, and agreements of the contract during the original term of the contract and any extensions, thereof that are granted by the Government, with or without notice of the Surety(ies) and during the life of any guaranty required under the contract, and (2) performs and fulfills all the undertakings, covenants, terms, conditions, and agreements of any and all duly authorized modifications of the contract that hereafter are made. Notice of those modifications to the Surety(ies) are waived.

Stated differently but yet similarly are other "faithful performance" type obligations that appear in typical subcontractor performance bonds:

> NOW, THEREFORE, if the said Principal shall well and truly perform and fulfill all the undertakings, covenants, terms, conditions, warranties and all other obligations contained in or arising out of said subcontract during the original term of said subcontract including warranty periods and any extensions thereof that may be granted by the Contractor, with or without notice to the Surety, shall well and truly perform and fulfill those obligations that by their nature extend beyond the term of subcontract warranty periods and shall also well and truly perform and fulfill all the undertakings, covenants, terms, conditions, warranties and all other obligations of any and all duly authorized additions to and modifications of said subcontract that may hereafter be made, notice of which additions and modifications to the Surety being hereby waived, then this obligation to be void; otherwise to remain in full force and effect.

The Miller Act performance bond and similar defeasance type bonds do not specifically authorize the Surety to proceed in tendering a completion contractor to the Obligee. However, these bonds do not explicitly prevent or reject the tender option either. Moreover, the tender option is allowed by law in many jurisdictions, so the reader should consult case law in the appropriate jurisdiction in the event it faces a bond Obligee reluctant to accept the tender option where the language of the performance bond at issue does not explicitly authorize a tender. Furthermore, when a governmental bond Obligee is involved and the Surety sufficiently convinces it that the competitive bid process and the best interests of the government are satisfied, or at least not adversely affected, by the tendering process, there should be no aversion to the tender option.

IV TENDERING TO A GOVERNMENTAL AGENCY; ADDRESSING THE PUBLIC BIDDING REQUIREMENTS

Public bidding requirements are nearly universal on both a state and federal level. These laws require projects to be competitively bid. Competitive bidding laws are intended to eliminate favoritism, fraud and corruption in the awarding of public contracts. Other purposes for enacting competitive bidding laws are to ensure that only qualified, adequately trained contractors and their employees work on public projects.[5] Generally, a competitively bid project can only be awarded to the lowest responsible bidder who submits a responsive bid.

A responsible bidder must typically be a licensed contractor who has not been barred from government contracts for prior misconduct. In addition, a responsible bidder must have the equipment and skills necessary to perform the work in question. For a bid to be "responsive," the bid must be an unconditional offer to provide the goods and services that are being bid upon, and the bid must comply with all the bid procedures that are set forth in the requirements of the bid documents. The Surety should always keep in mind that municipalities and public agencies have considerable discretion when it comes to determining who is the lowest responsible bidder.[6]

Public bidding/competitive bidding statutes are generally the same across state lines. For example, Oregon's competitive bidding law states that generally, "all public improvement contracts shall be based upon competitive bids."[7] New York's competitive bidding law states that except as otherwise provided, "all contracts for public work involving an expenditure of more than thirty-five thousand dollars and all purchase contracts involving an expenditure of more than twenty thousand dollars, shall be awarded by the appropriate officer, board or agency of a political subdivision or of any district therein … to the lowest responsible bidder."[8] Most states have authority to grant exemptions from public bidding requirements after weighing certain factors. In Oregon, a list of factors ranging from "public benefits that may result from granting the exemption," to "whether the public improvement will require a single phase of construction work or multiple phases of construction work to address specific project conditions"

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[5] Associated Builders & Constrs. V City of Northampton, 2019 US Dist. LEXIS 70166 (E.D.P.A. April 25, 2019).
[6] Crest Constr. Corp. v Shelpby County Bd. of Educ., 612 So.2d 425 (Alabama 1992).
[7] ORS 279C.335
[8] New York State General Municipal Law §103.

are to be considered.[9] The Surety should examine the applicable jurisdiction's laws to develop an argument, if needed, for why a tender situation would be entitled to be exempt from public bidding/competitive bidding laws.

When faced with a tender scenario, the public owner may be hesitant, because the idea of accepting a tendered contractor without complying with the public bidding law would theoretically expose the owner to potential liability. In overcoming this hesitation, the Surety should note that many regulations and statutes provide the governmental body with discretion in the means of determining the method of completing the contract. Some states may also offer specific guidance on whether a body has to comply with public bidding laws in the completion of a project. Further, the Surety can suggest that the public will not be harmed by the tender process because it has already received the benefit of the publicly let contract, and the Surety is just ensuring that it gets the benefit of the bargain and puts the public in the position that it initially intended to be in.[10]

Another option, and perhaps the least complicated and strenuous option, is for the Surety to "tender" the completion of the contract to the government. In the federal context, FAR 52.249-10(a) expressly allows the government to complete the work of a terminated principal and to take possession of and use any materials on the work site necessary for completing the work. While this option exposes a Surety to any damage to the government resulting from the principal's failure to complete the work within a specified time, as well as increased costs incurred by the government in completing the work, there are benefits to choosing this option if the Surety is facing a penal sum loss. In this situation, the surety can submit a payment to the government for the legitimate and documented costs in excess of the contract balance in order to fulfil its performance bond obligations. To further limit its exposure, the Surety can try to seek from the government a cost-to-complete proposal.

V THE RE-LET PROCESS

Once the Surety has determined that tendering a completion contractor to the Obligee is a viable completion option, the Surety then embarks on its mission of identifying the best contractor to tender to the Obligee. There are several issues for the Surety to address that will enhance its prospects for as seamless a transition to a tendered completion contractor as possible.

A. The Scope of Remaining Work

Typically, the Surety does not define the scope of remaining work in its re-let bid package. Rather, the Surety usually provides as much information as possible in the bid package and any subsequent addenda to allow the bidders to determine the scope of work necessary to complete all the former contractor's obligations.

The bid package defines what the "contract documents" are. The contract documents normally include the former contractor's contract, along with its general, supplementary and

[9] ORS 279C.335(b)(A-N).

[10] Patricia H. Thompson, *Completion Options Available to a Performance Bond Surety Other Than Financing Its Principal*, 17 FORUM 1215, 1221-22 (1982).

special conditions and addenda, the plans, specifications, change orders, the prime contract and more. The definition of contract documents does not typically include the bidder's proposal. Therefore, to the extent that the bidder's proposal contradicts or tries to limit its responsibility to the Principal's scope of work it will be irrelevant if it signs the re-let bid form without articulating exceptions, clarifications and/or assumptions to the bid. That is not to say that a bidder will not claim that certain contract requirements were not included in its price, thus leaving the door open in the bidder's mind for negotiating either a higher price after bid submission or change orders after executing a completion contract. However, as long as the bid package issued by the Surety clearly required the successful bidder to complete all the work remaining in the defaulted contract and this requirement was perhaps reiterated in a draft completion contract and/or tender agreement attached as an exhibit to the bid package, the apparent low bidder should not be able to negotiate additional monies out of the Obligee or the Surety for items of work that were allegedly omitted from the bidder's completion price.

B. Ratifying Key Former Subcontractors of the Principal

A typical goal of the performing surety is to ratify the key former subcontractors and suppliers of the defaulted Principal. Not only does ratification re-affirm these vendors' commitment to completing their work and continuing their supply of materials and equipment to the project, but the ratification process re-affirms their prices and rates. Additionally, the ratification agreement re-affirms the subcontractors' obligation to provide the requisite warranties, close-out documents, training, O&M manuals and as-built drawing submissions. Although the successful completion contractor is not obligated to use these subcontractors and suppliers, it theoretically limits the costs included in their completion price for the disciplines covered by the ratified subcontractors and suppliers to the remaining subcontract and purchase order prices of these vendors. The challenge to the Surety is to ratify the former subcontractors and suppliers of the Principal in time to include the ratification agreements in the re-let Invitation to Bid. If they are not completed in time for the initial issue of the re-let bid package, they can be included in a follow up addendum to the bid package to the extent they are obtained.

C. The Warranty of the Work

A challenging aspect of the tender process is obtaining the commitment of warranties from the tendered completion contractor not only for its work but for that of the work installed during the defaulted Principal's tenure. A contractor has no difficulty warranting its own work and that of the work installed under its supervision. However, it and its completion performance bond provider typically object to warrantying the work installed by and under the supervision of the defaulted Principal. There are several ways to overcome this objection:

1. Identifying as much as possible the defects that are known in the Principal's work through punchlists, Non-Conforming Work reports, test results, meeting minutes, daily reports, QA/QC reports, Inspection Reports, and a visual site inspection. This information reduces the unknowns regarding the Principal's work and allows the Completion Contractor to include the costs of the known risks in its completion price.

2. Providing language in the re-let bid package alerting the bidders to the fact that the completion contractor is going to be required to warrant the work of the former contractor.

3. Including a copy of the Principal's contract/subcontract in the bid package so that bidders can see what the warranty requirements are.

4. Including a latent defect provision in the re-let bid package alerting the bidders to the fact that the Surety will cover the cost to fix latent defects in the Principal's work so that if a warranty call arises on work installed by the Principal that was not known to be defective, the completion contractor will be able to get additional money via a change order.

5. As an alternative to C 4 above, the Surety may, in the re-let bid package, request a breakout price from the bidders for assuming all the risk for the work in place at the time of their bid. This way, the Surety can have a clean break from the project and its tender payment to the bond Obligee will complete the Surety's performance bond obligation. This option is more preferable where little work has been performed at the time of default and there is little risk being undertaken by the completion contractor that will be reflected in their price.

D. Including a Draft Tender Agreement in the Re-let Package

The more information about the defaulted project a prospective bidder knows, the more likely the Surety can obtain a sound completion bid price with less grounds for subsequent disputes. Including a copy of the draft Tender Agreement in the bid package is another means to providing the prospective bidder with as much information as possible while the bidder is developing its price. Some sureties include the tendered contractor as a signatory to the Tender Agreement. If this is going to be the case, then it is even more advisable for a draft Tender Agreement to be included in the bid package. Not only will the bidder be able to review a copy of the Principal's contract/subcontract in the bid package, but if it has a chance to receive and review the type of Tender Agreement it is going to be asked to sign if it is the successful bidder, the chances of disputes over the terms of the Principal's contract and/or the Tender Agreement arising subsequently are greatly diminished.

E. Getting a Bid Bond in the Re-let Process

If the Surety is going to require the tendered completion contractor to provide new Performance and Payment Bonds, then requiring a bid bond in the re-let process is prudent. When a bidder submits a bid bond with its bid, it confirms its ability to get bonds. Significant time after the bid submission can be wasted in trying to confirm the bondability of a completion contractor. Getting a bid bond after the contractor received the terms of the bid package (and all of its requirements), the defaulted Principal's contract/subcontract and a draft Tender Agreement, commits the completion surety to the requirements of these documents, including the warrantying of the defaulted Principal's work.

The language in the bid bond as to who is the beneficiary of the bond matters. If the Surety is named as the beneficiary in the bid bond, then a problem arises if the Surety intends to tender the completion contractor to the Obligee and is not going to accept the completion bid itself. Usually, the Surety tenders the low responsible completion contractor to the Obligee for completion of the project. In this process, the Surety does not typically "accept" the tendered completion contractor's bid but "assigns" or "tenders" the bid to the Obligee for acceptance.

It is not unusual for the Obligee to delay in accepting the bid for several reasons. For example, the Obligee, Surety and the Tendered Contractor may try unsuccessfully to negotiate the terms of the Tender Agreement for several weeks. There may be a dispute between the Obligee and the Surety as to the remaining contract balance of the Principal and therefore, the resulting value of the Surety's Tender Payment. Despite the fact that the Principal's contract/subcontract was included in the bid package on which the contractor based its price, it may express objections to some of the terms of the contract only after it learns that it is the apparent low bidder and only then forwards the contract to its lawyer for review. The Obligee may be a municipal body that must vote on acceptance of the completion contractor at its next regularly scheduled board or commission meeting. If the prospective completion contractors were not vetted by the Surety with the Obligee before bid submission, the Obligee may object to the selected tendered contractor; if the proposed tendered contractor has not been "pre-approved" by the Obligee, then the contractor will have to go through the approval process. All of the above events and more can and frequently do delay the tender process. As a result, if the prospective completion contractor's bid arguably expires before it is accepted by the Obligee, then it may claim that it is entitled to submit a new price (particularly after it has become aware of the second low bidder's price).

To avoid the above pitfalls, the Surety can propose its own version of the bid bond in the re-let package instead of leaving it up to bidders' sureties to provide a form that may not be acceptable to the Surety. For instance, a typical bid bond form may refer to bids remaining "open" for 60 days or some other period that may be less than the requirements in the bid package. Even though the Surety may dictate how the beneficiary in the Bid Bond is to be described, the bidders' sureties may use their own language. One method in addressing the above pitfalls is to require in the bid package or in the draft bid bond proposed by the Surety in the bid package the following language for the description of the beneficiary of the Bid Bond:

> Each bidder shall accompany each bid with a "forfeiture" Bid Bond equal to ___ percent (XX%) of the base bid as a liquidated amount, secured by a surety company acceptable to both the Surety and the Obligee, and authorized to do business in the State (or Commonwealth) of _______, naming the Surety and the Obligee as dual obligees (Surety as recipient of the bid and the Obligee as intended assignee), and conditioned upon: (a) the bidder entering into the Completion Contract in accordance with the bid; and (b) furnishing the required Performance Bond and Payment Bond to the satisfaction of Surety and/or the Obligee . If the bidder fails to execute and deliver a Completion Contract and furnish the required Performance Bond and Payment Bond, Surety and/or the

Obligee shall have the option of annulling the bid, resulting in the forfeiture of the Bid Bond.

The more a Surety involves itself in the tender process, the more likely it can be held responsible if things go wrong. If a Surety accepts a bid and then unsuccessfully tries to tender it to the Obligee, the Surety may find itself ultimately serving as a takeover and completing Surety, rather than tendering a completion contractor to the Obligee as it had set out to do.

F. Evaluating Purported Mistakes in the Bid

It is not uncommon after the bids are received and reviewed, a bidder claims that it made a mistake in its bid, such as failing to include a discreet portion of the work, failing to include its mark-up, making a mathematical or clerical mistake and several other claims. In some states, for a mistake to justify a rescission of a bid, (1) the mistake must be of such a consequence that to enforce the contract as actually made would be unconscionable; (2) the matter as to which the mistake was made must relate to the material feature of the contract; (3) the mistake must have occurred notwithstanding the exercise of reasonable care by the party making the mistake; and (4) it must be able to get relief by way of rescission without serious prejudice to the other party, except for loss of his bargain.[11] In others, a party who makes an honest and unintentional mistake can, in the interest of equity, be relieved from his contractual obligations.[12]

In the federal context, a contractor can establish a unilateral mistake that rescinds its contract when it shows, by clear and convincing evidence, that (1) a mistake in fact occurred prior to contract award; (2) the mistake was a clear-cut, clerical or mathematical error or a misreading of the specifications and not a judgmental error; (3) prior to award the Government knew, or should have known, that a mistake had been made and, therefore, should have requested bid verification; (4) the Government did not request bid verification or its request for bid verification was inadequate; and (5); proof of the intended bid is established."[13] A true mathematical or clerical error in a bid should be apparent on the face of the bid form itself and correctible. FAR Part 47.407 addresses mistakes in the bid before and after the award. A clerical error apparent on the face of the bid itself can be corrected by the bid reviewer after getting verification of the mistake from the bidder. Examples of such mistakes are obvious misplacements of a decimal, errors in the extension prices of unit prices and quantities, and applying incorrect discounts

Most frequently, the claims arise from assertions that the bidder's price did not include aspects of the contract requirements contained in defaulted Principal's contract, such as a warranty of the Principal's work, completed operations or umbrella insurance coverages, or specialty equipment, such as a heavy hoist or crane. The more detailed information the Surety includes in its re-let bid package the more likely the Surety is to be able to reject the latter claims.

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[11] Brick Twp. Bd. of Educ. v Wallace Bros., 2006 NJ Super. Unpub. LEXIS 2892 (2006).
[12] Balaban-Gordon Co v Brighton Sewer Dist., 67 Misc. 2d 76 (Sup Ct Monroe Cty, 1971); E. Porter County Sch. Corp. v Gough, Inc., 965 N.E.2d 684 (Indiana 2012).
[13] Info. Int'l Assoc. v United States, 74 Fed. Cl. 192 (2006).

The Surety's evaluation of bids is not as regimented as the federal and state competitive bidding requirements because it is a private bidding process. Additionally, the Surety's bid package typically includes language alerting the bidders to the fact that the Surety may reject any and all bids for any reason. On the other hand, there is most often pressure on the Surety to end the bidding process quickly and arrange for a completion contractor to re-commence the project work as quickly as possible. The Surety, which does not wish to spend a great deal of time addressing alleged mistakes in bids, has to decide whether to reject an otherwise favorable bid, make a claim on the bidder's bid bond surety if it is convinced that the alleged mistake is contrived or has no merit, or try to negotiate a resolution that is hopefully fair to both parties.

G. Latent Defect Issues

Because "time is money," the Surety tries to successfully navigate through the re-let process as quickly as possible while allowing sufficient time for prospective bidders to study and evaluate the project's plans and specifications, visit and become familiar with the project site and develop a responsive bid. The more unknowns that exist on the project, the more a bidder could be dissuaded to participate in the bid, assume unknown risks with escalated prices or specifically exclude the risks from their bid. Therefore, the more information the Surety can provide in its bid package regarding known or suspected defects in the Principal's work, the better the prospective bidder can price the cost to fix defective or nonconforming work. Including meeting minutes, Non-Conforming Work reports, Daily Reports, QA/QC reports, test and other inspection reports, punch lists, and other documents in the bid package helps achieve this end. Additionally, the Surety may want to highlight specific "Special Considerations" of which it has become aware during its investigation in a separate section of its bid package.

Despite its best efforts, the Surety and the Owner will likely not be able to identify all prospective defects in the Principal's work. Consequently, the Surety will either choose to seek a "buy-out" price from the prospective bidders to cover the cost of completing all the work, including latent defect work, or identifying a mechanism whereby the Surety's performance bond will remain in force during project completion to provide additional funds to the Completion Contractor to address latent defect issues that are uncovered during completion. In the former case, the Surety could request a breakout price in its bid form for the cost the bidders want for assuming the risk of remedying any latent defect work. This way the Surety can decide whether it wants to pay the increased cost up front to buy out of any further financial responsibility under its performance bond. In the latter case, the Surety's performance bond will remain open even after it tenders the completion contractor to the Obligee.

In the takeover process, the Surety will address latent defect issues directly with its completion contractor as issues arise during completion. In the tender scenario, the Surety will either deal only with the Obligee as to change order costs for latent defect work or directly with the completion contractor. In either case, the Surety requests that it be notified in writing by the completion contractor or the Obligee when latent defect issues arise so that it can evaluate the problem. However, problems can and do arise regardless of which option the Surety chooses.

If the Surety keeps its performance bond open in the Tender Agreement with the Obligee to cover latent defect issues, then the completion contractor's price proposal to address latent defect issues runs to the Obligee. Because the Surety is not in contractual privity with completion contractor, the Surety's must pay the Obligee the costs of the change order. Problems typically arise with regard to the negotiation of the change order price. Since the Obligee is getting reimbursed from the Surety for the change order, it is not necessarily as motivated to negotiate the price to fix defective work with the completion contractor as it would have been were it to be financially responsible for the change. The completion contractor may not be willing to negotiate its price with the Surety because it has no contract with the Surety. Unless the three parties meet to resolve the issue, it can remain open and thus risk affecting the completion schedule. If not resolved during construction, it will certainly be a matter that the Obligee and Surety will have to address later after the work is done and the completion contractor has demobilized from the site. Then, the Obligee's position is likely to be that the Surety owes it the price it paid to the completion contractor and is not now open for negotiation.

Alternatively, the Surety could enter into a "side agreement" with the completion contractor to address latent defect issues directly between the two parties without involving the Obligee. This option facilitates the direct negotiation of change order pricing between the Surety and the completion contractor. The downside is that if the parties cannot agree on whether the issue at hand truly involves a latent defect or if they cannot agree on a price to remedy the defect, the completion contractor may refuse to perform the work and the Obligee has no remedy against the Surety if the Surety was released in the Tender Agreement. This issue can devolve into a contract action by the completion contractor against the Surety under the "side agreement" but not a claim under the Surety's performance bond because the Surety would have been released by the Obligee in the Tender Agreement and not a claim under the Surety's payment bond because the completion contractor would not have furnished labor or material to the bonded Principal or to a subcontractor to the bonded Principal.

H. Getting the Completion Contractor on Board

After receipt and evaluation of the bids, the Surety identifies the apparent successful bidder in light of the selection criteria described in the re-let package and informs the bidder that it is the contractor that the Surety intends to "tender" to the Obligee. It is uncanny how often it happens that it is at this point that the bidder refers the defaulted Principal's contract to its outside counsel for review and comment for the first time. Or, this referral may occur for the first time when the Obligee forwards its contract (that the Principal had previously signed and which was incorporated as an exhibit in the Surety's bid package) to the completion contractor. It is at this time that the apparent low bidder starts trying to re-negotiate the terms of the former contractor's contract, wholly ignoring the fact that it just furnished a bid to complete all the terms of said contract. As long as the proposed revisions to the contract suggested by the completion contractor and its outside counsel are reasonable, the Obligee seldom takes issue with these requests. However, if one or more of the completion contractor's proposed changes are found by the Obligee to be unacceptable, it will likely reject the changes. The Surety will then be at risk to claims from the Obligee that it failed to tender an acceptable or responsive

Completion Contractor. Consequently, the Surety may have to involve itself in negotiating completion terms acceptable to both the Obligee and the Completion Contractor or rejecting the completion contractor's proposed changes that were not reserved as exceptions in its bid proposal and making a demand on the Completion Contractor's bid bond surety.

Issues may also arise if the Completion Contractor fails to provide the requisite project insurances dictated by the terms of the original contract, including discrepancies in the Certificate of Insurance or failure to provide the proper Additional Insured endorsements, including naming the proper parties as Additional Insureds.[14] Additional Insured endorsements require that a written contract identify the names of the parties to be named as Additional Insureds be identified in a written contract. Therefore, identifying the names of the parties to be named as Additional Insureds in the Surety's bid package, the Tender Agreement and the Completion Contract are key.

The schedule of the completion work is very important, as well. Typically, the Surety either dictates the completion schedule in the bid package (if there is no flexibility in the contract documents) or requests that the completion contractor include a schedule duration in its bid submission (such as completion within 180 or 365 days from receipt of a Notice to Proceed). The Surety also usually requires in the bid package that the completion bids remain open for 60, 90, 120 days or longer. If the completion contractor delays for any reason in signing the completion contract with the Obligee (due to its own fault, the fault of the Obligee or to no fault of either), it may claim that it can no longer satisfy the Obligee's completion schedule. If this issue arises, then the Surety is again at risk to claims from the Obligee that it failed to tender an acceptable or responsive completion contractor. Therefore, the Surety may have to stay involved in the tender process even after tendering a contractor to the Obligee for completion until the completion contract between the tendered contractor and the Obligee is consummated.

I. Sales Tax Issues

One has often heard the refrain that "nothing is certain in life but death and taxes." However, depending on the jurisdiction and the type of project, some contractors can remove themselves from having to pay sales taxes. Many states will exempt contractors (including subcontractors) from paying sales and use taxes on building materials they purchase for projects being performed under contract with state agencies, the federal government, municipalities, nonprofit hospitals, and other nonprofit organizations. For example, New York State Tax Law §1105 states that there is a four percent tax on installing property, except for installing property, which when installed, "will constitute an addition or capital improvement to real property …"[15]

To be entitled to this privilege, most states require a tax-exempt certificate (in New York, one would get a "Certificate of Capital Improvement"). Getting a certificate sometimes requires compliance with a phalanx of regulations, which has been identified as being a "trap for the

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[14] For a more in-depth discussion of the Surety and additional insured issues, the reader is invited to refer to Wayne D. Lambert and Christopher R. Morkan, *The Surety and the Additional Insured Status* (unpublished paper submitted at the National Bond Claims Conference on October 11, 2018 at Pinehurst, NC).

[15] *See also*, Saf-Tee Plumbing Corp. v Tully, 77 AD2d 1 (3rd Dept 1980) (holding that receipts from the sale of tangible personal property used in making capital improvements are exempt from the imposition of sales tax).

unwary." While the legal tests to determine whether a project is subject to a sales-tax exemption could be the subject of its own paper, suffice it here to say that if a potentially-exempt project involves new construction, additions to existing structures, the installation of air conditioning, replacement of hot water boilers, or the performance of anything else that will become a permanent installation, then the chances of the project being exempt from sales taxes increases.

48 CFR § 29.305 lists what is required to establish exemption from state and local taxes. Such evidence may include a copy of the contract, purchase orders, US Tax Exemption Form SF 1094, any state forms indicating that the supplies or services are for the exclusive use of the United States, and/or any other state or local required document for establishing an exemption.

If the defaulting contractor had a tax-exempt certificate for the project, then it should be easy to negotiate with the Obligee for the project to keep its tax-exempt status. The Surety should try to get any certificate ahead of time before the re-let package is released. The Surety should also communicate any tax-exempt status and provide any tax-exempt certificate to bidders in the re-let package. Any Completion Contract should include language mandating the Completion Contractor to comply with all local, state, and federal tax laws. Further, the Surety can and should argue, if it does receive a sales tax-exempt certificate in good faith, that it is entitled to rely on that as evidence of a project's tax-exempt status.[16]

The only issue that a Completion Contractor may face is that its scope of work on the project does not trigger the applicable legal test to make it tax-exempt. If the work is not necessitated by the Project (i.e. repair work to masonry to ensure that a new glass façade is attached to a structurally sound building), then the chances of it being subject to sales tax are greater.

J. Satisfying Minority/Disadvantaged/Service-Disabled Contractor Requirements

Nearly all states, the Federal Government[17], and even cities[18] have specific laws requiring the use of a certain percentage of Minority/Disadvantaged/Women/Service Disabled contractors on public contracts. Laws related to disadvantaged business entities (or "DBE Laws"). Legislators enact DBE laws to remedy apparent discrimination in the construction industry. The United States Supreme Court has consistently recognized the power of state and local legislators to "eradicate the effects of private discrimination within its own legislative jurisdiction."[19] However, such laws must be reasonable in the context of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment.[20]

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[16] In New York, if a contractor accepts in good faith a Capital Improvement Certificate from a customer, any subcontractor that receives a copy of the certificate may rely on the general contractor's good faith acceptance of the certificate from its customer and is not obligated to collect sales tax from the general contractor. ADVISORY OPINION – PETITION NO. S120307A, 2013 N.Y. Tax LEXIS 94.

[17] 49 CFR Part 26

[18] Tucson, Arizona Code of Ordinances Sec. 28-150

[19] Richmond v J.A. Cronson Co., 488 US 469 (1989)

[20] Concrete Works of Colo. v. City & County of Denver, 321 F.3d 950 (10th Cir. 2003); Associated Gen. Const., Inc. v Coalition for Economic Equity, 950 F.2d 1404 (9th Cir. 1991).

The goal in the application of the DBE Laws is to promote wider participation of minority or disadvantaged business entities in the construction of public projects. Legislators use DBE Laws as a way to give DBEs their "fair share" of participation in state contracts. To achieve this goal, many states require a contractor to submit, with any bid, proposal, or proposed negotiated contract, a "Utilization Plan" which contains a detailed description of the supplies and/or services to be provided by each DBE.[21]

In order for a DBE to count towards a contractor's participation goal, the DBE has to perform a "commercially useful function," which means that it has to (a) execute a distinct element of the work of a contract; (b) carry out its responsibilities by actually performing, managing, and supervising the work involved; and (c) furnish all supervision, labor, tools, equipment, materials, and supplies necessary to perform that distinct element of the contract work. A DBE does not perform a "commercially useful function" if its role is limited to that of an extra participant in a contract through which funds are merely passed.

The burden of ensuring compliance with the DBE Laws ultimately falls on the contractor and/or the DBE itself. Federal, State, and local agencies have taken aggressive steps to ensure compliance with the DBE Laws. A contractor that fails to comply with the DBE Laws can be subject to fines, civil lawsuits, and possibly even criminal prosecution.[22]

The Surety can take steps to address and/or satisfy the DBE Laws by: (1) including a request for DBE Law compliance information in the re-let bid package and; (2) including language in the Completion Contract where the Completion Contractor confirms its compliance with the applicable DBE Laws. Alternatively, the Surety can check first with the Obligee to verify whether or not the Surety or the Completion Contactor will need to continue to achieve the DBE goals set forth in the original contract. Most often, the Surety finds that achievement of the original DBE goals is not a requirement when completing a defaulted project.

VI CONCLUSION

The opportunities for a Performance Bond Surety to tender a Completion Contractor to a Bond Obligee for completion of a defaulted project have become more frequent in recent years as more Bond Obligees, particularly public entities, have become increasingly accepting of this completion option. Thus, the challenge facing the Surety more often these days is not trying to convince a recalcitrant Obligee to accept a tendered completion contractor, it is trying to tender a completion contractor to the Obligee as seamlessly and as timely as possible. The techniques, thoughts and ideas highlighted in this paper are offered with the intent of minimizing disputes that tend to inordinately delay the consummation of the tender process.

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[21] Article 15-A of the New York State Executive Law.

[22] https://www.democratandchronicle.com/story/news/2016/10/13/schneiderman-rcsd-modernization-fraud-minority-women/92011072/ (five contractors get assessed $825,000 in fines); *United States v. Tulio*, 263 Fed. Appx. 258 (3rd Cir 2008) (convictions upheld against Tulio Landscaping, Inc. and the company's owner, Michael Tulio, who were found guilty of mail fraud and conspiracy to commit mail fraud. Michael Tulio was sentenced to 15 months in prison with 24 months of probation and was fined $40,000).

SESSION 9

FINANCING THE PRINCIPAL - PROTECTING THE SURETY

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FINANCING THE PRINCIPAL - PROTECTING THE SURETY

INTRODUCTION

Upon a principal's default (or upon a principal's request) a surety can consider financing its principal. Financing a principal may be a treacherous journey on a bumpy road through very rough terrain. The principal's assurances and promises may be worthless, the principal's key employees may jump ship, the surety's money may be misappropriated, and the surety may still be stuck ponying up the penal sum of the bond. Despite all of these possible obstacles, financing the surety may still be the cheapest way for a surety to have a bonded contract completed in some circumstances; so financing the principal remains an option worth considering. The purpose of this presentation is to provide an overview of the financing option and to discuss how best to protect the surety - - and minimize its losses - -if financing is chosen.

OPTIONS AVAILABLE TO THE SURETY UPON DEFAULT

When a principal allegedly defaults on a project and the obligee turns to the surety and demands performance, the surety, in turn, will conduct an investigation to determine the appropriate method in which to respond. The surety has various options. First, the surety can deny the claim altogether. However, if the surety decides to acknowledge the propriety of the default, it has various options to consider – including: (1) a takeover of the project and completing the work; (2) tendering a new contractor to complete the work; (3) "buying out" the obligation; or (4) financing the principal to complete the work.[1]

FINANCING THE PRINCIPAL

Financing occurs when the surety provides direct or indirect financial assistance to the principal in an attempt to ensure that the obligations secured by the performance bond will be completed by the principal.[2] A surety may choose to finance the principal when it discovers that the principal experiences financial difficulties which halts or inhibits the project. Funds provided to the principal will pay any bills on behalf of the principal as they become due. As the surety has no obligation to finance the principal, the surety must conduct a thorough investigation to determine that financing the surety is the best option for the project and the most risk averse to itself. Financing the surety may be a viable option under the following circumstances: (1) the majority of the work has been completed; (2) the obligee has made no complaints regarding the principal's work; and (3) the surety believes that the default resulted

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[1] See Burgett, Melroy, Sexton, and Timpane, "Performance Options Available to the Surety," *The Law of Performance Bonds*, Third Edition 73 (2018).

[2] George Bachrach, "Financing the Principal," *Bond Default Manual*, Second Ed. 120 (1995).

solely from temporary cash flow problems.[3] As one of several options available to the surety, financing the principal has its advantages as well as disadvantages.

ADVANTAGES OF FINANCING THE PRINCIPAL

One advantage of financing the principal is the lower expected impact to the project timeline for completion when compared to other surety performance options.[4] Because the principal has expansive knowledge regarding the project and all involved parties, it may be the best decision to allow the principal to continue the work. Financing the principal may be the most time-efficient option to achieve completion of the project. Additionally, with financing the principal, pivotal subcontracts or supplier agreements need not be renegotiated -- which would inevitably prolong the completion of the project.[5] Financing the principal may also be a cheaper alternative as opposed to hiring a new contractor, who will likely hire its own subcontractors and suppliers. Moreover, a new contractor would need additional time to familiarize itself with the project plans and specifications, which would also prolong completion and increase project costs.[6] Finally, financing the principal gives the surety potential leverage to seek collateral or an increased amount of collateral against potential losses.[7] There are various cases in which the surety financed the principal and successfully recouped its funds.[8]

DISADVANTAGES OF FINANCING THE PRINCIPAL

Although financing the principal may yield positive results, there are disadvantages to this option as well. One disadvantage is that the funds provided to the principal may not count as a payment against the penal sum of the bond. As a result, the payments will not decrease the penal sum.[9] Another disadvantage to this option is the surety's inability to predict or affix the amount of its loss when financing the principal.[10] Because the surety cannot know the final

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3 § 12:79. Performance bond surety's options upon triggering of its bond obligation - - financing the principal, 4A Bruner & O'Connor Construction Law § 12:79.

4 *The Law of Performance Bonds*, at 88.

5 *Id*.

6 *Id*.

7 *Id*.

8 See *Aetna Cas. & Sur. Co. v. United States*, 845 F.2d. 971 (Fed. Cir. 1988) (surety was entitled to recover from retained funds amount it expended in completing contract pursuant to its performance bond, free from setoff for taxes owed by contractor); *Morrison Assur. Co. v. United States*, 3 Cl. Ct. 626 (1983) (surety recovered final contract payment after financing principal on Miller Act bond).

9 *The Law of Performance Bonds*. at 89. As a practical note, the surety should include a stipulation within the Financing Agreement that states any funds provided to the principal will count as performance bond expenditures which will in fact decrease the penal sum.

10 *Id*.

amount of its loss until the contract is complete, the surety must bear the costs associated with unexpected events such as bad weather, unreliable subcontractors, or late deliveries.[11] Finally, the surety retains the responsibility to fund all monthly payments that the principal would otherwise pay. Such expenses include payments to subcontractors, suppliers, the principal's payroll, home office overhead, and insurance costs.[12] Also, subsequent enlargements of the scope of the work and/or work remedying deficient work performed by the principal or its subcontractors could also increase the surety's exposure. There are various cases in which the surety chose to finance the principal but could not recover under the circumstances.[13]

CONSIDERATIONS BEFORE FINANCING THE PRINCIPAL

Financing the principal can be a risky endeavor for a surety. Thus, the surety should contemplate the different advantages and disadvantages of financing before making the final decision to finance. Furthermore, many specific considerations regarding the particular principal and its relationship with other parties may serve to either confirm the advantages or exacerbate the disadvantages of financing in any particular case. Thus, the surety should conduct a thorough investigation of these matters before making the final decision to finance the principal. The five main considerations are: (1) the principal's available cash; (2) willingness to provide collateral; (3) capacity to perform the work; (4) character of the principal; and (5) the scope of financing.

1. Available Cash of the Principal

When a surety is considering financing the principal, the principal obviously does not have enough cash available to pay all of the workers on the bonded projects and continue the work. However, the surety should conduct a thorough investigation of how much cash the principal actually has, how much it needs to stay current on the bonded contract bills, how much cash the principal will need in the near future, and any other sources of cash that the principal may have. These other sources of cash may include lines of credit on which to draw, receivables from non-bonded contracts, or any property the principal may have that can be sold for additional cash.[14] Additionally, in some circumstances the principal may have access to cash though a third party who is not an indemnitor, but has an interest in the principal remaining a viable ongoing entity.

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[11] *Id.*

[12] *Id.*

[13] *Travelers Cas. & Sur. Co. of Am. v. Baltimore Contractors*, LLC, No. CIV.A. WMN-08-2901, 2011 WL 1298005, at *8 (D. Md. Mar. 31, 2011) (reasoning that although surety financed principal, it showed no evidence that funds provided were reasonable and general agreement of indemnity failed to establish scope of indemnitors' liability).

[14] *Bond Default Manual*, at 122.

2. Will the Principal Provide Collateral?

The assets, and thus the potential collateral security of the principal, are an important consideration for a surety who is contemplating financing. This consideration is such a large factor because the collateral security may reduce or eliminate the surety's potential loss. If the surety takes collateral security, it "may not have to initiate an indemnity or exoneration action against the principal and the indemnitors."[15] This is important because it "avoids an immediate adversarial situation with the principal and the indemnitors, saving the surety time, costs, and energy, and allowing the surety to focus on resolving its performance bond obligations."[16] Therefore, the surety should investigate all of the relevant information concerning the assets of the principal before committing to financing. This may include the value and current lien status of the assets, such as whether there are consensual liens, judgment liens, or tax liens on any of them. For assets that are not titled, the surety should consider a physical inspection of the assets, preparation of an inventory, and periodically monitoring such assets. If these assets dissipate in value or "disappear" during the course of the financing, the surety may find itself financially exposed.

However, a thorough investigation of the specific details of these assets is only half the battle, for the surety must then discern how willing the principal and indemnitors are to pledge these assets. The principal and indemnitors may understandably be hesitant to pledge their personal property as collateral. Yet, the honesty with which the principal and indemnitors disclose the details of the assets and their willingness to pledge them will provide the surety with insight as to whether a financing agreement with them is likely to succeed. "If the principal and indemnitors begin to pick and choose the assets it will pledge, this is often a clear indication that financing very well may not be the best choice."[17]

3. Capacity of the Principal to Perform Work

The surety should only consider financing the principal if it is reasonably certain that the principal has the ability to complete the work once it is given the sufficient funds. Otherwise, the hoped-for advantages of financing disappear.

The surety should examine whether the principal has the necessary manpower, technical ability, construction expertise, and home office expertise to perform the work. The surety should also know that the principal has sufficient accounting and record-keeping expertise available to it so that the progress on the bonded contract work can be measured and

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[15] *Id*. at 125.

[16] *Id*.

[17] Ward, Pemberton, and Carson, *The Financing Trinity: 3 Key Considerations When Structuring a Financing Agreement to Avoid Losses* at 10 (2018).

computed.[18] In addition to these technical ability considerations, the surety should also analyze the principal's managerial and supervisory ability so that the project can continue in an organized fashion. Particularly relevant to this ability is the state of the principal's relationships with its subcontractors, its suppliers, and the obligees. These relationships should be in good shape to ensure a smooth management and timely performance of the work after financing. Finally, the surety may want to examine the principal's record of closing out projects in the past. If the principal has a history of failing to substantially complete these types of projects, this may indicate a higher risk of loss for the surety. In such cases, the retention of a construction consultant maybe considered.

4. Character of the Principal and Indemnitors

The most self-explanatory consideration in financing a principal may in fact be the most critical to the surety. Before entering into a financing arrangement, the surety must be comfortable that the principal and the indemnitors are honest, trustworthy, of good character, and committed to completing the bonded project. Again, examination of the principal's relationships with its subcontractors, suppliers, and the obligees may be important for this consideration. It is elementary that a surety should cease its consideration of financing if the principal does not possess the honesty, integrity, and trustworthiness necessary to ensure a successful financing agreement. A review into past projects where the principal received financing may also be beneficial to determine the character of the principal and indemnitors.

5. Scope of Financing

Of course, the exact scope of financing will be explicitly carved out and governed by the financing agreement executed between the parties. However, before the surety decides to finance the principal, the surety may consider the possible variations in this scope. If one of the above considerations weighs against financing the principal, the surety has the option of modifying the agreement, through the use of carve-outs in the scope of financing, etc., that may assuage some of those concerns.[19]

METHODS OF FINANCING THE PRINCIPAL

Once a surety makes the decision to finance the principal, the surety must then decide how it will do so. There are several methods of financing the principal, either directly or indirectly. In any case, it is crucial that an adequate joint control trust account for the collection and disbursement of the contract funds from the bonded projects be created between the surety and the principal. This way the surety can directly make sure that the bonded

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[18] *Bond Default Manual*, at 123.

[19] Ward, Pemberton, and Carson, *The Financing Trinity: 3 Key Considerations When Structuring a Financing Agreement to Avoid Losses* at 1 (2018).

contract funds received in the future will be used solely to pay bills on the bonded projects and to complete the work.[20] The four main methods of financing a principal are: (1) advancing or lending money to the principal; (2) guaranteeing a bank loan; (3) "back door financing;" and (4) providing additional bonds to the principal.

1. Advancing or Lending Money to the Principal

The most obvious and direct method of financing is advancing or lending money directly to the principal. "Look-see" financing is a common type of direct lending in which a surety immediately pays the principal's payroll and certain subcontractors or suppliers to keep the project moving for a short time while the surety contemplates its course of action.[21] This type of short-term financing is also referred to as "interim" financing.[22] This financing can be in the form of direct payments to the principal or in the establishment of a third party escrow account. The former approach requires the surety to have some degree of faith in the principal's ability to perform and trustworthiness. The latter approach provide some controls and oversight on the use of advanced funds insuring the surety's "kook-see" funds are used for the purposes intended.

2. Guaranteed Bank Loan

In one of the more indirect methods, the surety may decide to guarantee a bank loan for the principal. Normally, a surety should only be willing to do this if it is confident that the principal will eventually be able to pay off the loan. However, there are a few situations where it may be advisable for the surety to guarantee a bank loan and incur the interest and financing charges regardless of such confidence. One is where the contractor is broke but has some assets and is committed to completing the work. In this situation, the surety can have the principal pledge its assets to the bank as collateral security in order for the surety to guarantee the bank loan. The second situation is where federal contracts are involved. This is because the federal government does not recognize assignments to sureties, but it does recognize assignments to financial institutions.[23]

3. "Back Door Financing"

Another indirect method is so-called "back door financing," where the surety pays certain bills on the bonded contracts in order to keep payments current to the subcontractors

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[20] *Bon Default Manual*, at 129.

[21] Thomas A. Joyce & William F. Haug, *Financing the Contractor*, in *Bond Default Manual* note 1 at 22 (Richard S. Wisner ed., 1987).

[22] *The Law of Performance Bonds*, at 91.

[23] Joyce & Haug, *Financing the Contractor*, note 1 at 31.

and suppliers. The advantages of this method are that the subcontractors and suppliers are less likely to delay progress on the project if they are being timely paid, and the principal can then use the bonded contract funds to pay their bills in the future and complete the work. However, one disadvantage of this method is that the principal may become less willing to provide collateral security to the surety in the future if he is kept current and "healthy" by this financing.[24]

4. Additional Bonds

Yet another indirect method of financing is where the surety provides additional bonding credit to the principal. The idea here is that the additional work and contract funds may cure the principal's inability to pay its subcontractors and suppliers over time. However, the delay between the bid, the award, and the payment of the first requisition on the new bonded contracts may be too great to timely solve the initial problem of the principal's lack of cash.

Another disadvantage of this method is that the new work may cause progress on the initial project to be delayed further. The surety may also be doubling down on disaster through this method, as the additional projects may not be profitable, thus increasing the number of bonded projects in default and increasing the surety's total loss.

5. Issues Involving the Bankrupt Principal

If the surety wishes to finance the principal during a Chapter 11 bankruptcy proceeding, the Bankruptcy Court must approve the surety to do so after a hearing and notice to all creditors.[25] The Bankruptcy Court will decide either to adopt a prior financing agreement or require that the surety and the principal enter into a new one. In either case, the surety should avail itself of certain key rights regarding bankruptcy pursuant to the agreement.

First, the surety should not agree to finance the principal with its advances amounting to merely an administrative expense under section 364(b) of the Bankruptcy Code.[26] Instead, the Code provides several alternatives for protection of the surety beyond an administrative expense, such as a super-priority administrative expense, liens on the property of the principal's estate that are not otherwise subject to a lien, rights secured by a junior lien on property of the estate that is subject to a lien, and more.[27]

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24 *Bond Default Manual*, at 131.

25 11 U.S.C. § 364(b).

26 *Bond Default Manual*, at 157.

27 11 U.S.C. §§ 364(c) and (d).

The surety must also obtain all rights to the funds of the bonded contract under Section 363 of the Bankruptcy Code in the financing agreement. This section states that the principal/debtor may not use "cash collateral" unless: "(A) each entity that has an interest in such cash collateral consents; or (B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section."[28] The rights of a surety to bonded contract funds have been recognized by some as "cash collateral" under Section 363.[29]

The foregoing is merely a snapshot of the various rights a surety should obtain before financing a principal during Chapter 11 Bankruptcy proceedings. The ultimate goal of the surety is to mitigate its losses by obtaining such key rights that will place the surety in the same position of financing as if the principal had never filed the Chapter 11 bankruptcy proceeding.[30]

THE FINANCING AGREEMENT

Although the surety must weigh the advantages and disadvantages of financing the principal along with the various considerations involving financing, the surety has one more task to complete to protect itself. Once a surety decides to finance its principal, it should draft a separate financing agreement that fully outlines the expectations, rights, and obligations of all parties. Generally, the agreement should contain recitals; reaffirm the indemnity obligations of the principal and indemnitors; provide collateral security in exchange for financing the principal; provide a termination clause; and establish a bank account for the receipt and collection of bonded contract funds, funds advanced by the surety, and for payment of bills.[31]

Recitals establish the basic understandings and relationship between the principal, surety, and indemnitors. Additionally, the recitals should outline the facts that support the surety's decision to finance the principal. Below is an example of recitals to a financing agreement:

a) A description of the existing agreement(s) of indemnity, with copies attached;

b) An attached list of the relevant contracts and the bonds executed by the surety on behalf of the principal for those contracts;

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28 11 U.S.C. § 363(c)(2).

29 *Bond Default Manual*, at 158.

30 *Id*. at 161.

31 *Bond Default Manual*, at 143.

c) An acknowledgment that the bonds executed by the surety were induced by and provided in reliance upon the execution of the agreement of indemnity by the principal and the indemnitors, who should acknowledge and reaffirm their joint and several obligations and liabilities to the surety under the agreement of indemnity;

d) A "WHEREAS" clause stating that the contracts are in various stages of completion, and the principal and the indemnitors hereby acknowledge and admit that: (a) the principal is financially unable to perform or complete the performance of the contracts; (b) certain subcontractors and suppliers of labor and/or materials with respect to the contracts and projects have not been paid; (c) the principal has requested the financial assistance of the surety as a result of (a) and (b) above; and (d) but for the willingness of the surety to enter into the Agreement, the principal is unable to complete the performance of the contracts and pay its subcontractors and suppliers of labor and/or materials with respect to the contracts and projects; and

e) An acknowledgement that the agreement is a financial accommodation extended by the surety to the principal and the indemnitors.[32]

The financing agreement should also clearly state the indemnity rights and obligations of the parties. This is particularly important to the surety, as it will provide an additional layer of protection in case the principal defaults on its obligations under the agreement. The following is an example of indemnity provisions within a financing agreement:

a) The Principal and the Indemnitors hereby acknowledge their execution of the Agreement of Indemnity and reaffirm their joint and several obligations and liabilities to the Surety thereunder.

b) Nothing contained in this Agreement and done pursuant hereto shall in any way impair, alter or modify any and/or all of the rights and remedies of the Surety against the Principal and/or the Indemnitors under or in connection with the Agreement of Indemnity.

c) In the event that the Surety makes any payments under the Bonds, or in accordance with the terms of this Agreement or the Agreement of Indemnity, interest shall run at the rate of __% per annum on the

[32] Practical Guide to Construction Contract Surety Claims; Form F:13-14 Joint Control Trust Account Agreement between Surety, Indemnitors, and Contractor (with exhibits), PGCCS App F, Form 13-14.

amounts paid by the Surety, compounded monthly from the date of each payment by the Surety. Any reimbursements made by the Principal or the Indemnitors to the Surety shall be first applied to any and all expenses incurred by the Surety as provided in the Agreement of Indemnity, then to interest which has accrued on the payments made or losses incurred by the Surety, and then to the principal amounts of the payments or losses.

d) To secure the obligations of the Principal and the Indemnitors to the Surety pursuant to the terms of the Agreement of Indemnity and this Agreement, the Principal and the Indemnitors hereby grant to the Surety a security interest and lien in all of the real and personal property more fully described in the List of Collateral (the "Collateral") attached hereto as Exhibit __, including but not limited to any and all monies loaned or advanced by the Surety to the Principal or otherwise as provided in accordance with the provisions of this Agreement. The Principal and the Indemnitors shall execute a sufficient number of financing statements under the Uniform Commercial Code (UCC Form 1) in order for the Surety to perfect its security interests and liens in the Collateral. Furthermore, the Principal and the Indemnitors agree to execute such other and further instruments or documents reasonably required or deemed necessary by the Surety to confirm, perfect or otherwise establish the liens, security interests and rights granted in the Collateral to the Surety under this Agreement.

e) As part of this Agreement, and with the consent and approval of the Indemnitors, the Principal shall execute voluntary letters of default and termination (the "Letters of Default") addressed to the Obligees for each of the Contracts and Projects shown on the List of the Contracts and Bonds attached as Exhibit __, a sample copy of which is attached hereto as Exhibit __. In accordance with the terms of the Agreement of Indemnity and this Agreement, the Surety may use the Letters of Default on each Contract and Project, individually as to each separate Contract or as to all of the Contracts, in the sole option and discretion of the Surety, whether or not there is a default under any of the Contracts, the Agreement of Indemnity or this Agreement, or whether or not this Agreement has been terminated by the Surety.[33]

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[33] *Id.*

The financing agreement should also provide details regarding the account from which funds will be allocated, for this will be the instrument for financing the principal. The financing agreement should establish a joint-control trust checking account to ensure the surety is thoroughly protected from unauthorized withdrawals. Below are common provisions of a finance agreement that creates the parameters of the joint-control trust checking account:

a) The Principal and the Surety shall open and establish a joint control trust checking account (the "Trust Account") in [Insert name of Bank] (the "Bank") in the name of "[Name of Principal]" Trust Account for "[Name of Surety]" in accordance with a Trust Account Agreement, a copy of which is attached hereto as Exhibit __. The Principal authorizes the Bank to establish the Trust Account. The Principal shall not open any other trust account(s) without the express knowledge and consent of the Surety.

b) For the purposes of this Agreement, "Contract Funds" shall mean any and all monies payable to or received by the Principal under or in connection with the Contracts, including but not limited to monies earned and to be earned, payment of retained percentages and final payments due or to become due to the Principal of every kind or nature under the Contracts, including payments for all extras, claims, bonuses and/or of any other kind or nature which may be received by the Principal from the Contracts.

c) The Principal, with the agreement of the Surety and the Indemnitors, shall execute Letters of Direction addressed to the Obligees, a sample copy of which is attached hereto as Exhibit __, directing that all Contract Funds from the Contracts be made payable jointly to the Principal and the Surety, and mailed to the Surety.

d) The Principal, the Indemnitors and the Surety agree to deposit or cause to be deposited in the Trust Account all Contract Funds from the Contracts collected by the Principal or the Surety, and all monies which the Surety may, in its sole discretion and/or in accordance with the terms and conditions of this Agreement or the Agreement of Indemnity, advance or loan to the Principal. The Principal and the Indemnitors acknowledge and agree that all funds on deposit in the Trust Account are the sole property of the Surety. The Contract Funds shall not be deposited in any other account of the Principal.[34]

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[34] *Id*.

Despite the above-described provisions and precautions to maintain the surety's control over the joint-control trust checking account, it may still be susceptible to creditors of the principal who may attempt to garnish the funds in the account.[35] Although the surety cannot prevent this action from happening, it should request that the financial institution promptly notify the surety of such activity so it can request the court that any garnishment be released.[36] In some cases, the financial institution for the trust account may be the same as the principal's. As a result, the surety should make sure that any funds deposited into the account are not perceived as a set-off to any transactions between the principal and the bank that are unrelated to the project. Additionally, the financing agreement should state the exact purpose for the trust account to ensure funds are not mismanaged or incorrectly allocated. As a result, sureties should include the following provisions to protect itself against such instances:

a) The Contract Funds are hereby irrevocably segregated, earmarked and set aside solely and only for the purposes set forth in this Agreement. The Contract Funds and all other monies deposited in the Trust Account shall be considered and constituted as trust funds for the purposes set forth in this Agreement. The Principal shall hold all Contract Funds in the Trust Account in trust for the Surety separate and apart from all other funds and property of the Principal. The Principal hereby covenants and agrees that it will not knowingly permit any funds in the Trust Account, whether represented by checks, vouchers, orders or otherwise, to be used for any purpose other than as more particularly set forth in this Agreement. [37]

The following is a standard use of funds clause within a financing agreement:

a) The Contract Funds contained in the Trust Account shall be used solely for the payment of all labor and material costs, including amounts due to subcontractors and suppliers and for rental of equipment from others which is actually used in the prosecution of the work under the Contracts, incurred by the Principal, and the Principal's subcontractors and suppliers, which are necessary to complete the work under the Contracts and for which the Surety may become liable under the Bonds. The Principal agrees that it will not use or rent any of its equipment or machinery in any manner which will interfere with or delay the prompt

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35 *Bond Default Manual*, at 147.

36 *Id*.

37 Practical Guide to Construction Contract Surety Claims; Form F:13-14 Joint Control Trust Account Agreement between Surety, Indemnitors, and Contractor.

completion of the Contracts. It is specifically understood and agreed by the Principal, the Indemnitors and the Surety that the Contract Funds contained in the Trust Account shall not be used to pay the obligations of the Principal on contracts not bonded by the Surety.

b) The Surety is not obligated to pay or cause to be paid any of the overhead and general and administrative expenses of the Principal. The Surety, at its option and sole discretion, may consent to the use of funds from the Trust Account to pay all or a portion of the Principal's overhead and general and administrative expenses. The Principal acknowledges, agrees and consents that the Surety reserves the right to reject the payment of any bill(s) requested by the Principal pursuant to the procedures described below if the Surety deems, in its sole discretion, that the requested payment or payments are for the overhead and general and administrative expenses of the Principal.

c) On a monthly basis, the Principal shall provide to the Surety a budget of its anticipated revenues from the Contracts and estimated expenses for labor, materials, subcontractor payments and any other payments, including the overhead and general and administrative expenses described herein, that the Principal anticipates will be requested from the Trust Account.

d) Absent other mutually agreeable arrangements which must be reduced to a written document between and among the Principal, the Indemnitors and the Surety, the procedure for the payment of the Principal's bills on the Contracts, including its direct payroll, shall be as follows:

    (i) On a weekly basis or as otherwise required, the Principal shall provide to the representative of the Surety the following information:

    (ii) A summary sheet listing all of the invoices to be paid, broken down by Contract, showing the person to be paid, the amount to be paid, the date of the check, the check number and the total payments to all payees. The Principal shall designate on the summary sheet those invoices it believes should receive priority for payment in the event that the Contract Funds in the Trust Account are insufficient to pay all of the invoices submitted for payment. The Principal shall sign off its approval of the summary sheet and the payments described therein;

(iii) A copy of each invoice to be paid, showing the Contract for which the invoice was incurred, along with a copy of all necessary supporting documentation for the invoice.[38]

When the surety decides to finance the principal, it will inevitably be required to pay various bills of the principal. As a result, the financing agreement must contain a section that excludes certain bills and protects a surety from claims from the principal or indemnitors related to this disapproval. The following is an example of a clause that outlines payments made on behalf of the principal:

> It is expressly understood by the Principal and the Indemnitors that should the Surety or its representative disapprove any payments requested by the Principal or refuse to countersign any check drawn on the Trust Account, such decision is final as to the Principal and the Indemnitors, and the Principal and the Indemnitors shall have no right or cause of action of any kind or nature against the Surety, its agents, employees, attorneys or representatives as a result of such disapproval.[39]
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> To the extent that the contract funds in the Trust Account are insufficient to make the payments requested by the principal and approved by the surety, the surety may loan or advance monies to the principal or the Trust Account for the payment of those bills. The Agreement provides that any such advances to, loans to or funding of the principal or the Trust Account:
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> (1) Shall be conclusively presumed to be a loss to the surety; and
> (2) Shall constitute and be deemed to be trust funds in accordance with this Agreement.[40]

While the above provisions provide for payment for suppliers and subcontractors, the principal's internal payroll operates differently. In many instances, the principal utilizes a software program that automatically generates checks to its employees from a separate account that takes into consideration various deductions (*i.e.* taxes, insurance, etc.).[41] As a result, this separate account is not linked to the trust account pursuant to the financing agreement. The surety must therefore transfer the funds from the trust account to the payroll account to ensure

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38 *Id.*

39 *Id.*

40 *Bond Default Manual*, at 152.

41 *Id.*

the employees are paid accordingly. However, doing so could cause various problems for the surety. For example, once the surety transfers funds to the payroll account, they are no longer protected by the financing agreement.[42] Another problem the surety may face when transferring funds from the trust account is that the funds are more susceptible to outside creditors for garnishment. Additionally, the financial institution itself may target the funds and assert its right of setoff if the principal is indebted to the bank for amounts unrelated to the project.[43] If either of these instances occur, the surety may have significant difficulty in recouping the transferred funds. To further protect itself from such an instance, the surety should ensure the financing agreement contains a provision similar to the following:

> None of the Contract Funds deposited in the Trust Account shall be subject to any right of setoff by the Bank as a result of any transactions involving the Bank, the Principal and/or the Indemnitors, nor be assigned or diverted from the uses or purposes set forth in this Agreement. The Surety may require of the Bank a written acknowledgment of this paragraph as a condition to the establishment or continuance of the Trust Account at the Bank.[44]

The final noteworthy provision to protect the surety is the circumstances upon which the financing agreement can be terminated. This provision may be difficult to draft due to the conflicting intentions of the surety and principal. For example, the surety may want the sole ability to terminate the financing agreement at such time as it would deem appropriate, while the principal and indemnitors may want the agreement to terminate as quickly as possible.[45] The following provision serves to protect the best interests of the surety:

> a) The Surety shall have the right, at any time in its sole option and discretion, to terminate this Agreement, whether or not the Principal is in default under the terms of any of the Contracts, the Agreement of Indemnity, or this Agreement.[46]

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42 *Id*.

43 *Id*.

44 Practical Guide to Construction Contract Surety Claims; Form F:13-14 Joint Control Trust Account Agreement between Surety, Indemnitors, and Contractor.

45 *Bond Default Manual*, at 153.

46 Practical Guide to Construction Contract Surety Claims; Form F:13-14 Joint Control Trust Account Agreement between Surety, Indemnitors, and Contractor.

PROTECTING THE SURETY THROUGH FINANCING

The surety should perform some serious due diligence on the "Four C's" before agreeing to finance the principal. And the surety should make every effort to have its interests protected through a strong financing agreement.[47] But, it is equally important that the surety continue to monitor the principal during the course of the financing to protect its interests. Most of these protections should be in place under the financing agreement but it is important to make sure that the principal is actually honoring its obligations.

The surety should put practical procedures in place to ensure the principal complies with the stipulations set forth in the financing agreement. For example, the surety might perform regularly scheduled audits on the principal regarding project expectations. Additionally, the surety should request the production of reports and financials from its principal to ensure allocated funds are not misappropriated and the principal is not concealing any information that would compromise the surety or the finance agreement. Finally, the surety may appoint either a forensic accountant or a project representative who becomes intimately involved with the project during the duration of the financing. The surety should not solely rely on the reports of its principal regarding the process. The surety needs to know how much cash the principal has on hand, what other sources of cash are still available for the principal (and thus the surety), and needs to know the status of the principal's and the indemnitors' assets while completion of the bonded project(s) is ongoing.

Also, the surety should monitor the character of the principal and indemnitors to ensure they can continued to be trusted throughout the term of the financing agreement. Are they honoring their promises? Has there been a change in leadership? Are they being honest in their reporting to the surety? Are they making its books and records available to the surety? Are they putting forth their best efforts to complete the work on the bonded contract(s)? Are they attempting to minimize the surety's losses? These are questions that must be continually asked.

Additionally, the surety should continue to monitor and evaluate whether the principal still has the capability and capacity to finish the project. Does the principal have still have the technical ability and the managerial competence to perform the remaining work and close the project(s) out? In many instances, to answer these questions, the surety must identify the

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[47] And, the surety should file the indemnity and financing agreement under the U.C.C. There are various advantages of filing under the U.C.C. For example, the filing grants the surety enforceable rights to materials, equipment, and other personal property to which the principal outlines in the agreement -- which is not automatically available otherwise. *See* Smith and Covalt, "Should the Surety Stand on its Equitable Subrogation Rights or File its Indemnity Agreement Under the Uniform Commercial Code?," at 691.

principal's key personnel and continue to monitor them as the financing process moves forward.

Also, the surety should be cognizant of any additional contracts the principal has entered into during the term of the financing agreement. The surety must always be wary of the principal using contract funds or funds received from the surety for separate projects. The surety must also be wary of the principal's required attention to the bonded project(s) being diverted to other projects and ventures.

Again, the surety has most likely only made the decision to finance the principal after performing substantial due diligence into the principal. During the course of financing itself, the surety should continue to keep these high standards by proactively monitoring the principal and the funds allocated to the project.

The surety should also protect itself by securing all collateral by obtaining appropriate mortgages and deeds of trust on real estate, and perfected security interests and filed financing statements of personal property. These instruments should be filed before or contemporaneously with the execution of the financing agreement.

The surety has the right, whenever it incurs a loss, to be repaid and reimbursed. The financing agreement should allow the surety to seek prompt repayment of any losses from either excess contract funds or the proceeds of any sale of collateral. In addition, the financing agreement should acknowledge the principal's and indemnitors' indemnity agreement(s), and reaffirm their liability to the surety which will provide the surety with another cause of action (breach of the financing agreement) in addition to its rights under the indemnity agreement(s) to recover its losses.

Finally, if financing is not working out and the project is seriously heading south, the surety might consider utilizing the termination clause in the financing agreement and taking over the project pursuant to its takeover rights in the financing agreement. Throwing good money after bad generally does not make sense (although sometimes it is unavoidable) but a surety does not have to remain wed to the principal until the bitter end. Sometimes a divorce (while awkward, painful, and litigious) is the best choice.

CONCLUSION

In some situations, financing the principal may be the fastest and most cost-effective path to project completion. But that path has many risks that must be accounted for. Sureties need to perform a thorough investigation and conduct a rigorous cost-benefit analysis to determine if financing the surety is the best option. Once the surety decides that financing the principal is the best option, the financing agreement (along with securing collateral) becomes

the next important step to protect the surety through project completion and eventual termination of the financing agreement.

In addition, the surety should take precautions to ensure its principal complies with the terms of the financing agreement and is, in fact moving forward with the completion of the bonded contract(s). Whether the surety hires a forensic accountant, requires frequent reports from its principal, or conducts site inspections, the surety should remain vigilant to protect itself while financing the principal. The same thorough investigation and analysis that the surety took before it agreed to finance the principal should be ongoing during the financing itself. Finally, a surety should be ready to use any and all tools at its disposal to recover its losses when the principal is in breach of its obligations and should always be ready to terminate financing if warranted.

SESSION 10

AN UNDERGROUND AUTOPSY: STRATEGIES FOR ANALYZING, PRESENTING AND SUCCESSFULLY RESOLVING DIFFERING SITE CONDITION CLAIMS

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Our panel discussion will focus on practical tools, tips and strategies for a performing surety to consider when analyzing, presenting and successfully resolving its principal's differing site condition claim. The panelists will discuss their substantial experience handling these claims and share stories and examples of how to optimize the surety's recovery and minimize the cost of prosecuting these claims.

The written materials will address several unique situations that sureties may face when dealing with the claims and issues that arise when their general engineering contractor has been defaulted on an underground construction project. First, the authors will discuss the economic duress doctrine, and how it comes into play when your defaulted principal has executed pre-termination releases that the obligee is using to defend against the surety's site condition claim. Second, the authors will discuss practical tools to consider when dealing with an owner who, in addition to refusing to pay for the differing site conditions, has assessed liquidated damages because the project completion date has been extended. Finally, the authors will touch on the difficult situation surety's face when an obligee demands that the surety remove and replace underground construction after it has been inspected, paid for and covered up.

I. Dealing With Pre-Termination Releases Executed By Defaulted Bond Principal

In today's challenging economic environment, many contractors are just a pay cycle away from financial ruin. This is particularly true for underground contractors encountering differing site conditions. The loss or, at worst, elimination of production means that your principal is not generating its expected revenue. To make matters worse, your principal is likely spending more for its production in an effort to navigate its way around the differing site condition. These two factors can be catastrophic.

Faced with this reality, it is common for your principal to be presented with some form of change order or proposed settlement of its claim that falls well short of fully compensating your account for its damages. However, rejecting the proposal is often not an option, since the increased revenue that the proposed settlement provides may mean the difference between continuing to perform and abandoning the work. This is where the economic duress doctrine may come into play.

This section of the paper explains what the "economic duress" doctrine is and why it is important both when handling a differing site condition claim.

In *Rich & Whillock, Inc. v. Ashton Development, Inc.* (1984) 157 Cal.App.3d 1154, the California appellate court specifically addressed a contractor's ability to utilize the economic duress doctrine in the context of undisputed contract funds. Rich & Willock was an underground contractor that agreed to perform excavation work for Ashton Development. The contract expressly excluded blasting. When Rich & Whillock encountered rock, the owner directed the contractor to blast the unforeseen materials and bill the owner for the extra costs incurred. Rich

& Whillock invoiced the owner as the project progressed and accounted for the extra costs with daily time sheets. Once the work was completed, Rich & Whillock submitted a final billing in the amount of $72,286.45 for the extra work. The owner refused to pay.

When the contractor asked the owner why he was not being paid, the owner said he had run out of money and could not pay the amount claimed. The subcontractor informed the owner that he would "go broke" if he was not paid because they were a new company, the project was a big job for them, they had rented most of their equipment and they had subcontractors waiting to be paid.

Against these facts, the owner offered to pay Rich & Whillock $50,000 and told the contractor that if it did not accept this amount as a "compromise" he would get nothing, and could sue for the full amount. Not surprisingly, Rich & Whillock accepted the $50,000 compromise – but only after again complaining that the deal was "blackmail" and that they were only signing it to survive.

Four months after receiving its final payment, Rich & Whillock filed a lawsuit to recover the balance. After a bench trial, the court found that Rich & Whillock was due the additional $22,286.45 because the settlement and release was unenforceable under the economic duress doctrine. The owner appealed.

The Court of Appeal affirmed the trial court's ruling and held that "[t]he underlying concern of the economic duress doctrine is the enforceability in the marketplace of certain minimal

standards of business ethics." After acknowledging that reasonable settlements of good faith disputes are desirable, the Court made clear that the rules are entirely different when dealing with a debt that is due (not reasonably disputed) and a contractor that is experiencing financial difficulty. The Court went on to explain why the doctrine is necessary:

> The necessity for the doctrine in cases such as this has been graphically described: 'Nowadays, a wait of even a few weeks in collecting on a contract claim is sometimes serious or fatal for an enterprise at a crisis in its history. The business of a creditor in financial straits is at the mercy of an unscrupulous debtor, who need only suggest that if the creditor does not care to settle on the debtor's own hard terms, he can sue. This situation, in which promptness in payment is vastly more important than even approximate justice in the settlement terms, is too common in modern business relations to be ignored by society and the courts.

It is not surprising that Rich & Whillock was decided in 1981, which was a time of great economic turmoil in California. Because many in the construction industry are again faced with harsh financial realities buttressed by tight margins, difficult public owners, increasing costs and limited access to labor, the economic duress doctrine should be considered whenever the claim that you are pursuing involves a previously executed change order, release or settlement agreement.

Conversely, if you are the party looking to pay less than the principal amount due, consider these pointers (in addition to the regulatory prohibitions regarding this issue). First, never threaten the

claimant with a “take it or leave it” proposition. Second, consider expressly including a waiver of any claims based on economic duress in your release document.

If you are the party being offered less than the principal amount due you, consider accepting what is being offered then bringing an action to recover the balance. If you decide to take this route, be certain to communicate and document your position to the payor that you are only accepting the proposed settlement because refusing to accept the amount would ruin your company.

As a surety pursuing the claims of a principal who may have executed these documents, be aware of this doctrine and make sure that your investigation and claim preparation includes obtaining witnesses, documents and other evidence of the circumstances giving rise to the execution of the release. Of course, this is a difficult argument to make if your principal is large account with access to capitol to withstand the financial impact of the site conditions. This scenario is more likely to apply when you are dealing with small to medium size contractors who you can establish were relying on the revenue generated by this one project to support their overall business operation.

II. Practical Tools For Dealing With Liquidated Damages Assessments

We should all agree that public infrastructure projects should be paid for with public funds – not by private contractors or their sureties. Unfortunately, far too many public project and program managers have either forgotten, or chosen to ignore, this fundamental rule. This mindset manifests itself in many ways, not just the owner’s denial of your differing site condition claim. Among other things, owners often “pour salt on the wound” by denying additional compensation

on the one hand, and refusing to pay existing contract funds by assessing liquidated damages, on the other.

When abused by public owners (which is often the case), this strategy results in the contractor not only having to finance the construction of the improvement in differing or unusual site conditions, but also deprives the contractor of the contract funds that the owner agreed to pay in the first place. It takes an awful financial situation, and makes its exponentially worse. When abused, this strategy is nothing more than an effort to create settlement leverage and, in the worst cases, destroy businesses.

The owner often wants to be able to offer these same funds back to the contractor to settle its differing site condition claim. The strategy is abusive, improper and entirely inconsistent with traditional notions of good faith and fair dealing. The only way to stop public agencies from acting this way is to fight them when they decide to use these tactics and make them pay for their decisions.

Keep these general principles in mind when you are faced with an owner who refuses to compensate you or your principal for differing site conditions, and is holding onto hard-earned money in order to deprive you or your principal of cash, or create leverage to settle:

- The owner needs to prove that the contractor is the sole cause of the delay. Stated differently, if there is owner caused delay (site conditions, lack of permits, delayed responses to RFIs, re-designs, etc.) then the concurrency of the delays should be sufficient to defeat the liquidated damages claim. As cited in California's form jury

instruction (CACI No. 4532), "in the absence of a contractual provision for extensions of time, the rule generally followed is that an owner is precluded from obtaining liquidated damages not only for late completion caused entirely by him but also for a delay to which he has contributed, even though the contractor has caused some or most of the delay . . . . Acceptance of the reasoning urged by defendants would mean that, solely because there has been noncompliance with an extension-of-time provision, the position of an owner could be completely changed so that he could withhold liquidated damages for all of the period of late completion even those he alone caused the delay." *Peter Kiewit Sons' Co. v. Pasadena City Junior College Dist.* (1963) 59 Cal.2d 241, 245.

- Because concurrent delay defeats the liquidated damages assessment, a complete forensic scheduling analysis is not always required – you (and your counsel and/or consultants) could decide to focus on concurrency to get your money back and not invest the cost of the full scheduling analysis.
- In order to allege that liquidated damages should not be assessed, you should pay close attention to the notice and claim requirements of the prime contract and make sure that your contractor has documented events, facts and circumstances that suggest that factors outside of its control have delayed completion of the project. *Opinski v. City of Oakdale* (2011) 199 Cal.App. 4th 1107.
- Similarly, in addition to confirming that your principal has documented delaying events in daily reports, meeting minutes and emails, determine whether the contractor has properly responded to statements of working days provided by the owner, and make sure that the owner has accurately documented actual conditions. There is nothing more powerful than using the owner's own documents to defeat their position.

- Don’t forget about the prompt payment statutes in your jurisdiction, which can be gamechangers. Here, it is important to demand the release of contract funds being improperly retained as a result of the liquidated damages assessment on the grounds that there is, at worst, some concurrency. By framing the issue in this way from the outset, you are more likely to prevail on your argument that the withholding was improper and/or made without the requisite good faith or *bona fide* basis. Particularly in cases where the contract is silent on attorneys’ fees, these statutes often provide a source for fee and penalty recovery if you prevail on your claim.
- Finally, consider refusing to negotiate your claim until the owner has put all of your earned contract funds back on the table. This is an aggressive strategy; however, it will force the owner to quickly decide whether it wants to litigate the case or attempt to meaningfully resolve the claim for differing or unusual site conditions without holding the earned contract funds hostage.

III. Strategies For Dealing With Remove and Replace Demands

We have all encountered demands from obligees to remove and replace underground facilities that have been approved, inspected paid for and covered up. Unfortunately, obligees usually have plenty of contract terms at their disposal to rely on to justify their demands.

After installing the pipe, filling the trench and performing roadwork, the prospect of removing and replacing millions of dollars of work to fix joint separations, pipe sags or other allegedly non-conforming work, threatens the existence of even the most financially stable contractor.

With blood in the water, and performance bond sureties on the hook, public owners often refuse reasonable repair options and instead demand removal and replacement. When doing so, owners rely on defective work provisions in the general contract that require repairs despite prior inspection, acceptance and/or payment for the work by the owner. *See, e.g.*, California's Greenbook § 2-11 ("Inspection of the work shall not relieve the contractor of the obligation to fulfill the conditions of the Agreement").

By shifting the entire remedial burden onto the contractor, owners implicitly align themselves with their engineers, who are retained for the express purpose of inspecting the work as it is being installed. Unwilling to place blame on their engineers, owners are more likely to fault the contractor's workmanship when ordering costly repairs, including removing and replacing sections of the line altogether. Fortunately for those of us in California, there is an old Supreme Court case that suggests that by looking to the contractor, not the engineer, the owner selects the wrong horse.

In *City Improvement Co. v. City of Marysville* (1909) 155 Cal. 419, the Supreme Court held that where a city retains an engineer to inspect the installation of a sewer line, and that engineer has a full opportunity to inspect the line during the construction phase, all defects that were either visible, or could have been ascertained by the engineer after a reasonable inspection, are waived by the owner as against the contractor. *Id.* At 431.

City of Maryville involved an underground contractor that installed an entire sewer line over the course of seven months under the direct supervision of the City of Marysville's retained

engineer/inspector. Id. at 422. During the construction phase, "[n]o complaint was made as to the manner of work or kind of materials during the progress of the work, except in one or two instances, where the matter was at once remedied, and the work progressed to completion to the apparent satisfaction and approval of everybody engaged in supervising the work." Indeed, rather than note any deficiencies, the City's engineer certified that the work on the entire mainline was complete for purposes of estimating the amount due the contractor.

Once the installed line was connected to the existing facility and tested, however, the engineer discovered leaks at pipe joints throughout the mainline: "[a]lmost immediately thereafter, the sewers having been connected, the engineer and his associate caused a test to be made to ascertain the amount of leakage of water into the pipes laid by plaintiff. It was found that from the whole system there was flowing through the main pipe leaving to the sump 1,100 gallons of water a minute, which reached that point and could only reach it by reason of leakage into the sewer pipe laid by plaintiff. This flow was three-fourths of the carrying capacity of the pipe. The test was also made by districts [i.e. segments], and it was found that the leakage into the pipes was not confined to any particular section, but existed all over that portion of the system laid under the water level. [.. .] The test made it evident that somebody had blundered." *City Improvement Co. v. City of Marysville*, *supra*, 155 Cal. at 424.

With test results in hand, the City of Marysville demanded that "13 blocks" of pipe be uncovered and the leakage remedied, i.e., a remove and replace directive. The contractor refused, arguing that it had completed its contract work and was therefore entitled to final payment. The City of Marysville proceeded to complete the work with its own forces.

As part of the City of Marysville's completion effort, it conducted an investigation of the leaks once the pipes were uncovered and concluded that "on by far the greater portion of the joints there was either no cement at all on the lower half, or there were holes therein, while the cement on the upper half was all right." That is, the contractor had failed to cement the circumference of the pipe as it was required to under the specifications. There was no doubt that the contractor's workmanship was to blame. However, in a remarkably practical decision, the California Supreme Court recognized that the engineer was to blame for not having identified the problems when the pipe was uncovered and easily accessible for repairs.

Based on the trial testimony the Supreme Court concluded that the "inference is irresistible that the trouble was due to a failure on the part of the employees of the contractor to conform to the specifications." *Id.* at 425. "There was much testimony as to the original work, which showed a constant and reckless disregard by plaintiffs employees of the requirement as to water in the trenches, and that this was so was practically demonstrated by the condition in which the joints were found on being uncovered."

The question presented to the Supreme Court on appeal was whether the cost of repairing the defective work was the responsibility of the owner or the contractor. Relying principally on the existence, role and failings of the city's retained engineer/inspector, the Court ruled in favor of the contractor.

The Court started by reviewing the contract, and concluded that the parties contemplated that work would be performed "under the constant immediate supervision and direction of the engineer in charge and his subordinates, and inspected and rejected or approved as it progressed and before the trenches were refilled with earth." *Id.* at 427. The trial testimony confirmed that work was, indeed, performed under the constant eye of the city's engineer, who was the city's representative on the ground and "there for no other purpose than to see that the materials furnished and the work done by plaintiff's employees were in all respects as required by the contract, and to require compliance with the contract as the work progressed. whenever any departure there from was observed." Id.

Because the defects were not observed by the engineer and/or its representative before the pipe was covered, the work was deemed accepted and complete:

> The defects now alleged in regard to the work, that water was allowed to be in the trenches to such an extent as to injure the cement before it had set, and the failure on the part of workmen properly to apply the cement to the lower half of many of the joints, were matters which assuming they did occur, should have been observed by the engineer, through his representatives, at the time the work was being done, and when they could have easily been remedied. No portion of the work could be properly covered with earth until it had been inspected and found in proper shape, and there is no pretense that any of its was so covered prior to such inspection as was

> desired or requested by the inspectors. When it was allowed to be so covered, there was a practical approval and acceptance of the work by the engineer, through his representatives. and his acceptance was affirmed and approved from month to month by his own certificates to the common council of the city[.] Under these circumstances, we think the city is clearly estopped to urge that plaintiff has not performed its contract.

Id. at 427-428 (citing *Schliess v. City of Grand Rapids*, 131 Mich. 52 (City "could not lull the plaintiff into the belief that the work was satisfactory, and, when completed, reject it"); *Wildley v. Fractional School District*, 25 Mich. 419 ("whatever passed under his inspection as work progressed, and was, by good faith, approved by him, expressly or by implication, was not open to objection on the part of the defendant moving forward"); *Laylock v. Moon*, 97 Wis. 59 (because "alleged defects were obvious to the stipulated inspection, they could not avail defendant after completion of the work"); *Ashland v. Shores*, 105 Wis. 122 ("architect should not by silence allow unsatisfactory construction to proceed to a point where its removal from the building would be attended with serious loss to the builder, and that a failure to reject seasonably operated as a waiver")). The Court considered, then expressly rejected, the city's argument that by allowing the engineer's failure to identify defects in the placement of the pipeline to serve as an estoppel, the contractor could vary plain and unambiguous terms of its contract to the detriment of the city:

> As was said in *Standard Stamping Co. v. Heminghaus*, *supra*, where a similar contract was made, it was entirely competent for the city, through its engineer and his subordinates, to determine

> that the sewer as laid in the open trench and ready to be covered with earth was just what the contract required. Having seen it, and having had the fullest opportunity of inspecting it, all of those defects which were visible, or could have been ascertained by a reasonable inspection were waived. In other words, the question whether the work was in accord with the contract was thus finally determined so far as such defects were concerned, in the absence of bad faith or fraud on the part of the contractor.

The contractor could not be held responsible for the negligence of the city's inspector. The Court opined that where the engineer's failure to identify the defect prior to backfill results in an economically unreasonable repair option, the owner should look to his engineer or architect for recourse: "[I]f such representative failed to perform his duty the loss should fall on the owner, and not be shifted to the builder, who may have been lured into the belief that his work and material were satisfactory till too late to remedy the defects therein without serious loss, that the owner should look to his architects; that he should be and is bound the same as if he were upon the ground himself, charged with the duty of accepting or rejecting material or construction as soon as there is a reasonable opportunity for the inspection of it." *City Improvement Co. v. City of Marysville, supra*, 155 Cal. at 430.

Next time you are faced with a demand to repair and/or remove and replace your underground work, take time to revisit the rule of *City of Marysville* and be prepared to argue that you are not obligated to perform the repairs despite evidence of workmanship errors. At the very least. your knowledge of the *City of Marysville* principles may provide you with the leverage needed to

negotiate a reasonable, and economically feasible, resolution to the potentially devastating dispute.

SESSION 11

TESTING AND INSPECTIONS

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Testing and Inspections

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Introduction

There are various types of testing and inspections that take place during the life of a construction project. The materials involved include a diverse range of structures and consistencies, from soil and underground foundational elements to concrete, steel and masonry. With such a range of material there is an equally diverse range of testing and inspections needed to ensure that the materials meet or exceed a project's specifications.

The nature of a project dictates what types of testing and inspections will be required and who is responsible for performing them. The impact to the overall project schedule, as well as the financial impact to contractors or other interested parties, can be greatly affected by these requirements. Likewise, the failure to meet these requirements can have negative consequences for all involved. In the event of a default, a surety professional needs to be aware of these testing and inspection requirements that are often critical to the completion of the project. Looking at a construction project from beginning to end, this paper will exam some of the common testing and inspections required during each stage.

I. Determining Applicable Testing and Inspection Requirements

It is often difficult to ascertain which tests and inspections are required. Certain requirements for testing are buried deep within the project specifications. In more technical or specialized elements of the project (e.g., HVAC, electrical, fire/life/safety, balancing and commissioning, etc.), the testing and/or inspection requirements are often the responsibility of a specialty subcontractor. Sometimes, the testing and inspection requirements are only included in the contract documents and specifications via reference, such as referencing requirements of the Green Book, ASMI, NECA, or other industry standards. As discussed further below, general contractors often flow down these requirements to their subcontractors via general or vague subcontract language, making analysis of testing an inspection requirements an equally important consideration for subcontractors and suppliers.

Generally, an owner has the right, but not an obligation, to inspect the contractor's work. An owner's failure to conduct inspections is seldom, by itself, sufficient to relieve a contractor of responsibility to perform the work in accordance with the plans and specifications.[1] For example, in *Memphis-Shelby County Airport Authority v. Illinois Valley Paving Co.*, during work on a runway at Memphis International Airport, the contractor charged with installing the lighting cables under the runway was found to be in material breach of the contract for providing non-

[1] *See* 4A PHILIP L. BRUNER & PATRICK J. O'CONNOR, BRUNER & O'CONNOR ON CONSTRUCTION LAW § 13.33 n.1 (2018).

compliant materials, despite the fact that the owner failed to detect the non-compliance during the pre-install inspection.[2] On the other hand, where inspection or testing by the owner is required, failure to conduct it may restrict the owner's ability to reject the work or seek other recourse against the contractor.[3]

Although a general contractor generally has responsibility for inspecting their work, including the work of their subcontractors, they often flow down inspection obligations to their subcontractors and suppliers. One standard subcontract form contains the following inspection provision:

> The subcontractor shall schedule all required tests, approvals and inspections of the subcontract work or portions thereof at appropriate times so as not to delay the progress of the work. The subcontractor shall give proper written notice to all required parties of such tests, approvals and inspections. The subcontractor shall bear all expenses associated with tests, inspections and approvals required of the subcontractor by the subcontract documents which, unless otherwise agreed to, shall be conducted by an independent testing laboratory or entity approved by the contractor and owner. Required certificates of testing, approval or inspection shall, unless otherwise required by the subcontract documents, be secured by the subcontractor and promptly delivered to the contractor.[4]

However, testing and inspection beyond the scope of the contract documents are the responsibility of the owner unless they reveal that the work fails to comply with the requirements of the contract documents. In that instance, the contractor will bear the costs provided in connection with such inspections or testing.[5]

A poorly tested and inspected project can expose construction companies, sureties and owners to legal costs and cost associated with corrective measures. While owners typically bear the costs for some initial tests and inspections, if any retest or re-inspection is necessary due to the failure of the material to meet project specifications, as stated previously, it is the contractor that will undoubtedly bear all related costs for re-tests or re-inspections. In a situation where a failure results in default, the surety becomes exposed if the contractor is unable to cure the default and the surety is called upon to complete the work. A surety in this situation will likely be responsible not only for the costs associated with completing the work, but also the costs associated with the re-tests and re-inspection.

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[2] No.01-3041 B, 2006 WL 4608640, at *6 (W.D. Tenn. Sept. 15, 2006).
[3] *See* 4A Bruner & O'Connor, supra note 1, § 13.33 n.2; *see also* Eastover Corp. v. Martin Builders, 543 So.2d 1358, 1361 (La. Ct. App. 1989)).
[4] *See* 4A BRUNER & O'CONNOR, *supra* note 1, § 13.33 n.5
[5] *Id.* at § 5.251.

II. <u>Testing and Inspection at the Beginning of the Project</u>

Types of Testing and Inspection: Underground, Soils, and Geotechnical

If the project includes heavy civil or underground work, soils or geotechnical testing and reporting is critical. There are myriad unforeseen conditions existing underground, and if not properly addressed, those unknowns can delay the project from its start and increase construction costs significantly. Often, a contract will require the contractor to acknowledge that it is sufficiently aware of the underground conditions prior to starting work. However, pre-construction geotechnical reports may not contain sufficient or accurate information as to the existing underground conditions. When an unforeseen condition exists, the costs attributable to the delay and increased construction costs often become a fight among the owner/general contractor/subcontractor/engineer.

For example, in *Burlington v. Arnold Construction Co., Inc*., the owner hired a contractor to fill in a ravine on his tract of land to facilitate development.[6] The owner later claimed that the contractor failed to use proper fill, alleging that the contractor improperly used large boulders, topsoil, and debris in violation of the contract.[7] The contract contained the following inspection clause:

> Inspection: All grades and materials furnished for grading operations shall be subject to inspection by the owner and/or engineer. After establishment of proper grading, the engineer, owner, and/or their representatives shall inspect the existing grades as to their proper elevation; compaction tests for all areas of fill will be made by the inspector; if the area does not meet the specifications, the contractor shall make every effort to obtain the required density. The contractor shall bear the cost of retesting those areas that previously failed compaction testing.[8]

The contractor filed a counterclaim against the owner based upon the inspection provision, alleging that the contract required the owner to perform compaction tests for all areas of the fill and that the owner's failure to provide this inspection relieved the contractor of responsibility to meet density requirements.[9] The appellate court disagreed with the contractors interpretation and upheld the dismissal of the contractor's counterclaim.[10] The court held that the inspection provision allowed the owner to inspect, but did not create a duty upon the owner to perform such inspections.[11] In interpreting the inspection provision, the court noted:

> Apparently, [the contractor] faults the owner for not watching the job more closely and preventing [the contractor] from using faulty material. The above quotation [the inspection clause] does not obligate the owner to guard the contractor against his own mistakes. The [inspection clause] does not state that

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[6] 727 S.W.2d 241, 242 (Tenn. Ct. App. 1987).
[7] *Id.* at 245.
[8] *Id.*
[9] *Id.* at 246-247.
[10] *Id.* at 247.
[11] *Id.* at 247

> "the owner shall inspect." It states that grades and materials shall be subject to inspection. No time for such inspection is fixed except by the words "after establishment of proper grading." These words are interpreted to mean "when the job is completed." This is exactly when the inspection of material was made by digging pits in the fill to expose the nature of the material used for fill. It would have been more convenient and damages would have been reduced by constant surveillance, but this was not the owner's duty under the contract.[12]

Surety professionals should be cognizant that typical general conditions of a contract for construction, including the AIA A201-2007 General Conditions, require the contractor to be responsible for inspecting portions of work already performed under the contract to determine that it is in proper condition to receive subsequent work.[13]

III. Testing and Inspection at the Structural Stage of the Project

Types of Testing and Inspection: Concrete, Steel, Framing, Engineering Loads, and Pipes.

The strength of any structure, or part of a structure, is important. The degree of importance depends on the location of the structural element under consideration. The first-floor columns in a high-rise building, for example, are more important structurally than a non-load-bearing wall. Loading is more critical, and a deficiency in strength can lead to expensive and difficult repairs, or, at worst, a spectacular failure.

As opposed to other aspects of a project, failures at a structural level can be catastrophic in scope, and the resulting liability can be far-reaching. For instance, in *Stewart v. Schmeider*, the failure of a city planning official to properly review structural plans and specifications and detect a preventable design error resulted in the city being held liable for the deaths of five workers on a construction site after a building collapse.[14]. The court held that the city official had a duty to verify that the structural components were properly planned and to ensure that the plans were implemented safely—despite the fact that the plans had already been signed off on by a licensed architect.[15]

Structural failures can often be avoided by adequate testing. The testing process allows inspectors and contractors to identify faults before an actual stress test, where personal and environmental safety may be at risk. However, while detailed inspections are not infallible, they are still extremely cost-effective and helpful throughout the construction process.

For example, in testing concrete, strength is the basis for acceptance or rejection. The specifications or codes designate the strength (nearly always compressive) required of the concrete in the several parts of the structure. In those cases, where strength specimens fail to reach the required value, further testing of the concrete in place is usually specified. This may

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[12] *Id.* at 245-246.
[13] See 4A Bruner & O'Connor, *supra* note 1, § 13.33 n.3 (citing AM INST. OF ARCHITECTS, AIA A201-2007, General Conditions § 3.3.4 (2007).
[14] 386 So.2d 1351, 1358 (La. 1980)
[15] *Id.*

involve drilling cores from the structure or testing with certain non-destructive instruments that measure the hardness of the concrete. Some specifications permit a small amount of non-compliance, provided it is not serious, and may penalize the contractor by deducting from the payments due for the faulty concrete.[16]

IV. Testing and Inspection at the Building Progress Stage of the Project.

Types of Testing and Inspection: HVAC, Plumbing, Electrical, etc.

A typical vertical construction project presents several potential testing and inspection issues. Numerous trades become involved at this point in the project's progress as structural installation moves forward.

During this phase, most of the primary work will receive what is referred to as "rough-in" inspections. Rough framing, conduits, penetrations, ducting, and other building elements are often exposed, and any irregularities can be more easily addressed at this stage. Generally, sign-off, or acceptance of these "rough-in" inspections, are critical for keeping pace with the overall project schedule and sequencing of work. Trades and work scopes that typically require inspection(s) during this period may include: framing, accessibility and Americans with Disability Act requirements, electrical, mechanical, HVAC, plumbing/wet mechanical, fire sprinklers, specialized or motorized systems, elevators/lifts, or any of the fire/life/safety related installations.

Coordination of mechanical, electrical, and plumbing work can be especially critical at this stage of the project, as numerous issues can arise relating to corresponding inspection responsibilities. Depending on how a contract is bid or designed, responsibilities for both coordination and inspection can shift. This can depend on whether the contract was design-bid-build, design-build, or whether specific inspection related tasks are delegated to relevant subcontractors.

The consequences of failing to properly inspect critical systems during this stage of the project were demonstrated in *Eastover Corp. v. Martin Builders.*[17] In *Eastover Corp.*, a sewage system under a hotel collapsed several years after the building's construction.[18] The collapse was caused by improperly spaced pipe hangers, which should have been noted and corrected during a proper inspection by the project's architect.[19] The owner of the hotel at the time the damage was discovered, however, was left with no way to recover financially, as the architect who performed the shoddy inspection was business partners with the original owner of the property.[20] Their relationship meant that the architect's failure to inspect was imputed to the original owner, effectively waiving any claim against the project's contractors for the defective

[16] *See* INT'L CODE COUNCIL, *2012 Concrete Manual*, http://shop.iccsafe.org/media/wysiwyg/material/9090S12-sample.pdf
[17] 543 So.2d at 1361.
[18] *Id.* at 1359.
[19] *Id.* at 1362.
[20] *Id.*

work by future owners of the hotel.[21] In short, the current owner was forced to repair the damage without indemnity from the contractors who performed the work all because the original inspection (which he had no part in) was not done properly. [22]

Another aspect of this phase of construction especially relevant to sureties and legal professionals is that of deferred submittals. Deferred submittals often shift a portion of the design responsibility to subcontractors through submission of drawings. Examples often include: pre-fabricated steel stairs, handrails, and guards; curtain walls, window walls, and cladding systems; spray applied fire proofing; glass guardrail systems; and fire sprinklers, smoke detection, and alert systems.

This process typically involves a review of the deferred submittal by an architect or engineer, who will then certify to the owner that the documents submitted comply with the plans and specifications for the project. For example, the International Building Code requires:

> Documents for deferred submittal items shall be submitted to the registered design professional in responsible charge who shall review them and forward them to the building official with a notation indicating that the deferred [submittal] documents have been reviewed and found to be in general conformance to the design of the building.[23]

Generally, the subcontractor will not only be responsible for the design, but also for installation, management, inspection, compliance, and final acceptance of the deferred submittal items. Occasionally, this causes problems for a subcontractor where standards between various agencies or municipalities may differ, such as with fire/life/safety systems. This type of issue is ripe for dispute, as contractors in this situation remain responsible for all elements of the system, including its operation and commissioning. Contractors will often argue that they are being forced to incorporate a greater portion of the design than would ordinarily apply to their specific trade.

The importance of coordination and ensuring overall compliance throughout various stages of a project is exemplified by *Blumenthal Kahn Electric Ltd. Partnership v. Bethlehem Steel Corp*.[24] In *Blumenthal*, a dispute arose between an electrical subcontractor and a steel manufacturer over who was responsible for ensuring the correct placement of electrical stub outs in sections of a pre-fabricated roadway tunnel.[25] The public owner discovered that the stub outs had been placed incorrectly after delivery of the final segments of the tunnel, leading the parties to point fingers as to who was at fault.[26] Ultimately, the electrical subcontractor who designed the stub outs, and not the steel manufacturer who oversaw construction of the tunnel segments,

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[21] *Id.*
[22] *Id.* at 1363-1364.
[23] INT'L CODE COUNCIL, International Building Code § 107.3.4.2 (2009).
[24] 708 A.2d 1(Md. Ct. Spec. App. 1998)
[25] *Id.* at 2.
[26] *Id.* at 3.

was found liable.[27] The court so held because the contract entitled the steel manufacturer to inspect the stub outs, but only if "it chose to do so."[28]

Disputes in this area may also arise due to the interconnectivity/intersection of two or more deferred submittal scopes of work. For example, precast concrete sections may be a deferred submittal element and a structural element, which would intersect with the structural steel and building envelope. According to California Division of the State Architect guidelines, this design, attachment, and interconnectivity would be the responsibility of the architect of record, but is often pushed off to contractors and subcontractors via the deferred submittal process, resulting in limited coordination.[29]

The timing and coordination of inspection testing and approval at this stage may also vary based on the type of project or installation. Different types of projects and public owners (e.g., state, federal, municipal, agency, or utility projects) will have different procedures for testing, compliance, and acceptance, which must be closely adhered to and acknowledged in order for a contractor to adequately complete its scope of the work and receive final acceptance and payment.

V. Testing and Inspection at the Final Completion and Acceptance Stage of the Project

The last phase in construction is project closeout. Project acceptance is generally referred to as Final Inspection and Commissioning. Every finished and functional component of a project is inspected and is required to meet specific criteria, depending on the particular project and its requirements. During project closeout, the contractor and its subcontractors are required to startup all building systems. Typically, any tests required by the contract documents which have not been performed during the regular course of construction are accomplished at this time. If a test is associated with a system startup, then the test is performed in accordance with the manufacturer's instructions. Tests should be conducted in sufficient time to allow performance of the test, analysis of results, preparation of reports, and distribution of reports prior to the date of substantial completion.

Upon project completion, the owner conducts final inspections. Once an owner completes its final inspections and issues final acceptance, it generally means acceptance of the work as completed, including any deficiencies known to exist. At this point, the owner's contract rights against the contractor and surety become much more limited.

In *Beasley v. Monoko, Inc.*, the Ohio Department of Transportation (ODOT) made final inspections and acknowledged final acceptance of work on a bridge painting contract. [30] ODOT then made final payment to the contractor.[31] Several years later, inspections revealed that the

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[27] *Id.* at 8-9.
[28] *Id.* at 9.
https://www.dgs.ca.gov/DSA/Publications[30] 958 N.E.2d 1003, 1006 (Ohio Ct. App. 2011),
[30] 958 N.E.2d 1003, 1006 (Ohio Ct. App. 2011),
[31] *Id.* at 1006 .

original painting work had not been performed correctly. [32] ODOT sued the contractor and its surety arguing that its acceptance of the work did not mean that ODOT could not demand full compliance with the plans and specifications. According to ODOT, the contractor's obligations to meet the plans and specifications survived any final acceptance. [33] The contractor argued that final inspection and acceptance precluded all subsequent allegations that the work was not performed properly.[34] The contractor also argued that ODOT had inspection rights throughout performance and that the final inspection was intended to be ODOT's final chance to object to any problems with the work.[35] ODOT contended that it did not waive its ability to enforce the contract simply because it possessed the right to inspect the work during the course of the project.[36]

ODOT further argued the contractor's surety was contractually liable for the nonperforming work pursuant to the performance bond. ODOT argued that the bond required all work to be performed according to the project specifications and that the bond did not include an expiration provision, was not time-sensitive, and did not require that a claim be presented prior to final acceptance.[37]

The court, relying on language in the contract, found that ODOT's formal acceptance of the work was a legal acknowledgement that the work met the requirements of the plans and specifications. [38]The court cited the following language from the contract:

> This contract will be considered complete when all work has been completed and the final inspection made, the work accepted and the final estimate approved, in writing by the director. The Contractor will then be released from further obligations except as set forth in his bond.[39]

The court found that the quoted bond exception was limited to the contractor's post-acceptance duty to pay its subcontractors and suppliers.[40] While the contract allowed ODOT to reject work at any time before final acceptance, the language indicated that "final acceptance" was effectively a final acknowledgement of contract compliance and thus precluded any subsequent arguments that the contractor had not performed properly.[41] As a result the court found that the contractor as principal, was released from further obligations upon the issuance of the final acceptance and the surety was also released from liability.[42]

Another area in the final closeout/acceptance context that has recently given rise to challenges for contractors and surety professionals in satisfaction of performance obligations

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[32] *Id.* at 1009.
[33] *Id.* 1014.
[34] *Id.* at 1010.
[35] *Id.* at 1010.
[36] Id.at 1009.
[37] Id. at 1009
[38] *Id.* 1016.
[39] *Id.* at 1015.
[40] *Id.* 1018.
[41] *Id.* 1014.
[42] *Id.* 1019.

involves Leadership in Energy and Environmental Design (LEED) certification, as well as increasing electronic and communications related systems. While a given project's specifications will list requirements for final acceptance, various other requirements may be incorporated via reference such as those set forth by the Division of the State Architect, General Services Administration, United States Army Corps. of Engineers, LEED criteria, and others.

Some systems in a project are integrated and will require multi sub-trades for functional final testing, such as building management systems, HVAC, mechanical, FLS, and electronical access. This process may also involve specific commissioning agents, local or state inspectors, fire marshals, or other specialized inspectors. Understanding this collaborative process and managing it accordingly is the key to final completion/ acceptance and release of the surety from any further bond obligations.

Conclusion

Testing and inspections of construction and construction materials is an integral part of the building process. While comprehensive testing cannot rule out material failure under all circumstances thorough, rigorous and reliable materials testing is an essential element of any project. The outcome of testing, as well as the processes used, can ultimately affect the safety and longevity of the finished product. For sureties and those under performance bond obligations, testing and inspection requirements are a critical component in any project decision making process.

As discussed in this article, the materials involved on a project often encompass a broad range of structures and consistencies, from soil and underground foundational elements to concrete, steel, and masonry. Equally as diverse is the range of testing/inspection processes and techniques that must be applied to ensure that the materials used meet or exceed project specifications. The stakes in ensuring compliance are high; a poorly tested project can lead to structural failures that can cost contractors, sureties, and owners huge amounts of money in legal exposure and corrective work.

SESSION 12

SHOW ME THE MONEY:
ETHICS IN MEDIATION AND NEGOTIATION

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Show Me the Money: Ethics in Mediation and Negotiation

By: Meredith E. Dishaw

Sureties are often involved in lawsuits with complicated factual scenarios and complex legal issues involving multiple parties on large-scale construction projects. In such situations, it is often in the economic interests of all parties to resolve their claims in advance of trial. One of the most favored processes to accomplish such resolution is mediation. While mediation can be an effective and economical procedure for settling a dispute, it can also raise certain ethical issues that surety representatives, consultants, and practitioners need to consider. This paper will briefly address certain ethical issues relating to conflicts of interest, ethical duties surrounding zealous advocacy and truthfulness, and the protection of proprietary and confidential information. We note that this is brief and narrow discussion of certain ethical issues that could arise and is not intended to be a comprehensive overview. All representatives, consultants, and practitioners should be familiar with the applicable rules of professional conduct for the relevant jurisdiction prior to participation in any mediation.

I. Applicable Rules

In examining the relevant ethical standards, the starting point is the jurisdiction's rules of professional conduct. The American Bar Association's ("ABA") Model Rules of Professional Conduct ("Model Rules") was adopted in 1983. Since that time, all fifty states have utilized the Model Rules to create their jurisdictional rules of professional conduct. In 2018, California was the last state to utilize the ABA's Model Rules as a pattern for its own ethical code.

In addition to the general ethical rules, there are model codes directed specifically to mediation. First, the National Conference of Commissioners on Uniform State law promulgated the Uniform Mediation Act ("Uniform Act"), which has been adopted in whole or in part, in several states, including the District of Columbia, Hawaii, Idaho, Illinois, Iowa, Nebraska, New Jersey, Ohio, South Dakota, Utah, Vermont, and Washington.[1] The focus of the Act is to provide for confidentiality by creating a privilege for mediation communications. The Uniform Act also discusses conflicts of interests.

More specifically, as to the third-party neutral, the ABA adopted the Model Standards of Conduct for Mediators ("Model Standards"). The Model Standards "are designed to serve as fundamental ethical guidelines for persons mediating in all practice contexts."[2] The Model Standards were not only designed to assist mediators, but are also designed to "inform the mediating parties; and to promote public confidence in mediation as a process for resolving disputes."[3] The Model Standards guiding principal for conducting mediation is "self-determination" of the parties which is defined as "the act of coming to a voluntary, uncoerced

[1] DC Code §§ 16-4201 - 16-4213; Haw Rev. Stat. § 658H 1-13; Idaho Code Ann. §§ 9-801 - 9-814; Ill. Comp. Stat. 35/1 – 35/99; Iowa Code Ann. §§ 679C.101 – 679C.115; Neb. Rev. Stat. §§ 25-2930 – 25-2942; N.J. Stat. Ann. 2A:23C1-2A:23C-13; Ohio Rev. Code Ann. §§ 2710.01 – 2710.10; S.D. Codified Laws §§ 19-13A-1 – 19-13A-15; Utah Code Ann. §§ 78B-10-101 – 78B-10-114; Vt. Stat. Ann. Tit. 12, §§ 5711-5723; Wash. Rev. Code. Ann. §§ 7.07.010-7.07.904.
[2] Model Standards, Preamble.
[3] *Id.*

decision in which each party makes free and informed choices as to process and outcome."[4] Other topics covered by the Model Standards include the mediator's impartiality, conflicts of interest, mediator's competence, confidentiality, the quality of the process, guidelines for the mediator's advertising and solicitation of his or her practice, costs of mediation, and the mediator's efforts to advance mediation practice.[5] Some states have also adopted similar rules to apply to certified or court-appointed mediators.[6]

While the various model rules are useful guidelines, states have separate applicable rules relating mediation and negotiation. Most notably, many states have enacted legislation which addresses the confidentiality of certain information and documents revealed during the mediation process. Many state statutes provide for a qualified privilege that exempts mediation communications from discovery and dictate that mediation communications are inadmissible as evidence.[7] Further, the federal rules of evidence and, the evidence rules of most states, dictate that evidence of compromise offers and conduct and statements made during negotiations are not admissible "either to prove or disprove the validity or amount of a disputed claim or to impeach by a prior inconsistent statement or contradiction."[8] Some states have passed statutes which prohibit parties or mediators from voluntarily disclosing mediation statements[9] and certain statutes preclude mediators from being compelled to testify.[10]

The above-cited resources create a baseline of the applicable ethical rules and guidelines in mediation and negotiation. Of course, parties and mediators may negotiate separate terms which expand upon the applicable protections or obligations governing a private mediation. Notably, however, while private agreements may expand upon the protections and/or ethical obligations, most states hold that parties may not seek to limit or contradict the applicable state statutes and ethical rules governing the process.

II. <u>Ethical Issues Relating to Conflicts of Interest</u>

Conflicts of interest arise whenever parties have incompatible interests or concerns. In the context of litigation, conflicts of interest are generally quite clear. However, conflicts of interest become more nuanced as conflicts can arise amongst parties that previously appeared aligned in a common goal. This is particularly true when examining the mediation or resolution goals of a surety and a principal in the context of a construction dispute with the bond obligee.

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[4] ABA Model Standards, Standard I.
[5] *Id.* at Standards II – IX.
[6] *See*, *e.g.*, Fla. Stat. Ann. Mediator Rule 10.700-910; MI R. MCR 2.411; N.C. Standards of Professional Conduct for Mediators.
[7] *See*, *e.g.*, N.C. Gen Stat. § 7A-38.1; Pa. C.S.A. § 5949; RCW 7.07.030.
[8] Fed. R. Evid. 408. *See also*, Alaska R. Evid. 408; Ark. R. Evid. 408; Conn. Code Evid. § 4-8; Fla. Stat. Ann. § 90.408; Ga. Code Ann. §24-4-408; Haw. R. Evid. 408; Idaho R. Evid. 408; Ky. R. Evid. 408; La. Code Evid. Ann. Art 408; Md. R. Evid. 5-408; Mich. R. Evid. 408; Minn. R. Evid. 408; Miss. R. Evid. 408; Mont. R. Evid. 408; Neb. Rev. Stat. Ann. § 27-408; Nev. Rev. Stat. Ann. § 48.015; N.H. R. Evid. 408; N.J. R. Evid. 408; N.C. R. Evid. 408; Ohio R. Evid. 408; Okla. Stat. Ann. Tit. 12, § 2408; Or. R. Evid. 408; R.I. R. Evid. 408; S.C. R. Evid 408; Tenn. R. Evid. 408; Wash. R. Evid. 408; Wis. Stat. Ann. § 904.08; Wyo. R. Evid. 408.
[9] *See*, *e.g.*, Conn. Gen. Stat. § 52-235d; Kansas Stat. Ann. § 60-452a.
[10] *See, e.g.*, Ala. Code § 6-6-25; West Ann. Cal. Evid. Code § 703.5; Kansas Stat. Ann. § 60-452a; N.C. Gen. Stat.

For practitioners, the Model Rules address conflicts of interest in the attorney's past, present, or future representation of a party.[11] Model Rule 1.7 provides that "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest," which exists in two situations: (a) "the representation of one client will be directly adverse to another client; or" (b) "there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."[12] In specifically detailing conflicts of interest as to current clients, the Model Rules provide, in part, that "[a] lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, expect as permitted or required by these Rules."[13] As relevant to settlement, the Model Rules provide that "[a] lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients…unless each client gives informed consent, in a writing signed by the client."[14]

One example of the type of conflict of interest that can arise in mediation was examined by the United States Bankruptcy Court for the Southern District of New York. The Court concluded that a law firm had a grave conflict of interest when it represented a Chapter 7 bankruptcy trustee and also represented the debtors in a separate personal injury action, which the law firm settled prior to trial.[15] While the district court recognized that the differing interests between a bankruptcy trustee and a debtor may never become an actual controversy, here, there was an actual conflict between the trustee and the debtors in relation with the debtors' settlement of the personal injury action.[16] The bankruptcy court explained the conflict as follows: "The potential for that conflict was evident from the moment that the [debtors] expressed their disinclination to participate in a mediation. The conflict became patent during and after the mediation, not only because the [debtors] made clear their rejection of settlement and their desire to go to trial, but because the proposed settlement was palpably contrary to the debtors' interests, although it was recommended to the Trustee by [the law firm]."[17]

A more specific example of a conflict in the suretyship context is set forth in an opinion by the United States District Court for the Southern District of Florida. The Court denied the surety's motion for summary judgment, and, in doing so, analyzed whether the surety had a conflict when it settled competing claims between a general contractor and its principal, the subcontractor.[18] Important to the court's analysis was that the surety, or at the least, the surety and a related corporate entity, issued bonds on behalf of both the principal/subcontractor, Carles Construction, Inc. ("Carles"), and the general contractor, Facchina-McGaughan, LLC ("FM").[19] The subcontractor filed a lawsuit claiming damages totaling approximately $4,500,000, against FM and its surety, for FM's non-payment for the work Carles had performed.[20] In response, FM

[11] Model Rules, Rule 1.7-1.11.
[12] *Id.* at Rule 1.7 (a).
[13] *Id.* at Rule 1.8 (b).
[14] *Id.* at Rule 1.8 (g).
[15] *In re Mercury*, 280 B.R. 35 (S.D.N.Y. Bankr. 2002), *aff'd* 122 Fed. Appx. 528 (2004).
[16] *Id.* at 60.
[17] *Id.*
[18] *Carles Const., Inc. v. Travelers Cas. & Sur. Co. of America*, 56 F. Supp. 3d 1259 (2014).
[19] *Id.* at 1262-1263.
[20] *Id.* at 1262.

asserted counterclaims totaling $16,000,000 for alleged unsatisfactory work and delays.[21] Ultimately, Carles' surety settled all of the disputes between FM and Carles after mediation with a payment of $3,500,000 to FM.[22] Carles filed a lawsuit against the surety, who brought an indemnity counterclaim and third-party complaint.[23] The trial court concluded that the surety had a conflict because it served as the surety to both parties to the construction contract.[24] Carles argued that the surety entered into a settlement favorable to FM, in part, because of the annual premiums paid by FM.[25] After extensive review of the facts and law, the court concluded:

> In the final analysis, [the surety] eliminated Carles's claim for lack of payments owed by [FM] totaling approximately $4,500,000 (as to which it appears that [the surety] conducted no research to determine the validity of those claims, apparently accepting them as valid), and then paid an additional $3,550,000 to [FM] for a grand total benefit to [FM] of $8,050,000. In essence, [the surety] settled a grossly inflated claim of $16,000,000 by ultimately allowing [FM] to recover more than 50% of the claim. If [the surety] had not been operating under an apparent conflict of interest, perhaps it would have been more aggressive in pursuing Carles's claim against [FM] (and [the related surety], pursuant to the payment bond issued to [FM] to which Carles was an obligee) for the failure to make contractual payments. Instead, Carles was left with a loss of the $4,500,000 in unpaid earnings, and now faces a claim from [the surety] in indemnification in excess of $4,000,000."[26]

In conclusion, the district court noted that the surety "appear[ed] to have operated under a conflict of interest in resolving claims brought by two principals in litigation as to separate issued bonds."[27]

While it is fairly common that a surety will have issued two or more bonds relating to a single construction project, the trial court's analysis of that decision should be considered in the light in which it was made – denying a motion for summary judgment where there the court found genuine issues of material fact based, in part, by the principal's affidavits. Nevertheless, the case presents a factual scenario where the interests of the surety and the principal may diverge in resolving an obligee's claim in mediation, particularly when a demand for reimbursement for the surety's loss is later made against that same principal pursuant to the indemnity agreement.

As for mediators, a conflict of interest arises when the known facts would raise a question as to the mediator's impartiality.[28] Such known facts could be related to the mediator's prior involving with the same subject matter; past or present relationships, either personal or professional, with a party to the mediation; or a financial or personal interest in the outcome of

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[21] *Id.*
[22] *Id.* at 1263.
[23] *Id.* at 1271.
[24] *Id.* at 1278.
[25] *Id.* at 1271.
[26] *Id.* at 1280.
[27] *Id.* at 1283.
[28] ABA Model Standards, Standard III (A); Uniform Act, § 9.

mediation.[29] If, upon examination of the known facts, the mediator concludes that there could be a question as to his or her impartiality, the mediator shall disclose such facts to the parties.[30] If the parties agree after such disclosure, then mediator may proceed with mediation.[31] It is notable, however that, "[i]f a mediator's conflict of interest might be viewed as undermining the integrity of the mediation, a mediator shall withdraw or decline to proceed with mediation regardless of the expressed desires or agreement of the parties to the contrary.[32]

One recent decision closely examined the issues surrounding a mediator's conflict of interest and the requirement to disclose such conflicts.[33] In *CEATS, Inc. v. Continental Airlines, Inc.*, while the appellate court ultimately denied the party's request for relief from judgment based on the mediator's failure to disclose a conflict of interest, the court nevertheless concluded that the mediator had an obligation to disclose that conflict of interest.[34] In reaching its decision, the appellate court noted that, because parties have a close relationship with mediators, "it is critical that potential mediators not project any reasonable hint of bias or partiality."[35] The parties' trust of the mediator is crucial because parties are encouraged to share confidential information with the mediator which is often essential to reaching resolution.[36] The appellate court concluded that the mediator improperly failed to disclose his prior relationship with one law firm where the mediator had previously acted as an arbitrator and issued an award in favor of the law firm's client.[37] In reviewing the facts, the appellate court noted that, "at the same time [the mediator] served as a court-appointed mediator" in the instant litigation, the mediator's relationship with the law firm in the prior arbitration was at issue in a pending appeal.[38] "Importantly, this meant that [the law firm] … was actively defending [the mediator's] personal disclosure decisions while he was mediating this case."[39] The court found that the ongoing defense of the award, "could give rise to the appearance [of] impropriety."[40] While the court did not address what specific disclosures the mediator should have made, it did conclude that, "based on the totality of the facts and circumstances surrounding the [arbitration] litigation, [the mediator] breached his duty as a mediator to disclose 'all actual and potential conflicts of interest that are reasonably known to the mediator and could *reasonably be seen* as raising a question about the mediator's impartiality."[41]

Meditation is important to the litigation process, the courts, and, particularly, the participating parties.[42] In order for the process to be successful, the parties and the courts must

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[29] *Id.*
[30] ABA Model Standards, Standard III (B), (C); Uniform Act, § 9 (a).
[31] ABA Model Standards, Standard III (C), (D).
[32] *Id.* at III (E).
[33] *CEATS, Inc., v. Continental Airlines, Inc.*, 755 F.3d 1356 (Fed. Cir. 2014).
[34] *Id.* at 1358, 1361-1362.
[35] *Id.* at 1362.
[36] *Id.* at 1363.
[37] *Id.* at 1364.
[38] *Id.* Notably, the appellate court was examining whether the arbitration award should be vacated in light of the arbitrator's failure to disclose an extensive personal and business relationship with one of the lawyers at the law firm involved in both the arbitration and the mediation.
[39] *Id.*
[40] *Id.*
[41] *Id.* at 1365 (citing ABA Model Standards III (C)).
[42] *Id*. at 1362.

feel that it is fair and unbiased and, thus, the parties must have full trust in the third-party neutral working to resolve the matter.[43] To gain the parties' trust, mediators must disclose any fact that may even hint at a question of impartiality. While this is the mediator's obligation, parties should also be aware of potential conflicts and be proactive in seeking information that the party would deem relevant in decided whether to select or move forward with any particular mediator.

III. Ethical Issues Relating to Zealous Representation and the Duty of Candor

It is one of the paramount duties of an attorney is to act as a zealous advocate for his or her client. In describing an attorney's responsibilities to a client, the Model Rules state that the attorney-advocate "zealously asserts the client's position under the rules of the adversary system."[44] The Model Rules seem to recognize the potential conflict with an attorney's duty of zealous advocacy and duty of honesty when it states that, "[a]s a negotiator, a lawyer seeks a result advantageous to the client but consistent with requirements of honest dealings with others."[45]

The Model Rules require that the attorney act with fairness to an opposing party and opposing counsel.[46] This rule requires, in part, that an attorney not "unlawfully obstruct another party's access to evidence or unlawfully alter, destroy or conceal a document or other material having potential evidentiary value."[47] A lawyer is also obligated to be truthful in statements to others, which would include a mediator or other third party: "a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client…."[48] It constitutes professional misconduct if a lawyer engages "in conduct involving dishonesty, fraud, deceit or misrepresentation" or "in conduct that is prejudicial to the administration of justice."[49]

The ABA addressed the conflict between zealous advocacy and the honesty in its formal ethics opinions. Most recently, in 2006, the ABA examined the duty of honesty under Rule 4.1 and "puffing" statements made regarding a party's settlement goals or willingness to compromise.[50] The opinion noted that, often statements regarding a party's position are made during mediation, which are not entirely accurate, including, as an example, statements which understate a party's willingness to make concessions or a party's exaggeration of the strengths of its case.[51] The ABA distinguished such posturing statements as "statements upon which parties to a negotiation ordinarily would not be expected justifiably to rely, and must be distinguished

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[43] *Id.*
[44] ABA Model Rules, Preamble [2]. Further, Model Rule 1.3 dictates that "[a] lawyer should pursue a matter on behalf of a client despite opposition, obstruction or personal inconvenience to the lawyer, and take whatever lawful and ethical measures are required to vindicate a client's cause or endeavor. A lawyer ***must also act with commitment and dedication to the interests of the client with zeal in advocacy upon the client's behalf***." (emphasis added).
[45] ABA Model Rules, Preamble [2].
[46] *Id.* at Rule 3.4.
[47] *Id.* at Rule 3.4 (a).
[48] *Id.* at Rule 4.1.
[49] *Id.* at Rule 8.4.
[50] ABA Formal Opinion 06-439.
[51] *Id.* at 791.

from false statements of material fact." [52] Previously, the ABA concluded that a lawyer could ethically decline to answer a question from the tribunal as to the lawyer's settlement authority, but the lawyer could not lie or misrepresent any facts in response to such a question.[53] Further, while a lawyer may not mispresent adverse facts, such as the running of the statute of limitations on a client's claim, the lawyer need not reveal such an adverse fact during negotiations.[54] Ultimately, the ABA concluded that Rule 4.1 demands that a lawyer "not make a false statement of material fact to a third person" in a negotiation, but that "statements regarding a party's negotiating goals or its willingness to compromise, as well as statements that can fairly be characterized as negotiation 'puffing,' are ordinarily not considered 'false statements of material fact' within the meaning of the Model Rules."[55] The ABA cautioned lawyers to take care "to ensure that communications regarding the client's position, which otherwise would not be considered statements 'of fact,' are not conveyed in language that converts them, even inadvertently, into false factual representations."[56]

Recently, the United States District Court for the Southern District of New York issued an unpublished decision addressing the issues of truthfulness in negotiation on cross-motions for sanctions for alleged misrepresentations during a settlement conference.[57] Ultimately, the court did not impose sanctions because the defendant did not establish, by clear and convincing evidence, that the plaintiff's attorney acted with bad faith or that the conduct constituted a fraud upon the court.[58] Nevertheless, the court stated that it was "troubled by the allegations surrounding [the plaintiff's attorney]'s purported misuse of the Warner Bros. license for the purpose of attempting to set a damages figure at the settlement conference."[59] The district court concluded that, "[t]o the extent [the plaintiff's attorney] was attempting to use the potential Warner Bros. license as leverage to support a higher settlement demand in this case, and he thought that the license could be considered separate from the settlement agreement (or at least wanted to argue that it could) he was posturing about the value of Otto's case at the conference, as lawyer's often do."[60] While the court did not impose sanctions on the plaintiff's attorney, it did not condone the attorney's "alleged practice of attempting to use a so-called stand-alone license as a bargaining chip in other cases."[61] Indeed, the court noted that, if there was a clear record that the "license" was obtained solely as a result of a separate settlement, "it is plainly misleading to suggest that the license has any significance independent of the settlement or that it should be used to form the basis of damages calculations."[62]

It has been consistently recognized that, when examining an attorney's duty of truthfulness in settlement negotiations, it is difficult to draw the line between ethical and

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[52] *Id.* at 792.
[53] *Id.* at 794 (citing ABA Formal Opinion 93-370).
[54] *Id.* at 795 (citing ABA Formal Opinion 94-387). Conversely though, the ABA did conclude that a lawyer in settlement negotiations with the opposing party in a personal injury matter was obligated to promptly notify the other party of the client's death as that was a material fact. *Id.* at 795 (citing ABA Formal Opinion 95-397).
[55] *Id*. at 798.
[56] *Id.*
[57] *Otto v. Hearst Communications, Inc.*, 2019 WL 1034116 (Feb. 21, 2019).
[58] *Id.* at *7.
[59] *Id.*
[60] *Id.* at *8.
[61] *Id.* at *9.
[62] *Id.*

unethical behavior.[63] While it is clear that a certain amount of posturing or puffery is expected and acceptable, it is not clear when such posturing becomes an ethical violation. As cautioned by the ABA, it seems clear that such posturing or puffery around material factual statements could be grounds for trouble, particularly if a resulting settlement is based on what may be perceived as a factual misrepresentation.

IV. Ethical Issues Relating Confidential Information at Mediation

The law protects the attorney-client relationship by providing confidentiality to the discussions between the client and attorney. Similarly, the law also protects certain documents evidencing confidential, private, or proprietary information from being revealed in the public forum. The Model Rules impose an obligation on an attorney to maintain the confidentiality of all information relating to the representation of a client unless the client gives informed consent for its disclosure or if certain narrow exceptions apply.[64]

For similar reasons, almost every jurisdiction recognizes the need to protect the confidentiality of mediation process as such confidentiality allows for the open and effective dialog necessary to reach resolution.[65] Again, as noted above, most states have enacted various provisions protecting the confidentiality of information and documents exchanged in mediation or in settlement negotiations. The Uniform Act provides that, unless the information and documents are subject to the applicable jurisdiction's public records or open meetings act, "mediation communications are confidential to the extent agreed by the parties or provided by other law or rule of th[e] State."[66] Further, mediators have separate obligations to maintain the confidentiality of any information obtained during mediation and to not disclose the parties' conduct during mediation.[67] Further, it is the mediator's obligation to maintain the confidentiality of any information disclosed to him or her by one party from the other parties, unless the mediator was given expressed consent to share the information.[68] States have adopted their own rules regarding the confidentiality of mediation, and some states have adopted a nearly comprehensive prohibition on the mediator's disclosure of information learned before, during, or after mediation.[69]

The confidentiality of mediation and the protections inherent to the client in the attorney-client relationship provide security that the client's information disclosed during the mediation process will more than likely remain confidential and protected from discovery or from the public view. However, none of the rules, codes, or guidelines address whether a party can reveal confidential or private information about another party, to the mediator or otherwise, during the course of mediation. While anything shared with the mediator should remain confidential from the other parties, unless the party expressly agrees it can be shared, a party and its counsel should

[63] *Id.* at *9 (citing *Ausherman v. Bank of America Corp.*, 212 F. Supp. 2d 435, 446 (D. Md. 2002)).
[64] ABA Model Rules 1.6.
[65] *See*, *e.g.*, *McKenzie Const. v. St. Croix Storage Corp.*, 961 F. Supp. 857, 861-862 (D.V.I. 1997).
[66] Uniform Act, § 8. "Mediation Communication" is defined as "a statement, whether oral or in a record or verbal or nonverbal that occurs during a mediation or is made for purposed of considering, conducting, participating in, initiating, continuing, or reconvening a mediation or retaining a mediator." *Id.* at § 2 (2).
[67] Model Standards, Standard V.
[68] Model Standards, Standard V (B).
[69] Revised Standards of Professional Conduct for Mediators, adopted by the North Carolina Supreme Court as amended in 2014, Standard III.

still carefully consider what information about another party it can or should reveal, particularly if that information could be used to prejudice the other party in its settlement negotiations or otherwise.

V. Conclusion

Mediation is an effective and efficient tool to resolve disputes in the suretyship context, particularly when there are multiple parties involved and where complex factual and legal issues are presented. Nevertheless, the parties, their counsel, and the mediator must take care in navigating the ethical issues that can arise during mediation, including conflict of interest issues, the clash of duties of zealous representation and truthfulness, and the duties around protecting confidential information.

SESSION 13

SERVING TWO MASTERS:
THE ETHICAL RISKS OF JOINT REPRESENTATION OF THE CONTRACTOR AND SURETY

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PEARLMAN 2019

September 5-6, 2019

Columbia Winery | Woodinville, WA

Serving Two Masters: The Ethical Risks of Joint Representation of the Contractor and Surety

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Introduction

A tender defense is representation offered in defense of a claim, which one contracting party offers to another party pursuant to a contractual obligation to provide for the defense of the second party. The most common example is the defense tendered by insurance companies to their insured. In this case, an insurance company has an obligation both to pay the covered claim and to provide a defense to the policy holder. The insurer is not a party to the litigation, only the insured. Nevertheless, pursuant to the insurance policy, the insurer hires an attorney to represent the insured, at the insurer's expense. The insured is the direct client, notwithstanding the fact that the fees are paid by the insurer. Thus, the defense is tendered the insurance company to the policy holder. The insurer does so since, although not an actual party to the litigation, it will ultimately have to bear the cost for paying a covered claim.

A tendered defense in the context of a surety bond works in an entirely different, and mostly opposite fashion. A surety is, by definition, jointly liable to claimants. Where there is a surety bond in place, typically a performance and payment bond, the contractor obtaining the bond will almost certainly have agreed to provide the surety with indemnity for all claims and expenses, including the expense of attorneys' fees for handling any claim on the bond. A claimant will generally sue both the contractor and the surety company. It is common practice for the surety, upon receipt of a claim, to tender its defense to its principal/contractor. Often in these circumstances, the contractor will offer, in lieu of having to repay the surety for the attorneys hired by the surety, to directly retain an attorney to defend the claims on behalf of the surety. Usually, this will be the same attorney who is defending the principal. No matter if the suggestion of a tender defense is proposed by the surety or the principal, it is the principal who will tender the services of an attorney to defend the surety against liability and the surety company becomes the direct client of the attorney. It is the principal who pays the attorneys' fees. In other situations, the surety company may ask the contractor to either resolve the claim or

to provide the defense attorney. Thus, the defense is tendered by the bonded principal to the surety company. The bond principal does so, even though the surety may be jointly liable to the claimant, because the principal must then repay the surety and so the principal will ultimately have to bear the cost for paying the covered claim.

As a consequence, the ethical concerns raised by the surety tender defense are fundamentally different from those which arise from time to time in the insurance defense. In suretyship cases, it is necessary to consider three sources of concern: substantive surety law, the Rules of Professional Conduct, and that area of great concern" business realty. Furthermore, even after undertaking the tender defense, the attorney must continually revisit these concerns to determine whether the tender defense remains viable and ethical.

Advantages of joint representation

However, if after investigation, the surety and the contractor concur that there is a basis for defending a claim and agree to work out the indemnification issues thereafter or between themselves, there are advantages for both the surety and the general contractor gained from joint representation. Since the general contractor would also be obliged to indemnify the surety for any separate legal defense costs, it is in the contractor's interest to have to pay only one attorney, not two (his own and the surety's). The client's interest in saving money through joint representation is usually mentioned but given short shrift in discussions about ethics. Often the only way a client can obtain effective representation is through cost savings and this benefit shouldn't be rejected because of purely abstract concerns about conflicts. From the surety's point of view, if the contractor tenders a defense through his own counsel, the contractor is not going to be able to contest the counsel fees or even whether any settlement is imposed by the surety in bad faith.

Once again, it is useful to contrast the suretyship tender defense with problems arising under insurance policies. An insured has an obvious interest ·in insisting on the insurer's obligation to

indemnify him for any losses in a policy. Insurance coverage is the source that the contractor can rely on to pay any losses. Thus, an insured will have an interest in not allowing the claims which are covered to be dismissed prior to the claims which may not be covered, since by doing so he will lose coverage and payment for the claims. A wise and solvent contractor will understand that he will ultimately have to pay for any liability found against the surety. He has no interest in "keeping the surety in the case". Therefore, defending the surety ultimately constit11tes a defense of his own funds. Furthermore, a contractor who wishes to remain in business will continue to have demands for future bonding. If the surety and the contractor have had a long standing underwriting relationship, uniting in a tender defense can serve to promote their mutual business good will. Joint representation will often result in the simplification of issues, expedite the litigation and the jointly represented parties will gain the strength of presenting a united front.

Finally, a joint defense might make it easier to preserve the attorney-client privilege with respect to the joint development of expert reports ai1d other litigation work product. It will also enable the attorney to more easily and expeditiously obtain information needed for litigation, since he will be free to contact both the surety claims manager and the contractor's key personnel where they are both his clients.

Identifying conflict and confidentiality issues

Ordinarily an attorney benefits a client by exercising his or her professional judgment for the exclusive benefit of the client. In the case of representation of multiple clients, this singular focus might be compromised because the attorney is advocating for the benefit of multiple clients. An attorney must determine whether each client will be adequate; the absence of exclusivity as to each client must not adversely impact the representation of the interests of each individual client.

The undertaking of a multiple representation is a multi-step process that requires caution. The question of whether the interests of the parties are directly adverse is only the threshold inquiry. Once the attorney determines that the clients' interests are not directly adverse, the attorney must consult with the clients and disclose potential conflicts and acquire their informed consent to joint representation.

Informed, written consent of clients

The rules of provisional conduct in all jurisdictions does not necessarily require that a clients informed consent to joint representation be in writing. Best practices, however, dictates that such consent always be obtained in writing. The burden of establishing disclosure and consent will be on the attorney. This generally includes a discussion with the clients at the outset that alerts the clients to the pros and cons of the joint representation. This discussion occurs only after the attorney satisfies himself or herself that joint representation will not adversely affect the interests of any individual client. There might be instances where it might be impossible to give the disclosures necessary to obtain informed consent, such as when one of the prospective clients refuses to give the attorney to disclose certain information to another prospective client. In this case, the attorney must decline the joint representation.

Surety defenses that could be adverse to the principal's interests

The surety also has certain defenses which are unique to it, and which the contractor cannot assert. These defenses, called the "personal defenses" of the surety, are often hostile in some ways to the interests of the contractor. The commonly recognized "personal defenses" include: (1) the surety's liability is strictly limited to the terms of the bond, including the limits on the amount of the bond and direct contractual claims as opposed to extra-contractual recoveries; (2) overpayment by the owner to the contractor; (3) the obligee's fraudulent inducement of the surety to execute the bond; (4) alterations to the underlying contract which materially change the surety's risk; (5) failure to comply with notice and other requirements for

perfecting claims against the bond; (6) lapse of the statute of1imitations for bond claims; (7) limitation on the scope of beneficiaries who are protected by the bond; (8) release of the principal.

Some of these defenses arise from the surety's right to succeed to the contractor's interest. If the surety is called upon, under the bond, to fulfill some of the contractor's obligations, then the surety succeeds to the contractor's rights from the owner or claimant. Most important1y, the surety is entitled to receive the payment from the owner of the contract monies which the owner would have paid to the contractor for work performed. This right is of crucial importance to the surety, since it is from the contract fund that the surety expects that it will most likely be able to obtain its indemnification. Therefore, the owner has an obligation not to waste away, pledge to another entity, or disburse the contract fund, and should expect to pay the contractor for that work done.

The overpayment defense arises where the owner, sometimes accidentally and sometimes deliberately to "help" the contractor, pays the contractor before the contractor has completed the work and is owed the money. This practice hurts the surety in two ways. First, once the funds have been paid, they may no longer be available to be paid to the surety. Second, as any consumer who has had house remodeling done knows, there is no better way to lessen a contractor's enthusiasm for doing work in a timely manner than by prepaying him for it. Thus, if an owner pays the contractor the full amount halfway through the project rather than in the installments specified in the contract, and if the contractor, having received its money shows no interest in doing any further work, the owner will not be able to demand that the surety complete the work. Similarly, if the contract requires the owner to inspect that the work being done is satisfactory, and if the owner fails to do so but still pays for it, the owner cannot expect the surety to provide the repairs and reworking for free.

A variation of this defense which has been recognized in the federal courts is the breach of contractual procedures by the owner. Under this defense, the surety asserts that many provisions in the contract serve to protect the surety by requiring the monitoring and enforcement of the contractor's performance on an ongoing basis so that defaults, diversion of funds, and other problems can be avoided before they tum into expensive bond claims. When asserting this defense, the surety is essentially asserting that the owner (and the owner's architect and construction managers) so mismanaged the contract that they were "incapable of protecting the surety's equitable rights."

Other defenses arise because a claim on a surety bond is subject to specific requirements of notice, and time of suit. For instance, the federal bond claim act, known as the Miller Act, has a one-year jurisdictional statute of limitations. After the lapse of this year, the subcontractor can sue the contractor (but not the bonding company) for payment. Once the Miller Act claim is dismissed on this ground, the federal court may even dismiss the state law claims against the contractor (assuming no diversity jurisdiction). The bond is also specific to the underlying contract; "extra-contractual" claims against the contractor are not always regarded as legitimate claims on the bond. The surety, for instance, will not be responsible for loss of profit claims or negligence claims asserted against the contractor.

Indemnity issues

The final set of obligations is between the surety and its principal, the contractor. Generally, a principal/contractor is obliged under both common law principles and a written agreement to indemnify the surety for the costs and expenses to the surety of investigation, resolving and defending any claim on the bond. The indemnitors and principal are also obliged to notify the surety of any defenses which may exist. Under most written indemnity agreements, the surety retains the right to adjust a claim under the bond itself. As long as its decision is made

in good faith, it can be assumed that when a settlement or payment is made, it is made in good faith.

The surety company's common law right to indemnification is one that the courts favor. The written agreement of indemnity may vary from company to company. However, they are generally tightly drafted and provide the surety with a wide range of rights and options to enforce the indemnity obligations. Nevertheless, these agreements are regarded as a fair bargain for the principal as the price of obtaining the guaranty to the obligee. The only defenses to the duty to indemnify which have received widespread recognition are: (1) claims that the surety has already been repaid; (2) claims that the indemnitor was discharged through bankruptcy; (3) claims that the indemnity agreement was forged; and (4) claims that the surety's losses and expenses were incurred in bad faith. The burden of proof is on the indemnitor to prove these defenses. With respect to indemnification to the surety of its legal fees, some jurisdictions will allow indemnitors to challenge the fees as unreasonably high, but not to assert the full panoply of defenses to attorneys' fees that a direct client may assert in first party fee litigation.

Surety's tender of defense under GIA

Oftentimes, when faced with an obligee's payment or performance bond claim, it makes sense for the surety to tender its defense to the principal's attorney. For the reasons set forth above, however, this scenario may present some obvious ethical conflicts. Accordingly, prior to making the decision to tender its defense, the surety must consider whether its interests are adverse, or may become adverse, to the principal's, and the surety must evaluate the impact of how confidential information may be shared in a joint representation. Depending upon the issues in dispute, and the surety's potential separate defenses, the surety may determine that a conflict with its principal is likely. The surety will be guided in this decision by the ethical rules and considerations set forth above. Notwithstanding, if the surety determines a conflict is likely, the surety should be aware that in procuring a separate defense, its costs and fees may not always be

recoverable in a subsequent indemnity action against its principal. The surety should take care to review the factors that courts have considered in making this determination.

When is the surety entitled to retain separate counsel? Principal's challenges to the surety's indemnity claim for separate counsel.

Courts have analyzed a number of factors related to recovery of legal fees separately incurred by the surety. In evaluating whether the surety could recover the fees expended for separate counsel, courts have held that the surety must establish its good faith and show that the expenditure of attorneys' fees was reasonably necessary. Some of the factors that have been reviewed to evaluate reasonableness include:

- The amount of risk to which the surety was exposed;
- Whether the principal was solvent;
- Whether the principal refused to deposit with the surety collateral in the amount of the claim;
- Whether the principal was notified of the action and given the opportunity to defend for itself and the surety;
- Whether the principal hired the attorney for both himself and the surety;
- Whether the principal notified the surety that it hired an attorney;
- The competency of the attorney hired by the principal;
- The diligence displayed by the principal and its attorney in defense of the claim;
- Whether there is a conflict of interest between the parties,
- The attitude and cooperativeness of the surety; and
- The amount charged and diligence of the attorney hired by the surety.

Other courts have declined to engage in this reasonableness analysis where an indemnity agreement contains a "prima facie evidence" clause. Courts have stated this "prima facie

evidence" clause shifts to the indemnitor the burden of proving that the attorneys' fees incurred by the surety were not recoverable.

Rules of Professional Conduct

Conflicts of interest

When can an attorney ethically represent multiple parties? The rules surrounding this question are found in each state's rules of professional conduct (RPC). Each states' rules of professional conduct are generally bases upon the ABA Model Rules of Professional Conduct. States commonly modify the model rules, so attorneys must look to the rules of professional conduct as adopted in their particular jurisdiction.

RPC 1.6. Confidentiality and the duty of loyalty

Rule 1.6 addresses and attorney's specific obligation to preserve client confidences and prohibits disclosure of a client's confidences without informed consent. This can prove problematic for attorneys engaged in the joint representation a principal/contractor and surety.

Washington, Rule 1.6. Confidentiality of Information.

> **(a)** A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
> **(b)** A lawyer to the extent the lawyer reasonably believes necessary:
> (1) shall reveal information relating to the representation of a client to prevent reasonably certain death or substantial bodily harm;
> (2) may reveal information relating to the representation of a client to prevent the client from committing a crime;
> (3) may reveal information relating to the representation of a client to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services;
> (4) may reveal information relating to the representation of a client to secure legal advice about the lawyer's compliance with these Rules;
> (5) may reveal information relating to the representation of a client to establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a

defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client;

(6) may reveal information relating to the representation of a client to comply with a court order;

(7) may reveal information relating to the representation to detect and resolve conflicts of interest arising from the lawyer's change of employment or from changes in the composition or ownership of a firm, but only if the revealed information would not compromise the attorney-client privilege or otherwise prejudice the client; or

(8) may reveal information relating to the representation of a client to inform a tribunal about any breach of fiduciary responsibility when the client is serving as a court-appointed fiduciary such as a guardian, personal representative, or receiver.

(c) A lawyer shall make reasonable efforts to prevent the inadvertent or unauthorized disclosure of, or unauthorized access to, information relating to the representation of a client.

California. Rule 1.6. Confidential Information of Client.

(a) A lawyer shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) unless the client gives informed consent,[1] or the disclosure is permitted by paragraph (b) of this rule.

(b) A lawyer may, but is not required to, reveal information protected by Business and Professions Code section 6068, subdivision (e)(1) to the extent that the lawyer reasonably believes* the disclosure is necessary to prevent a criminal act that the lawyer reasonably believes* is likely to result in death of, or substantial* bodily harm to, an individual, as provided in paragraph (c).

(c) Before revealing information protected by Business and Professions Code section 6068, subdivision (e)(1) to prevent a criminal act as provided in paragraph (b), a lawyer shall, if reasonable* under the circumstances:

(1) make a good faith effort to persuade the client: (i) not to commit or to continue the criminal act; or (ii) to pursue a course of conduct that will prevent the threatened death or substantial* bodily harm; or do both (i) and (ii); and

(2) inform the client, at an appropriate time, of the lawyer's ability or decision to reveal information protected by Business and Professions Code section 6068, subdivision (e)(1) as provided in paragraph (b).

(d) In revealing information protected by Business and Professions Code section 6068, subdivision (e)(1) as provided in paragraph (b), the lawyer's disclosure must be no more than is necessary to prevent the criminal act, given the information known* to the lawyer at the time of the disclosure.

(e) A lawyer who does not reveal information permitted by paragraph (b) does not violate this rule.

RPC 1.7. Conflicts of interest

Rule 1.7 sets out the specific duties of an attorney to current clients when considering whether the attorney can represent another party with respect to a claim adverse to the interest of a current client. If the duties to one client could materially impact the attorney's representation of another client, the representation is prohibited.

Washington. RPC 1.7. Conflict of Interest. Current Clients.

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
(1) the representation of one client will be directly adverse to another client; or
(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:
(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
(2) the representation is not prohibited by law;
(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
(4) each affected client gives informed consent, confirmed in writing (following authorization from the other client to make any required disclosures).

California. RPC 1.7. Conflict of Interest: Current Clients.

(a) A lawyer shall not, without informed written consent[1] from each client and compliance with paragraph (d), represent a client if the representation is directly adverse to another client in the same or a separate matter.
(b) A lawyer shall not, without informed written consent from each affected client and compliance with paragraph (d), represent a client if there is a significant risk the lawyer's representation of the client will be materially limited by the lawyer's responsibilities to

or relationships with another client, a former client or a third person, or by the lawyer's own interests.

(c) Even when a significant risk requiring a lawyer to comply with paragraph (b) is not present, a lawyer shall not represent a client without written disclosure of the relationship to the client and compliance with paragraph (d) where:

(1) the lawyer has, or knows* that another lawyer in the lawyer's firm* has, a legal, business, financial, professional, or personal relationship with or responsibility to a party or witness in the same matter; or

(2) the lawyer knows or reasonably should know that another party's lawyer is a spouse, parent, child, or sibling of the lawyer, lives with the lawyer, is a client of the lawyer or another lawyer in the lawyer's firm, or has an intimate personal relationship with the lawyer.

(d) Representation is permitted under this rule only if the lawyer complies with paragraphs (a), (b), and (c), and:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law; and

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal.

(e) For purposes of this rule, “matter” includes any judicial or other proceeding, application, request for a ruling or other determination, contract, transaction, claim, controversy, investigation, charge, accusation, arrest, or other deliberation, decision, or action that is focused on the interests of specific persons, or a discrete and identifiable class of persons.

RPC 1.8. Prohibited transactions.

Washington. RPC 1.8. Conflict of Interest: Current Clients: Specific Rules.

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of an independent lawyer on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, expect as permitted or required by these Rules.
(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of the client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.
(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.
(e) A lawyer shall not, while representing a client in connection with contemplated or pending litigation, advance or guarantee financial assistance to a client, except that:
(1) a lawyer may advance or guarantee the expenses of litigation, including court costs, expenses of investigation, expenses of medical examination, and costs of obtaining and presenting evidence, provided the client remains ultimately liable for such expenses; and
(2) in matters maintained as class actions only, repayment of expenses of litigation may be contingent on the outcome of the matter.
(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:
(1) the client gives informed consent;
(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
(3) information relating to representation of a client is protected as required by Rule 1.6.
(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, confirmed in writing. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and the participation of each person in the settlement.
(h) A lawyer shall not:
(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented by a lawyer in making the agreement; or
(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of an independent lawyer in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:
(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and
(2) contract with a client for a reasonable contingent fee in a civil case.
(j) A lawyer shall not:
(1) have sexual relations with a current client of the lawyer unless a consensual sexual relationship existed between them at the time the client-lawyer relationship commenced; or
(2) have sexual relations with a representative of a current client if the sexual relations would, or would likely, damage or prejudice the client in the representation.
(3) For purposes of Rule 1.8(j), "lawyer" means any lawyer who assists in the representation of the client, but does not include other firm members who provide no such assistance.
(k) While lawyers are associated in a firm with other lawyers or LLLTs, a prohibition in the foregoing paragraphs (a) through (i) of this Rule or LLLT RPC 1.8 that applies to any one of them shall apply to all of them, except that the prohibitions in paragraphs (a), (h), and (i) of LLLT RPC 1.8 shall apply to firm lawyers only if the conduct is also prohibited by this Rule.
(l) A lawyer who is related to another lawyer or LLLT as parent, child, sibling, or spouse, or who has any other close familial or intimate relationship with another lawyer or LLLT, shall not represent a client in a matter directly adverse to a person who the lawyer knows is represented by the related lawyer or LLLT unless:
(1) the client gives informed consent to the representation; and
(2) the representation is not otherwise prohibited by Rule 1.7.
(m) A lawyer shall not:
(1) make or participate in making an agreement with a governmental entity for the delivery of indigent defense services if the terms of the agreement obligate the contracting lawyer or law firm:
(i) to bear the cost of providing conflict counsel; or
(ii) to bear the cost of providing investigation or expert services, unless a fair and reasonable amount for such costs is specifically designated in the agreement in a manner that does not adversely affect the income or compensation allocated to the lawyer, law firm, or law firm personnel; or
(2) knowingly accept compensation for the delivery of indigent defense services from a lawyer who has entered into a current agreement in violation of paragraph (m)(1).

California. RPC 1.8.1 to 1.8.11. See the extensive list of rules adopted in California.

Joint defense agreement

Certain conflicts between a principal and surety may be ameliorated by entering into a joint defense agreement. Courts have recognized that a principal and surety may share a work product privilege, often referred to as the common defense privilege. In this situation, the parties may internally draft an agreement which identifies how confidential information will be shared and distributed among the parties. Such agreements will facilitate the parties' understanding as to how the joint representation will progress and the manner in which confidential information will be shared, thereby avoiding issues of conflict of interest. If the interests of the principal and surety diverge, however, the use of confidential information may pose a problem for both parties and their attorney. Certain claims by one party may open the door to discovery from the other party of information which otherwise might be confidential and not normally subject to disclosure. An example would be the principal's claim for loss bonding capacity, which could open the door for discoverability of the surety's underwriting file, which likely contains certain confidential and proprietary information related to the surety's underwriting methodology and calculus, among other things. Accordingly, the surety should be aware of the production and use of confidential information in the context of joint defense or representation.

Thus, in considering joint representation, the surety must be mindful of the potential conflicts of interest that may arise, and whether the interests of the parties are aligned or likely to become diverse. Additionally, the surety must consider how the disclosure of confidential information will be handled and whether such information is shared among the parties through a joint defense agreement or otherwise.

Settling the principal’s claim

The surety is afforded wide latitude in invoking its rights under indemnity agreements. Notwithstanding, in conjunction with the ethical parameters discussed above, the surety must determine when and how best to invoke these rights. In this regard, there are a number of ethical

issues that the surety must consider in its handling of the principal's claims, including its decision to settle such claims. The surety may be faced with a conflict of interest with its principal - the surety desiring to settle the claims and the principal seeking to further adjudicate the claims. While courts have uniformly enforced the surety's rights under indemnity agreements, and have held that the surety has broad discretion to settle its principal's claims under such agreements, whenever the surety is considering invoking its rights under the indemnity agreement, there is almost certainly a direct conflict between the principal and surety making joint representation no longer feasible.

Determinations related to settlement such as when to invoke the power of attorney clause, for example, involve an analysis of many business, legal and ethical considerations for the surety. In this regard, the surety may have already incurred losses on the bonded project, and may have also demanded collateral security from its principal, to no avail. The principal's refusal to put the surety in funds, leaves the surety with the option to take over the principal's affirmative claims, as collateral to mitigate its losses. The case law indicates that the surety has the right to enforce the power of attorney and claims settlement provisions upon the principal's default under the indemnity agreement - and specifically when the surety has incurred losses. The surety, guided by ethical principles, must decide, however, when to invoke these rights.

Courts have recognized the surety's right to settle the principal's claims, but are split on whether the surety’s settlement of the claim must comport with the contractual and ethical duties of good faith. Some courts have held that the surety’s settlement must comply with good faith requirements, while others have held that where a surety faces loss exposure, and its principal fails to post collateral as required under the indemnity agreement, the principal is precluded from alleging any defense of bad faith arising from the surety's settlements made pursuant to its claims assignment. The surety should be cautious in its implementation of its rights under an indemnity agreement.

Meritorious claims or contentions

Issues can arise when an attorney is representing both the principal and surety and when the surety is pursing the principal's claims via assignment. The rules provide that all claims presented by an attorney must have a valid basis in fact and law.

RPC 3.1. Meritorious claims and contentions

Washington. RPC 3.1. Meritorious Claims and Defenses.

> A lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law. A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in incarceration, may nevertheless so defend the proceeding as to require that every element of the case be established.

California. RPC 3.1. Meritorious Claims and Contentions.

> **(a)** A lawyer shall not:
> (1) bring or continue an action, conduct a defense, assert a position in litigation, or take an appeal, without probable cause and for the purpose of harassing or maliciously injuring any person; or
> (2) present a claim or defense in litigation that is not warranted under existing law, unless it can be supported by a good faith argument for an extension, modification, or reversal of the existing law.
> **(b)** A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in incarceration, or involuntary commitment or confinement, may nevertheless defend the proceeding by requiring that every element of the case be established.

RPC 3.2. Expediting litigation

Washington. RPC 3.2. Expediting Litigation.

> A lawyer shall make reasonable efforts to expedite litigation consistent with the interests of the client.

California. RPC 3.2. Delay of Litigation.

> In representing a client, a lawyer shall not use means that have no substantial[1] purpose other than to delay or prolong the proceeding or to cause needless expense.

RPC 3.3. Candor toward the tribunal

Washington. RPC 3.3. Candor Toward the Tribunal.

(a) A lawyer shall not knowingly:
(1) make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal by the lawyer;
(2) fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client unless such disclosure is prohibited by Rule 1.6;
(3) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by the opposing party;
(4) offer evidence that the lawyer knows to be false.
(b) The duties stated in paragraph (a) continue to the conclusion of the proceeding.
(c) If the lawyer has offered material evidence and comes to know of its falsity, the lawyer shall promptly disclose this fact to the tribunal unless such disclosure is prohibited by Rule 1.6.
(d) If the lawyer has offered material evidence and comes to know of its falsity, and disclosure of this fact is prohibited by Rule 1.6, the lawyer shall promptly make reasonable efforts to convince the client to consent to disclosure. If the client refuses to consent to disclosure, the lawyer may seek to withdraw from the representation in accordance with Rule 1.16.
(e) A lawyer may refuse to offer evidence that the lawyer reasonably believes is false.
(f) In an ex parte proceeding, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse.

California. RPC 3.3. Candor Toward the Tribunal.

(a) A lawyer shall not:
(1) knowingly make a false statement of fact or law to a tribunal or fail to correct a false statement of material fact or law previously made to the tribunal* by the lawyer;
(2) fail to disclose to the tribunal legal authority in the controlling jurisdiction known to the lawyer to be directly adverse to the position of the client and not disclosed by opposing counsel, or knowingly misquote to a tribunal the language of a book, statute, decision or other authority; or
(3) offer evidence that the lawyer knows to be false. If a lawyer, the lawyer's client, or a witness called by the lawyer, has offered material evidence, and the lawyer comes to know of its falsity, the lawyer shall take reasonable remedial measures, including, if necessary, disclosure to the tribunal, unless disclosure is prohibited by Business and Professions Code section 6068, subdivision

(e) and rule 1.6. A lawyer may refuse to offer evidence, other than the testimony of a defendant in a criminal matter, that the lawyer reasonably believes is false.
(b) A lawyer who represents a client in a proceeding before a tribunal and who knows that a person intends to engage, is engaging or has engaged in criminal or fraudulent conduct related to the proceeding shall take reasonable remedial measures to the extent permitted by Business and Professions Code section 6068, subdivision (e) and rule 1.6.
(c) The duties stated in paragraphs (a) and (b) continue to the conclusion of the proceeding.
(d) In an ex parte proceeding where notice to the opposing party in the proceeding is not required or given and the opposing party is not present, a lawyer shall inform the tribunal of all material facts known to the lawyer that will enable the tribunal to make an informed decision, whether or not the facts are adverse to the position of the client

RPC 4.1 Truthfulness in statements to others

Washington. RPC 4.1 Truthfulness In Statements to Others.

In the course of representing a client a lawyer shall not knowingly:
(a) make a false statement of material fact or law to a third person; or
(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.

California. RPC 4.1. Truthfulness In Statements to Others.

In the course of representing a client a lawyer shall not knowingly:
(a) make a false statement of material fact or law to a third person; or
(b) fail to disclose a material fact to a third person when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Business and Professions Code section 6068, subdivision (e)(1) or rule 1.6.

Federal False Claims Act. 31 U.S.C. § 3729

Just a brief mention of the Federal False Claims Act, 31 U.S.C. § 3729, et seq., which generally provides that any person who knowingly presents, or causes to be presented, to the Government a false or fraudulent claim for payment or approval will be liable to the United States Government for certain civil penalties. This can apply to both attorneys and non-

attorneys. To establish a claim under the False Claims Act, the Government must prove, by a preponderance of the evidence, that (1) the contractor presented to the United States a claim for payment; (2) the claim was false or fraudulent; (3) the contractor knew the claim was false or fraudulent; and (4) the United States suffered damages as a result of the false or fraudulent claim. A person will be deemed to have “knowingly” presented a false claim within the meaning of the Act when the person either has actual knowledge that the claim is false, or it acted in “deliberate ignorance” or “reckless disregard” of the truth or falsity of the claim. A surety who plans to assert the claims of its principal must conduct a thorough review of its contractor's records prior to submitting the principal's claims.

Conclusion

The surety tender defense is quite different than the liability insurer tender defense because the obligations which run between the obligee, bonded principal, surety and indemnitors are more complex. Where the contractor and the surety both intend to continue to honor their obligations to each other and are either united with respect to their claims and defenses or share a common strategy with respect to separate claims and defenses, a tender defense may be to their joint advantage. The challenge for the attorney is being able to evaluate whether this fortunate concurrence exists at the outset, being able to carefully advise each client at that point, and obtain their informed consent to joint representation. The attorney then will be further challenged to continually and accurately reassess this concurrence as the case continues.