WELCOME TO

PEARLMAN 2022

Pearlman 2022

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 27th, 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.

A great big thanks to **Brenna Stuhlman** for obtaining CE credits for Washington, Texas, and Florida. She also has applied for CLE credits in Texas!

Thank you to **Booth Mitchel & Strange** for applying and obtaining California CLE credits.

Lastly, a very special thanks to **Carney Badley Spellman P.S.** for applying and obtaining Washington CLE credits.

Schedule of Events

Wednesday, September 7th

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

Hospitality Reception Entertainment
Hosted by Faux Law Group and Williams Kastner

Thursday, September 8th

7:00-8:10 **Registration and Breakfast –** Sparkman Cellars Winery, Woodinville
Hosted by SMTD Law LLP, PCA Consulting Group, and Forcon International Corporation

All Day Coffee/Beverage Service
Hosted by Sokol Larkin

Espresso Bar
Hosted by MPCS – Maximum Property Construction Services

8:10-8:30 **Welcome/Introductory Remarks**
R. Jeffrey Olson
Co-Chairs: Shauna Szczechowicz, Wayne Lambert, Edward Rubacha

The Good, The Bad & The Ugly – The Surety Bonding Relationship

8:30-9:10 **Evaluating GMP and ADP Projects with Underwriting Considerations – 2022 *Spearin Doctrine* Update**
Panelists: Jim Case, Michael Sugar III, Terry Dahl, Greg Thomas, Sean Fallows

9:10-9:45 **Re-Visiting Force Majeure: Pandemic, Supply Chain, and Labor Shortage Issues**
Panelists: Greg Weinstein, Charles Delaporte, Jason Stonefeld

9:45-10:15 **Cardinal Changes – Still Viable? Change Orders and the Penal Sum of the Performance Bond**
Panelists: Jesse Ormond, Jim Carlson, Elizabeth Henderson, Chris Simmelink

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

10:30-11:15 **Surety Performance Bond and Design-Build Contracts, Performance Specifications and Delegated Design Specifications**
Panelists: Mike Timpane, Michael Spinelli II, David Garcia, Laura Sherry, Maureen O'Connell

11:15-12:00 **Affirmative Claims and the Surety**
Panelists: Brian Kantar, Jon Bondy, Laura Abrahamson, Chris Alexander

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

1:15-2:00 **GC/Sub Relationship – Duty of Good Faith and Fair Dealing, Supplementation, and Offsets**
Panelists: David Veis, Mark Stein, Jack Costenbader, Bob Riggs

2:00-2:45 **Conditions and Correlations of the A312 Performance Bond and the A313 Warranty Bond**
Panelists: Jarrod Stone, Amy Bernadas, Rachel Walsh

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

3:00-3:45 **Indemnity Considerations – How to Get the Money**
Panelists: Edward Rubacha, Matt Geary, Whit Campbell, Kara London

3:45-4:30 **Bankruptcy Dating Game**
Panelists: Jennifer Kneeland, Marguerite DeVoll, Paul Harmon, Sonia Linnaus, Bryce Holzer

5:00 **Welcome Reception/Cocktails –** Sparkman Cellars Winery, Woodinville
Hosted by Sokol Larkin

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

7:15 **Hold 'Em Tournament –** Sparkman Cellars Winery, Woodinville
Dealers Sponsored by J.S. Held LLC and Weinstein Radcliff Pipkin, LLP

Cocktails
Hosted by Krebs Farley & Dry, PLLC

Friday Morning, September 9th

7:00-8:00 **Registration and Breakfast –** Sparkman Cellars Winery, Woodinville
Hosted by Cashin Spinelli & Ferretti, LLC, Snow, Christensen & Martineau, and Carney Badley Spellman P.S.

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

Bloody Mary Bar
Sponsored by the Pearlman Association

Espresso Bar
Hosted by MPCS – Maximum Property Construction Services

8:00-8:10 **Welcome/Program Introduction**
R. Jeffrey Olson, Shauna Szczechowicz, Wayne Lambert, Edward Rubacha

8:10-8:45 **Commercial Surety Considerations: Attorney's Fees – Risks and Pitfalls**
Panelists: Paul Friedrich, Meredith Dishaw, Gene Zipperle, Sue Miller

8:45-9:15 **Surety Financing Decision: Cash Flow Tools from an Accounting Perspective**
Panelists: Elliot Scharfenberg, Nick Femia, Mark Woodbury, Price Jones

9:15-9:55 **Pass Through Claims/False Claims Act/Liquidating Agreements**
Panelists: Michael Prisco, Rodney Tompkins, Jr, Luis Aragon

9:55-10:10 **Break**

10:10-10:40 **Contracting Mechanisms and Considerations on Hiring a Completion Contractor**
Panelists: Sunny Lee, Brent McSwain, Patrick Toulouse

10:40-11:30 **Ethics: Gone Fishin' – Navigating the Water, Avoiding Snags, and Smooth(er) Sailing with the Joint Defense and Common Interest Privileges**
Panelists: Brian Streicher, Keith Langley, Genise Teich

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

11:35 **Lunch – On Your Own**

Friday Afternoon, September 9th – Golf Tournament and Dinner at Harbour Pointe Golf Club

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

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, Ernstrom & Dreste, LLP, and The Sutor Group

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

Cocktails
Hosted by Sokol Larkin

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

8:00 **Buses return to Sparkman Cellars Winery and Willows Lodge**

Friday Afternoon, September 9th – Sip 'N Putt

12:30-3:30 Sip 'N Putt at Rainbow Run Mini Golf at Willows Run,
10402 Willows Road, Redmond, WA 98052
Transportation: On your own
Hosted by Liberty Mutual Surety, IAT Insurance Group,
Booth, Mitchel & Strange LLP, and Pondera Winery

Saturday, September 10th - "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
SMTD Law LLP
Law Offices of T. Scott Leo, P.C.

Program Co-Chairs

WAYNE 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 in 1998, Mr. Lambert was a Senior Surety Counsel for Liberty Bond Services (now Liberty Mutual Surety) and the Assistant Vice President in charge of surety claims for Continental Insurance Company's Southern Region. Prior to his surety company experience, Mr. Lambert was a lawyer in private practice with Margolin & Kirwan in Kansas City, MO and a Captain in the U.S. Army's Judge Advocate General's Corps. In addition to being a lawyer, Mr. Lambert is a licensed claim adjuster. He has served as a Vice Chair of the Fidelity & Surety Law Committee for ABA TIPS and as a co-chair of the FSLC Law Division. Mr. Lambert is a graduate of Georgetown University and the Western New England College School of Law.

EDWARD RUBACHA

Edward Rubacha is a partner in the law firm of Jennings Haug Keleher McLeod, LLP located in Phoenix, Arizona. Ed is a graduate of Purdue University (B.S.E.E. 1978), Arizona State University (M.B.A. 1981 and J. D., cum laude, 1987). He is admitted to practice in state and federal courts in Arizona, California, Colorado and New Mexico.

Edward's practice focuses on suretyship and construction litigation, as well as general, civil and commercial litigation. Ed is nationally-recognized in the area of contracting on Indian reservations. Ed is the author of "Reservations About the Reservation: Surety Concerns When Contracting with Native American Tribes and Tribal Entities," "Construction Contracts with Indian Tribes or on Tribal Lands," The Construction Lawyer, Vol. 26, No. 1, Winter 2006, and numerous other publications on the topic.

Edward is a contributing author of 50 State Construction Lien and Bond Law, (Arizona chapter), Wiley Law Publications, 1992 and annual supplements, and State by State Analysis of Legal Issues Affecting Architects, Engineers, Contractors and Owners from a Contracting and Claims Perspective, Aspen Law & Business (Arizona Chapter).

SHAUNA SZCZECHOWICZ

Shauna Szczechowicz is an Assistant Vice President of Surety Claims for Philadelphia Insurance Companies. Prior to going in-house, Shauna was in private practice in California and handled a wide range of cases for sureties on federal, state, and private construction projects, and commercial probate fiduciary claims.

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.

LAURA ABRAHAMSON

Laura C. Abrahamson, Esq., brings extensive domestic and international ADR experience dealing with conflicts in the engineering, construction, oil and gas, and chemicals industries to her practice as a full time arbitrator and mediator with JAMS. Prior to joining JAMS, Ms. Abrahamson served for five years as Senior Vice President, Deputy General Counsel and Global Head of Litigation at AECOM, an American multinational firm that provides engineering, design, consulting and construction services, where she oversaw complex, cross-border disputes. Previously, Ms. Abrahamson spent nearly 20 years in-house at Occidental Petroleum (OXY), where she led major litigation and domestic and international arbitration efforts. Her experience at OXY and AECOM included responsibility for risk assessment, claims valuation, and numerous plaintiffs' claims arising out of energy, power and construction infrastructure projects.

Ms. Abrahamson is a Fellow of the Chartered Institute of Arbitrators (CIArb), a board member of CIArb's North American Branch, a Vice President of California Arbitration and is a panelist on multiple domestic and international arbitration centers, including the Hong Kong International Arbitration Centre (HKIAC); the London Court of International Arbitration (LCIA); the Court of Arbitration for Sport (CAS) and California's Public Works Contract Arbitration Program (PWCA).

Ms. Abrahamson holds a degree in business administration from the Haas School of Business at UC Berkeley, with a dual major in accounting and finance, and a J.D. from the UCLA School of Law.

CHRISTINE ALEXANDER

Christine (Chris) Alexander is Senior Vice President, Surety Claims, at Arch Insurance Group in Philadelphia. Prior to joining Arch, Chris was Managing Director & Counsel, Surety Claims, at Travelers in Philadelphia. She started her legal career as an Associate at the firm of Thomas & Libowitz, P.A. in Baltimore, Maryland. She began her Surety Claims career in at USF&G in Baltimore, joined The Saint Paul Companies when it purchased USF&G, and joined Travelers in 2004 when it purchased The St. Paul Companies. Chris is a graduate of the University of Delaware and the University of Baltimore School of Law. She is licensed to practice law in Maryland, the District of Columbia, and Pennsylvania. She has spoken at a number of industry conferences and written a number of papers on topics of

interest related to Surety Claims. Chris serves as the President of the Philadelphia Surety Claims Association. She is a Member of the Board of Directors of the Philadelphia Surety Claims Association and of the Surety Claims Institute.

LUIS F. ARAGON

Luis F. Aragon is Senior Surety Claims Counsel with Liberty Mutual Surety.

Luis is from Seattle, Washington, and received his B.S., B.A., and J.D degrees from the University of Washington (Go Dawgs!). He loves Seattle.

After graduating from law school, Luis opened his own practice. He spent three years focusing primarily on residential and commercial real estate matters. He also handled a construction matter that provided him his introduction to the surety world. In 2011, Luis accepted an offer with Watt, Tieder, Hoffar and Fitzgerald and worked out of the Seattle office. Luis joined as part of the Surety group, providing services to the firm's many surety clients. In 2013, Luis transitioned in-house, and accepted an offer as Surety Claims Counsel for Liberty Mutual Surety, in its Seattle office. He continues in this role today.

Luis is married to a wonderful wife and has two amazing daughters. Outside of work, Luis enjoys spending time with his family, and playing soccer. Luis's dream is to take a nap.

AMY BERNADAS

Amy Bernadas has over 14 years of experience handling contract surety claims as both outside and inside counsel. She practiced for ten years with Krebs, Farley, PLLC in New Orleans, LA, focusing on construction litigation and surety law before moving to Zurich North America where she spent 3 years handling contract surety claims. Amy obtained her JD from Tulane University School of Law and a BA in History from Baylor University. Amy is joining Liberty Mutual Surety later this month as Senior Surety Claims Counsel.

JONATHAN BONDY

Jonathan Bondy is a Member, Litigation and Fidelity & Surety Groups, at Chiesa Shahinian & Giantomasi PC. His practice is concentrated in the field of commercial litigation, with a focus on construction, surety and contract issues in New York and New Jersey. As a member of the firm, Jon represents and advises sureties with respect to performance and payment bond claims, the defense of prevailing wage claims, affirmative surety claims, loss recovery, bankruptcy issues and contractor workouts.

He represents developers, contractors and building material suppliers in litigation matters, such as claims for breach of contract, applications for injunctive relief, delay claims and payment claims.

Prior to joining the firm, Jon served as an assistant district attorney in Kings County (Brooklyn), New York. He is a graduate of Benjamin N. Cardozo School of Law, where he was a member of the Moot Court Board and the *ILSA Journal of International Law*. Jon received his undergraduate degree from the University of Pennsylvania, Wharton School of Business.

WHIT CAMPBELL

Whit Campbell was born and raised in Honolulu Hawaii, moving to the mainland to attend college at the University of Puget Sound where he graduated with a BA in Finance and Economics.

Whit started his surety career at Reliance Insurance Company in 2005 where he worked in the Federal Way HO, Spokane, and Portland Branch. He moved to Seattle with Safeco in 1987 and spent time back at Reliance and Travelers before landing at the Hartford in 2003. Whit is currently the Pacific Northwest Regional Assistant Manager at The Hartford and his territory covers four Western States.

Whit and his wife Malia live in Kirkland Washington, they have three adult children. Whit is a true history junkie and is the Surety Association of Washington's historian. He enjoys gardening and tending his two hives of bees and two chickens.

JIM CARLSON, BS, MBA, JD

Jim Carlson is the Managing Principal of Maximum Property Construction Services, sister company to Maximum Energy Professionals.

Jim brings more than 20 years of experience in owner's representation, surety claims, litigation, mediation, productivity plans, expert testimony, strategic programs, and construction oversight. Notably, Mr. Carlson has performed a significant amount of work in the Middle East where he worked on construction and commissioning of pumping lifting forwarding stations, mechanical cooling for the primary pump motor systems, and substation connection and cooling systems. In addition, he was routinely relied upon to source difficult to find materials, and creatively expedited approvals and deliveries through multiple borders and customs processes.

JAMES R. CASE

James R. Case is a Member of Dykema. Jim represents design professionals, general contractors, subcontractors, owners, and suppliers in various construction-related issues, including damages for delay, differing site conditions, construction change directives, owner interference, design errors and omissions, payment disputes, and contract interpretation. He also advises and advocates for sureties involved in defaults, claims against performance, payment bonds, and litigation.

Jim is a true litigator who possesses actual trial experience and a command of ADR techniques. Highly respected by his peers for his judgment and perspective, Jim frequently serves as a mediator and arbitrator in construction cases. His litigation experience has undoubtedly made him a more effective neutral. Jim has the pleasure of serving on the American Arbitration Association's National Roster of Arbitrators and Mediators, and the AAA's Large, Complex Case Panel.

Jim has presented papers, articles and speeches at numerous seminars and events in Michigan and nationally for the Surety Claims Institute; ABA Forum on the Construction Industry; Trial Practice Program at the IADC Fidelity & Surety Midwinter Meetings; National Bond Claim Association; Institute of Continuing Legal Education; Real Property Law Section of the State Bar of Michigan; National Business Institute, Inc.; National Electrical Contractors Association; Builders Institute of America; and the Engineering Society of Detroit.

Jim received is BA from Colgate University and his JD, with honors, from St. John's University School of Law. He is admitted to the State Bar of Michigan. His court admissions include U.S. District Court, Eastern District of Michigan, U.S. District Court, Western District of Michigan, U.S. Court of Appeals, 6th Circuit, and U.S. Supreme Court.

JACK COSTENBADER

Jack Costenbader is President of PCA Consulting Group, a San Francisco based construction consulting firm and PCA Disbursements, Inc. a California licensed Funds Control Agent. Jack has 44 years of direct experience in contract surety, and property insurance claims consulting throughout the country. In addition, Jack has 11 years of hands-on, build for profit construction experience.

TERENCE J. DAHL, ESQ.

Terry Dahl is a graduate of the University of Rhode Island and worked in the waste management industry for 10 years before attending Seton Hall law school in the evening program. After graduating from law school Terry worked at AIG and Markel handling environmental claims. Terry has been working in Surety claims for 15 years, the last seven as head of surety claims for One Beacon/Intact Insurance in their NYC office. When he's not working Terry likes to spend time with his 3 children at the beach or skiing.

CHARLES DELAPORTE

Charles Delaporte is an engineering consultant at Guardian Group, Inc., and is based in Seattle, WA. He has over ten years of experience in engineering design, project management, and construction. He is a licensed Professional Engineer (Civil) in the states of Washington, Oregon, California, Texas, and Florida and is a LEED Accredited Professional (BD+C).

Charles works with insurance claims professionals and their counsel to analyze and mitigate construction related damages in the areas of Construction Defect, Property and Casualty claims, and Surety bond losses. Charles assists with claims investigation and construction dispute resolution, including affirmative claims reparation, delay claims analysis, and payment and performance bond claims analysis. He also provides project management, evaluates project status, performs cost estimates, and directly supervises subcontractors for a wide variety of bonded commercial, municipal, and residential projects.

Charles received his B.A.I. in Civil, Structural, and Environmental Engineering from Trinity College Dublin in Ireland, and his M.S. in Civil Engineering and City Planning from INSA Lyon in France (a French grande école).

MARGUERITE LEE DEVOLL

Marguerite Lee DeVoll is a partner in Watt, Tieder, Fitzgerald & Hoffar LLP's Creditors' Rights, Bankruptcy and Insolvency Practice. Her practice focuses on business restructurings, bankruptcy, and creditors' rights, as well as complex commercial disputes in state and federal courts across the United States. Marguerite frequently represents landlords, financial institutions, sureties, and other creditor-parties who must protect their rights in connection with construction, real estate-related loans, indemnity, leases, probate, and other situations where the other party is in default or risk of default.

Marguerite currently serves on the Board of Directors for the Maryland Bankruptcy Bar Association as Assistant Treasurer. She also serves on the Standing Rules Committee for the United States Bankruptcy Court for the District of Maryland and on the Maryland Bankruptcy Bar-United States District Court of Maryland Bench Liaison Committee.

Marguerite serves on the Board of Directors for Exceptional Families of the Military, Inc. ("EFM Inc."). EFM Inc. is a non-profit dedicated to connecting military families with Disabilities, Special Healthcare Needs, or additional educational needs from all branches of the service in order to navigate within the Exceptional Family Member Programs and identify areas of improvement that affect those families.

Marguerite earned her undergraduate degree *with distinction* from the University of Virginia and her law degree from Emory School of law where she was the Editor-in-Chief of

the Emory Bankruptcy Developments Journal. After graduating from law school, she served as a law clerk for the Honorable William R. Sawyer of the United States Bankruptcy Court for the Middle District of Alabama from 2010-2012.

MEREDITH DISHAW

Meredith Dishaw is a Member of the Williams Kastner law firm based in Seattle, WA, where she is the Co-Chair of the firm's Construction and Surety practice teams. Meredith 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 negotiations, trials and appeals. Meredith received her B.A. in Political Science from Boston University and her law degree, *cum laude*, from Seattle University School of Law.

SEAN FALLOWS

Sean Fallows is the Pacific Northwest Regional Manager for Intact Insurance handling contract surety across the states of Washington, Oregon, Montana, and Alaska. Sean started his career in surety in 2006 and has worked at Berkley Surety Group and Philadelphia Insurance prior to opening the Pacific Northwest branch for Intact Insurance in 2019.

Sean has a business degree from Washington State University with a major in Finance. In his spare time, Sean enjoys playing golf and spending time with his two children, Cameron and Carter.

NICK FEMIA

Nick Femia is a Certified Public Accountant in New York State who graduated from Hofstra University with Bachelor of Business Administration in Accounting and Master of Science in Taxation. Nick's experience includes construction accounting and forensic analysis, specializing in surety consulting providing both accounting and construction management services to complete construction projects. Focusing on determining potential surety exposure and performing functions to limit such exposure. Nick also has additional experience in the preparation of budget reports, analysis of payment bond claims, cash flow projections, AIA payment applications, and estimated Loss Reports based on the evaluation of contract status, current and future obligations, and cost-to-complete estimates.

PAUL K. FRIEDRICH

Paul K. Friedrich is a Member in the Seattle office of Williams Kastner, is a Co-Chair of the firm's Construction Litigation & Surety Practices Team, and is licensed to practice in both Washington and Oregon. His practice is focused on representing sureties and insurers in all

aspects of contract, commercial, and fidelity bond claims, with a particular emphasis on construction law, including the representation of general contractors and subcontractors on a wide range of issues involving public and private projects. Mr. Friedrich has extensive experience defending against surety-related bad faith claims and is a frequent speaker and author on surety and construction related legal issues.

DAVID J. GARCIA

David J. Garcia is a Senior Consultant with Sage Associates, Inc. Mr. Garcia has been involved in the construction industry for over 40 years, practicing as a registered Architect and licensed General Contractor, specializing in design-build and other complex delivery projects.

Mr. Garcia received his Bachelor of Architecture from the University of Southwestern Louisiana, Lafayette, Louisiana and his Master of Real Estate and Construction Management from University of Denver, Denver, Colorado.

Mr. Garcia served as a full-time faculty member at the University of Denver in the Real Estate and Construction Management Department of the College of Business. He has taught graduate and undergraduate construction management courses including construction systems, project management, cost estimating, scheduling, construction contracts, value engineering, and loss and claims analysis. He was also integral as a faculty team member in designing and delivering the quality assurance/quality control component of the MBA program.

In his career, Mr. Garcia has managed a multi-discipline staff and construction consulting caseload that included a myriad of defect litigation matters and contract claims disputes. Mr. Garcia also provided course-of-construction inspections, staff training, and other risk management services. Mr. Garcia has significant experience as a testifying expert in a broad range of construction issues.

Mr. Garcia has also presented numerous construction-based educational programs to attorneys and insurance professionals working in the "construction trouble" business. Programs include: Construction Systems and Practices, Construction Financing/Accounting, Reading Construction Documents, Construction Scheduling, Building Air Quality Evaluation/Mold Remediation, Evaluating/Interpreting Building Damage and Causes, Identifying Subrogation Opportunities and Risks, and Class-Action Analyses and Strategies.

MATTHEW W. GEARY

Matthew W. Geary is a Shareholder at Dysart Taylor in Kansas City. Matt has over twenty years' experience in commercial litigation, insurance coverage, and matters involving surety bonds. Matt regularly appears in federal and state courts in Missouri and Kansas.

Prior to entering private practice, Matt was a law clerk for the Honorable Patricia Breckenridge of the Missouri Court of Appeals. Matt received a B.A. from William Jewell College and a J.D. from the University of Kansas School of Law, where he was an editor of the Kansas Law Review.

PAUL C. HARMON, ESQ.

Paul C. Harmon is Senior Claim Counsel with Travelers Bond & Specialty Insurance. In December 2007, Paul Harmon joined the Federal Way, Washington 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.

ELIZABETH HENDERSON

Ms. Henderson has been a claims handler since 2015, currently serving as Claims Analyst for IAT Insurance Group's surety arm with particular focus on claims with associated litigation and principals in bankruptcy. She also enjoys working on internal auditing projects as needed.

When away from work, Ms. Henderson enjoys snorkeling, SCUBA diving, hiking and schutzhund with her two German Shepherd Dogs. She and her younger dog are a back-up search and rescue team for several counties in the Pacific Northwest.

BRYCE HOLZER

Bryce Holzer is Technical Director & Counsel with Travelers Bond & Specialty Insurance. After a stint in private practice, Bryce joined Travelers in August 2012 in the Federal Way Construction Services Claim office handling complex performance and payment bond claims. Bryce graduated from Washington State University with a B.A in Economics and Political Science in May, 2007. After working for the Boeing Company as an Industrial Engineer, Bryce attended law school at the University of Washington and graduated in March 2011. Bryce is a member of the Washington State Bar Association.

PRICE JONES

Price Jones joined Liberty Mutual Surety in 2011. He is a Surety Account Analyst in Liberty Mutual's Surety Claims-Financial Services Department in Plymouth Meeting, PA. In his role, Price conducts account visits to review the books and records of contractors to assess their current financial condition and develop a loss forecast. He also supports the claim handlers in reviewing bond claims and monitoring contractor and project financing through various escrow accounts.

Price is a Pennsylvania CPA who graduated from LeMoyne College (Syracuse, NY) in 1997 with a B.S. Accounting degree. After college he began his accounting career with a traditional public accounting firm in Syracuse, NY. In 2001 he began his surety career when he joined a Philadelphia, PA public accounting firm, Nihill & Riedley, PC, specializing in consulting with sureties on contractor loss and claim matters. He is currently completing a Master of Accountancy with a Data Analytics focus through the University of Scranton.

BRIAN KANTAR

Brian Kantar is a partner with the law firm of Chiesa Shahinian Giantomasi. Brian's practice is concentrated in commercial litigation, with a focus on fidelity and surety, construction and bankruptcy matters. Brian regularly represents surety companies, contractors and developers in a wide variety of contract disputes, performance and payment bond claims, affirmative claims, loss recovery, bankruptcy issues and contractor workouts. While Brian's practice is primarily based in New York and New Jersey, Brian regularly collaborates with his surety clients on projects and claims both on a national and international basis.

Brian served as co-chair of the Surety Program at the 2020 ABA FSLC Fidelity & Surety Law Committee's Mid-Winter Meeting and has been appointed to serve as program chair of the Surety Claims Institute's Annual Meeting in 2023 and 2024. Brian serves as Managing Editor of the Surety Claims Institute's Newsletter in which he also authors a highly regarded surety case update. Brian is a Vice-Chair of the ABA Fidelity & Surety Law Committee.

In 2005-2006, Brian served as a law clerk to Judge Ross R. Anzaldi, presiding judge of the Civil Division, Superior Court of New Jersey, Union County. He graduated in 2001, summa cum laude, from Hofstra University, where he was elected to Phi Beta Kappa. He earned his J.D. magna cum laude from Seton Hall Law School, in 2005, where he was elected to the Order of the Coif. While in law school, Brian served as chairman of the Honor Council and interned for Judge Mary C. Jacobson of the Superior Court of New Jersey, Civil Division, Essex County.

JENNIFER KNEELAND

Jennifer Larkin Kneeland is a Senior Partner at Watt, Tieder, Hoffar & Fitzgerald where she serves as the Chair of the firm's Creditors' Rights, Bankruptcy and Insolvency Practice. She focuses her practice on business restructuring, workouts, bankruptcy and creditors' rights in bankruptcy courts throughout the United States.

The majority of Jennifer's clients are financial institutions, real estate investment trusts, sureties, landlords and other creditor- parties who must protect their rights in connection with construction, real estate related loans and other types of obligations that are either in

default or at risk of default. She has handled complex chapter 11 cases throughout the United States.

Jennifer is a Past President of the Bankruptcy Bar Association for the District of Maryland. The Maryland Bankruptcy Bar Association is the premier bar association for attorneys who practice bankruptcy law in the State of Maryland. Jennifer also holds an Officer position with the Northern Virginia Bankruptcy Bar Association, which is the bankruptcy bar association that serves the Northern Virginia-Metropolitan region.

Jennifer is an honorary member of the Board of Directors of the Olney Theatre Center for the Arts, Inc. in Olney, Maryland. She served as Board President from 2014-2017. Olney Theater is a not-for-profit corporation dedicated to theatre and the performing arts. Jennifer restructured Olney Theatre's financial affairs on a *pro bono* basis, saving it from bankruptcy.

Jennifer earned her undergraduate degree from the University of Virginia and her law degree *cum laude* from Villanova University School of Law.

WAYNE 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 in 1998, Mr. Lambert was a Senior Surety Counsel for Liberty Bond Services (now Liberty Mutual Surety) and the Assistant Vice President in charge of surety claims for Continental Insurance Company's Southern Region. Prior to his surety company experience, Mr. Lambert was a lawyer in private practice with Margolin & Kirwan in Kansas City, MO and a Captain in the U.S. Army's Judge Advocate General's Corps. In addition to being a lawyer, Mr. Lambert is a licensed claim adjuster. He has served as a Vice Chair of the Fidelity & Surety Law Committee for ABA TIPS and as a co-chair of the FSLC Law Division. Mr. Lambert is a graduate of Georgetown University and the Western New England College School of Law.

KEITH LANGLEY

Keith Langley is an energetic, experienced, creative problem solver and a trial lawyer with particular expertise in surety, construction, bankruptcy, and contract law and disputes. Keith is the go-to lawyer for eight figure recovery actions against sophisticated accounting firms, disputatious participants in the construction arena who need realistic expectations established, and complex bankruptcies where opportunities abound for fast moving, creative solutions. Keith says "the practice of law is like many things in life, seek to understand, communicate effectively, and above all brainstorm with the team. From there, get out ahead of things by setting action items and target dates. It all comes down to

understanding the business of the client, understanding the transaction or dispute, understanding the goals and positions of the parties, creating realistic expectations, carefully planning the work and then executing the plan with passion and purpose."

Keith 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 and often appears nationwide in bankruptcy cases and major lawsuits.

SUNNY LEE

Sunny Lee is a partner with Bronster Fujichaku Robbins in Honolulu. He received his B.A. from the University of Hawaii in 1999 and a J.D. from Seattle University in 2003. Mr. Lee practiced in Seattle before returning to Hawaii. Prior to joining Bronster Fujichaku Robbins, he was in-house counsel for a title company. Mr. Lee's litigation practice is focused on construction, real estate development, AOAO, surety, complex commercial cases, and business disputes.

SONIA LINNAUS

Sonia Linnaus is Surety Claims Counsel with Liberty Mutual Surety. Before joining AmTrust as claims counsel in June 2016 and Liberty Mutual via the AmTrust acquisition in 2019, Ms. Linnaus spent nine years in private practice as a construction and surety attorney at the law firms of Watt, Tieder, Hoffar & Fitzgerald and Lanak & Hanna, P.C. At both firms she represented sureties at administrative hearings and in federal and superior court on claims brought against various types of bonds, including court bonds, probate bonds, license bonds, subdivision bonds, and both private and public works payment and performance bonds. She also pursued subrogation and indemnity litigation on behalf of her surety clients. In addition, Sonia represented general contractors, subcontractors, and material suppliers in various construction and business matters, including enforcement of job rights, breach of contract, construction defect, and employment actions.

Sonia received a B.A. in Political Science (2004), University of California, Berkeley and a J.D. (2007), University of Southern California Gould School of Law and she is admitted to practice in California.

KARA LONDON

Kara London is an Assistant Vice President, Commercial Surety, for Philadelphia Insurance Companies. Kara's twenty plus year career includes underwriting on the Company side and retail on the Broker side with a focus on commercial surety.

R. BRENT MCSWAIN

R. Brent McSwain received his Bachelor of Science degree in Industrial-Construction Management from Colorado State University in 1981 and has been in the construction business since 1977. Brent has worked as an owner representative, responsible for developing multi-million dollar acute care hospital facilities, offices, warehouses, correctional and probation facilities, recreational facilities, as well as administering disaster recovery services. He has extensive experience in preparing and defending claims that involve schedule delays, disruptions, and damages for correctional facilities, water treatment plants, office buildings, hotels, luxury condominiums, recreational facilities, schools, football stadiums, power plants, refineries, and airport parking garages. He has experience in litigation support, deposition and trial testimony.

SUSAN MILLER

Susan Miller is a senior bond claims specialist with Hudson Insurance Company where she handles Department of Motor Vehicle, Interstate Commerce Commission and other miscellaneous surety bond claims throughout the United States. Prior to joining Hudson in 2016, Sue was a consultant with the Connecticut office of Cashin Spinelli & Ferretti, LLC where she handled a variety of surety bond claims.

MAUREEN O'CONNELL

Maureen O'Connell is an Executive Vice President, Account Executive and Western Regional Bond Manager for Gallagher Construction Services.

Maureen has over thirty-five years of experience in the surety industry and has handled medium to large contract, commercial and real estate development surety accounts. Prior to joining Gallagher in 2002, Maureen was the Regional Manager of the San Francisco office of Fireman's Fund and the Regional Surety Manager of Kemper Surety. Maureen has handled contract and commercial customer's bond needs worldwide, including Australia, Asia, and South America. Maureen started her career in 1986, at Safeco Surety in San Francisco as a contract surety underwriter.

Maureen received her Bachelor of Arts degree in Political Economy of Industrial Societies from the University of California, Berkeley and a Masters of Business Administration from St. Mary's College of California.

She is a member of CFMA, AGC, Surety Association of America, National Association of Surety Bond Producers, and a board member of California Surety Federation and Women in Construction, West Coast.

JESSE ORMOND

Jesse C. Ormond is a member of Sokol Larkin based in Portland, Oregon. His practice concentrates on construction and design matters with a particular focus on solving “real time” problems with distressed construction projects. He counsels owners, developers, contractors, subcontractors, sureties, and design professionals on every phase of the construction process from project delivery selection to dispute resolution processes.

Jesse has extensive experience with high-stakes construction disputes before federal courts, state courts and private arbitration panels. *Oregon Super Lawyers* named Jesse a “*Rising Star*“ from 2020-2022. Best Lawyers named Jesse “*One to Watch*” in 2023.

MICHAEL A. PRISCO

Michael A. Prisco is partner at Torre Lentz Gamell Gary and Rittmaster, LLP in New York. He focuses his practice on construction and surety litigation, commercial litigation and appellate advocacy.

Following the conclusion of his clerkship with the New York State Supreme Court, Appellate Division, Third Department, Michael joined Torre Lentz, where he has been involved in successfully litigating some of the largest surety and construction disputes in the country. Michael has not only achieved positive defensive results for his surety clients, but also large affirmative recoveries. Michael has also been closely involved in the firm’s appellate practice, using the insight and expertise he gained during his clerkship at the Appellate Division to challenge and defend lower court decisions.

Michael graduated from the University at Buffalo earning a B.A. in Political Science in 2006. Michael then graduated first in his class and as Valedictorian while earning his JD from Touro Law Center in 2010. While there, Michael was a Faculty Fellow and served as an Editor for the Law Review.

Michael is a member of the ABA’s Tort Trial and Insurance Practice Section and was selected as a co-author for the Tort Trial & Insurance Practice Law Journal.

ROBERT D. RIGGS

Robert Riggs is the Director of Construction Operations for The Hanover Insurance Group - Surety Claims, based in Worcester, Massachusetts since 2008. He is responsible for overseeing the day-to-day operations in support of surety performance obligations and enhancing the interface between claims and underwriting. Responsibilities also include claim analysis, all construction completion work and assisting counsel and claim attorneys in court actions, mediation and arbitration.

Robert has a wealth of surety and construction experience, having served in every key role of a building construction team over the last 40 years, including Architecture and Engineering Design and Management, Estimator, Superintendent, Project Manager, as well as executive management positions. Previously, as President of RBI he developed a company that provided surety consulting, claims management, completion contracting and expert witness testimony for sureties throughout the Northeastern U.S. RBI also provided design-build and general contracting services concentrating in the metro NY area.

Mr. Riggs is a graduate of the University of Florida with a Master's Degree in Architecture. He received his undergraduate background at Florida Institute of Technology in Oceanographic Engineering and the University of Florida in Architectural Design.

EDWARD RUBACHA

Edward Rubacha is a partner in the law firm of Jennings Haug Keleher McLeod, LLP located in Phoenix, Arizona. Ed is a graduate of Purdue University (B.S.E.E. 1978), Arizona State University (M.B.A. 1981 and J. D., *cum laude*, 1987). He is admitted to practice in state and federal courts in Arizona, California, Colorado and New Mexico.

Ed's practice focuses on suretyship and construction litigation, as well as general, civil and commercial litigation. Ed is nationally-recognized in the area of contracting on Indian reservations. Ed is the author of "Reservations About the Reservation: Surety Concerns When Contracting with Native American Tribes and Tribal Entities," "Construction Contracts with Indian Tribes or on Tribal Lands," The Construction Lawyer, Vol. 26, No. 1, Winter 2006, and numerous other publications on the topic.

Ed is a contributing author of 50 State Construction Lien and Bond Law, (Arizona chapter), Wiley Law Publications, 1992 and annual supplements, and State by State Analysis of Legal Issues Affecting Architects, Engineers, Contractors and Owners from a Contracting and Claims Perspective, Aspen Law & Business (Arizona Chapter).

ELLIOT SCHARFENBERG

Elliot Scharfenberg practices law in New Orleans, Louisiana at Krebs Farley & Dry. Most of his practice consists of representing sureties in all manner of disputes, but he also has a substantial practice representing insurers on subcontractor default insurances cases. Elliot loves being a lawyer, and his favorite part is working closely with his clients to reach creative solutions to complex problems. Elliot received his law degree from Tulane University, Order of the Coif, and received his undergraduate degree from Baylor University.

LAURA SHERRY

Laura Sherry is an attorney in the Collin County, TX office of Clark Hill. She represents clients in various fidelity and surety litigation matters in state and federal courts throughout the United States. Laura's previous career was as a licensed Professional Civil Engineer with backgrounds in project design and construction. Laura graduated with a B.S. in Civil Engineering from Louisiana Tech University and earned her law degree from Texas Tech University School of Law.

CHRIS SIMMELINK

Chris joined the team at Hudson Insurance in 2020, where he leads the Contract Surety Claims group. He was previously Claims Director at RLI, joining the company through its 2011 acquisition of Contractors Bonding and Insurance Company (CBIC) after serving 10 years as CBIC's claims leader. He has 20+ years of experience managing the investigation of complex payment and performance bond claims throughout the US, and has handled claims in Canada and Puerto Rico. He also served as CBIC's Special Investigation Unit (SIU) leader, investigating suspected fraudulent claims and acting as liaison between the surety and state regulatory and investigative bodies. Chris has experience in a broad portfolio of claims in the contract, commercial, miscellaneous and energy bond spaces.

MICHAEL SPINELLI II, ASSOCIATE AIA, SEED

Michael Spinelli is an emerging architectural professional currently working as a project manager at Cashin Spinelli & Ferretti, LLC's (CSF) New York office.

Michael has experience in project design, development, planning and permitting, construction documentation and project close out phases on a variety of projects in multiple jurisdictions. Prior to joining CSF, Michael had prior professional experience with the Facilities Department of the Federal Reserve Board of Governors and as a level 2 "Staff Designer" at Bonstra | Haresign Architects in Washington, D.C. Mr. Spinelli has experience in governmental, historical, multi- family housing, and hospitality projects. Due to his experience and education within architecture, real estate development, facilities management and owner's representation, Michael is effective at communicating with all team members in creative problem solving and project progress.

Michael received his Bachelor of Science in Architecture from The Catholic University of America in Washington, D.C. Michael continued at Catholic University where he graduated Summa Cum Laude while achieving his Masters of Architecture and Masters of Science in Facilities Management. As an Associate AIA member, Michael sits as a Programs Coordinator on the Emerging Professionals Committee for the Long Island Chapter of the AIA.

MARK STEIN

Mark Stein is Vice President – Surety at VERTEX. Mr. Stein has worked as a real estate facilities manager and construction professional for over twenty-five years with senior and executive project management experience including large scale hospitality & resort, commercial, telecommunications infrastructure, institutional, residential, and heavy highway projects in the U.S., Caribbean and South America. At VERTEX, Mr. Stein is a forensic surety consultant and construction project management expert. Mr. Stein has conducted over one thousand investigations for property and casualty insurance claims, surety bond claims, and construction claims for insurance carriers, attorneys, building owners, developers and adjusters.

Mr. Stein has been selected numerous times as an appraiser for residential and commercial property claims and as an expert for premise liability claims, damage claims, and construction defect matters where his depositions, responses to interrogatories, affidavits and work product have been used in mediation, litigation and arbitration with successful results. His areas of expertise include construction project management, facilities management, damages, telecommunications infrastructure, building envelope, constructions and cladding materials, roofing, fenestrations, non-structural waterproofing, hard surface flooring, wood flooring, millwork, paint & coating applications, concrete pools, EIFS & stucco, and other construction related systems.

JARROD W. STONE

Jarrod Stone is a Shareholder with Manier & Herod, where he is the Head of the firm's Surety and Fidelity Department. Jarrod practices in the areas of surety law, fidelity law, construction law, insurance law, and general commercial law. In addition to being heavily involved in litigation, Jarrod also represents sureties in distressed contractor transactions and workouts, intercreditor transactions, surety credit facilities, bankruptcies, performance bond defaults, payment bond claims, and virtually every aspect of surety law. Jarrod is licensed to practice in Tennessee, Kentucky, and Ohio and is admitted to various federal courts throughout the country.

Mr. Stone received his B.S. (2001), magna cum laude, from Middle Tennessee State University. He received his J.D. (2004), summa cum laude, Order of the Coif, and Order of Barristers from the University of Tennessee College of Law. While at the College of Law, Mr. Stone competed on the National Moot Court Team, for which he was awarded the Susan B. Devitt National Moot Court Award. He also competed on the College of Law's National Trial Team, for which he received a Medal for Excellence in Advocacy from the American College of Trial Lawyers. Mr. Stone also twice won the College of Law's Advocate's Prize Moot Court Competition.

Mr. Stone was admitted to practice in Tennessee in 2004 and was subsequently admitted to practice in Kentucky in 2011 and in Ohio in 2016. Mr. Stone is admitted to practice in all federal courts in Tennessee, Kentucky, Ohio, Indiana, and Arkansas. Mr. Stone has represented sureties and fidelity insurers in relation to disputes arising in a number of states including Alabama, Arkansas, the District of Columbia, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

Mr. Stone is also a frequent author and presenter on topics related to surety, fidelity, and insurance coverage law. He Co-Chaired the Surety Program at the ABA Fidelity and Surety Law Committee's 2016 Midwinter Meeting held in New York in January 2016. He also often conducts in-house seminars and CE presentations for his clients.

JASON STONEFELD

Jason is celebrating the 20th anniversary of both attending the Pearlman conference and being in the surety claims business; 15 years of which has been with Liberty Mutual. During that time he has handled over $100 Million in Surety losses. Jason attributes his professional longevity to his use of the Oxford Comma.

BRIAN STREICHER

Brian M. Streicher is an experienced commercial litigator at Ernstrom & Dreste, LLP in Rochester, New York with over a decade of practice in litigation and risk management. Brian represents a variety of clients in commercial and construction disputes--sureties, contractors, design professionals, property owners, construction managers, and corporations. He also has extensive experience representing financial institutions in commercial and construction financing, real estate financing, and bankruptcy proceedings. Brian earned his Bachelor of Arts from SUNY Geneseo and his J.D. from Case Western Reserve University School of Law. He is admitted to practice in New York, Florida, the District of Columbia, and numerous federal courts.

MICHAEL J. SUGAR, III

Michael grew up in Florida as a diehard Seminole, Lightning, and Bucs fan. He received his Bachelor of Science in Mechanical Engineering from Boston University.

Following his graduation from BU, Michael moved to Tampa and began his career with Clark Construction Group where he worked for six years on various federal projects and obtained his MBA during that timeframe.

In 2012 Michael joined Forcon International as a consultant and, in 2018, he was promoted to President of Forcon. Michael currently oversees the day-to-day operations of the Company and manages a staff of 21 employees and 100+ consultants while still consulting on projects and acting as an expert witness for Surety(ies).

On a personal note, Michael and his wife, Julie, happily granted their respective parents' wishes and have three children who behave exactly like they did.

SHAUNA SZCZECHOWICZ

Shauna Szczechowicz is an Assistant Vice President of Surety Claims for Philadelphia Insurance Companies. Prior to going in-house, Shauna was in private practice in California and handled a wide range of cases for sureties on federal, state, and private construction projects, and commercial probate fiduciary claims.

GENISE TEICH

Genise W. Teich is a Surety Claims Counsel with Liberty Mutual Insurance Company for four years and has almost 30 years of experience in surety law, handling bankruptcies, complex contract and commercial claims as well as fidelity claims. She was previously a Senior Managing Claims Counsel at International Fidelity Insurance Company. Genise graduated with an AB degree in Molecular Biology from Brandeis University and Juris Doctor from Boston University School of Law. She is licensed to practice law in New Jersey, New York, Massachusetts, and Florida and co-authored a chapter of the Second Edition of The Law of Performance Bonds, published by the ABA, Tort and Insurance Practice Section.

GREG THOMAS

Greg Thomas is a Contract Underwriting Officer working with the Orange, CA and Phoenix, AZ offices. Greg started with Safeco in 1989 as a Safeco Contract Representative in Seattle. Then in 1994 he was tasked to launch First National in Oregon, Western Washington and Alaska.

In 1999, he launched First National in Chicago as Area Manager over the Hoffman Estates, Cincinnati and Minneapolis offices. In 2006, he was transferred back to Seattle to his current position in the Seattle home office. Since becoming a Contract Underwriting Officer he has worked directly with offices throughout the Southeast region, the Pacific Northwest, St. Louis, Kansas City, Denver, Orange, and Phoenix offices.

Greg has a BS degree in finance from Oregon State University and an MBA from Seattle University.

MICHAEL J. TIMPANE

Michael J. 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. In 2004, Mike trained and then began practicing as a mediator and arbitrator. After developing a substantial ADR practice, Mike became a member of the JAMS Global Engineering and Construction Group from 2008-2012. Mike joined SMTD Law in 2012, and just celebrated his tenth anniversary with the firm.

In his 38 years of practice, Mike has focused on litigating and resolving surety and construction matters. Mike 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 as well as being a member of the AAA Large and Complex Case and Construction Arbitration panels.

RODNEY J. TOMPKINS, JR., JD

Rodney J. Tompkins Jr. is Vice President and managing partner of RJT Construction Inc., Consulting Services. Mr. Tompkins is based in Irvine, California and has successfully managed Surety claims, completion, and litigation matters for over 20 years.

Mr. Tompkins has assisted Surety and Attorney clients across the country in a myriad of construction related matters, and maintains RJT's focus on Surety claims, construction law, complex project and surety loss mitigation, scheduling, estimating, accounting, litigation, and construction processes and methodology.

Mr. Tompkins obtained his bachelor's degree at University of San Diego, Post Graduate Construction Management at U.C. Berkley School of Engineering. Mr. Tompkins also earned his Law Degree at Lincoln Law School of Sacramento where he was Editor-In-Chief of the Voir Dire and recipient of multiple awards including Moot Court, ADR and selected to represent the school at state-wide Negotiations competition.

Mr. Tompkins remains active in industry leadership including the ABA, FSLC, and other professional organizations. He is a frequent presenter and speaker on topics of Construction and Project Management, Surety Claims, Damages, Electronic Discovery, Books and Records, and others. He also dedicates his time to his family and youth sports, Boy Scouts of America, and serves on the board of local non-profit youth organizations in Southern California.

PATRICK TOULOUSE

Patrick Toulouse earned a B.A. in Economics from Pomona College in Claremont, California in 1983. He received a J.D. from Cornell University in 1986 and a M.B.A. from the University of Washington in 1999. Prior to joining Travelers in 2002, Patrick was in private practice in Seattle for 16 years working on general business, bankruptcy, commercial, real estate, construction, and estate planning matters. He is currently a Technical Director & Counsel in Travelers' office in Federal Way, Washington where he manages and resolves complex performance and payment bond matters.

DAVID VEIS

David Veis is Of Counsel with Clyde&Co. David has trial and appellate experience in construction, fidelity, and surety law, including financial institution bonds, security dealer bonds, public (federal and state) and private payment and performance bonds, subdivision bonds and license, permit and miscellaneous bonds, directors and officers liability policies, and professional e rrors and omission policies.

David's experience includes construction defect litigation/surety involvement, public official bond claims, recoveries in bankruptcy, fraudulent insurance claims, public work performance bond claims/issues, recovery actions under indemnity agreements, Department of Labor claims, and subdivision development.

David received his BA and MA from USC, *with honors*, and his JD from Southwestern University School of Law. He is admitted to practice in California, US Court of Appeals, US Court of Appeals, Federal Circuit, US Court of Federal Claims, and US District Court for the Central, Eastern, Northern, and Southern Districts of California.

RACHEL WALSH

Rachel Walsh is Regional Vice President, Northeast Surety Claims for Liberty Mutual Insurance Company. Before joining Liberty Mutual, she practiced at Krebs, Farley & Pelleteri, PLLC in New Orleans, Louisiana, where she focused on surety and fidelity law and construction litigation. Ms. Walsh received her Juris Doctor, magna cum laude, from Loyola University New Orleans in 2007 and a bachelor of arts, cum laude, from Tulane University in 2004. She serves as an Assistant Bar Examiner for the State of Louisiana, routinely speaks at American Bar Association and industry events regarding various aspects of surety law, and additionally serves as a Vice President of the Philadelphia Surety Claims Association.

GREGORY M. WEINSTEIN

Gregory M. Weinstein is a founding Partner in the law firm Weinstein Radcliff Pipkin LLP. Greg primarily represents national sureties, contractors, developers, and insurance carriers

in cases involving a wide variety of issues, including complex defaults, construction defects, design defects, delay claims, and coverage disputes. Greg is licensed to practice law in Texas, Oklahoma, Arkansas, and numerous federal courts across the country. He received a B.A. in history, *with distinguished honors*, from the University of Pennsylvania, a M.S. in history from Edinburgh University, and a J.D. from Southern Methodist University Dedman School of Law.

MARK WOODBURY

Mark Woodbury has been with Matson Driscoll and Damico LLC for the past six years and has over 25 years of surety consulting experience. He received his B.S. in Business Administration from Salem State University and is a Certified Public Accountant, Certified Management Accountant and Certified Fraud Examiner. He resides in the Tampa Bay area.

GENE F. ZIPPERLE, JR.

Gene F. Zipperle, Jr. began graduated from the University of Louisville Law School in 1988. He has been licensed to practice law in Kentucky since 1988 and in Indiana since 1989 in both state and federal courts. Gene has litigated cases in the state and federal courts of Kentucky, Indiana, Ohio, Florida and North Carolina. His current practice focuses on all aspects of surety and fidelity law, transportation litigation and insurance coverage litigation. Gene has presented at numerous conferences in the United States and Canada. He was published numerous articles in various Defense Research Institute publications and other trade journals. Gene is a member of the Louisville Bar Association, the Kentucky Bar Association, Kentucky Defense Counsel, the Indiana State Bar Association, the American Bar Association Tort Trial & Insurance Practice Section and the ABA Surety and Fidelity Law Committee, the DRI Fidelity and Surety Law and Trucking Law Committees, and other legal trade organizations.

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

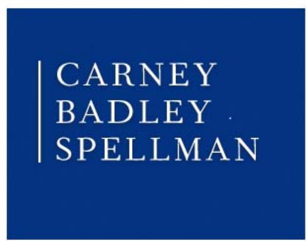
ATTORNEYS AT LAW

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. Since 2000, Cashin Spinelli & Ferretti has been 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 Accounts, Field Inspectors and Claims experts, Cashin Spinelli & Ferretti is well poised to offer Surety consulting and litigation support services to

the industry. Cashin Spinelli & Ferretti's workforce is large enough to handle any surety matter, but still maintain the client contact that is so important in our industry.

Operating from offices in: Hauppauge, New York (Long Island); Southampton, Pennsylvania (Philadelphia area); Avon, Connecticut (Hartford area); Crystal Lake, Illinois (Chicago area); Bend, Oregon; and Miami, Florida; Cashin Spinelli & Ferretti provides its services to all areas of the United States, and the Caribbean.

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 and creditors' rights, construction, corporate and securities, employment, environmental law, ERISA and employee benefits, fidelity and surety, government and regulatory affairs, health law, intellectual property, internal investigations and monitoring, litigation, media and technology, private equity, product liability and 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 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's Fidelity & Surety group have worked in partnership with our clients in every aspect of the industry.

Clark Hill'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.clarkhill.com.

D'Arcy | Vicknair LLC is a law firm that primarily focuses on Construction Law and Surety Law. The firm is a group of attorneys with records of successful litigation outcomes. Many of our attorneys are named in Super Lawyers, Best Lawyers, and many of the firm's attorneys also participate in bar associations and other professional organizations, frequently serving in leadership roles. Our attorneys also have degrees in other areas

related to the practices of the firm, such as Electrical Engineering, Economics and Civil Engineering. In addition, two of our attorneys (including Mr. D'Arcy) teach at Loyola Law School New Orleans as adjunct law professors. As regards surety work, all aspects of construction performance and construction claims are handled by D'Arcy Vicknair. The firm tackles each phase of bond work from assessing claims through working out settlements, and, when appropriate and necessary, through detailed discovery, trial of the claim and handling any appeals, and associated indemnity actions. The firm provides a full range of surety-related legal services including, but not limited to, defaults, claim analysis, management and coordination, project takeovers, indemnity issues, subrogation issues, workouts, and mediation, arbitration, and litigation. Headquartered in New Orleans, Louisiana, the firm has attorneys licensed to practice in Louisiana, Texas, Mississippi, and New York. Please visit our website at www.darcyvicknair.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.

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 Keleher McLeod 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.jhkm.law.

Founded in Phoenix, Arizona in 1942, Jennings Strouss is a dynamic law firm with the talent and insight to address a wide range of business legal issues. With law offices in Phoenix, Peoria and Yuma, Arizona, and Washington, D.C., the firm leverages its resources regionally and nationally.

Our litigation department stands as one of the most respected in the Southwest, with a proven track record of trial victories and successful outcomes for clients. The transactional department handles an array of business legal matters, from the negotiation and closing of complex transactions to providing counsel on common legal questions.

One of the many benefits of a relationship with Jennings Strouss is our pragmatic and results-oriented legal advice coupled with a healthy, well-managed and friendly relationship with our attorneys. In fact, several of our key clients have been with us for 30+ years. We feel privileged to enjoy lasting relationships with them, which we take as a testament to their confidence in and comfort with us.

We believe that to offer excellent advice and service, we need to understand our clients, as well as their business. Excellent service also means taking a long-term view and investing in relationships with clients as well as in our own people, processes, and services. No client service could be better than that given by a united firm, which values collaboration and teamwork. We believe everyone at the firm can make a difference in serving all of our clients.

Please visit our website at www.jsslaw.com.

Jermain Dunnagan & Owens, P.C. 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.

Please visit our website at www.jdolaw.com.

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 Bains, 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 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.

Our attorneys have successfully represented clients in complex performance and payment bond cases ranging from major contractor defaults to bond fraud to bad faith allegations. Such experience includes negotiating takeover and tender agreements, and performance bond buybacks, as well as the assertion and litigation of affirmative claims against owners, design professionals, or subcontractors.

Our proficiency extends beyond contract surety to bonds of all types: fidelity, probate and many other commercial lines, including notary bonds, mortgage broker bonds, motor vehicle dealer bonds, bankruptcy trustee bonds, and license bonds, among others. Our work with fidelity bonds includes employee dishonesty bonds, commercial crime policies, and other similar products.

We bring substantial experience in matters involving loss recovery, including indemnification and subrogation. This includes asserting various indemnity agreement rights such as the right to review books and records, and the entitlement to collateral security.

We have also successfully represented sureties in various subrogation matters, including disputes with lenders, the IRS, bankruptcy trustees, and other creditors.

Our attorneys have served as authors and editors of books, periodicals, articles, and newsletters in the surety and fidelity fields. They are regularly asked to speak at ABA/Surety and Fidelity Law Committee functions and other national surety industry conferences and seminars, and have held leadership positions in industry groups.

Please visit our website at https://lipsonneilson.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.

Matson, Driscoll & Damico LLP 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.

Maximum Property Construction's mission is to provide expertise in the unique practices of Construction Defect Evaluations, Expert Witness Services, Owner's Representative Services, and Surety Claims Investigations. We apply core values of rapid response to all inquiries, personal integrity in our business relationships, impeccable customer service, and excellence of our work product at all times.

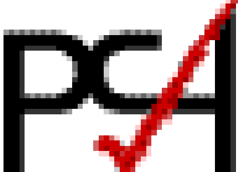
Our services include:

- Expert Witness services in the fields of mechanical-HVAC, plumbing, and general construction
- Construction Defect Evaluation, Analysis, and Litigation Support
- Construction Surety Claims Investigations
- Owner's Representative
- Commercial Construction License

Please visit our website at www.mep-llc.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.

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.

Sokol Larkin, a boutique law firm located in Portland, Oregon, has earned its reputation as one of the Pacific Northwest's premier firms in the areas of construction and design law, surety and fidelity law, and business, commercial and real estate matters. The firm's clients range from individuals and small businesses to large multi-national companies.

Jan Sokol and Tom Larkin established the firm to create a team of excellent attorneys. With principle, passion and purpose, our mission is to provide the highest level of legal service in an aggressive, though pragmatic and cost-effective, manner to help clients achieve the best possible results. The firm's success has helped the firm develop long-standing trust and relationships with its clients. At Sokol Larkin our attorneys and support staff each contribute their individual expertise to provide our clients with exceptional service and personal attention in all matters. The firm has attorneys admitted to practice in Oregon, Washington, Idaho, Alaska, California, the District of Columbia and other jurisdictions.

Please visit our website at www.sokol-larkin.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.

The Sage 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 Group Team makes rapid and precise evaluation of costs to complete and project status possible. The Sage Group'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. The Sage Group 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.

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.

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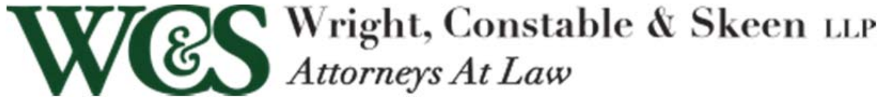

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Driving Directions

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

Papers

PANEL 1

EVALUATING GMP AND ADP PROJECTS WITH UNDERWRITING CONSIDERATIONS – 2022 *SPEARIN* UPDATE

Jim Case | Dykema Gossett, PLLC | Detroit, MI

Terry Dahl | Intact Insurance Specialty Solutions | New York, NY

Sean Fallows | Intact Insurance Specialty Solutions | Seattle, WA

Michael Sugar, III | Forcon International Corporation | Tampa, FL

Gregory Thomas | Liberty Mutual Surety | Seattle, WA

PEARLMAN 2022

September 8-9, 2022

Sparkman Cellars Winery | Woodinville, WA

Introduction

Guaranteed Maximum Price (GMP) and Alternative Delivery Method Projects (ADP) have slowly and steadily become more common practice in the Construction Industry. Owners have found value in a turn-key solution and Contractors have become amenable to taking on responsibility outside of the actual construction of the project. Federal, State and Foreign Governments have utilized this procurement method for many years. The transfer of risk in GMP/ADP projects is much more unique and complex than traditional Design-Bid-Build Construction and requires a sophisticated understanding of not just labor & materials but the economy, other key/critical partners, a thorough understanding of the Owner/Obligee and forecasting the future.

We hope to provide a broad overview of the factors considered by both Contractors and Underwriters when evaluating GMP/ADP Risk. Additionally, we found it only fitting to cover the most recent updates to *Spearin* as many GMP/ADP contracts include some level of design as part of the Contractor's responsibilities.

Part 1: *" A Contractors Perspective"*: Analyzing the Risk in a GMP or ADP/PPP contract

I. Economic & Financial Risk Factors

Economic factors always play a considerable role in the decision to undertake any financial risk or exposure in every industry. The Construction Industry provides a prime example of economic risk evaluation, especially in the current state of domestic, and foreign, economic uncertainty. Lead times for critical domestically produced and imported items such as servers, cabinetry, and other materials & equipment commonly procured in all facets of construction have increased from a few weeks to months or even years. Market economies have forced price escalation on items where demand far exceeds supply. This price escalation has led to financial burden for Contractors especially on projects under construction or in procurement since early 2020. Further, price escalation has contributed to higher inflation rates, increased wage demands and the tightening of financing formerly available to Contractors.

Bidding GMP and ADP/PPP projects relies heavily upon the Contractor's ability to forecast impacts that might result from cost escalation, inflation, labor availability and regulatory changes. Global economic uncertainty, over the last 2 years, has changed how the risks presented by non-traditional Design-Bid-Build procurement are evaluated. Many Contractors are comfortable with production rates and typically used materials costs (although rapid changes in the various Material's Indices have presented problems), but evaluating long term financing risk and market forecasting has never been a Contractor's *forte* (optimism still tends to trump economic realities).

To complement the Contractor's *in-house* construction knowledge, Contractors have turned to other industries (such as Insurance and Finance) for best practices on how to evaluate long term financial risk. Property & Casualty Insurance policies serve as a transfer of risk, in exchange for

a premium; GMP Contracts & PPP projects are very similar, the transfer of financial risk in exchange for a Contract Price. Similar to Insurance carriers, Contractors have begun to utilize Actuarial Science to model the risk of "other" factors such as inflation, owner financial stability or operating & maintenance costs and apply the appropriate "premium" on this risk.

II. Strategic & Established Partnerships

While there are a number of underlying reasons and factors explaining "why" an Owner and/or Obligee would elect to utilize GMP as the Project Delivery method, one of the most common factors is the desire for a turn-key process (Design to Delivery and even Maintenance). The term "design/build" has existed for years, and it is frequently used for the construction of facilities where either a similar building has been constructed (but perhaps in a different region) or the Owner/Obligee has a set of design & performance requirements but has not completed, or not started to develop, the Contract Plans or prescriptive specifications. Many different State Department(s) of Transportation will take it one step further by contracting for the operation & maintenance of the Project (Design-Build-Operate-Maintain), and even the Project financing (these additional obligations/services often involve projects which enter into the realm of "Public-Private Partnerships" or "PPP"/"P3").

Those entities who have enjoyed success in the GMP & ADM arena will typically have developed long-standing relationships of trust and confidence with design teams, maintenance contractors (think Toll roads & Bridges), and financial institutions. Established relationships and partnerships not only provide a competitive advantage from the standpoint of a 'pre-assembled' team, but also the efficiencies of having worked together before, understanding each member's strengths/weaknesses and the trust that each member is able to complete its deliverables.

As a CM/EPC/General Contractor (or possible an A/E firm) evaluates whether or not to pursue a GMP/ADP project, it will inevitably look at the success rate of similar projects undertaken in the past. More importantly, it will be evaluating the success rate of the other team members on similar projects. Unlike traditional Design-Bid-Build procurement, the Construction and Design firms are "one" team and, usually, jointly liable to the Owner for any performance failure by any of the other firms involved in the venture. While the CM/EPC/General Contractor may ultimately decide not to pursue a project even though a key-partner has had success with similar projects in the past, it would be far more likely to decline such an opportunity if the success rate of its prospective partner(s) on similar projects was low.

III. Evaluating the Owner/Obligee

Just as important as the evaluation of prospective partners is the CM/EPC/General Contractor's experience with the Owner/Obligee. The Owner's past success rate on GMP/ADM projects, most importantly the success rate on any projects which the CM/EPC/General Contractor has performed under similar terms with the Owner/Obligee is one of, if not the most, influential factors considered when pursuing a project.

While a CM/EPC/ General Contractor evaluates many factors with respect to the Owner in considering whether and what amount to bid on any projects, a project that requires a GMP/ADM as the contractual vehicle for delivery presents a significant increase in risk due to the large umbrella of obligations placed on the bidder. Key factors that the CM/EPC/General Contractor has to consider in evaluating the Owner are:

1) Does the Owner pay on time?
   a) If they don't then does it make sense at the very least to increase the profit markup to offset the cost of financing the project
2) Is the Owner reasonable with the negotiation, processing and payment of Change Orders?
3) What is the Owner's source of funding?
   a) Public funding is more secure, but comes with red tape
   b) Private funding has less restrictions, but Banks may introduce their own terms & conditions for payment

The answers to these questions will ultimately decide whether or not the CM/EPC/General Contractor pursues the Project. An Owner who pays on time but is unreasonable with Change Order requests and has had financing problems may cause reluctance to bid; there is simply too much risk. Yet, an Owner who is slow to pay but reasonable with regard to Change Orders and has adequate financial strength might not be as much of a red flag so long as the bid is adjusted accordingly.

The process of evaluating whether or not the Project is a good fit is a complex assessment of risk. Economics, the structure of the project team and the Owner/Obligee's financial strength and history represent varying, but equally important, pieces of the puzzle in determining whether the CM/EPC/General Contractor would not, or should not, pursue a bid. Each piece of the puzzle discussed above should play critical roles in decision-making because it is a recipe for disaster if these pieces do not fall into place.

Part 2: *"Should we do it?"* Underwriting Considerations for GMP & PPP/ADP Contracts

In general, "underwriting" involves the collection and assessment of a combination of objective and subjective data. Since no Principal, Contract, Obligee, or Surety is the same, there isn't one checklist, but here is a selection of the general questions that an underwriter might ask when evaluating the Surety's risk associated with a GMP contract.

1. Has the contractor had their attorney review the contract?
2. At what point in the process are they required to provide a performance and payment bond?
   a. Will the design be finished and the GMP be set prior to needing final bonds?
3. How is the project funded and what evidence is available that the funding is in place?

    a. What obligations and requirements may be set forth by the financing firm which might be incorporated, but not explicitly stated, in the Bid Documents or Contract?
4. Is there a consent of Surety requirement before each payment or payments at certain milestones?
5. How does the Principal work through value added design type portions of the contract – like electrical or HVAC, and who assumes the associated GMP risk?
6. How much of the project has been designed by the Owner/Obligee?
7. How complicated is the project?
    a. How much experience does the Principal have with this type, size, complexity, and geographical territory for the work?
    b. What is their previous experience – scope, date, contract price, final gross profit?
8. What attracts this Principal to this work, what risks does the Principal see in the Project or the Contract, and how are they approaching and mitigating them?
    a. Has the same project been completed elsewhere before? Was it successful (win-win)?
    b. Has the Principal worked with this Obligee?
9. How will the Principal protect itself from cost increases, supply delays, long lead times, etc?
    a. Are contingencies and allowances permitted in the contract or budget to cover escalation in material prices?
10. If the Principal exceeds the GMP and with no hope of relief, can the Principal withstand the loss?

Part 3: *"Further Development"* of Contract Documents in the GMP Context: Surety Perspectives

I. Introduction

What happens when a design is not fully developed in a GMP contract structure and there is a cost to developing the Contract Documents? For instance, what happens when a contractor defaults in this scenario and the surety is asked to honor the obligations in, for example, the AIA A312-2010 Performance Bond. In standard contracts with GMPs, the language will likely indicate that the certain aspects of the GMP will be developed after the execution of the document. The obvious problem is that this can cause an increase in the cost of performance post-contract execution. In cases where contractor has defaulted, the obligee will attempt to interpret this contract language as broadly as possible in order to impose the greatest liability possible on the surety. This paper, and the panel's discussion of it, attempt to alert sureties to the contract language tied to this potential liability exposure and explores how a surety might raise arguments that attempt to narrow its applicability, or at least limit exposure.

II. Example Contract Language Implicated

In an ideal scenario, contract language would spell out exactly what costs are included in the GMP to the extent the Contract Documents require further development. However, as is often the

case, construction projects, and the contracts to which a surety ultimately may be bound, are not usually so clear.

For example, the AIA A102-2017 Standard Form of Agreement Between the Owner and Contractor where the basis of payment is the Cost of the Work Plus a Fee with a Guaranteed Maximum Price (the A102) contains language addressing "further development costs."

> Article 5.2.5 provides:
>
> To the extent that the Contract Documents are anticipated to require further development, the Guaranteed Maximum Price ***includes the costs attributable to such further development*** consistent with the Contract Documents and reasonably inferable therefrom. Such further development does not include changes in scope, systems, kinds and quality of materials, finishes or equipment, all of which, if required, shall be incorporated by Change Order. [Emphasis added.]

Two other provisions are implicated by Article 5.2.5 – those identifying the Contract Documents and the GMP.

Article 1 defines the Contract Documents:

> The Contract Documents consist of this Agreement (the A102), Conditions of the Contract (General, Supplementary, and other Conditions), Drawings, Specifications, Addenda issued prior to the execution of this Agreement, other documents listed in this Agreement and Modifications issued after execution of this Agreement, all of which form the Contract, and are as fully a part of the Contract as if attached to this Agreement or repeated herein. The Contract represents the entire and integrated agreement between the parties hereto and supersedes prior negotiations, representations, or agreements, either written or oral. If anything in the other Contract Documents, other than a Modification, is inconsistent with this Agreement, this Agreement shall govern. An enumeration of the Contract Documents, other than a modification, appears in Article 16.

GMP is defined in Article 5.2:

> The Contract Sum is guaranteed by the Contractor not to exceed _________, subject to additions and deductions by Change Order as provided in the Contract Documents. This maximum sum is referred to in the Contract Documents as the Guaranteed Maximum Price. Costs which would case the Guaranteed Maximum Price to be exceeded shall be paid by the Contractor without reimbursement by the Owner.

Significantly, the Contract Documents are defined rather broadly while the GMP is defined narrowly and simply. However, a clear definition of "further development" is (in standard, unaltered language) not provided. This results in what one would have hoped to be a clear and simple allocation of risk and responsibility in Article 5.2.5 being not so simple a task.

The very first sentence of Article 5.2.5 opens the can of worms. It requires costs that might be subject to further development of the project to be part of the GMP, but arguably, only to the extent that those further development costs were expected, i.e., “to the extent that the Contract Documents *are anticipated to require* further development…” In the author’s experience, that expectation is rarely, if ever, memorialized in the Contract Documents. But, isn’t that expectation inherent in the selection of a cost-plus, GMP contract structure? If further development was completely unexpected and the Owner and Contractor were dealing with a completed set of plans and specifications, presumably (provided there was commercial incentive for it) they could have executed a fixed-fee agreement, the Owner would be happy with a known contact sum and the Contractor would be happy (subject to pricing) to bid the job, know, and then earn its margin. Just because that argument makes logical sense, do not expect every adjudicator to buy it.

A savvy obligee will argue that strict construction of Article 5.2.5 mandates the ability to pass on costs, even if they are inclusive of the specifically excluded costs enumerated by 5.2.5. And depending on the law of the jurisdiction where a dispute arises between an obligee and a performing surety, the argument may prevail. This is true notwithstanding the fact that Owners and Contractors/Principals know and agree – albeit tacitly, perhaps – that the construction documents will likely need “further development’ in a cost-plus, GMP structure. However, evidence related to a surety’s counterargument may not even be considered, let alone weighed, if a court or arbitrator determines that the contract language is unambiguous and bars extrinsic evidence to aid in its interpretation.

Provided the surety can defeat this threshold argument, its ability to limit liability for further development costs gets slightly easier thanks to the list of exclusions in Article 5.2.5. Further development costs do not include changes related to scope, systems, kinds and quality of materials, finishes or equipment. These changes, if dealing with an A102 or similar language, all have to be memorialized by Change Order. So, the task for the completing surety becomes fitting each cost that is trying to be passed on to the surety into at least one of these categories or arguing that “further development” was not reasonably inferable from the Contract Documents thus entitling the completing surety, assuming that it follows contract requirements for one, to a Change Order.

This is a fact-intensive inquiry and a surety’s ability to make such an argument is going to depend on how thorough the universe of project documents is and how the parties conducted themselves prior to takeover (i.e. their applicable course of dealing, which, again depending on the jurisdiction can be binding).

III. Caselaw Insights on Article 5.2.5

Caselaw on the nuanced issue of this paper is scant. However, there is caselaw interpreting Article 5.2.5 of the A102 in general payment disputes. Sureties should remember a couple central themes that come from the limited caselaw interpreting 5.2.5.

A. Article 5.2.5 is unambiguous and is not a get out of jail free card for a busted GMP

An owner and a contractor litigated a busted GMP, with the contractor arguing that the GMP was less guaranteed than the contract language actually provided.[1] The contractor had failed to follow specific change order provisions and sought to modify the GMP. Even though parties to a GMP contract "understood and anticipated that the scope of work and GMP were subject to change," Article 5.2.5 clearly requires anticipated changes to be accounted for in the GMP.[2] Article 5.2.5, read in conjunction with the contract's change order provisions, mandated that (in this case) scope changes be memorialized in a Change Order. The court noted that "the contracts do not show uncertainty or conditions on these requirements."[3] There was "no ambiguity in this provision that would allow us [the court] to look at evidence beyond the plain language of the contracts."[4]

B. Article 5.2.5 should be read in concert with Article 5.2.4

Article 5.2.4 of the A102 provides an opportunity for the contracting parties to list "[a]ssumptions, if any, upon which the Guaranteed Maximum Price is based." These assumptions can certainly help identify the parties expectations of whether the Contract Documents may require further development. As a matter of fact, Article 5.2.6 requires an Owner to "promptly furnish revised Contract Documents to the Contractor (those incorporating assumptions from 5.2.4)." It is then incumbent upon, and in fact required of, the Contractor to notify the Owner and Architect of "inconsistencies between the agreed-upon assumptions contained in Section 5.2.4 and the revised Contract Documents." Provided the assumptions do not include an excluded category listed in 5.2.5, the Contractor's costs, if any, associated with 5.2.6 would seem to comprise "further development consistent with the Contract Documents and reasonably inferable therefrom," which would be non-compensable.

However, in a dispute between an owner and a terminated contractor, the contractor was not able to rely on 5.2.4 to support a change to the GMP.[5] The contractor argued that its damages should not be limited to the GMP because notwithstanding certain assumptions listed in 5.2.4, after signature, the owner amended the original plans in a way that required substantially more work than that indicated in the assumptions, i.e. the assumptions did not pan out.[6] The contractor had not submitted a change order for this, yet sought compensation. The court noted that 5.2.4 and 5.2.5 (among other relevant contract provisions) could be read harmoniously together and did not

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[1] *Ryan Cos. Us v. Fdp Wtc*, 2022 Iowa App. LEXIS 160; 2022 WL 469336; *vacating and replacing prior decision at* 967 N.W.2d 361 (Iowa Ct. App. Oct. 6, 2021).

[2] *Id*.

[3] *Id*.

[4] *Id*., *citing Hartig Drug Co. v. Hartig*, 602 N.W.2d 794 (Iowa 1999) (allowing extrinsic evidence only if a contract is uncertain or ambiguous).

[5] *Timber Ridge Escapes, LLC v. Quality Structures of Ark., LLC*, 2019 U.S. Dist. LEXIS 80582; 2019 WL 2080030 (W.D. Mo., Feb. 28, 2019).

[6] *Id*.

allow the contractor to seek damages in excess of the GMP. The large scale changes that the contractor argued would be compensable were scope-related and regardless of whether the 5.2.4 assumptions held, "the contract, read as a whole [after citing 5.2.5], leaves no question that Change Orders and Change Directives were the method by which the parties could change the GMP."[7] Certain "re-bid" provisions did not by themselves require changing the GMP and because the contractor failed to memorialize a change to the GMP by requesting a change order, the damages it sought were limited.

IV. Conclusion and Takeaways for Sureties

Based on limited caselaw available interpreting 5.2.5, there are a few important points for sureties to keep in mind during the takeover and performance process. First, for work the surety contends were changes that occurred before a default, unless the principal has followed the contractual change order process, the surety likely will not be entitled to claim an increase in the contract sum.

Second, this is particularly true given guidance from courts that 5.2.5 is unambiguous. Thus, even though a surety might be able to argue under 5.2.5 that its principal performed work that expressly fell within one of the categories that would allow for an increase in the GMP as articulated in 5.2.5, adjudicators will probably find that an increase in the contract sum was waived due to failure to follow the contract's change order provisions. This might not be the end of the argument, though. If enough project documentation exists to establish a course of dealing between the principal and the obligee that waived strict compliance with the contract, the surety will at a minimum be able to argue entitlement to an increase in the contract sum. Without it, the surety will be left to sleep in the bed made by its principal – a waiver of the ability to recoup the increased cost.

Third, not all hope is lost. For example, the inverse of the foregoing waiver argument can logically apply. If the surety is successful in defeating an obligee's argument for broad application of 5.2.5, and the surety can show that the principal followed the contractual change order process, a corresponding increase to the contract sum might be due from the obligee.

Fourth and finally, upon and after takeover, the surety and its consultants must conduct a detailed review of change orders, change order requests, and correspondence related to requests to increase the contract sum by the principal pre-default, and must follow the change order process outlined in the contract to the letter after takeover. Performing this evaluation and conducting itself in this way allows the surety to avoid an overreaching 5.2.5 argument from an obligee in terms of prior work done that may or may not fall in 5.2.5's purview. The surety can at least attempt to memorialize prior changes in after-the-fact change orders in an effort to preserve its right to argue entitlement later. Further, if post-takeover changes later become disputed, the surety will be able to point to strict contractual compliance when arguing its entitlement to an adjudicator. Contract compliance from day one is ideal, but in the surety's world, compliance is better late than never and should be attempted to the extent the surety can assert colorable claims

[7] *Id.*

for changes that an obligee may otherwise try to argue fall within the purview of the "further development" language in 5.2.5.

Part 4: *Spearin* Update

Before discussing recent cases addressing the *Spearin* Doctrine issue, it is worth briefly describing what the *Spearin* Doctrine is. The *Spearin* Doctrine originated with the U.S. Supreme Court decision in *United States v. Spearin*, 248 U.S. 132, 136 (1918). In that case, the Supreme Court held that "if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications." The *Spearin* Doctrine has evolved to cover two specific implied warranties. Under *Spearin*, an owner that has supplied project drawings and specifications to a contractor is deemed to have impliedly warranted that the plans and specifications are: (1) accurate; and (2) suitable for their intended purpose. Stated alternatively and simplistically, where an owner is supplying plans and specifications to a contractor, it is impliedly warranting to the contractor that the project can be built as designed.

***AP Alts., LLC v. Rosendin Elec., Inc.*, No. 5:18-CV-01748, 2019 U.S. Dist. LEXIS 139084 (N.D. Ohio Aug. 16, 2019).**

AP Alternatives, LLC ("Plaintiff") brought claims resulting from work on a project that Plaintiff was allegedly not paid. The *Spearin* discussion arose when Plaintiff moved the Northern District of Ohio for leave to amend its complaint to add numerous claims, including a claim which was titled: "Breach of Implied Warranty – *Spearin* Doctrine" against certain NextEra Defendants. The claim alleged that the NetxEra Defendants breached their implied duty to provide accurate information to Plaintiff. Specifically, Plaintiff alleged there was a subsurface condition information that was improper and damages resulted because of the improper information. The NextEra Defendants objected.

The NextEra Defendants argued, among other things, that since the NextEra Defendants were not involved with a government contract, the *Spearin* Doctrine did not apply. The Northern District determined that this argument was persuasive. The Northern District relied on an Ohio Supreme Court Case (*Dugan & Meyers Constr. Co., Inc.* v. *Ohio Dept. Of Adm. Servs)* which held that the *Spearin* Doctrine pertains to government contracts only. The *Dugan* court declined in expanding the doctrine's reach and The Northern District found that since no other Ohio Supreme Court or any other Ohio Court has found to extend the *Spearin* Doctrine to contracts between private parties they would not do so either. In Ohio, it is necessary that the contract between the parties be a government contract to extend the application of the *Spearin* Doctrine.

***James Talcott Constr. Inc. v. United States*, No. 14-427 C, 2019 U.S. Claims LEXIS 158 (Fed. Cl. Mar. 4, 2019)**

James Talcott Construction, Inc. ("Plaintiff") brought a breach of Warranty of Plans and Specifications claim against the U.S. Government. The claim stemmed from a contract it was awarded for construction of military family housing. Plaintiff sought damages because it claimed that the U.S. Government did not provide a complete and proper contract. Plaintiff contended that the U.S. Government issued defective, conflicting and ambiguous design documents that did not represent the project accurately which led to additional work being performed, causing the project to run over schedule by 145 days.

The Court of Federal Claims held that the *Spearin* Doctrine did not apply to performance specifications. The court discussed how *Spearin* established that when the government includes detailed specifications in a contract, the government impliedly warrants: 1) if the contractor follows those specifications, the resultant product will not be defective or unsafe and 2) if the resultant product proves defective or unsafe, the contractor will not be liable for the consequences.

Relying on *Daewoo Eng'g & Constr. Co.* v. *United States,* the court determined that the *Spearin* doctrine does not apply to performance specifications. The contractor was free to employ its own means and methods to achieve the result acceptable to the Government.The Court explained that the appropriate manner in which to determine if there was a claim was to check the contract to determine the responsibility for the means, methods, and sequence of construction. The contract stated that Plaintiff was responsible. This meant that Plaintiff was free to determine how to complete the contract to provide an acceptable result. As the housing provided to the U.S. Government contained substantial amounts of mold growth in crawl spaces, floor joists, decking, walls etc. the court ruled it was not reasonable for the government to find the project had been completed in acceptable fashion, and as the contractor had complete control over means and methods, the issue was the contractor's to resolve.

***Vill. Homes of Grandview Square II Ass'n v. R. E. C.*, No. A19-1681, 2020 Minn. App. LEXIS 224 (Ct. App. Aug. 3, 2020)**

A condominium homeowners association, Village Homes of Grandview Square II Association ("Plaintiff"), sued a number of contractors and subcontractors. The *Spearin* Doctrine discussion related to a defense raised by one of the subcontractors ("Fox Valley"). Plaintiff's claims arose from alleged construction defects in the stucco of the condominium building provided by Fox Valley. (Fox Valley was found liable as it owed a duty in both contract and tort to the association as the issues arose from the subcontractors improper workmanship and not defects in the plans provided.)

The key in deciding the *Spearin* argument raised by Fox Valley was that Plaintiff was a third-party beneficiary. The court discussed how *Spearin* does not indicate any protection against subcontractors against all parties with respect to all possible liability related to their work so long as they follow provided plans. *Spearin* was a recognition of the allocation of the risk of deficient plans to the party who provided plans. The court concluded that the rejection of Fox Valley's *Spearin* argument was appropriate as Plaintiff was not the designer of the plans or owner of the buildings, only a third party beneficiary.

***Christopher Glass & Aluminum, Inc. v. Tishman Constr. Corp.*, 2020 IL App (1st) 191972-U**

Christopher Glass and Aluminum, Inc. ("CGA") filed a complaint against Tishman Construction Corporation of Illinois ("TCC") to recover damages for wrongful termination of a subcontract. TCC was the general contractor for the project and contracted with CGA to deliver and complete installation of the building's exterior window system. As the window system did not meet the standards of the project, litigation ensued.

The dispute between TCC and CGA made its' way to the 1st District Appellate court in Illinois. TCC argued that *Spearin* does not apply as a contractor cannot complain of defects in the contractual requirements if it fails to follow them. TCC made the argument that the plans and specifications did not require use of a specific window system, while CGA held that it did.

TCC and CGA met with CGA's supplier of windows, United States Aluminum ("US Aluminum"), to discuss what type of windows they could provide that would fit the needs of the project. It was determined that that US Aluminum had a system of windows known as the USA 4500 system that would serve that purpose. TCC took it upon itself to include, in the subcontract, that the USA 4500 system would be used "exclusively". TCC made an argument that because the requirement for using the USA 4500 system was found in the subcontract, and not the project specifications, *Spearin* does not apply. The Appellate Court held that there was nowhere in *Spearin* where the United States Supreme Court discussed or mentioned the requirement in question be written in the plans and specifications or in the contract itself. The Appellate Court continued that there existed no condition on the rule that the required action be in the plans for the work provided to the contractor or in the contract to perform according to the plans. The basis for the Appellate Court's holding was that the contractor should be relieved of a claim for defective work if it was misled by what it was required to do no matter where in the contract documents the requirement appeared. The Appellate Court also relied on Illinois law (*Clark* v. *Pope,* 70 Ill. 128 (1873), pre-dating *Spearin*, which discussed that a contractor who builds according to plans and specifications furnished to him and performs the job in a good and workmanlike manner is protected.

Here, because TCC specifically made the choice to place the USA 4500 system in the subcontract, TCC impliedly warranted that the system would perform to the specifications for the project.

PANEL 2

RE-VISITING FORCE MAJEURE:
PANDEMIC, SUPPLY CHAIN, LABOR SHORTAGE ISSUES

Charles Delaporte | Guardian Group, Inc. | Torrance, CA

Jason Stonefeld | Liberty Mutual Surety | Seattle, WA

Gregory Weinstein | Weinstein Radcliff Pipkin LLP | Dallas, TX

PEARLMAN 2022

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RE-VISITING FORCE MAJEURE: PANDEMIC, SUPPLY CHAIN, LABOR SHORTAGE ISSUES

Jason Stonefeld[1]
Charles Delaporte, PE
Gregory M. Weinstein

We address the relationship between the COVID 19 pandemic and *force majeure* in the construction industry.

What is *Force Majeure*?

- French for "superior force."
- Common principle found in construction contracts to address specific types of delays beyond the control of the contracting parties. *Force majeure* clauses generally do not create an opt-out because of being limited in scope.[2]
- Language generally included in construction contracts to cover force majeure events include: "Any act, event, or condition that has a material adverse effect on the ability of a party to this Agreement to perform its obligations hereunder if such act, event, or condition is beyond the reasonable control of such party and is not the result of such party's willful or negligent action or inaction and shall include, without limitation, (i) acts of God, war, public disorders, insurrection, rebellion, floods, hurricanes, earthquakes, lightning, or other natural calamities; (ii) acts or inaction of governmental or regulatory agencies or judicial bodies or changes in laws; (iii) explosions or fires; (iv) strikes or labor disturbances; (v) delays in obtaining goods or services from any subcontractor, materialman, or supplier by reason of any occurrence of any of the foregoing causes; or (v) any unforeseeable act or omission of any third party."[3]
- Not necessary to use the specific phrase "force majeure" as long as the language addresses the concept.
- Example of pre-COVID 19 force majeure type provision may be found in the AIA A101 (2017 Version).

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[2] *Princeton Homes, Inc. v. Virone*, 612 F.3d 1324, 1332 (11th Cir. 2010) (internal citations and quotation marks omitted).

[3] *Solid Waste Auth. of Cent. Ohio v. FirmGreen Fuels of Ohio, L.L.C.*, 2010 Ohio Misc. LEXIS 20220 (2010). See also Kyocera Corp. v. Hemlock Semiconductor, LLC, 313 Mich. App. 437, 448, 886 N.W.2d 445, 452 (2015).

> § 3.3.4 The Substantial Completion Date shall be extended by one (1) day for each day that a Force Majeure event impacts the critical path of the Work. For purposes of this Agreement, "Force Majeure" shall mean: strikes, lockouts or labor disputes affecting all or a material part of the work force available to perform the Work; war and/or warlike operations or conditions; sabotage or terrorism affecting the premises that otherwise prevents or interferes with continued work at the Project site; governmental actions; condemnation or eminent domain proceedings affecting a material portion of the Project site; fire or other casualty damaging improvements at the Project site; shortages or inability to obtain materials or equipment due to circumstances outside the reasonable control of the Contractor; and/or adverse weather conditions. Adverse weather conditions include, but are not limited to, conditions which impact or prevent work on the Project and which have a direct effect on the Contractor's predefined critical work sequence including days lost due to mud, muck, ice, or other conditions wherein Contractor's access to the Project site is materially impeded resulting in an adverse effect on the Schedule of Work [4]

- Typical force majeure clause focuses on time extension to the Contractor and may limit the Contractor's exposure to consequential damages and penalties for delays.

- Beyond recovery of time and costs for delay, attention should be given to the recovery of other "disruption" costs (e.g., cost escalation, compliance with COVID testing protocols, mobilization/re-mobilization, etc.). Potential recovery depends on specific contract language.

Enforcement of *Force Majeure* Clauses

- Courts examine the language of the clause and the cause of the delay or lack of performance to determine whether a force majeure clause excuses performance. "*Force majeure clauses broader than the scope of impossibility are enforceable under Florida law*."[5]

- Force majeure clauses excusing delays caused by an event not within the reasonable control of the impacted party are enforceable.[6]

- Enforceability varies from state to state and usually depends on the extent of foreseeability of the event. For example, Texas requires a showing of unforeseeability for a "catchall" provision to apply.[7]

- Courts generally apply the doctrine of *ejusdem generis* to decide whether a "catchall" provision applies. The application of this doctrine results in a narrow construction of the events that may qualify as force majeure events under a catchall provision.[8]

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[4] AIA Document A101 – 2017.
[5] *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849, 857 & n.6 (11th Cir. 2009).
[6] *St. Joe Paper Co. v. State Dep't of Envtl. Regulation*, 371 So. 2d 178, 180 (Fla. Dist. Ct. App. 1979); *See also Gulf Oil Corp. v. F.E.R.C.*, 706 F.2d 444, 452 (3d Cir. 1983).
[7] *TEC Olmos, LLC v. ConocoPhillips Co.*, 555 S.W.3d 176, 184 (Tex. App. 2018).
[8] *Great Lakes Gas Transmission Ltd. P'ship v. Essar Steel Minn., LLC*, 871 F. Supp. 2d 843, 854 (D. Minn. 2012) *Seitz v. Mark-O-Lite Sign Contractors, Inc.*, 210 N.J. Super. 646, 510 A.2d 319, 321 (N.J. Super. Ct. Law

- To qualify as a force majeure event, the event must render performance impossible. Alleging difficulty or hardship of performance may not be sufficient.[9]

Force Majeure and Delays Due to COVID-19/Pandemics

- No extensive published case law on whether a disease outbreak may constitute a force majeure event.
- Published opinion out of New York focused on whether to construe a pandemic as a natural disaster.[10]
- Language used in pre-COVID construction contracts will determine whether delays attributable to a pandemic/epidemic qualify as force majeure.
- Clauses specifically mentioning pandemics/epidemics offer the best protection in jurisdictions that strictly construe force majeure provisions such as Texas.
- Examples of contract language specifically addressing impacts caused by COVID-19 pandemic.

> **Coronavirus/COVID-19 Impacts**. Notwithstanding the requirements and obligations set forth in this Agreement or any other Contract Documents, the Contractor shall be entitled to an extension of the Contract Time and an equitable adjustment of the Contract Price, due to labor shortages, material escalation, or otherwise, related to the performance of the Work due to any and all impacts from governmental orders issued by the federal government, State of Texas, or Dallas County that expressly limit commercial construction in Dallas County as a result of the Coronavirus/COVID-19 pandemic. Contractor will employ commercially reasonable efforts to mitigate such delays and increased costs in consultation with the Owner and will provide regular updates to Owner as to any time or cost impacts resulting from this provision. Any disputes as to the entitlement of extensions of Contract Time or increases in the Contract Price shall be resolved pursuant to the Claims and Dispute Resolution provisions of this Agreement.
>
> **Claims for Increase in Agreement Price**. If Contractor claims entitlement to extra compensation notice of any such claim and substantiation therefor shall be submitted to

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Div. 1986); *Team Mktg. USA Corp. v. Power Pact, LLC*, 41 A.D.3d 939, 942–43, 839 N.Y.S.2d 242, 246 (N.Y. App. Div. June 7, 2007); *Castor Petroleum v. Petroterminal De Panama*, 107 A.D.3d 497 (2013) (holding that the attachment of plaintiff's oil due to lawsuits fell within the contract's "relatively broad" catch-all provision—"or other similar or dissimilar event or circumstances"— and excused defendant's contractual obligations despite the fact that the force majeure clause only listed "government embargo or other interventions" as triggering events).

[9] *Phillips Puerto Rico Core, Inc. v. Tradax Petroleum Ltd.*, 782 F.2d 314, 319–20 (S.D.N.Y. 1985).

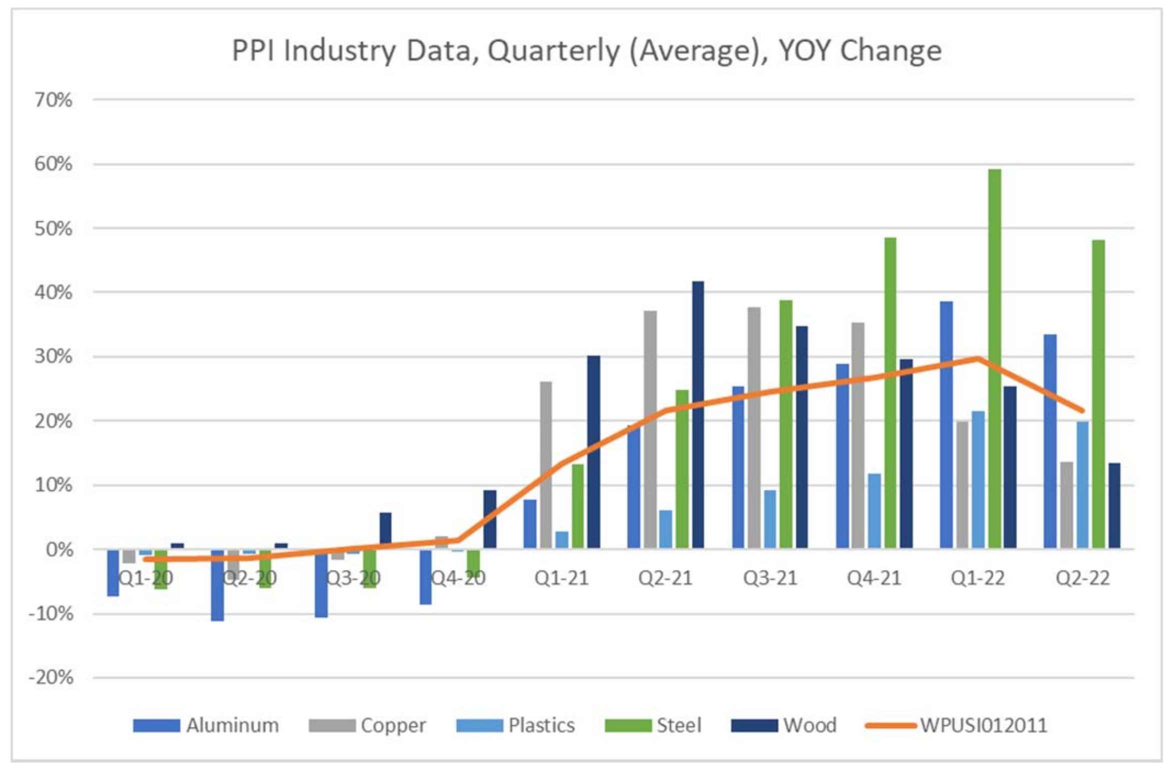
[10] *See JN Contemporary Art LLC v. Phillips Auctioneers LLC*, 2020 WL 7405262 (S.D.N.Y. Dec. 16, 2020) (excused performance under the contract because COVID-19 is indisputably a "natural disaster" and falls within the scope of the force majeure provision).

> Owner in writing by Contractor within ten (10) business days of Contractor's knowledge of the basis for the claim; otherwise the claim shall be waived and released. Except for any remedies due to a suspension or delay by Owner in **Paragraph 8(c)** or if specifically provided for in a Job Order, nothing herein shall authorize the Contractor to recover an increase in the Contract Price as a result of price escalations in the marketplace or price increases due to (i) COVID-19 or other epidemics or pandemics, (ii) tariffs, or (iii) labor or materials shortages, or to recover such increases in excess of the Contract Price. Owner has requested that Contractor prepare the Contract Price with potential delays in deliveries, workforce inefficiencies, price escalations, and material shortages related to COVID-19 and the current state of the market in mind. Contractor may request an extension of the Outside Substantial Completion Date only to the extent the delays, labor shortages, and/or labor inefficiencies were incapable of being known and accounted for prior to the execution of the Agreement. Contractor shall not be entitled to increases in the Contract Price for delays in deliveries, labor shortages, and workforce inefficiencies.

- Key items to identify in a construction contract in evaluating a COVID related delay:
  - Any reference to delays caused by disease, outbreak of disease, epidemic, or pandemic?
  - If no specific reference, does the contract contain a catch-all provision? Does the contract address foreseeability of delays?
  - What is the remedy for a party affected by force majeure? Equitable adjustment of the contract time and/or contract price?
- Other contract considerations for addressing potential delays from pandemics include:
  - Directives by owners
  - Directives by general contractors
  - Labor shortages over concerns with contracting COVID-19
  - Labor shortages over positive test results
  - PPE requirements

Supply Chain Disruptions Due To COVID

- Volatile Pricing from Material Shortages[11]



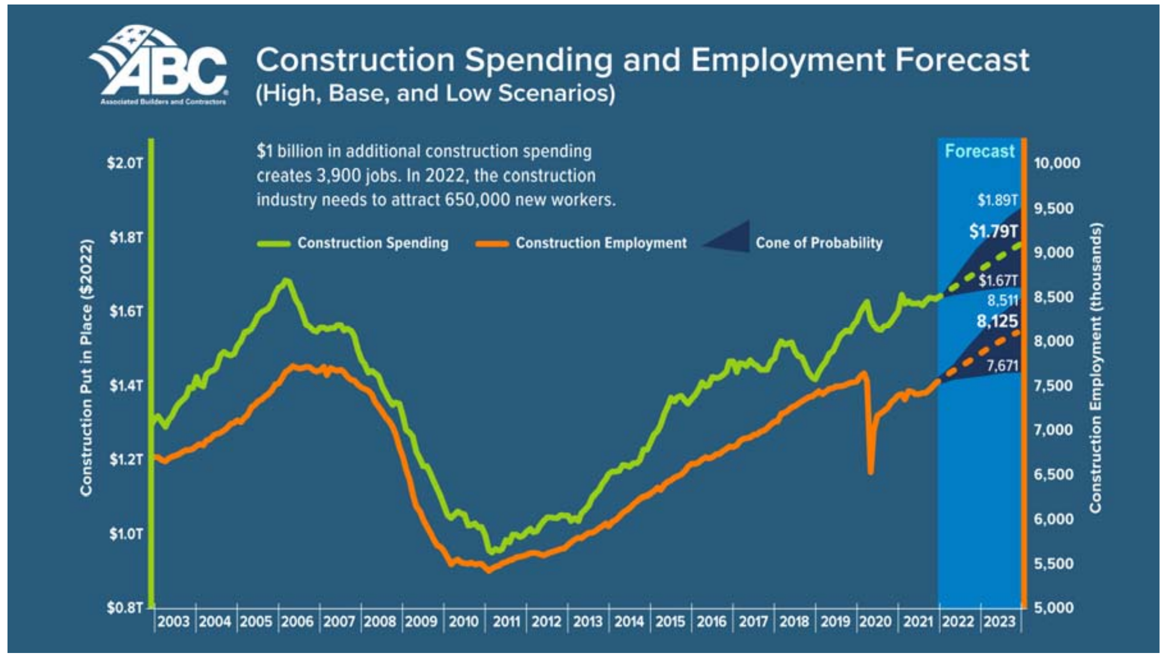
Notes:
[1] Producer Price Index (PPI) measures the average change over time in the selling prices received by domestic producers for their output.
[2] WPUSI012011 is a Special Index provided by U.S. Federal Reserve Economic Data, it corresponds to the PPI for Construction Materials.

- Construction costs rising mostly due to material shortages.

[11] U.S. Federal Reserve Economic Data (https://fred.stlouisfed.org); U.S. Bureau of Labor Statistics (https://www.bls.gov/data/home.htm).

Continued Labor Force Challenges

- Associated Builders and Contractors (ABC) forecasting the need for 650,000 additional workers in 2022 to meet labor demand.[12]



- Michael Bellaman, ABC president and CEO. "The Infrastructure Investment and Jobs Act passed in November and stimulus from COVID-19 relief will pump billions in new spending into our nation's most critical infrastructure, and qualified craft professionals are essential to efficiently modernize roads, bridges, energy production and other projects across the country. More regulations and less worker freedom make it harder to fill these jobs."[13]

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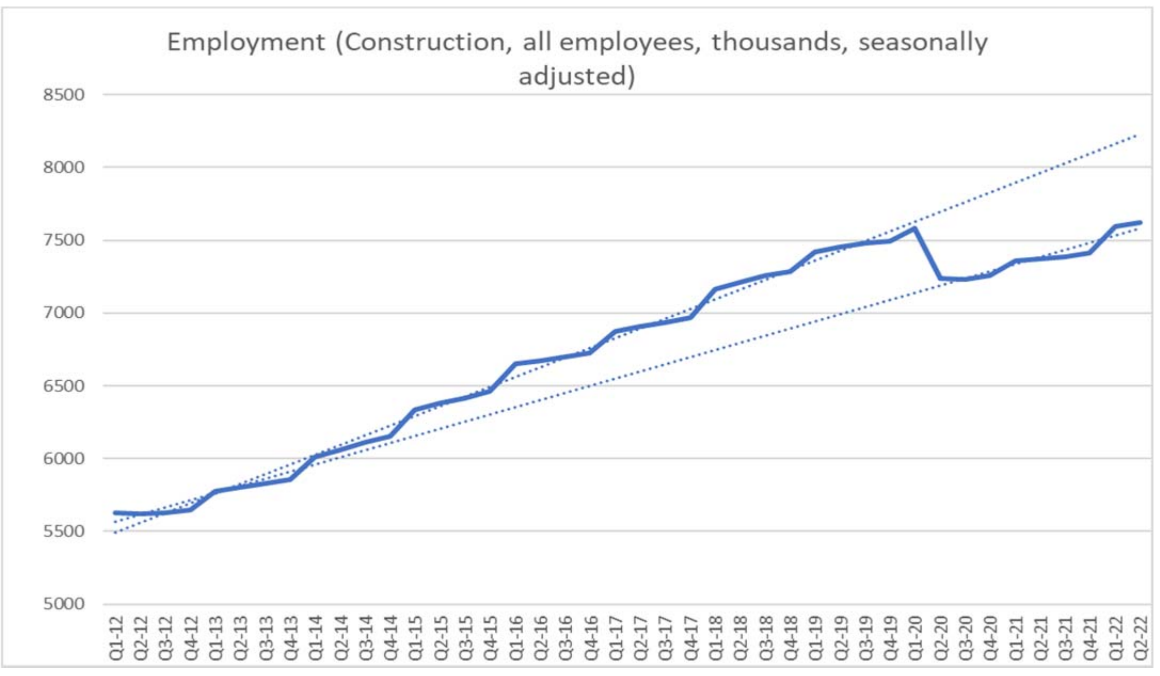
[12] Posted in Employment, Construction Economic Update, Construction Economics, Workforce and Safety, News Release 2022.
[13] *Id.*

- **Employment Gap.** Employment has not fully recovered, gap between expected (pre-COVID trend) and actual is widening.[14]



Bond Claims Impacted by COVID - Force Majeure Delays

- Surety excused from performance if COVID related delays led to termination of the Principal.

- Time extensions and scheduling changes necessitated by COVID-related delays.

- Cost to complete increases from material/labor shortages.

- Recommencement costs for projects shut down during COVID.

[14] U.S. Bureau of Labor Statistics (https://www.bls.gov/data/home.htm).

PANEL 3

CARDINAL CHANGES – STILL VIABLE? CHANGE ORDERS AND THE PENAL SUM OF THE PERFORMANCE BOND

Jim Carlson | Maximum Property Construction | Torrance, CA

Elizabeth Henderson | IAT Insurance Group Surety | Bellevue, WA

Jesse Ormond | Sokol Larkin Wagner Storti LLC | Portland, OR

Chris Simmelink | Hudson Insurance Company | New York, NY

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Cardinal Changes – Still Viable?

An Overview of Change Orders and the Performance Bond Penal Sum

David J. Guild II | *SOKOL LARKIN*

I. INTRODUCTION

Construction project change events often drive disputes between owners, design professionals, contractors, sureties, and other project stakeholders. To manage related risk, most construction contract forms[1] include contract administration processes for impacts to contract sum and contract time. For example, construction contracts routinely define the process and protocol for minor changes in the work, design clarifications to the work, architect's supplemental instructions, change directives, change order proposals, and change orders.[2] While these and other provisions control distinct change events with different levels of impact – all recognize the fact that construction projects involve change.

These traditional contract administration remedies fall short, however, when attempting to administer a change that completely modifies material terms of the original construction contract. Where a change event dramatically impacts a project and requires the performance of material terms never bargained for – project stakeholders often turn to the doctrine of "Cardinal Change" for relief outside of the contract. Courts that recognize this doctrine[3] often emphasize the extraordinary character of a cardinal change when examining what the parties originally bargained for and what the change event means in that context.

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[1] *See, e.g.*, CONSENSUSDOCS, ConsensusDocs 200; AMERICAN INST. OF ARCHITECTS, AIA A201™–2017; DESIGN-BUILD INST. OF AMERICA, DBIA Contract Document #501.

[2] Article 7 of the AIA A201™–2017 provides examples of such provisions, including provisions for Minor Changes in the Contract Work at § 7.4, Construction Change Directives at § 7.3, and Change Orders at § 7.2.

[3] Certain state courts (and federal courts applying state law in diversity cases) do not recognize the Cardinal Change Doctrine. *See, e.g.*, Durr Mechanical Construction, Inc. v. PSEG Fossil, LLC, 516 F. Supp. 3d 407, 416 (D.N.J. 2021) ("I find no compelling reason to recognize a cardinal change doctrine claim under New Jersey law, and decline to do so.").

This paper begins in Section II with an overview of the Cardinal Change Doctrine and explores whether it remains a viable remedy in the modern construction industry before Section III discusses change orders and their impact (if any) on the performance bond penal sum. Finally, Section IV concludes this paper.

II. THE CARDINAL CHANGE DOCTRINE

A cardinal change occurs "when the [owner] effects an alteration in the work so drastic that it effectively requires the contractor to perform duties materially different than those originally bargained for."[4] It is often used as a claim to provide recovery in *quantum meruit*, as the work falls outside the scope of the contract.[5] Some jurisdictions may even allow for abandonment of the contract should cardinal changes occur. Indeed, a cardinal change is by definition not "redressable under the contract."[6] Thus, courts first examine whether the change(s) falls outside the scope of the contract when determining whether a cardinal change occurred.[7] Of note, the United States Court of Federal Claims, when examining this question, found:

> There is no exact formula for determining the point at which a single change or a series of changes must be considered to go beyond the scope of the contract and necessarily in breach of it. Each case must be analyzed on its own facts and in light of its own circumstances, giving just consideration to the magnitude and quality of the changes ordered and their cumulative effect upon the project as a whole.[8]

While there is no exact formula, the cases provide some guiding principles in determining when a change amounts to a cardinal change.

A. The Cardinal Change Doctrine

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[4] American Line Builders, Inc. v. United States, 26 Cl. Ct. 1155, 1182 (Fed. Cl. 1992).

[5] This raises an interesting question as it relates to contractual provisions requiring a contractor to provide prompt notice to the owner of claims for extra compensation or contractual time. Depending on the jurisdiction, claims in *quantum meruit* for work beyond the scope of the contract do not need to adhere to such provisions as the claims definitionally fall beyond the scope of the contract. *See* Gen. Constr. Co. v. Pub. Util. Dist. No. 2 of Grant County, 195 Wn. App. 698, 709-10 (Wa. Ct. App. 2016).

[6] American Line Builders, Inc., 26 Cl. Ct. at 1182.

[7] Edward R. Marden Corp. v. United States, 442 F.2d 344, 369-70 (Ct. Cl. 1971).

[8] Wunderlich Contracting Co. v. United States, 351 F.2d 956, 966 (Ct. Cl. 1965).

The term "cardinal change" first appeared in the United States Court of Federal Claims[9] in *General Contracting & Constr. Co. v. United States.*[10] In *General Contracting*, the Court found a cardinal change occurred where the Owner/Government removed an entire building from the project plans under the guise of the construction contract's Changes Clause. The Court reasoned that an alteration to the base contract itself must be made with consent of both parties, and consequently the Contractor should be awarded damages for the breach of contract.[11] After *General Contracting,* the Court of Federal Claims analyzed cardinal changes in several different cases that provide context for how courts may apply the Cardinal Change Doctrine.

For instance, courts have found cardinal changes where numerous small changes effectively changed the nature of the contract.[12] Further, courts have allowed recovery for a cardinal change claim where the amount of work, although of the same nature, doubled.[13] Overall, for a court to find a cardinal change has occurred, the changed or extra work must either fall outside the scope of the intended contract or changes the very nature of the contract entered into.

In contrast, Contractor complaints regarding accelerated work, redoing work, and contending with the stacking of trades do not reflect a fundamental alteration

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[9] From 1863 to 1982, the Court was known as the Court of Claims, from 1982 to 1992 the United States Claims Court was the successor to the original jurisdiction of the Court of Claims, and since 1992 the Court has been known as the United States Court of Federal Claims. For ease, the Court will be referred to as the Court of Federal Claims.

[10] 84 Ct. Cl. 570 (Ct. Cl. 1937).

[11] General Contracting & Constr. Co., 84 Ct. Cl. at 579-80.

[12] Air-A-Plane Corp. v. United States, 408 F.2d 1030, 1033 (Ct. Cl. 1969) (allowing a cardinal change claim to proceed to trial where, in a procurement contract for smoke generators, the government made numerous changes, essentially creating a development contract).

[13] Saddler, 287 F.2d at 414 (finding in a contract to construct a levee, the government doubled the amount of earth to be placed, which while generally falling within the purpose of the contract (to construct a levee) certainly fell beyond the scope of the intended contract).

of the project, especially where the contract contains remedial provisions that cover the contingencies the Contractor encountered.[14]

In one particularly interesting case, *Aragona Constr. Co. v. United States*,[15] an Owner prevented a Contractor from building a Veteran's Administration hospital with building materials such as steel, copper, brass and aluminum due to government priority orders that diverted these materials to production efforts to fight the Second World War.[16] The Owner instructed the Contractor, via change order, to procure and use substitute materials. After completing the project, the Contractor filed an action alleging the cumulative effect of the changes compelled it to construct a wholly different project than what the specifications called for, and was thus a cardinal change.[17] The Court rejected the Contractor's claim for cardinal change, declaring all the changes were "interstitial in nature" and did not alter the "nature of the thing to be constructed," the "nature of the bargain" entered into, or "cause [the contractor] to perform a different contract."[18] The Court based its reasoning, in part, on its finding that neither party was at fault for the added expenses necessitated by the Second World War.[19] *Aragona* is best read as a case where the changes do not meet the level of "drastic change" required to constitute a cardinal change as opposed to a rule dictating a cardinal change cannot occur when the end product is the same. Subsequent case law supports this interpretation, finding a cardinal change can occur even where the final product is the same

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[14] Hensel Phelps Constr. Co. v. King County, 57 Wn. App. 170, 182-83 (1990)
[15] 165 Ct. Cl. 382 (Ct. Cl. 1964).
[16] *Id.* at 384-85.
[17] *Id.*
[18] *Id.* at 390-91 ("All the changes that plaintiff was asked to make was interstitial in nature. For example, it substituted fabric-and-mastic waterproofing for copper flashing, wooden interior shelves for metal ones, and steel-and-enamel mirror frames for chromium ones.").
[19] *Id.* at 386.

because courts look at the "entire undertaking of the contractor, rather than the product."[20]

B. Is the Cardinal Change Doctrine Viable?

The cardinal change doctrine is not a common remedy in the modern construction industry context. It is a fact intensive inquiry where the court must decide whether the changes (normally a large change or numerous small changes) fall outside the scope of the contract. When considering whether to advance a cardinal change claim (especially as a standalone claim), parties should carefully examine the facts of the case at issue and compare that fact pattern against the few decisions available on record before determining whether to proceed.

III. CHANGE ORDERS AND THE PERFORMANCE BOND PENAL SUM

When change orders increase or decrease the price of the underlying contract, sureties are presented with the question of whether these changes impact the penal sum of the performance bond. One might assume that since the contract price increases that the penal sum of the bond likewise increases. Yet, unless the terms of the bond itself dictate an automatic increase in the penal sum due to a change order, that is not the case. Many standard performance bond forms do not include such language, thus, to satisfy the Statute of Frauds, obligees may require

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[20] Rumsfeld v. Freedom NY, Inc., 329 F.3d 1320, 1332 (Fed. Cir. 2003); Edward R. Marden Corp., 442 F.2d at 369-70. ("[W]here drastic consequences follow from defective specifications, we have held that the change was not within the contract, i.e., that it was a cardinal change . . . If plaintiff's allegations are true, then it performed work which was not 'essentially the same work as the parties bargained for when the contract was awarded . . . based on the sheer magnitude of reconstruction work caused by the alleged defective specifications." (citation omitted)); Saddler v. United States, 287 F.2d 411, 414-14 (Cl. Ct. 1961) ("The nature of this particular contract was so changed by the added work, albeit the same kind of work described in the original specifications, as to amount to a cardinal alteration falling outside of the scope of the contract"); Northrup Grumman Corp. v. United States, 50 Fed. Cl. 443, 466 (2001) ("When contract language requires very specific products or services, and bids for the contract were keyed primarily to those requirements, changing such requirements after contract award will be deemed outside the scope, even if such a change does not significantly alter the work being performed.").

provisions which automatically increase the penal sum as change orders are enacted. How these automatic increase provisions interact with standard bond provisions vary, and sureties must be aware of the scenarios which could unfold.

A. Performance Bond Form

The form and language of the performance bond is critical in determining whether the penal sum will change in accordance with a change order. If the terms of the bond dictate an automatic increase to the penal sum when the contract price increases, then the penal sum increases. But, if the form does not have such language, a strong argument exists that the penal sum does not increase, as per the language of the instrument. For instance, the form performance bond provided by the American Institute of Architects, AIA A312-2010, strictly provides that "[i]f the Surety elects to act under section 5.1, 5.3 or 5.4,[21] the Surety's liability **is limited to the amount of this Bond**."[22] While AIA A312-2010 does contain a provision waiving notice of changes to the underlying contract,[23] there is no provision that increases the Bond limit in conjunction with an increase in contract price. Thus, by its own terms, the penal sum of the Bond does not increase merely because a change order increases the contract price.

Likewise, Standard Form 25 – the performance bond prescribed by FAR 53.228(b), sets the limit of liability at the penal sum with no provision increasing

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[21] "§ 5.1 Arrange for the Contractor, with the consent of the Owner, to perform and complete the Construction Contract;" "§ 5.3 Obtain bids or negotiated proposals from qualified contracts acceptable to the Owner for a contract for performance and completion of the Construction Contract . . . and pay to the Owner the amount of damages . . . in excess of the Balance of the Contract Price incurred by the Owner as a result of the Contractor Default;" "§ 5.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances: .1 After investigation, determine the amount for which it may be liable to the Owner, and, as soon as practicable after the amount is determined, make payment to the Owner; or .2 Deny liability in whole or in part and notify the Owner, citing the reasons for denial."

[22] § 8 (emphasis added).

[23] "§ 10 The Surety hereby waives notice of any change, including changes of time, to the Construction Contract or to related subcontracts, purchase orders and other obligations." AIA A312-2010.

the penal sum if the underlying contract price increase. The pertinent language states "[i]f no limit of liability is indicated, the limit of liability is the full amount of the penal sum."[24] The FAR continues, providing a clause be inserted into the underlying contract, in part stating:

> Additional bond protection. (i) The Government may require additional performance and payment bond protection if the contract price is increased. The increase in protection generally will equal 100 percent of the increase in contract price. (ii) The Government may secure the additional protection by directing the Contractor to increase the penal amount of the existing bond or to obtain an additional bond.[25]

Thus, it appears contracts with the Federal Government contemplate that additional action be taken before the penal sum increases (as opposed to the penal sum increasing automatically with an increase in contract price).

B. Statute of Frauds

The general rule is that contracts do not need to be in writing or signed to be enforceable; however, under the Statute of Frauds, certain contracts require a signed writing to be binding. These include various categories which may differ state by state,[26] but, for our purposes, at common law an agreement to answer for the debt, default or miscarriage of another, i.e., a surety contract or bond, required a signed writing. The same reasoning applies to changes to a surety bond, such as an increase in the penal sum. At least one court has recognized and applied this

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[24] Standard Form 25, found at FAR 53.228(b).

[25] FAR 52.228-15.

[26] For example, Oregon's Statute of Frauds, ORS 41.580, in pertinent part, reads:

> (1) In the following cases the agreement is void unless it, or some note or memorandum thereof, expressing the consideration, is in writing and subscribed by the party to be charged, or by the lawfully authorized agent of the party; evidence, therefore, of the agreement shall not be received other than the writing, or secondary evidence of its contents in the cases prescribed by law:
>
> ***
>
> (b) An agreement to answer for the debt, default or miscarriage of another.

reasoning, holding the penal sum of surety bonds do not increase despite increases in the price of the underlying contract, due to the Statute of Frauds.[27]

In *Technology for Energy Corp.*, Technology for Energy Corporation ("TEC") agreed to build a radiation monitoring system for a nuclear powerplant for the plaintiffs Bechtel and Public Service.[28] This was accomplished through two purchase orders with a payment and performance bond posted by American Insurance Company on behalf of TEC for each purchase order.[29] The penal sum of the bonds equaled the initial contract price of $3,900,000.[30] Changes to the contract increased the price to $6,950,000.[31] The bonds waived notice of contract changes and provided the changes did not release American Insurance Company from liability under the bonds.[32] Yet, the Court ultimately held that a material change in the contract required a signed writing under the Statute of Frauds, and as the penal sum is a "key part of the surety's promise" any increase in the penal sum would be a material change to the bond requiring a signed writing.[33]

In contrast, and without any analysis of the Statute of Frauds, the Court in *United States ex rel. B & M Roofing v. AKM Associates, Inc.*,[34] denied a surety's motion for summary judgment seeking to limit the surety's liability to the penal sum of the bond. Instead, the court found the surety's liability presented a question of fact that could go beyond the penal bond on the sum, a question which required interpretation of relevant statutory law and federal regulation as well as the underlying contract.[35] Further, the contractor and surety was put on notice of the indefinite delivery, indefinite quantity ("IDIQ") contract, which naturally comports

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[27] Pub. Serv. Elec. & Gas Co. v. Tech. for Energy Corp. (*In re* Tech. for Energy Corp.), 140 B.R. 214, 229 (Bankr. E.D. Tenn. 1992).
[28] *Id.* at 215.
[29] *Id.*
[30] *Id.*
[31] *Id.*
[32] *Id.*
[33] *Id.* at 228.
[34] 961 F. Supp. 1441 (D. Colo. 1997).
[35] *Id.* at 1444-45.

with a changing penal sum, and the fact the underlying contract contained a provision instructing the "bidder" (which the Court interpreted as including the surety) to consider the effect of delivery orders in determining the total bonding liability.[36] While perhaps not founded on the strongest lines of legal reasoning, *AKM Associates* should be recognized for that fact that arguments exist to holding a surety liable beyond the penal sum limit, especially where the underlying contract, generally incorporating the bonds therein, contains provisions indicating the bond limit may fluctuate with the orders and changes of the contract.

C. Common Bond Provisions

As mentioned in the outset of this section, the provisions of the bond matter. As a matter of course, most bonds contain a notice waiver provision, where a surety waives notice of any change to the underlying contract.[37] A second provision directly applicable to the issue of whether change orders increase the penal sum of the bond, is what will be called an "automatic increase" provision, increasing the penal sum of the bond with an increase in the underlying contract price. Such provision could read: "Any increase in the Construction Contract amount shall correspondingly increase this Bond's penal sum." The interplay between these two provisions provides interesting results, as discussed in the following examples.

1. Bond Contains an Automatic Increase Provision, but Lacks a Notice Waiver Provision

Although unlikely, a scenario may arise where the bond requires a surety to receive notice of changes to the underlying contract, yet an automatic provision exists that increases the penal sum of the bond in accordance with increases in the underlying contract price. It is unlikely such notice requirements would be followed, as sureties tend to follow the industry standard and waive notice of changes to the underlying contract.

[36] *Id.* at 1444 n. 3.
[37] "§ 10 The Surety hereby waives notice of any change, including changes of time, to the Construction Contract or to related subcontracts, purchase orders and other obligations." AIA A312-2010.

2. Bond Contains an Automatic Increase Provision and a Notice Waiver Provision

Where both types of provisions are found in a bond, sureties should tread with caution as a court may interpret and allow change orders well in excess of the contract price to increase the penal sum accordingly.[38] If these underlying changes are executed by both the principal and obligee, it is possible a surety will not be able to assert a cardinal change defense, as the executed change orders became part of the contract. In these instances, a surety's exposure may arguably extend as far as an obligee and principal may wish, without any notice of the underlying changes. To avoid such exposure, a surety should not agree to an automatic increase provision where a notice wavier provision exists. Alternatively, the surety could consider tailoring the automatic increase provision to only trigger (and increase the penal sum) if the change in the underlying contract price is less than 50% of the original contract price.[39] For increases in the underlying contract price amounting to 50% or more of the original contract price, the provision would require written agreement from the surety before increasing the penal sum of the performance bond. This tailoring would allow the surety to retain a degree of control to its exposure while still providing the obligee with protection as change orders accrue.

3. Bond Lacks an Automatic Increase Provision, but Contains a Notice Waiver Provision (AIA 312-2010)

In such a scenario contained by the standard form AIA 312-2010, change orders will not increase the penal sum due to the Statute of Frauds and likewise the sureties will not receive notice of any underlying changes. Sureties must still be

[38] *But see supra* Sec. II, The Cardinal Changes Doctrine.
[39] Expressly considered by FAR 52.228-15.

aware of the underlying contract in case a court finds the surety has notice the bond was intended to increase in accordance with the contract price.[40]

4. Bond Lacks Both an Automatic Increase Provision and a Notice Waiver Provision (Standard Form 25)

Where a bond lacks an automatic increase provision and a notice waiver provision, sureties will not be exposed to automatic increases in the penal sum of the bond due to an increase in the underlying contract price and will find themselves receiving notice of any changes in the underlying contract.

D. Practical Application

The performance bond penal sum will not change due to a change in the underlying contract price via a change order, unless the performance bond specifically provides for such a change (which is becoming more and more common). Such provisions are an area to negotiate prior to the issuance of a bond as opposed to determining the result via subsequent litigation.

IV. CONCLUSION

When changes occur on a construction project, it is important to know what these changes can implicate for both contractors and sureties. Where the changes, whether numerous minor changes or a single large change, fall outside the scope of the contract or change the nature of the contract, contractors and sureties should consider the cardinal change doctrine and its accompanying rights and remedies. Even if no cardinal change exists, the question still arises whether the change increases the penal sum of the performance bond. Understanding the common bond provisions and possible alternatives prior to posting a performance bond will aid a surety in limiting its exposure should changes to the underlying contract drastically increase the contract price.

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[40] *See* United States *ex rel.* B & M Roofing, 961 F. Supp. 1441.

PANEL 4

SURETY PERFORMANCE BOND AND DESIGN-BUILD CONTRACTS, PERFORMANCE SPECIFICATIONS, AND DELEGATED DESIGN SPECIFICATIONS

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Surety Performance Bond and Design-Build Contracts, Performance Specifications, and Delegated Design Specifications

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I. Introduction

Complex construction projects are often fraught with pitfalls and complications due to a myriad of issues such as delays, delivery of non-conforming equipment or materials, work stoppages, weather, etc. Contract delivery methods are constantly evolving from the more traditional lump sum agreements based on the Design-Bid-Build method. As construction projects become more complex, owners have an interest in pursuing alternative project delivery methods that can save time and money, and lessen the risk of litigation, liens, or nonperformance. As a result, emerging project delivery methods often combine scopes in unique ways in an attempt to streamline a project, providing a single point of contact, and transferring risk from owner to contractor. Determining whether the surety has potential exposure often depends on the type of contract delivery method selected by the parties, as well as the applicable law governing those types of contracts.

While alternative delivery methods may be convenient for owners, from the surety's perspective, the additional risk requires a heightened analysis. This paper will briefly discuss the potential impact that alternate delivery methods may have on surety claims, including an in-depth look at how the design-build and EPC delivery methods can impact the obligations of a surety under a performance bond.

II. Different Types of Construction Contract Delivery Methods

A. *Design-Bid-Build*

The Design-Bid-Build delivery method is the traditional method of project delivery. Under the Design-Bid-Build method, the owner separately contracts with the designer and contractor. The designer will typically provide all plans and specifications necessary for the project, and the owner, in turn, solicits bids from contractors to build pursuant to those drawings. While the Design-Bid-Build provides an Owner the most control over both the design and construction aspects of the project, such control comes with an assumption of risk for disagreements between the design and construction.

One area of potential risk for the owner when using the Design-Bid-Build delivery method is that in almost all jurisdictions the owner impliedly warrants the plans and specifications are free from defects. This warranty is dictated by what is commonly referred to as the *Spearin Doctrine*. The *Spearin Doctrine* is derived from a United States Supreme Court Case styled *United States v.*

Spearin, 248 U.S. 132 (1918). In *Spearin*, a contractor contracted to build a dry dock at the Brooklyn Navy Yard in accordance with plans and specifications that had been prepared by the government.[1] The work included the relocation of a 6-foot sewer before the work on constructing the dry dock could begin.[2] The sewer ultimately failed due to a weather event that flooded the excavation of the dry dock and the government and Spearin ultimately determined that it was unsafe to continue the work until the sewer was repaired.[3] The government claimed Spearin was responsible for extra costs associated with the repair of the sewer.[4] The Navy ultimately annulled the contract and proceeded to complete the entirety of the remaining work, based on a modified design, using different contractors.[5] Spearin then brought suit seeking payment for work it had performed and damages resulting from the termination of its contract.[6] In finding the government wrongfully terminated the contract, the Supreme Court ultimately found that the government impliedly warranted that if the specifications were complied with, the sewer would have been adequate.[7] This warranty was not overcome by clauses in the contract requiring Spearin to examine the site, check the plans, and assume responsibility for the work until completion and acceptance by the government.[8] With those findings, *Spearin* became a lynchpin case shifting the risk for errors in drawings and specifications to the owner in a Design-Bid-Build contract.

Although an owner may have a heightened risk for design errors using the Design-Bid-Build delivery method, the Design-Bid-Build method can typically provide for more consistent cost savings as contractors do not need to account for the potential risk of liability, delays, or additional costs caused by defective designs. That said, there can be additional drawbacks to the Design-Bid-Build method, namely speed, ability, and potential for conflicts and litigation. For instance, when an owner needs to complete the project quickly, the Design-Bid-Build delivery method may be less attractive because the design and construction processes are largely sequential. In other words, the Design-Bid-Build delivery method often requires more time from design inception to the start of construction than other delivery methods. In addition, given the separation of design and construction, the potential for conflicts and litigation between the design and construction teams (that the owner is in the middle of) can be significant as the parties may point fingers at each other for problems with design, construction, or both.

In light of the additional obligations of the owner when using a Design-Bid-Build delivery method, the delivery method may be more susceptible to a material alteration of the bonded risk. For instance, an owner may promise to require the designer to review and approve submittals or administer the construction contract including reviewing and approving pay applications. Courts have recognized that when an owner fails to comply with and enforce the terms of the bonded contract, the surety's obligations under the bond may be discharged.[9] Other delivery methods

[1] *Spearin*, 248 U.S. at 133.
[2] *Id.*
[3] *Id.* at 134-35.
[4] *Id.* at 135.
[5] *Id.*
[6] *Id.* at 133.
[7] *Id.* at 137.
[8] *Id.*
[9] *See, e.g., Old Colony Ins. Co. v. City of Quitman*, 352 S.W.2d 452 (Tex. 1961); *XL Specialty Ins. Co. v. Virginia Dep't of Transp.*, 611 S.E.2d 356, 370 (Va. 2005); *Success Constr. Corp. v. Superintendent of Ins. (In re Liquidation*

where many of those obligations are shifted to the bonded contract may be less likely to give rise to such a defense for the surety. Regardless, it is important for a surety's underwriting and claims team to understand the separation of design and construction obligations in the Design-Bid-Build context and appropriately evaluate risk and exposure related to potential claims resulting from defects implicating both design and construction defects.

B. *Design-Build*

Where the Design-Bid-Build method places design risk on the owner, the Design-Build method shifts the majority of that risk to the contractor. While it was once considered an "alternative" delivery method, Design-Build gained significant popularity in the 1990s and is now considered a common delivery method that accounts for over 40% of projects today.[10] In fact, the federal government and all but two states utilize Design-Build as a project delivery method for public projects.[11]

Design-Build seeks to take what can be an adversarial relationship between the contractor, owner, and design team as discussed above in the context of Design-Bid-Build and place those parties in a situation where the owner, designer, and builder work collaboratively. This is done by shifting the owner's separate contracting relationship with the contractor and designer to one contracting relationship with a design-builder who is ultimately responsible for both the design and construction of the project. With the design and construction under one entity, the theory behind Design-Build is that the project can be completed more efficiently with better communication, an increase in problem-solving and collaboration, fewer errors, less rework, minimized risk of litigation, and ultimately, cost savings as a result of the risk for errors being consolidated into one entity.

While the owner may benefit from a reduction of risk, the surety's exposure may increase in Design-Build if it issues a bond on behalf of the design-builder. Underwriters and claims professionals need to be aware of additional design exposure when issuing bonds on behalf of design-builders that may not exist in the more traditional Design-Bid-Build delivery method. In light of this increased exposure from design, it is prudent for surety professionals to evaluate the complexity and requirements of the project, the design and construction teams assembled by the principal, and the corporate structure of the design-builder (is it a joint venture or some other specially created entity?), the experience of the principal in Design-Build, and the risk management strategy for the principal including available insurance for design errors.

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of Union Indem. Ins. Co. of New York), 220 A.D.2d 339, 340 (N.Y. App. Div. 1995); *Emp'rs Ins. Of Wausau v. Constr. Mgmt. Eng'rs of Fla., Inc.*, 377 S.E.2d 119, 122 (S.C. Ct. App. 1989).

[10] "Study Shows Popularity of Design-Build Contracts Grows," Richard Korman, *Engineering News-Record*, Sept. 29, 2021.

[11] Pennsylvania and New Jersey architect licensing boards take the position that design-build is illegal. Illinois has a specific "design-build" procurement act which states "it is the intent of the general assembly that the capital development board be allowed to use the design-build delivery method for public projects if it is shown to be in the State's best interest for that particular project." 30 ILCS §537/5. Arizona authorizes public projects to proceed under the Design-Bid-Build, Design-Build, Construction Manager at risk, and job-order contracting project delivery methods. Ariz. Stat. § 34-602. Colorado Rev. Stat. § 43-1-1401 (2020) acknowledges that the design-build delivery method can provide "a savings of time, cost, and administrative burden, improved quality expectations," completion of projects, "and a reduction in the risks associated with transportation projects."

More specific to exposure for design services, a surety may find itself on the hook for design services it intended to include based on the language in standard bond forms. For example, the AIA A312 Performance Bond applies to the "performance of the construction contract, which is incorporated herein by reference."[12] To the extent the "construction contract" includes design services, the surety may be liable.[13] To that point, the AIA A141 Standard Form of Agreement Between Owner and Design-Builder provides that, "the Design-Builder shall be responsible to the Owner for acts and omission of the Design-Builder's employees, Architect, Consultants, Contractors, and their agents and employees, and other persons or entities performing portions of the Work."[14] Therefore, it is important to evaluate not only the language of the bond form used on a particular project but also the underlying bonded contract and determine the extent of design responsibilities undertaken by the principal in evaluating risk.

The risk associated with Design-Build can also manifest in recovery. While not necessarily unique to Design-Build, design builders may end up being joint ventures between contractors and design firms. While a surety may have previously bonded the contractor and may have a viable indemnity agreement in place governing the relationship between surety and indemnitors if there is a loss, the designer may not be part of that arrangement. Surety professionals should be aware of changes in corporate structure to fit the needs of a Design-Build project and ensure that it not only understands the additional risk associated with design and construction but that it has sufficiently planned for potential recovery needs in the event of claims associated with a Design-Build project.

C. *Engineering, Procurement, and Construction* ("EPC")

The EPC contract is often associated with large infrastructure and energy projects and is commonly referred to as the Turn-Key contract (the owner needs only to "turn a key" to start operating the facility). EPC behaves similarly to Design-Build in that the owner typically contracts with a single entity for design and construction. EPC, however, often has additional responsibilities for commissioning and testing a complex facility after that facility is mechanically complete. In short, an EPC contract often places most, if not all risk of liability on the EPC Contractor.

Given the industries EPC contracts are used in, they often involve very technical equipment that is procured based on detailed performance specifications. For example, a power plant may have a specified power generation capacity, while a pulp mill may have certain quality, performance, and production standards requiring close coordination between design, procurement, and construction. The overlap in this work can make it difficult to find a competent completion contractor should the principal default, which can dramatically increase the surety's risk in the event of a default. Similar to Design-Build, the owner will look to the contractor to take full responsibility for the project and, in the event of a dispute between the contractor and any downstream party, resolve those disputes without involving the owner.

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[12] AIA Doc. A312-2010 §1.
[13] *See e.g. Nicholson & Loup, Inc. v. Carl E. Woodward, Inc.*, 596 So.2d 374 (La.App.1992).
[14] AIA Doc. A141-2014 §3.1.4.

Again, similar to Design-Build, it is important for surety professionals to properly analyze the agreements between the obligee and principal and evaluate the actual scope of work undertaken by the principal. In light of the broad scope of work undertaken by EPC contractors, the risk management strategy for the principal is again a key consideration when evaluating whether to bond an EPC contractor. For instance, is there sufficient insurance to address claims for design liability? Does the principal have appropriate pollution coverage in the event there are environmental claims the surety may be responsible for? What is the scope of the CGL coverage and are the limits available to the principal appropriate for the size and scope of the proposed project? Obviously, those considerations should be weighed along with the financial viability of the principal, but they are important considerations at both underwriting and claims as the surety may find itself potentially responsible for work it may not have been in a more traditional Design-Bid-Build delivery method.

III. Performance vs. Prescriptive Specifications – No Real Bright Line Standard

In both the Design-Build and EPC contexts, the principal will generally receive a set of design parameters from the owner pursuant to which it will prepare detailed designs for construction. But, Design-Bid-Build projects can also delegate design to the principal by way of performance specifications. Determining whether a specification is a performance versus prescriptive specification is often a source of murky analysis to determine the appropriate risk allocation between the designer and contractor. Luckily, the distinction between performance and prescriptive specifications has been the subject of analysis by courts around the United States, which provides some guidance on how to evaluate issues as they arise during a project.

"Performance specifications" are specifications that set forth an objective or standard to be achieved, requiring the contractor to exercise its ingenuity in achieving the standard of performance, in selecting the means, and assuming a corresponding responsibility for that selection.[15] Whereas "design (or prescriptive) specifications" set forth in precise detail the materials to be employed and the manner in which the work is to be performed from which a contractor is not privileged to deviate but is required to follow as a road map.[16] While an owner who provides plans that a contractor must strictly follow impliedly warrants the accuracy of those plans (design specifications) as discussed previously based on the *Spearin Doctrine*, the owner does not typically impliedly warrant plans in which the contractor furnishes the design for such work (performance specifications).

Even with these defined terms, determining whether a specification is one of performance or design (prescriptive) can be increasingly difficult to ascertain from the complex designs, specifications, and contracts involved in multi-million dollar construction projects. When considering whether a specification is one of design or performance, courts caution against a tail-wagging-the-dog approach. The obligation imposed by the specification determines the extent to which it is a "performance" or "design" specification, not the other way around.[17] Meaning

[15] *See J.L. Simmons Co. v. U.S.*, 188 Ct. Cl. 684, 689.
[16] *Aleutian Constructors v. U.S.*, 24 Cl. Ct. 372, 378 (1991) (citing *J.L. Simmons*, 188 Ct. Cl. at 689).
[17] *Fru-Con Construction Corp. v. United States*, 42 Fed. Cl. 94 (1998).

"design specification" and "performance specification" labels are not definitive in and of themselves, nor do they independently create, limit, or remove a contractor's obligations.[18]

To determine whether a specification is "design" or "performance" in nature, some courts deploy a "road map" analysis.[19] For example, in *Fruin-Colnon Corp.*, when considering a watertightness clause, the court noted that, when read in isolation, the clause appeared to be a performance specification because it specified the end objective and standard by which to measure compliance and not the method by which the objective should be achieved.[20] However, when considering the contract as a whole, "as well as the parties' usage and course of performance under the contract," the court concluded a prescriptive specification was created. *Id.*

IV. The Potential Impact of Downstream Claims by Design Professionals on Payment Bond Exposure

While the addition of design responsibilities either through a performance specification or deployment of Design-Build or EPC delivery methods can certainly impact performance exposure for a surety, they can also impact potential payment bond exposure. A tension point, however, in the ability to recover for design services is that those services are not necessarily directly incorporated into the project like construction services. Understanding the statutory framework in the jurisdiction governing the project is important to understanding the rights a design professional may have when attempting to recover against a payment bond.

A. The Miller Act

The Miller Act requires a prime contractor to furnish payment and performance bonds for the construction, alteration, or repair of any public building or public work of the Federal Government over $100,000.[21] The Miller Act provides certain statutorily guaranteed rights to subcontractors and suppliers for "labor and materials" that are contracted directly with the prime contractor or a first-tier subcontractor.

Design professionals have historically been excluded from the type of subcontractors that could make Miller Act claims because they did not provide labor, i.e. "physical toil," or materials or supplies. Thus, in a Design-Build or EPC delivery method, design professionals subcontracting with a prime contractor may not be able to recover against the payment bond for nonpayment. However, courts have generally permitted an architect or engineer to make a claim against a Miller Act bond if it was providing supervisory services during construction.[22] Courts reason that the act of supervision or inspection by a design professional satisfies the "labor in the prosecution of the work" provision of the Miller Act.[23]

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[18] *Zinger Constr. Co. v. United States*, 807 F.2d 979, 981 (Fed.Cir.1986).

[19] *See, e.g., Caddell Construction Co. v. United States*, 78 Fed. Cl. 406 (2007); *Fruin-Colnon Corp. v. Niagara Frontier Transportation Authority*, 180 A.D.2d 222 (1992).

[20] *Fruin-Colnon*, 180 A.D. at 230.

[21] 40 U.S.C §§ 3131-3134.

[22] *See, e.g., U. S. ex Rel. Naberhaus-Burke, Inc. v. Butt & Head, Inc.*, 535 F. Supp. 1155, 1158 (S.D. Ohio 1982); *U.S. ex rel. Olsen v. W.H. Cates Constr. Co., Inc.*, 972 F.2d 987 (8th Cir. 1992).

[23] *Id*.

To illustrate, in *U. S. ex Rel. Naberhaus-Burke, Inc. v. Butt & Head, Inc.*,[24] the engineer, a second-tier subcontractor, could not recover for its work in preparing certain calculations and shop drawings, but was permitted to recover against the payment bond for the performance of on-site services including project superintending, supervision, and inspection. Similarly in *U.S. ex rel. Olsen v. W.H. Cates Constr. Co., Inc.*, the Eighth Circuit affirmed that professional supervisory work covered by the Miller Act is limited to "skilled professional work" involving actual on-site superintending, supervision, or inspection.[25]

However, some courts may still find that even when a designer performs some services onsite it still may not be able to recover under the Miller Act. For instance, in *U.S. ex rel. Constructors, Inc. v. Gulf Ins. Co.*,[26] the court held that supervisory activities must still be hands-on to justify a claim under the Miller Act. Supervisory activities akin to clerical or administrative tasks like paying invoices, reviewing proposals, and supervising hiring, even if performed on-site, do not involve the physical or manual toil required to recover under the Miller Act.[27]

B. Little Miller Acts

Many state legislatures have passed replicas of the Miller Act for state public works projects often referred to as "Little Miller Act" statutes.[28] Little Miller Act statutes vary state-by-state in their bond requirements, contract price threshold, and protections afforded to subcontractors. For example, California's Little Miller Act requires payment bonds for state public works projects over $25,000 and protects claimants that provide work to the direct contractor.[29] Unlike its federal counterpart, the California Miller Act allows subcontractors at every level to recover on a payment bond so long as the claimant "supplies labor or material" to the project pursuant to the construction contract.[30] However, design professionals are not considered "director contractors" and are not required to give a payment bond. [31] Further, design professionals cannot make claims on a Little Miller Act payment bond if their work is performed prior to or outside the scope of the construction contract.[32]

In contrast, Florida's Little Miller Act, which applies to state projects over $100,000, specifically protects architects and engineers as parties "who furnish labor, services, or materials for the prosecution of work provided for in the contract."[33] Florida goes further and includes an architect, landscape architect, or engineer who improves real property pursuant to a Design-Build

[24] 535 F. Supp. 1155, 1158 (S.D. Ohio 1982).
[25] 972 F.2d 987 (8th Cir. 1992).
[26] 313 F.Supp.2d 593, 597 (E.D.Va. 2004).
[27] *Id.*
[28] *See, e.g.*: Ala. Code. §§ 39-1-1 et seq. (Alabama); Cal. Civ. Code §§ 9550 et seq. (California); Colo. Revised Stat. CO ST § 38-26-101 et seq. (Colorado); Conn. General Stat. §§ 49-41 et seq. (Connecticut); Fla. Stat. § 255.05 (Florida); O.C.G.A. §§ 13-10-1 et seq. (Georgia); 30 ILCS 550/1 et seq. (Illinois); Iowa Code. § 573.2 (Iowa); M.G.L. c. 149, § 29 (Massachusetts); N.J.S.A. 2A:44-143 et seq. (New Jersey); New York State Finance Law § 137 et seq. (New York); 8 P.S. §§ 191 et seq. (Pennsylvania); Tex. Gov't Code §§ 2253 et seq. (Texas).
[29] Cal. Civ. Code §§ 9550(a), 9566(a).
[30] *Union Asphalt, Inc. v. Planet Ins. Co.*, 21 Cal. App. 4th 1762, 1765 (2d Dist. 1994).
[31] *Id.* at § 9550(d).
[32] *Union Asphalt, Inc.*, 21 Cal. App. 4th at 1766-67.
[33] Fla. Stat. § 255.05, 713.01.; *see also*, *Cincinnati Ins. Co. v. Putnam*, 335 So.2d 855, 856 (Fla. Dist. Ct. App. 1976).

contract as a "contractor." Fla. Stat. § 713.01(8). As seen by the differences between how various jurisdictions treat the recovery of design-related fees, it is vital for a claims professional to analyze the local law applicable to a particular project when evaluating payment claims made by design professionals.

V. Conclusion

New contract delivery methods have worked to increase cooperation and try to limit some of the adversarial relationships that may lead to disputes plaguing projects for years. In reality, those delivery methods are used to shift risk primarily from the owner downstream to a single entity that may be more equipped to coordinate and manage both the design and construction processes on a complex construction project. Understanding the impact of how that shifting of risk impacts a surety's potential exposure is vital to understand when evaluating potential exposure for a surety. That risk evaluation should start with underwriting in evaluating the scope of design and construction responsibilities delegated to the principal and continue to claims when analyzing the potential impact of ratification of design professionals or cost associated with identifying completion contractors capable of undertaking the completion of the principal's design and construction responsibilities. While the benefits of consolidating the relationships between design and construction may be helpful to the overall health of a project, surety professionals need to be cognizant of the impact those may have in the claims handling process.

PANEL 5

AFFIRMATIVE CLAIMS AND THE SURETY

Laura Abrahamson | JAMS | Los Angeles, CA

Christine Alexander | Arch Insurance Group, Inc. | Philadelphia, PA

Jonathan Bondy | Chiesa Shahinian & Giantomasi PC | West Orange, NJ

Brian Kantar | Chiesa Shahinian & Giantomasi PC | West Orange, NJ

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OUTLINE

AFFIRMATIVE CLAIMS AND THE SURETY

(45 Minute Presentation)

Jonathan Bondy – Chiesa Shahinian Giantomasi PC
Brian Kantar – Chiesa Shahinian Giantomasi PC
Christine Alexander – Arch Insurance Company
Laura Abrahamson – JAMS

I. Introduction

a. This presentation will be moderated by Brian Kantar, with each of Jon Bondy, Chris Alexander and Laura Abrahamson responding to inquiries or sharing their thoughts on various considerations attendant to affirmative claims.

b. With only forty-five minutes, we will be skimming treetops. We will not delve into any one area in any great depth. As a general overview, this presentation may not cover every single detail or consideration.

c. Not intended to be one size fits all. Every affirmative claim brings its own challenges. These are often as much business decisions as they are legal.

II. What is an Affirmative Claim?

a. Presentation is focused on Affirmative Claims as they affect sureties
    i. Not addressing affirmative claims where there is no claim on the bond and no surety involvement.

b. Generally, an affirmative claim means a claim for damages against an owner/obligee for additional funds due as a result of owner/obligee's actions or inactions.
    i. It is not a straight breach of contract action for failure to pay for approved work.
    ii. It is also not a defense.
        1. A surety asserting overpayment or failure to comply with conditions precedent is usually asserting a defense – not an affirmative claim. It can be a claim if the surety performed under a reservation of rights and the amount of the contract proffered by the obligee was too low and the surety seeks to recover the additional amount that it contends was properly due
    iii. Affirmative claims can include:
        1. delay (including loss of productivity, extended general conditions, additional home and field office overhead, escalation costs for both labor and material, etc.),

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2. scope disputes (especially where the principal is directed to perform disputed work without a change order), and
3. consequential damages (if not barred by a waiver).

c. A surety may encounter affirmative claims in many ways:
   i. Obligee terminates principal and makes claim on bond – principal claims it was improperly terminated, and principal has its own substantial claims.
   ii. Obligee terminates principal, surety takes over, and claims arise during the course of completion.
   iii. No termination, but principal is financially unable to complete project because of obligee's conduct. Principal asks surety to finance. Surety must decide whether to finance/pursue claims arising out of such conduct.
   iv. Affirmative claim as defense/bargaining chip with respect to an obligee claim

III. Threshold Considerations

Standing

a. Who is asserting?
   i. Surety or principal?

b. Surety may not be able to bring claim in its own name.
   i. If surety hasn't sustained losses, may not be able to assert subrogation rights.
   ii. Assignment rights under Indemnity Agreement might grant surety those rights, but it depends on whether there are any conditions to the assignment and whether the underlying bonded contract prohibits assignments of any kind without he obligee's consent.
   iii. If a government contract, the statutes and regulations may prohibit such claims (e.g., Anti-Assignment Act (41 U.S.C. § 6305, 31 U.S.C. § 3727 and 41 U.S.C. § 15).
   iv. Severin Doctrine may preclude bringing of pass-through claims.
      1. If Surety satisfies subcontractors claim and obtains release, no standing to bring claim. Must have a liquidating agreement or preservation of claim rights.

Conditions/Waiver

a. Does the contract have notice and time requirements as to claims?
b. Has the principal complied with all of the legal requirements?
   i. If not, this may serve as a significant impediment to pursuing a claim.
c. Are there statutory conditions?

        i. For example, in addition to contractual conditions, certain government entities require separate notice of claim. These notices are a *sine qua non* to bringing a claim.
d. Does the contract contain a no damage for delay clause and/or a consequential damage waiver?
    i. May be able to work around these to an extent, but they can make the hill a lot steeper.
e. Has principal executed waivers in exchange for progress payments?
    i. These waivers may be fatal to claims, unless principal carved claims out from scope of waiver.

IV. Proof, Value, and Cost

Proof

a. Prior to spending time and money evaluating the merits of the claim (by hiring counsel and consultant), Surety should confirm that is has sufficient documents and witnesses:
    i. If principal handed surety the keys, or is just difficult, the task becomes much more difficult and costly.
    ii. Are witnesses available? Will they cooperate? What will they say?
    iii. Is the contractor (and its witnesses) believable?

b. Does the contract allow for the claim? Is it expressly barred?
    i. If the contract does not allow for the claim or it is expressly barred, does the jurisdiction permit deviation from the contract?

c. Delay claims:
    i. Were there concurrent delays?
    ii. Did the principal delay?
        1. Getting around the principal's delays is not impossible, but can be difficult and often reduces the value of the claim
    iii. Does a scheduling expert agree with the logic of the claim? Will a Court?
    iv. How complicated will it be to establish delay?
        1. Does a straight CPM analysis establish the claim?
        2. Are there admissions or acknowledgments from obligee?
    v. Establishing delay. Several approaches. Examples:
        1. Total cost method?
            a. Easiest, but often rejected.
        2. Modified Total Cost?
            a. More acceptance, but still subject to resistance.
        3. Earned Value?
        4. Measured mile approach?
            a. Better, but can be complicated and need to compare apples to apples.

        5. There are challenges with each of these approaches (and there are others). Not every jurisdiction (or contract) looks favorably at all approaches, yet the available approaches may be more difficult to establish under the circumstances.

- d. Scope Disputes:
    - i. Sometimes an affirmative claim is not about delay, but rather, about whether the principal is responsible for the work under the contract.
    - ii. This is sometimes as simple as reading the contract documents.
    - iii. More often, this can require expert analysis and testimony with respect to whether the work should have been contemplated in the bid.
    - iv. This is sometimes related to design errors.
        1. Whether a surety can pursue a claim against a design professional may depend on the language of the design professional's contract with the obligee and local case law.
        2. For instance, a design professional's contract may limit its liability to its fees.
        3. While design professionals often seek to dismiss principal/surety claims on privity grounds, sureties can assert their equitable subrogation rights to get around such standing arguments.
        4. Not necessary to pursue design professional – ultimately obligee's responsibility vis-à-vis principal. But still, need to establish this was an obligee design issue vs. a principal work issue.
            - a. *Spearin* doctrine issues.
        5. Did the principal have design responsibility?
            - a. Should it have known better?
            - b. Did principal have a duty to say something before undertaking work it knew was improperly designed?
            - c. Did the principal deviate from its own shop drawings?

<u>Value & Cost</u>

- a. What is the claim actually worth?
    - i. On paper vs. realistically?

- b. What is the cost to pursue the claim?
    - i. Consultant/expert fees to work up?
    - ii. Legal costs to pursue?
    - iii. Paying to keep the Principal (or employees or former employees of the Principal) engaged.

- c. Are there potential counterclaims?
    - i. Will obligee assert in absence of an affirmative claim?

            1. Worth poking the sleeping bear?
      ii. Merits of counterclaim?
            1. Once counterclaim asserted, cannot just dismiss affirmative claim.

d. Cost/benefit analysis?
   i. Is it a smart business decision to pursue claim?
      1. What discussions are held within the Surety and who gets involved in the Surety's decision to pursue the claim? Is the discussion a collaboration involving claims and underwriting? If usually not, does the level of claim and the costs of pursuit change the decision matrix?
   ii. What are the odds of winning?
   iii. If a homerun on the claim is $1 million, but the cost to pursue is $500,000, is it worth pursuing? Add in the potential for a counterclaim and the cost of defending against it.
   iv. What factors drive the decision as to whether the Surety seeks outside legal or consulting assistance in evaluating the claim?
   v. What happens if principal files for bankruptcy?
   vi. What happens if obligee files for bankruptcy?

e. Are indemnitors standing behind claims or does surety have to fund? Do the indemnitors have the wherewithal?

f. Collectability:
   i. If a private job, does the owner/obligee have the wherewithal to pay?

g. Risk:
   i. If a public job, is there potential for false claims act issues?
      1. Address recent developments in *Scollick v. Narula* (could a surety be liable if it brings claims in its own name?)
      2. *Hanover v. Lodge* (potential liability for supporting principal's claim)

V. Other Considerations

a. Duty to assert affirmative claims?
   i. Indemnitors often gripe that there are great defenses or claims the surety should assert instead of resolving bond claims.
   ii. Surety does not have an obligation to pursue a claim – principal should do so.
   iii. Word of caution, some indemnity agreements appear to assign all claim rights to surety upon declaration of default, arguably divesting principal of standing. *See Siba Contracting Corp. v. Stantec. Inc.*, 2016 WL 613781 (N.Y. Sup. Ct. Oct. 18, 2016), *aff'd* 68 N.Y.S. 3d

327 (N.Y. App. Div. Feb 8, 2018). But the surety can assign them back, disclaim specific rights/claims assigned, or advise it is foregoing the exercise of its assignment rights as to the specific claim

b. Affirmative Claim as (valid) leverage
    i. While the possibility of a counterclaim may turn a surety away from asserting an affirmative claim, the possibility of an affirmative claim might turn an obligee away from pursuing a default or bond claim (or at least make them more reasonable).
    ii. Can trade release or reduction of affirmative claim for release or reduction of obligee claim.
        1. If principal does not agree, a surety might be able to utilize its attorney-in-fact rights and release principal's claims over its objections. *See Hutton Constr. Co., Inc. v. Cnty. of Rockland*, 52 F.3d 1191 (2d Cir. 1995).
        2. This typically requires a collateral demand and failure to provide collateral.

PANEL 6

GC/SUBCONTRACTOR RELATIONSHIP – DUTY OF GOOD FAITH AND FAIR DEALING/SUPPLEMENTATION AND OFFSETS

Jack Costenbader | PCA Consulting | San Francisco, CA

Robert Riggs | Hanover Insurance | Fairfield, CT

Mark Stein | The Vertex Companies, Inc. | Irving, TX

David Veis | Clyde & Co LLP | Los Angeles, CA

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GC/Subcontractor Relationship – Duty of Good Faith and Fair Dealing/ Supplementation and Offsets

Robert Riggs
Hanover Insurance
David Veis
Clyde & Co US LLP
Mark Stein
Vertex
Jack Costenbader
PCA Consulting

Supplementation has been and remains a contentious issue in private and public work construction. Supplementation is the exercise of action by an obligee to correct or provide additional workforces at the expense of the principal. An owner may seek to supplement a general contractor or a general contractor may seek to supplement a subcontractor.

From an owner or general contractor perspective, electing to supplement is an action to get the project timely completed with minimal expense. From a general contractor or a subcontractor's perspective that is being supplemented, it is viewed as an interference with contract and an unwanted and unnecessary reduction of the contract value. From the perspective of a surety for a general contractor or a subcontractor being supplemented, it is an interference with the surety's completion options and an unnecessary or improper exposure to loss.

A party seeking the right of supplementation, attempts to include contract provisions giving broad rights to supplement. A party faced with supplementation exposure needs to carefully review contract provisions and where possible limit the use of supplementation. Sureties faced with supplementation of its principal must review both the underlying contract and bond provisions to preserve their rights to

notice and completion options to limit exposure from supplementation. Being aware of the issues and perspectives from all three parties is critical in evaluating rights and exposures involving supplementation.

As noted, the parties often have directly opposing perspectives and goals. An owner/general contractor may try to include broad rights to supplementation in the contract and avoid notice requirements to either the principal or the surety. A general contractor/subcontractor faced with exposures to supplementation will seek to require a default declaration followed by a reasonable cure period to limit the right to supplementation. A surety exposed to supplementation will try to condition a bond claim right on adequate prior notice to preserve completion options and require satisfaction of all provisions under the Agreement.

Because it is rare that parties carefully review the underlying contracts and bond provisions in anticipation of supplementation, when faced with a supplementation situation, it is necessary to review case authority to determine how the rights and obligations of the parties have been determined. Unfortunately, the cases involving supplementation provide few clear guidelines. Instead, the case authority is often inconsistent. A prime example of this is seen in the contradictory decisions dealing with whether a default is to be declared before a right to supplement.

Declaring a Default

Elm Haven Construction Limited Partnership v. Neri Construction LLC 376 F.3d 96 (2004) establishes the rule that failure to declare a default before supplementation precludes an opportunity to cure the default and prejudices the surety thereby discharging the surety's obligations. In that case, the bond required a declaration of default as a condition precedent for action by the surety and afforded the surety certain rights upon such a declaration. Although the obligee copied the surety on notices to the principal that its work would be supplemented by others, the obligee failed to declare the principal in default before supplementing its labor. The obligee had a replacement contractor performing work five weeks before a declaration of default was made to the surety. The Court held that this impaired the surety's rights and discharged the surety.

In *Colorado Structures, Inc. v. Insurance Company of the West* 167 P.3rd. 1125 (2007), the obligee notified the surety of concerns but decided to supplement the principal rather than terminate the contract. Like the bond in *Elm Haven*, the bond

in this case required a declaration of default as a condition precedent for action by the surety and afforded the surety certain rights. The obligee notified the surety of its chosen remedy. When the obligee sought recovery against the surety for the cost of the supplementation, the court held that there was no duty to declare a default to trigger the surety's liability.

Can *Elm Haven* which required a declaration of default and *Colorado Structures* which concluded that no declaration of default was necessary be reconciled? Not easily. Both cases were analyzed in light of *L&A Contracting Co. v. Southern Concrete Services, Inc.*, 17 F.3d 106 (5th Cir. 1994), which held that a declaration of default term of a performance bond was satisfied only by a clear, direct, and unequivocal or precise declaration of default. Perhaps, the decision in *Colorado Structures* relied on the fact that the surety was on notice of the issues. Even if this justification is accepted, the surety in *Colorado Structures* was prejudiced as it was exposed on the bond without allowing its performance options.

Advance Notice to Surety

Several cases have held that an obligee with a contract right to supplement need not give the surety notice before supplementing to collect on a performance bond. See, e.g., *Commercial Casualty Insurance Company of Georgia v. Maritime Trade* 257 Ga.App. 779 (2002), noting that the performance bond did not address the contingency of the obligee supplementing the principal's work before it defaulted while the bonded subcontract authorized supplementation only upon 48-hour notice to the subcontractor, without any provision requiring notice to the surety. See, also, *Nova Casualty Company v. Turner Construction Co.*, 335 S.W.3d 698 (2011).

Other courts require a notice of default as a condition precedent to recovery against a surety. In *Hunt Const. Group, Inc. v. National Wrecking Corporation* 542 F. Supp. 2d. 87 (2008), the court held that where the obligee fails to notify a surety of an obligee's default in a timely fashion, so the surety can exercise its options under the bond, the obligee renders the bond null and void. In this case, the notice to the surety was made after the bonded scope of work had been completed and the alleged default could no longer be remedied. *Hunt* rejected *Colorado Structures*' analysis of the bond terms, which led the latter court to hold that there was no duty to declare a default to trigger the surety's liability. Similarly, *International Fidelity Insurance Company v. Americarbe – Moriarty JV*. 192 F. Supp. 1326 (2016) held that IFIC had a right to reasonable notice and that unilaterally hiring a completion

contractor breached the terms of the performance bond. In this case, the supplementation began within days of the obligee's declaration of the principal's default. Thus, the surety was deprived of the opportunity to exercise the options in response to a declaration of default stated in the performance bond.

As demonstrated, the case law may be helpful depending upon facts but it is not determinative. Instead, if involved at the outset of the project, understand the differing needs of the parties and try to include provisions to assist your position. If you are reviewing the matter during construction, understand the contractual provisions allowing supplementation, any cure provisions, notice of default and notice to surety provisions to evaluate and defend against claims. Examples of contract language allowing supplementation are set forth at the end of this paper.

These cases are often fact specific. Review of the contract and performance bond provisions are critical. Further, investigation requires a review of the following:

1. Are there contract provisions allowing supplementation?

2. Are there notice provisions in the contract or performance bond to either the principal or the surety before supplementation?

3. Is a declaration of default required under the contract and/or the performance before supplementation?

4. If a default or failure to perform is declared, is there a cure provision for the principal and/or the surety to act before supplementation?

5. Did the obligee wait to act until the cure period expired?

6. Did the supplementation impair the surety's rights under the performance bond to mitigate damages?

As noted, the cases decided weigh these and other considerations and often rule based upon unique facts and/or equitable considerations as opposed to strict legal rules.

Contract Provisions Allowing Supplementation

Example 1

3.12 Right of Set Off. Contractor may withhold and unilaterally deduct amounts otherwise due under this Agreement, or any other agreement in which either Contractor or Subcontractor has an ownership interest, sub affiliation, or corporate affiliation ("Other Agreements"), to cover Contractor's reasonable estimate of any costs (including reasonable overhead and profit), damages, or liability Contractor has incurred or may incur for which Subcontractor may be responsible for under this Agreement or Other Agreements, or to reimburse Contractor for Contractor's costs associated with performing Subcontractor's Work prior to Subcontractor's default.

Example 2

14.2 Remedies for Default. If any Default continues for two (2) Days after Contractor gives written notice thereof, Contractor may, in addition to all its other rights and remedies under the Agreement, the Contract Documents, and Applicable Law, (i) withhold payment to Subcontractor in an amount sufficient, in Contractor's sole judgment, to remedy the Default and compensate Contractor for any damages it may sustain due to the Default; (ii) **supplement Subcontractor**; and/or (iii) terminate this Agreement, in whole or in part ("Termination for Cause").

14.2.1 If Contractor elects to supplement Subcontractor, Contractor may provide additional labor, materials, equipment, supervision, and/or take any action that Contractor, in its sole discretion, deems necessary to cure the Default, at Subcontractor's sole cost and expense.

Example 3

8.1 Failure of Performance and Default. If the Contractor determines at its sole discretion that the Subcontractor has: (i) refused or failed to supply enough properly skilled workers, proper materials, or maintain the Schedule of Work…… If the Subcontractor fails within seventy-two (72) hours after receipt of written notice (facsimile, email, or letter, shall constitute sufficient written notice and declaration of default) to commence and continue satisfactory correction of such default with diligence and promptness, the Subcontractor shall have materially breached this Agreement, and the Contractor, without prejudice to any other rights or remedies, shall have the right to any or all of the following remedies: (i) supply such number of workers and quantity of materials, equipment and other facilities as the Contractor deems necessary for the completion of the Subcontractor's Work, or any part thereof which the Subcontractor has failed to complete or perform after

the aforesaid notice, and charge the cost thereof to the Subcontractor, who shall be liable for the payment of same including reasonable overhead, profit and attorney's fees; (ii) contract with one or more additional contractors to perform all or such part of the Subcontractor's Work as the Contractor shall determine will provide the most expeditious completion of the total Work and charge the cost thereof to the Subcontractor who shall be liable for the payment of same including reasonable overhead and profit; (iii) discharge the claim of non-payment; and/or (iv) withhold payment of any moneys due the Subcontractor pending corrective action to the extent required by and to the satisfaction of the Contractor, Owner, and the Architect/Engineer.

Example 4

7. Price, Progress Payments. Contractor may, under this Agreement or any other agreement between Contractor and this Subcontractor, withhold or unilaterally deduct the whole or part of any payment to Subcontractor including final payment, or may nullify any payment due to information discovered after such payment, to protect Contractor from or reimburse Contractor for loss on account of (a) defective work not remedied; (b) failure of Subcontractor to make payments properly to its subcontractors or for materials, equipment, labor or fringe benefits; (c) third party claims filed or reasonable evidence indicating probable filing of such claims; (d) reasonable doubt that the Work under this Agreement can be completed for the balance of the Subcontract Price then unpaid; (e) reasonable doubt that the Work under this Agreement can be completed within the time required herein and that the balance of the Subcontract Price then unpaid would be sufficient to cover damages resulting from the anticipated delay.

15. Breach of Agreement, Failure to Perform, Remedies. If Subcontractor is in default, Contractor shall have the right, after three (3) days written notice to Subcontractor mailed or delivered to its last known address, to (a) perform and furnish itself or through others all or any portion of the Work, and to deduct the cost from any monies due or to become due under this Agreement, or any other agreement between Contractor and this Subcontractor, and/or (b) terminate Subcontractor's employment for all or any portion of the Work.

PANEL 7

CONDITIONS AND CORRELATIONS OF THE A312 PERFORMANCE BOND AND THE A313 WARRANTY BOND

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CONDITIONS AND CORRELATIONS OF THE A312 PERFORMANCE BOND AND THE A313 WARRANTY BOND

By: Jarrod Stone, Amy Bernadas, and Rachel Walsh

I. INTRODUCTION

This paper discusses the various conditions and correlations of the 2010 Version of the AIA Document A312 Performance Bond (the "A312 Performance Bond") and the AIA Document A313 Warranty Bond (the "A313 Warranty Bond"), which the American Institute of Architects (the "AIA") unveiled in 2020. The authors of this paper have heard surety practitioners refer to the A312 Performance Bond as the proverbial "Cadillac of performance bonds," whereas very few surety practitioners have even heard of the A313 Warranty Bond. Moreover, while many surety practitioners can rattle-off the various conditions precedent to a surety's performance obligations and/potential liability under the A312 Performance Bond, not all of them fully understand the nuances and/or disputes that may arise when determining whether those conditions precedent have been satisfied. In at least one author's experience, that appears to be especially true in the context of the obligee's duty to agree/commit to paying the "Balance of the Contract Price" to the surety, which is often thought of as an afterthought. At least one of the authors has also debated the issue of whether one of those conditions precedent, namely the existence and declaration of a "Contractor Default," can be satisfied following the principal's substantial performance and/or the after bonded project at issue has reached the point of substantial completion, which begs the question of whether the A312 Performance Bond was intended to cover the principal's warranty obligations. Now that the AIA has unveiled the A313 Warranty Bond, a new question becomes, "If the surety's performance obligations and/or potential liability extended to warranty obligations under the A312 Performance Bond, then why would the A313 Warranty Bond ever be necessary?" That question and other issues are discussed in more detail below.[1]

II. SO, YOU THINK YOU KNOW THE A312 PERFORMANCE BOND'S CONDITIONS PRECEDENT?

Surety practitioners learn very early in their careers that the conditions precedent to a surety's performance obligations and/or potential liability under an A312 Performance Bond are set forth in Section 3 of that bond form. Some of us may have even awoken in the middle of the night in a cold sweat while muttering "Paragraph 3, Paragraph 3, Paragraph 3 . . . ." In any event, those well-known conditions precedent state:

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[1] As a disclaimer, this paper is being drafted and published solely for educational purposes and is not intended to be an exhaustive discussion of the legal principles referenced herein. Instead, this paper is being drafted under the pressures and time constraints with which surety practitioners are all-too-familiar. Assuming that someone in the world actually reads this paper other than the authors, the reader should perform his or her own analysis of the factual scenario at hand in conjunction with the legal principles that may be applicable to the interpretation or enforcement of an A312 Performance Bond or an A313 Warranty Bond.

§ 3 **If there is no Owner Default** under the Construction Contract, the Surety's obligation under this Bond shall arise after

.1 **the Owner first provides notice to the Contractor and the Surety that the Owner is considering declaring a Contractor Default**. Such notice shall indicate whether the Owner is requesting a conference among the Owner, Contractor and Surety to discuss the Contractor's performance. If the Owner does not request a conference, the Surety may, within five (5) business days after receipt of the Owner's notice, request such a conference. If the Surety timely requests a conference, the Owner shall attend. Unless the Owner agrees otherwise, any conference requested under this Section 3.1 shall be held within ten (10) business days of the Surety's receipt of the Owner's notice. If the Owner, the Contractor and the Surety agree, the Contractor shall be allowed a reasonable time to perform the Construction Contract, but such an agreement shall not waive the Owner's right, if any, subsequently to declare a Contractor Default;

.2 **the Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety**; and

.3 **the Owner has agreed to pay the Balance of the Contract Price in accordance with the terms of the Construction Contract to the Surety or to a contractor selected to perform the Construction Contract**.

(Emphasis added). Section 5 of A312 Performance Bond expressly references those conditions precedent as the "conditions of Section 3." Moreover, courts throughout the United States have held that the events listed in Section 3 of the A312 performance bond constitute conditions precedent to the surety's performance obligations and/or potential liability thereunder. [2]

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[2] *See, e.g., Stonington Water Street Assoc. v. Hodess Bldg. Co.*, 792 F. Supp. 2d 253 (D. Conn. 2011) (explaining that "suretyship law in Connecticut and elsewhere dictates that compliance with the conditions precedent [contained in Paragraph 3] is necessary in order to invoke the surety's obligation under the performance bond and failure to do is fatal to the obligee's claim for coverage"); *Developers Sur. & Indem. Co. v. Dismal River Club*, 2008 WL 2223872 (D. Neb. May 22, 2008) (citing seven cases for this proposition and stating "courts in other jurisdictions have consistently held that the notice requirement and other provisions of paragraph 3 are conditions precedent to the surety's obligation to perform"); *LBL Skysystems, Inc. v. APG-America, Inc.*, 2006 WL 2590497, *24 (E.D. Pa. Sep. 6, 2006) (recognizing that "the language of Paragraph 3 of the Performance Bond . . . creates conditions precedent to the duty of the surety"); *120 Greenwich Dev. Assoc., LLC v. Reliance Ins. Co.*, 2004 WL 1277998 (S.D.N.Y. June 8, 2004) (holding that the language of Paragraph 3 "creates unambiguous preconditions for triggering [the surety's] obligations under the Bond that apply not just to the completion options in Paragraph 4, but also to its obligations for delay costs and other damages under Paragraph 6"); *Enterprise Capital, Inc. v. San-Gra Corp.*, 284 F. Supp. 2d 166 (D. Mass. 2003) (noting that "other courts have consistently interpreted the language in this Performance Bond . . . to indicate the listing of conditions precedent"); *N. Am. Specialty Ins. Co. v. Chichester Sch. Dist.*, 2000 WL 1052055, *16 (E.D. Pa. July 20, 2000) (stating that "the paragraph three obligations act as conditions precedent to the paragraph four obligations of the surety"); *East 49th Street Development II v. Prestige Air & Design, LLC*, 938 N.Y.S. 2d 226 (N.Y. Sup. Ct. 2011) (citing six different cases for this proposition and stating "that the failure to strictly comply with these conditions precedent are fatal to an obligee's claim under a performance bond"); *Bank of Brewton, Inc. v. Int'l. Fid. Ins. Co.*, 827 So. 2d 747 (Ala. 2002) (holding that Paragraph 3 contains conditions precedent to the surety's

Technically speaking, the first condition precedent to the surety's performance obligations and/or potential liability under an A312 Performance Bond is the lack of an "Owner Default." Section 14.4 of the A312 Performance Bond defines an "Owner Default" as follows, "Failure of the Owner, which has not been remedied or waived, **to pay the Contractor as required under the Construction Contract** or to perform and complete or comply **with the other material terms of the Construction Contract**." (Emphasis added). Thus, the existence of an "Owner Default" would prevent the surety's performance obligations and/or potential liability from arising in the first place if (1) the obligee has failed to pay the principal "as required under the Construction Contract" and/or (2) the obligee has failed to comply with other "material terms of the Construction Contract." While the definition of "Owner Default" implies that the failure to pay the principal "as required under the Construction Contract" would in-and-of-itself constitute a material breach of the "Construction Contract," whether the obligee has failed to comply with other "material terms of the Construction Contract" could be a factual issue that may complicate a surety professional's decision-making process when faced with a claim under and A312 Performance Bond.

The next quasi-condition precedent to the surety's performance obligations and/or potential liability under an A312 Performance Bond is the obligee's duty to notify the principal and the surety "that the Owner is considering declaring a Contractor Default." That requirement is referenced as a quasi-condition precedent based upon Section 4, which states, "Failure on the part of the Owner to comply with the notice requirement in Section 3.1 **shall not constitute a failure to comply with a condition precedent to the Surety's obligations, or release the Surety from its obligations, except to the extent the Surety demonstrates actual prejudice**." (Emphasis added). Thus, the obligee's failure to comply with Section 3.1 will equate to the failure to satisfy a condition precedent if, but only if, the surety can establish actual prejudice resulting from the obligee's failure to comply with Section 3.1. The authors are having a hard time imagining a scenario in which no actual prejudice would arise from the obligee's failure to comply with Section 3.1, but they digress.

The next condition precedent to the surety's performance obligations and/or potential liability under an A312 Performance Bond is the three-part requirement that the obligee "declare a Contractor Default," "terminate the Construction Contract," and "notify the Surety." On the one hand, Section 14.3 of the A312 Performance Bond defines a "Contractor Default as follows, "Failure of the Contractor, which has not been remedied or waived, to perform or otherwise **to comply with a <u>material term</u> of the Construction Contract**." (Emphasis added). On the other hand, however, the A312 Performance Bond does not define the phrase "declares a Contractor Default." Nonetheless, the requirement that the obligee "declare a Contractor Default" correlates to the fact that a surety's performance obligations and/or potential liability under the A312 Performance Bond's predecessor, the AIA Document A311 Performance Bond (the "A311 Performance Bond"), could only arise if the "Contractor shall be, and declared by Owner to be in default under the Contract." In recognition of the important of the declaration of a "default," which many surety practitioners have referred to as the proverbial nuclear option over the years,

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duty to perform and/or potential liability); *Breath of Life Christian Church v. Travelers Ins. Co.*, 2010 WL 1172080 (Tenn. Ct. App. Mar. 26, 2010) (stating that Paragraph 3 "unambiguously sets-forth the conditions under which Travelers' obligations as surety would arise").

many courts construing the A311 Performance Bond distinguished a mere breach of a contract from a default. Unlike a mere breach, a default has been described as a material breach or a series of material breaches that would justify the termination of the contract itself. As explained in a leading case on the topic:

> Although the terms "breach" and "default" are sometimes used interchangeably, their meanings are distinct in construction suretyship law. Not every breach of a construction contract constitutes a default sufficient to require the surety to step in and remedy it. To constitute a legal default, there must be a (1) material breach or series of material breaches (2) of such magnitude that the obligee is justified in terminating the contract.[3]

In other words, not all breaches are defaults, and Section 14.3 of the A312 Performance Bond injects a materiality requirement into the concept of a "Contractor Default," which is similar the judicial gloss the courts applied when interpreting/enforcing the A311 Performance Bond. Moreover, when interpreting/enforcing the A311 Performance Bond, courts recognized that a "declaration" of a "default" had to clearly and unequivocally advise the surety that (1) a material breach or series of material breach existed, (2) the bonded contract had been terminated, and (3) the obligee expected the surety to perform. Though courts often quibbled over whether the A311 Performance Bond required a formal termination of the bonded contract to trigger the surety's performance obligations and/potential liability, Section 14.3 of the A312 Performance Bond does in fact require such a formal termination.

The materiality requirement of a "Contractor Default" merits additional discussion. As a result of the materiality requirement, not every breach of a bonded contract could give rise to the surety's performance obligations and/or potential liability under an A312 Performance Bond. Unfortunately for sureties, principals, and owners alike, the legal standard for gauging the materiality of a breach of a construction contract is anything but uniform. In fact, the determination of whether a breach is material or immaterial is often very fact intensive, and the outcome of such determinations is very hard to predict. A leading treatise has labeled the legal standard for materiality as "amorphous" and has commented that "[a]lthough the materiality of breach is the paramount issue in every contract termination dispute, there surprisingly is no adequate common law legal standard by which 'material breach' may be judged."[4] Like the question of material breach, the question of substantial performance is often litigated after the obligee terminates the principal's right to complete the bonded contract before final completion and acceptance, and the legal standard for substantial performance is anything but uniform. For example, some courts view the question of substantial performance objectively and focus on whether the bonded project can be used for its intended purpose despite the existence of defects and/or whether the purpose of the bonded contract has been fulfilled.[5] Some courts force the

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3 *L&A Contracting, Co.*, 17 F.3d at 110 (applying Florida law). *See also Elm Haven Constr. Ltd. P'ship., LLC*, 281 F. Supp. 2d at 100; *Seaboard Sur. Co. v. Town of Greenfield*, 266 F. Supp. 2d 189 (D. Mass. 2003); *Enter. Capital, Inc. v. San-Gra Corp.*, 284 F. Supp. 2d 166 (D. Mass. 2003); *St. Paul Fire & Marine Ins. Co. v. City of Green River*, 93 F. Supp. 2d 1170 (D. Wyo. 2000); *Balfour Beatty Constr., Inc.,* 986 F. Supp. at 85; *Co. Structures, Inc.*, 167 P.3d at 1132.

4 Amorphous legal standard of material breach, 5 Bruner & O'Connor Construction Law § 18:4.

5 *See, e.g., Matador Drilling Co. v. Post*, 662 F.2d 1190, 1195 (5th Cir. 1981); *Shell v. Shcmidt*, 330 P.2d 817, 820 (Cal. Ct. App. 1958); *Howard v. Jay*, 561 N.E.2d 274, 278 (Ill. Ct. App. 1990); *Allstate Enter., Inc. v. Brown*,

trier of fact to engage in the difficult task of determining whether the underlying defects should be characterized as "pervasive," "unimportant," "minor," "trivial," or "slight," which are subjective and/or relative terms.[6] Some courts also require the trier of fact to determine whether the principal performed in good faith and whether the underlying defects resulted from inadvertence, an honest mistake, or willfulness.[7] Unfortunately, such analysis seems to result in an "I know it when I see it" determination for substantial performance.[8]

Nevertheless, there is an undeniable legal distinction between a material breach and substantial performance. Many commentators and surety professionals consider the concepts of material breach and substantial performance to be like opposite sides of the same coin. Like heads or tails, you can have one or the other, but not both. A leading treatise has explained: "The doctrine of material breach is simply the converse of the doctrine of substantial performance. Substantial performance is performance without a material breach, and a material breach results in performance that is not substantial."[9] Other commentators have described the doctrine of substantial performance as being the "antithesis" of the doctrine of material breach.[10] A finding of substantial performance necessarily precludes a finding of a material breach and the owner's remedy is limited to money damages for any defects. At least one court has stated that "[t]he law is clear that a building contract may not be dissolved after substantial performance has been rendered."[11] Many courts have used the terms "substantial completion" and "substantial performance" as if they have the same meaning.[12] Unless the bonded contract contains a more specific definition, the term "substantial completion" generally refers to the point at which the underlying project is capable of being used for its intended purposes and/or the owner "has obtained, for all intents and purposes, all of the benefits it reasonably anticipated receiving under the contract."[13] At least one of these authors has argued in multiple instances (with some

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907 So. 2d 904, 913 (La. Ct. App. 2005); *Jackson v. Caffey*, 78 So. 2d 361, 371 (Miss. 1955); *Eliker v. Chief Indus., Inc.*, 498 N.W.2d 564, 567 (Neb. 1993); *Pioneer Enter., Inc. v. Edens*, 345 N.W.2d 16, 18 (Neb. 1984); *Manshul Constr. Corp. v. Dormitory Auth.*, 444 N.Y.S.2d 792, 802 (N.Y. App. Div. 1981);

6 *See, e.g., Hardin v. Beaman*, 49 So. 2d 732, 733 (Miss. 1951); *Circle B. Enter. Inc. v. Steinke*, 584 N.W.2d 97, 100 (N.D. 1998); *Mort Co. v. Paul*, 76 A.2d 445, 446 (Pa. 1950); *Alhers Bldg. Supply, Inv. V. Larsen,* 535 N.W.2d 431, 435 (S.D. 1995); *Cont'l Dredging, Inc. v. De-Kaizered, Inc*., 120 S.W.3d 380, 394 (Tex. Ct. App. 2003); *Reliance Inc. v. Utah Dep't of Transp*., 858 P.2d 1363, 1370 (Utah 1993); *Forrester v. Craddock*, 317 P.2d 1077, 1083 (Wash. 1957).

7 *See, e.g., Miles v. Moore*, 79 So. 2d 432, 444-45 (Ala. 1955); *Nat'l Constructors, Inv. v. Ellenberg*, 681 So. 2d 791, 793-94 (Fla. Ct. App. 1996); *Nat'l Wrecking So. v. Midwest Terminal Corp*., 601 N.E.2d 999, 1006 (Ill. Ct. App. 1992); *Bidwell v. Midwest Solariums, Inc*., 543 N.W.2d 293, 295 (Iowa 1995); *Hardin*, 49 So. 2d at 733; *Circle B. Enter. Inc*, 584 N.W.2d at 100; *Mort Co.*, 76 A.2d at 446; *Cont'l Dredging, Inc.*, 120 S.W.3d at 394; *Reliance Inc*, 858 P.2d at 1370 (Utah 1993)

8 The "I know it when I see it" analysis is often linked to a statement Justice Stewart made in his concurring opinion in *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964), in which Justice Stewart noted that obscenity is hard to define "[b]ut I know it when I see it."

9 II FARNSWORTH ON CONTRACTS § 8.16 (2d ed. 1998).

10 CALAMARI & PERILLO, CONTRACTS § 11-18(b) (3d ed. 1997*)*

11 *Huguet v. Musso P'ship*, 509 So. 2d at 93.

12 *See* 5 BRUNNER & O'CONNOR CONSTRUCTION LAW § 15, n.3 (2008) (citing *Worthington Corp. v. Consol. Aluminum Corp.*, 544 F.2d 227 (5th Cir. 1976); *Franklin E. Penney Co. v. United States*, 207 Ct. Cl. 842 (1975); *Blinderman Constr. Co. v. United States*, 39 Fed. Cl. 529 (1997); *Husar Industries, Inc. v. A.L. Huber & Son, Inc.*, 674 S.W.2d 565 (Mo. Ct. App. 1984)).

13 *Kinetic Builder's Inc. v. Peters*, 226 F.3d 1307, 1315-16 (Fed. Cir. 2000); s*ee also Brooks Towers Corp. v. Hunkin-Conkey Const. Co.*, 454 F.2d 1203 (10th Cir. 1972); *Blinderman Const. Co. v. United States*, 39 Fed. Cl. 529 (1997); *Reliance Ins. Co. v. Utah Dep't of Transp.*, 858 P.2d 1363 (Utah 1993).

success) that, once a principal has substantially performed and/or the bonded project has reached the point of substantial completion, no material breach could occur as a matter of law. That same author drafted an article as "baby lawyer" several years ago in which the following supposition was articulated:

> A surety may properly assert that *no* post-completion breach of a bonded contract, such as the principal's breach of a warranty obligation, can trigger the surety's potential liability when the underlying performance bond conditions the surety's liability upon the principal's default. [M]any courts have accepted the legal distinction between the principal's mere breach of a bonded contract (for which the principal may be liable) and the principal's material breach of the bonded contract sufficient to be deemed a default and sufficient to warrant a termination of the bonded contract (potentially implicating the surety's performance bond obligations). A project that has been finally completed and finally accepted has necessarily passed the point of substantial completion, which many jurisdictions equate to the point at which the principal has substantially performed its obligations under the bonded contract. Because the inference of substantial performance associated with substantial completion should preclude the finding of a material breach in most post-completion scenarios, final completion and acceptance would preclude a post-completion declaration of default in most cases and thereby also preclude the surety's liability for latent defects discovered after final acceptance and completion under a performance bond conditioned upon the principal's default.

Under that argument, the surety's performance obligations and/or potential liability would be discharged upon the principal's substantial performance and/or the substantial completion of the project as a matter of law.[14] Likewise, the surety's performance obligations and/potential liability would never extend to the principal's post-substantial performance/completion warranty obligations.

In any event, the next and condition precedent to the surety's performance obligations and/potential liability under the A312 Performance Bond is the owner's agreement "to pay the Balance of the Contract Price in accordance with the terms of the Construction Contract to the Surety or to a contractor selected to perform the Construction Contract." Section 7 of the A312 Performance Bond also clarifies that the surety's monetary liability is "[s]ubject to the commitment by the Owner to pay the Balance of the Contract Price . . . ." Section 14.1 defines the "Balance of the Contract Price" as follows:

> **The total amount payable by the Owner to the Contractor under the Construction Contract** after all proper adjustments have been made, including allowance to the Contractor of any amounts received or to be received by the Owner in settlement of insurance or other claims for damages to which the Contractor is entitled, **reduced by all valid and proper payments made to or on behalf of the Contractor under the Construction Contract.**

[14] In *Bank of Brewton, Inc. v. Int'l Fid. Ins. Co.*, 827 So. 2d 747 (Ala. 2002), the Alabama Supreme Court noted that a surety's obligations under an A312 Performance Bond would "conclude" upon "completion of the project."

(Emphasis added).

In the opinion of one of the authors, the A312 Performance Bond's definition of the "Balance of the Contract Price" is one of the least understood provisions of that bond form. That author has engaged in many hotly contested debates as to whether an obligee can setoff against and/or reduce the "Balance of the Contract Price" in relation to any claims the obligee may possess against the principal and/or any damages arising from those claims. In other words, an often debated question is whether the obligee's claims/damages factor into the calculation of the "Balance of the Contract Price." In the real world, many surety practitioners have faced scenarios in which an obligee had taken the position that there simply is no "Balance of the Contract Price" to pay to the surety because the obligee's damages exceed the unpaid balance of the bonded contract. In the very, very strongly held opinion of one of the authors, however, there are only two variables in the calculation of the "Balance of the Contract Price" under the A312 Performance Bond — (1) the "Contract Price" itself and (2) the amount of "all valid and proper payments made to or on behalf of the Contractor under the Construction Contract" — neither of which is impacted or dependent upon the amount of any claims/damages the obligee may possess against the principal.

That author's opinion is based upon a reading of the A312 Performance Bond's definition of the "Balance of the Contract Price" in conjunction with the AIA's Document A201-2007 General Conditions of the Contract for Construction (the "AIA General Conditions"), which were in effect at the time the AIA unveiled the A312 Performance Bond in 2010. When the A312 Performance Bond's definition of the "Balance of the Contract Price" is read in conjunction with the AIA General Conditions, the inescapable conclusion is that the phrase "[t]he total amount payable by the Owner to the Contractor under the Construction Contract after all proper adjustments have been made" in the definition of the "Balance of the Contract Price" is synonymous with the "Contract Sum" as that term is defined in the AIA General Conditions.

Specifically, Article 9.1.1 of the AIA General conditions states, "The Contract Sum is stated in the Agreement and, including authorized adjustments, is the total amount payable by the Owner to the Contractor for performance of the Work under the Contract Document." Therefore, when the A312 Performance Bond's definition of the "Balance of the Contract Price" references "[t]he total amount payable by the Owner to the Contractor under the Construction Contract after all proper adjustments have been made," that definition is necessarily referencing the "Contract Sum." That makes perfect sense considering that the first variable for calculating the "Balance of the Contract Price" should be the "Contract Price" itself — which the AIA General Conditions refers to as the "Contract Sum." An obligee's claims/damages may permit the owner to withhold certain portions of the "Contract Sum" from the principal under certain circumstances. However, under no circumstances would an obligee's claims/damages result in an "adjustment" to the "Contract Price"/"Contract Sum" itself. For what it is worth, at least one court has agreed with an author's opinion on that topic and held that an obligee breached and A312 Performance Bond by setting off against and/or reducing the amount of the "Balance of the Contract Price" in relation to the obligee's alleged liquidated damages.[15]

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[15] In *Welty-Testa Builders, LLC v. Villa San Bernardo, LLC*, *et al*, Case No. CV-19-917323, the Court of Common Pleas for Cuyahoga County, Ohio granted summary judgment in the surety's favor where the surety substantially

Another often overlooked condition in the A312 Performance Bond is the obligee's duty to declare the surety to be in default before the obligee exercises any of its "self-help remedies" under the bonded contract and/or takes any other actions that may deprive the surety of the opportunity to exercise any of its performance options. On that note, Section 6 of the A312 Performance Bond states:

> If the Surety does not proceed as provided in Section 5 with reasonable promptness, the Surety shall be deemed to be in default on this Bond seven days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform its obligations under this Bond, and the Owner shall be entitled to enforce any remedy available to the Owner. If the Surety proceeds as provided in Section 5.4, and the Owner refuses the payment or the Surety has denied liability, in whole or in part, without further notice the Owner shall be entitled to enforce any remedy available to the Owner

A number of courts have held that the obligee material breaches the A312 Performance Bond and thereby discharges the surety's performance obligations and/or potential liability by exercising its "self-help remedies" and/or taking action that deprives the surety and its opportunity to exercise its performance options without first declaring the surety to be in default as required by Section 6.[16]

In summary, the conditions precedent to a surety's performance obligations and/potential liability under an A312 Performance Bond include (1) a lack of an "Owner Default," (2) the existence and declaration of a "Contractor Default," (3) the termination of the principal's right to complete the bonded contract, (4) the obligee's notification to the surety of the declaration of a "Contractor Default" and termination of the principal's right to complete the bonded contract, and (5) the obligee's agreement/commitment to pay the "Balance of the Contract Price" to the surety or to the surety's selected completion contractor. In practice, the most hotly contested conditions precedent tend to be (1) the existence of a "Contractor Default" based upon the materiality of the breach at issue and (2) the calculation of the "Balance of the Contract Price" based upon an obligee's assertion that it is entitled to set off against and/or reduce the "Balance of the Contract Price" based upon the obligee's alleged claims/damages.

III. SO, WHAT EXACTLY IS AN A313 WARRANTY BOND?

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performed its performance bond obligations by completing the bonded contract and the obligee breached the performance bond by withholding payment from the surety on the grounds that the obligee's liquidated damages exceeded the remaining "Balance of the Contract Price."

[16] *Seaboard Sur. Co. v. Town of Greenfield*, 370 F.3d 215, 219-20 (1st Cir. 2004) ("Failure to provide this notice constitutes a material breach of the bond"); *Sleeper Village, LLC v. NGM Ins. Co.*, 2010 WL 3860373 (D.N.H. Oct. 1, 2010) (holding that the surety's liability was discharged because "[i]t is undisputed that [the obligee] contracted with [another contractor] to complete the construction contract without first giving [the surety] the notice of contractor default required by paragraph 5"); *Developers Sur. & Indem. Co. v. Dismal River Club, LLC*, 2008 WL 2223872 (D. Neb. May 22, 2008) (same); *Tishman Westwide Constr., LLC v. ASF Glass, Inc.*, 33 A.D.2d 539 (N.Y. App. Div. 2006) (holding that the obligee materially breached the bond by failing to declare the surety to be in default).

As noted above, the AIA unveiled the A313 Warranty Bond in the Fall of 2020, with very little to no fanfare. To date, the authors of this paper have only encountered a handful of surety practitioners who have even heard of the A313 Warranty Bond, much less have any real world experience with it. In the authors' opinion, discussing the A313 Warranty Bond is beneficial because it will help prepare surety practitioners for what they may face in the future and will help foster the discussion of whether the A312 Performance Bond is intended to cover the principal's warranty obligations (which is one of the things one of the authors has argued against for many years now).

The first notable facet of the A313 Warranty Bond is the "Term of this Bond." On that note, the first page of the A313 Warranty Bond states, "The Term of this Bond commences on the date of final completion under the Construction Contract and continues for a period of 2 years, unless otherwise specified below, notwithstanding a longer warranty period set forth in the Construction Contract." Pursuant to Article 9.10.1 of the AIA General Conditions, the date of "final completion" corresponds to the date upon which the Architect issues its final "Certificate for Payment." Interestingly, pursuant to Article 9.8.4 of the AIA General Conditions, the "[w]arranties required by the Contract Documents shall commence on the date of Substantial Completion of the Work or designated portion thereof unless otherwise provided in the Certificate of Substantial Completion." Therefore, because the "Term of this Bond" under an A313 Warranty Bond seemingly does not commence until the Architect issues its final "Certificate for Payment," a question arises as to whether only the principal would be responsible for any and warranty obligations that may exist from the point of Substantial Completion through the architect's issuance of its final "Certificate for Payment" or whether the surety's performance obligations and/or potential liability would also cover those warranty obligations under the A312 Performance Bond. In any event, Section 8 of the A313 Warranty Bond sets forth the procedure under which the obligee can request an extension of the "Term of this Bond" and the surety's option of granting such extensions as follows:

> § 8 The Owner may request an extension of the Term of this Bond. The Surety, at its sole option, may extend the Term of this Bond by continuation certificate or writer setting forth the new expiration date.
>
> .1 If the Surety extends the Term of this Bond, the Bond shall be considered one continuous bond.
>
> .2 If the Surety decides not to extend the Term of this Bond, then the Surety shall notify the Owner in writing within thirty (30) days prior to the end of the current term of this Bond at the address indicated on page 1.
>
> .3 Neither the Surety's failure to extend the Term of this Bond nor the Contractor's failure to provide a replacement Bond or other acceptable security shall be considered a breach or default by the Surety or the Contractor on this Bond, nor serve as a basis for a claim or demand on this Bond.

Section 9 of the A313 Warranty Bond clarifies that the surety's liability remains capped at the penal sum regardless of the "Term of this Bond" as follows, "The Surety's total liability under this Bond is limited to the Amount of this Bond indicated on Page 1, regardless of whether the Term of this Bond is extended, the length of time this Bond remains in force, and the number of premiums that shall be payable or paid."

Like Section 3 of the A312 Performance Bond, Section 3 of the A313 Warranty Bond sets forth the conditions precedent to the surety's performance obligations and/potential liability thereunder. On that note, Section 3 states:

> § 3 If there is no Owner Default under the Construction Contract, the Surety's obligation under this Bond shall arise after:
>
> .1 the Owner first provides notice to the Contractor and the Surety during the Term of the Bond of the Owner's intent to declare a Contractor Default;
>
> 2. The Contractor fails to remedy the Contractor Default within a reasonable amount of time of such notice; and,
>
> 3. The Owner declares a Contractor Default and notifies the Surety.

Thus, the first condition precedent is the lack of an "Owner Default," which Section 14.3 of the A313 Warranty Bond defines as follows, "Failure of the Owner, which has not been remedied or waived, to perform or otherwise comply with the other material terms of the Construction Contract." Like Section 3.1 of the A312 Performance Bond, Section 3.1 of the A313 Warranty Bond is a quasi-condition precedent based upon Section 4, which states, "Failure on the part of the Owner to comply with the notice requirement in Section 3 shall not constitute a failure to comply with a condition precedent to the Surety's obligations, or release the Surety from its obligations, except to the extent the Surety demonstrates actual prejudice." The next condition precedent is the existence of a "Contractor Default," which Section 14.2 defines as follows, "Failure of the Contractor, which has not been remedied or waived, to perform or otherwise to comply with the warranties required under the Construction Contract." The final condition precedent is the two-part requirement that the obligee declare a "Contractor Default" and notifies the surety.

Section 5 of the A313 Warranty Bond sets forth the surety's performance obligation as follows, "When the Owner has satisfied the conditions of Section 3, the Surety shall promptly, under a reservation of rights, and at the Surety's expense, remedy the Contractor's Default. The Surety may, with the consent of the Owner, arrange for the Contractor to remedy the Contractor's Default." Section 7 clarifies that the surety's responsibilities to the obligee are no greater than the principal's responsibilities under the Construction Contract as follows:

> The responsibilities of the Surety to the Owner shall not be greater than those of the Contractor under the Construction Contract, and the responsibilities of the Owner to the Surety shall not be greater than those of the Owner under the

> Construction Contract. The Surety is obligated, without modification or qualification, for the responsibilities of the Contractor for correction of defective work as set forth in the Construction Contract, and additional legal and design professional costs resulting from the Contractor's Default or resulting from the actions or failure to act of the Surety under Section 5.

Notably, Section 2 of the A313 Warranty Bond clarifies that no coverage is afforded for warranties of suppliers and/or manufacturers as follows, "It is understood and agreed that in no event shall the Surety's obligations under this Bond extend to warranties provided by the Contractor's suppliers and manufacturers."

As dictated by the terms discussed above, the surety's performance obligations and/or potential liability under the A313 Warranty Bond necessarily must be read in conjunction with the warranty obligations set forth in the bonded contract. As noted above, pursuant to Article 9.8.4 of the AIA General Conditions, the "[w]arranties required by the Contract Documents shall commence on the date of Substantial Completion of the Work or designated portion thereof unless otherwise provided in the Certificate of Substantial Completion." Article 3.5 of the AIA General Conditions articulates the principal's general warranty obligation as follows:

> The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, materials, or equipment not conforming to these requirements may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the Work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

Article 9.3.3 of the AIA General Conditions also requires the principal to warrant title to all "Work" as follows:

> The Contractor warrants that title to all Work covered by an Application for Payment will pass to the Owner no later than the time of payment. The Contractor further warrants that upon submittal of an Application for Payment all Work for which Certificates for Payment have been previously issued and payments received from the Owner shall, to the best of the Contractor's knowledge, information and belief, be free and clear of liens, claims, security interests or encumbrances in favor of the Contractor, Subcontractors, material suppliers, or other persons or entities making a claim by reason of having provided labor, materials and equipment relating to the Work.

Article 12.2.2.1 of the AIA General Conditions requires the Principal to remedy any defective work discovered within one year of the date of Substantial Completion" as follows:

> In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1, or by terms of an applicable special warranty required by the Contract Documents, any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.

In conclusion, the A313 Warranty Bond guarantees the performance of the principal's warranty obligations during the "Term of this Bond" and subject to the satisfaction of the conditions precedent set forth in Section 3.

IV. SO, WHY EXACTLY DID WE NEED THE A313 WARRANTY BOND?

A question that one of the authors has pondered since 2020, for which no adequate answer has been received, is why exactly did we need the A313 Warranty Bond in the first place if the A312 Performance Bond was intended to guarantee the performance of the principal's warranty obligations? Of course, there could be scenarios in which the A313 Warranty Bond is issued as a "standalone bond" in relation to a construction contract for which no performance bond was required. However, assuming for the sake of argument that the A313 Warranty Bond was intended to be included in the package of AIA documents to be used on a traditional construction project, there would appear to have been no need for the A313 Warranty Bond unless one of these authors has been right all along in his strongly held belief that the A312 Performance Bond was never intended to cover warranty claims and/or any other claims that could arise after the principal substantially performs and/or the bonded project has reached the point of substantial completion.

PANEL 8

UNDERWRITING AND INDEMNITY CONSIDERATIONS-HOW TO SET UP GETTING THE MONEY

Whit Campbell | The Hartford | Kirkland, WA

Kara London | Philadelphia Insurance Companies | Seattle, WA

Edward Rubacha | Jennings Haug Keleher McLeod | Phoenix, AZ

PEARLMAN 2022

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Underwriting and Indemnity Considerations- How to Set up Getting the Money

Edward Rubacha – Jennings Haug Keleher McLeod, LLP
George Crittenden – Liberty Mutual

INTRODUCTION

No one agrees to a new account or agrees to issue the next bond for an existing account with the thoughts that "What if this goes bad? What are my options to recover?" However, underwriters are faced with this consideration every day. The underwriter's analysis of the financials of the new account or of the existing account when the next bond is requested that is critical to the process if the transaction goes bad. Typically, when the principal defaults, the claims agent or attorney must first rely on what the underwriter identified as available assets and then go further, if those assets are insufficient.

In each new account/additional transaction, the underwriter must consider a number of factors. Certainly, the financial/credit position of the principal as well as the financial/credit position of the company's owners both have a bearing on the underwriting decision. Certainly, a quick six month duration project requires less analysis than a contemplated two-year project. Could the principal's or its owners' financial position change in the two years? Could one or more of the experienced owners or a key employee decide to retire or is there an issue with one owner's health?

More broadly, for example, the type of work to be performed: is this something the principal has done numerous times such that the effort is well within her wheel-house? Or is it the first time this principal has done, say, a tribal project? Or could it be the size of the requested bond: three to four times the size of any bond requested previously? The underwriter may look to the bid spread to determine if the principal has missed a critical element in its bid or has applied a Pollyanna approach to its estimating? The cautious underwriter may examine the bond forms being used/requested and/or the form of the contract to be bonded: possibly an A312 bond form, allowing the surety options in the event of default or an onerous public works

bond form that is essentially an indemnity bond? Does the contract contain a large liquidated damages provision?

All of these issues have been the subject of numerous papers and discussions. Here, we will look at these considerations with the question not "Should I issue this bond?" but, rather, "If I issue this bond and the project goes bad, what/how can the claims attorney recover any losses incurred?" Looking at the issues with that question in mind is, in the authors' opinions, a slightly different approach. As noted, it's not a mind-set any underwriter typically employs but this paper will discuss various aspects under that "What if?" scenario.

A. The Most Important Piece of Paper – The General Indemnity Agreement

Given a bond or bonds have been issued, in the event of a default or termination of the principal, besides the terms of the contract and the provisions in the bond, the GIA is the tool the surety will use to support not only a reduction of any possible loss but, also, the means to recover from the principal and indemnitors for any loss incurred. The surety's common law rights of indemnity are a poor substitute for the powerful rights provided the surety by a well-crafted GIA. Those GIA rights often include: (1) the indemnification provision; (2) the collateral deposit provision; (3) the right-to-settle provision; (4) the *prima facie* evidence provision; (5) the assignment provision; (6) right to examine books and records provision; (7) the duty to cooperate provision; and (8) the waiver of homestead provision, to name a few of the more powerful provisions found in most GIAs today.

1. Who's signing?

However, the strength of the GIA language means little if the GIA is not signed, whether at all, or by the wrong person. For example, Arizona, a community property state[1], does not follow the perhaps more familiar tenet of community property law that "either spouse can bind the community." See, e.g., Cal.Fam.Code § 910 (. . .the community estate is liable for a debt incurred by either spouse . . . during marriage, regardless of which spouse has the management and control of the property and

[1] Nine states are "community property" states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. In these states, assets acquired by spouses during their marriage are assets of the community, termed "community property," regardless of who buys it.

regardless of whether one or both spouses are parties to the debt or to a judgment for the debt."); *Lezine v. Sec. Pac. Fin.*, 14 Cal. 4th 56, 72, 925 P.2d 1002, 1011 (1996)(CCP § 695.020 establishes the liability of community real property for the satisfaction of money judgments rendered against either spouse, including the non-debtor spouse's one-half community interest).

Arizona's statutes require <u>both</u> spouses to sign a guaranty or, as more pertinent here, the GIA, to bind the community: "C. Either spouse separately may acquire, manage, control or dispose of community property or bind the community, except that joinder of both spouses is required in any of the following cases: . . . 2. Any transaction of guaranty, indemnity or suretyship." A.R.S. § 25-214. If the wife signs the GIA for the principal company but the husband does not, even if the company is a community asset (shares are held as community property or both are members of an limited liability company), the "community" cannot be held liable under the GIA. The surety could get a judgment against the signing spouse but only against her separate property, if any she has.

Another example is in the tribal context. Although this topic is the subject of numerous papers by one of the authors, in simple terms, any attempt to obtain a waiver of sovereign immunity to allow the enforcement of a GIA against the tribe or tribal principal will fail unless the appropriate person signs the GIA and/or waiver. Under well-known corporate law, an officer or member (perhaps managing member) signing a GIA will bind the entity to the terms thereof. Unfortunately, such well-established law does not apply generally in the context of a waiver of sovereign immunity, which depends on federal law and the underlying tribal law. Numerous decisions have determined that where an officer has signed a contract with a tribal entity yet the officer had no authority, any purported waiver was invalid. See, *e.g.*, *Yavapai-Apache Nation v. Iipay Nation of Santa Ysabel*, 201 Cal. App. 4th 190, 205, 135 Cal.Rptr.3d 42, 53 (2011) (signature of tribal chairman on contract that purportedly waived tribe's sovereign immunity had no legal binding effect unless and until the tribe authorized it); *World Touch Gaming, Inc. v. Massena Mgmt., LLC*, 117 F.Supp.2d 271, 276 (N.D.N.Y.2000) (senior vice president's signature to agreement with express waiver of sovereign immunity provision ineffective when right to waive reserved exclusively to the tribal council).

2. "<u>I didn't sign the GIA." and various other related defenses</u>.

Perhaps one of the most-presented defenses to an action on an indemnity agreement is "That's not my signature." Sloppy practices by agents often lead to unenforceable GIAs years after the fact because the "signed" GIA in the underwriting file was provided by the agent who sent the GIA to the principal and individual indemnitors for signatures. Years later, no witnesses are available to controvert the testimony of indemnitors claiming "That's not my signature." The careful underwriter looking at unwitnessed signatures should not agree to issuance of bonds by an agent unless and until she has notarized or witnessed signatures.

Another classic defense asserted is "I signed the GIA for that (those) bond(s) but not for the subsequent ones." Or "I signed the original GIA but not the subsequent GIA that others signed and the bonds that resulted in losses were covered by the (subsequent) GIA." Most of these cases are decided on summary judgment based on the language of the GIA allowing that losses any bonds issued in reliance on the indemnitors' signatures are recoverable. See, *e.g.*, *Kruse Classic Auction Co., Inc. v. Aetna Cas. & Sur. Co.*, 511 N.E.2d 326, 328 (Ind. Ct. App. 1987) (parties who sign the agreement are bound by it unless it affirmatively appears that they did not intend to be bound unless others also signed; non-signatory parties are not bound); *Vigilant Ins. Co. v. Burnell*, 844 F. Supp. 9, 12 (D. Me. 1994) (question of fact whether novation agreement included GIA signed by indemnitors to apply to new surety); *Transamerica Ins. Co. v. Bloomfield*, 401 F.2d 357, 363 (6th Cir. 1968) (reversing trial court on losses for bonds issued on subsequent GIA); *Developers Sur. & Indem. Co. v. Chrisellie Corp.*, 497 F. Supp. 3d 9, 19–20 (W.D. Pa. 2020) (that indemnitor did not sign a subsequent GIA is not relevant to her ongoing liability under prior GIA where no evidence that any indemnitor to action to modify or revoke their obligations under prior GIA); but see *Sur. Underwriters v. E & C Trucking, Inc.*, 10 P.3d 338, 346 (Utah 2000) (GIA cannot be enforced against indemnitors where surety not authorized to issue bond).

3. "The surety paid claims in bad faith."

There remain a few surety "bad faith" states: Colorado; Arizona[2]; Florida; Montana; Alaska; North Dakota, just to name a few. These states have found bad faith in the surety context on a number of bases: (1) sureties are insurers and are therefore subject to the same remedies as insureds to insurers; (2) suretyship is a form of insurance, thus subjecting sureties to the same obligations and penalties as insurance companies; like insurance companies, sureties have a superior bargaining power in relation to obligees in the creation of the bonds; (4) a "special relationship" exists between a surety and its obligee. Bad faith can be both common law and statutory in these states. Certain states, such as California, that previously imposed bad faith on sureties, have since rejected that application. See, *i.e., Cates Constr., Inc. v. Talbot Partners*, 980 P.2d 407, 412 (Cal.1999). The exploration in-depth of surety bad faith is beyond the scope of this paper and is raised here only because in "bad faith" states, and in other "implied covenant of good faith and fair dealing" states, indemnitors sued under the GIA to reimburse the surety for payments made often assert the surety "is in bad faith" or made payments in bad faith. Most of these instances, however, result in summary judgment for the surety.[3]

Because of the standard clauses in the GIA, including the right to settle, the vast majority of courts hold sureties are entitled to reimbursement from indemnitors. See, *e.g., Fid. & Deposit Co. v. Bristol Steel*, 722 F.2d 1160, 1163 (6th Cir. 1983) (under the letter of the contract, surety had the right to reimbursement for payments made in good faith, whether or not the principal had defaulted and liability existed); *Commercial Ins. Co. of Newark v. Pacific–Peru Constr. Corp.*, 558 F.2d 948, 952 (9th Cir. 1977) (ruling that the argument that surety suffered no actual liability under its bond is no defense to indemnification under express language of surety agreement); *Frontier Ins. Co. v. Int'l Inc.*, 124 F.Supp.2d 1211, 1215 (N.D. Ala. 2000) (holding that a principal's actual liability is not a prerequisite to surety's right to reimbursement under indemnity contract); *United States Fid. & Guar. Co. v. Feibus*, 15 F.Supp.2d 579, 583 (M.D. Pa. 1998) (holding

[2] Arizona has limited surety bad faith in the context of public works bond statutes finding the statutory scheme does not allow an additional cause of action for bad faith. *S&S Paving & Constr., Inc. v. Berkley Reg'l Ins. Co.*, 239 Ariz. 512, 513, 372 P.3d 1036, 1037 (App. 2016) (Arizona's Little Miller Act, A.R.S. § 34-223 neither imposed nor appeared to contemplate any pre-litigation investigative or processing duties on sureties).

[3] The argument that a surety would pay out its own money needlessly because it can just get it back from the indemnitors exhibits the ludicrous basis of such an argument.

that the terms of the indemnity agreement governed and its language "does not require that payments be made only in the face of actual liability under the bonds"); *Gen. Acc. Ins. Co. of Am. v. Merritt-Meridian Constr. Corp.*, 975 F.Supp. 511, 517 n.4 (S.D.N.Y. 1997) (concluding surety had right to indemnification for claims it reasonably determined it was liable for, regardless of actual liability); *Emp'rs Ins. Wausau v. Able Green, Inc.*, 749 F.Supp. 1100, 1102-03 (S.D. Fla. 1990) (explaining "this case involves interpretation of language contained within a General Indemnity Agreement" and finding surety entitled to reimbursement for payments made in good faith, regardless of whether any liability actually existed); *Fireman's Fund Ins. Co. v. Nizdil*, 709 F.Supp. 975, 976-77 (D. Or. 1989) ("Any claim asserted against the surety, regardless if it is valid or outside the scope of the bond triggers the obligation to indemnify the surety."); *U.S. Use Int'l Bhd. Elec. Workers v. United Pac. Ins. Co.*, 697 F.Supp. 378, 381 (D. Id. 1988) (holding that, "upon the express terms of the Agreement, the Indemnitors are liable to indemnify [Surety] no matter what the legal defenses or other avenues of resolution may have been"); *Arch Ins. Co. v. Centerplan Constr. Co., LLC*, 368 F. Supp. 3d 350, 365 (D. Conn. 2019) ("under an indemnity agreement, it is not essential that a principal be liable for the claims upon which the surety seeks to be indemnified"), aff'd, 855 Fed. Appx. 11 (2d Cir. 2021).

Unfortunately, these well-reasoned decisions do not prevent indemnitors from asserting the "bad faith" talisman in the effort to evade responsibility under the GIA and some courts have followed this flawed reasoning. See, *e.g.*, *Associated Indem. Corp. v. CAT Contracting, Inc.*, 964 S.W.2d 276, 286 (Tex. 1998) (where "some" evidence of bad faith, surety denied relief under the indemnity agreement; defining "bad faith" as "'bad faith' means more than merely negligent or unreasonable conduct; it requires proof of an improper motive or willful ignorance of the facts"); *Engbrock v. Fed. Ins. Co.*, 370 F.2d 784, 786 (5th Cir.1967) ("In the face of these provisions, an indemnitor may successfully attack payments made by [the surety] only by pleading and proving fraud or lack of good faith by [the surety]."). Still other courts strain the interpretation to the language in the GIA. See, *e.g.*, *Gulf Ins. Co. v. AMSCO, Inc.*, 153 N.H. 28, 34, 889 A.2d 1040, 1046 (2005) (where the language of the GAI required the indemnitors to indemnify surety only for "reasonable" expenses, and the GAI contained a burden-shifting provision requiring AMSCO to prove that Gulf's claimed expenses were unreasonable; court refused to apply "bad faith" test to surety's expenses). And other courts lessen the "bad faith" test from "dishonest purposes" and "improper motives" to "reasonable

investigation." See, *e.g.*, *City of Portland v. George D. Ward & Associates, Inc.*, 89 Or. App. 452, 750 P.2d 171 (1988) ("to prove lack of good faith of surety in settling claim, principals needed only to prove that surety failed to make reasonable investigation of validity of claims against them or to consider reasonably the viability of their counterclaims and defenses, and not that surety acted for dishonest purposes of proper motives").

As one author summarized "best practices" in this area, the surety should: (1) respond promptly to claims; (2) investigate properly; (3) evaluate independently; (4) obtain competent professionals when necessary; (5) respond promptly to correspondence; (6) respond in writing; (7) keep a log or diary of conversations; (8) thoroughly detail the denial of a bond claim; (9) be accurate; (10) keep it professional; and, finally (11) never threaten. Kingsley, Patrick R., "Bad Faith Claims Against Sureties," Defense Research Institute (2010). To ensure the surety finds the money when paying claims and enduring an obstinate principal and individual indemnitors, the surety should follow these practices, thereby thwarting what sometimes appears to be an "inevitable" assertion of defenses based in bad faith in such states as still recognize that cause of action against sureties.

4. The "Post Collateral" Clause.

One long-established place to find money is the clause in the standard general indemnity agreement that requires the indemnitors to post collateral in the event the surety anticipates a loss. There is no better place to find money to cover a loss than when the surety holds the funds itself. In the past, if the indemnitors failed to provide the funds demanded, the surety could file an action in *quia timet* or simply demand injunctive relief in the form of a court order requiring funds be posted. Unfortunately, the viability of legal recourse given such a clause has been called into question by the courts.

The federal district courts and circuit courts are now split on the surety's rights under the general indemnity agreement to injunctive relief to require indemnitors to post collateral. The district court for the Western District of Arkansas recently surmised as follows: "there are more district courts that come down squarely on the side of granting preliminary injunctive relief in indemnity agreement cases." *Merchants Bonding Co. (Mut.) v. Arkansas Constr. Sols., LLC*, 2019 WL 452767, at *4 (W.D. Ark. Feb. 5, 2019)

(citing numerous district court decisions upholding a surety's right to injunctive relief). However, the following year, the district court for the District of Colorado held:

> Purely economic loss "is usually insufficient to constitute irreparable harm" because economic losses can readily be compensated with monetary damages. *Crowe & Dunlevy, P.C. v. Stidham*, 640 F.3d 1140, 1158 (10th Cir. 2011). Thus, in order to be "irreparable," the harm must be "incapable of being 'adequately atoned for in money'; or of the sort that 'the district court cannot remedy following a final determination on the merits.' " *Hunter v. Hirsig*, 614 F. App'x 960, 962 (10th Cir. 2015) (quoting *Prairie Band of Potawatomi Indians v. Pierce*, 253 F.3d 1234, 1250 (10th Cir. 2001))

Cincinnati Ins. Co. v. Rocky Mountain Water Works, LLC, 2020 WL 978744 (D. Colo. 2020).

The *Rocky Mountain Water Works* court simply followed the controlling Tenth Circuit authority holding economic damages cannot support injunctive relief. The Ninth Circuit also follows this approach. See, *e.g.*, *Cal. Pharmacists Ass'n v. Maxwell–Jolly*, 563 F.3d 847, 852 (9th Cir. 2009) ("Economic damages are not traditionally considered irreparable because the injury can later be remedied by a monetary award."); *Rent–A–Center, Inc. v. Canyon Television & Appliance Rental, Inc.*, 944 F.2d 597, 603 (9th Cir. 1991) (Economic injury alone "does not support a finding of irreparable harm, because such injury can be remedied by a damage award."); accord *Ohio Cas. Ins. Co. v. Campbell's Siding & Windows*, 2015 WL 6758137 (D. Idaho 2015)(surety's demand for TRO requiring collateral be posted was purely economic which did not establish irreparable injury that could not be remedied later).

However, in the most recent decision on this point, the district court for the Middle District of Florida held the surety can obtain a preliminary injunction to force indemnitors to post collateral:

> Courts in the Middle District of Florida, including this one, have recognized that "the nature of the injury in collateral security provision cases is the lack of collateralization while claims are pending, and nothing can remedy that injury after the fact." [citing numerous unreported decisions] Here, PIIC incurred expenses in connection with the bonds,

paid a claim, and faces the prospect of future claims, so the asserted "harm is not remote or speculative." *Frankenmuth Mut. Ins. Co. v. Pac. Comm., Inc.*, No. 1:20-cv-24064, 2021 WL 1204975, at *6 (S.D. Fla. March 19, 2021) (finding irreparable harm where defendants "dissipated" and transferred assets"; "numerous creditors were pursuing legal claims against the assets remaining"; and the surety submitted "concrete evidence of actual losses incurred" and faced continued "exposure[ ]").

Philadelphia Indem. Ins. Co. v. Quinco Elec., Inc., 2022 WL 1230110 (M.D.Fla. 2022).

Certain state courts are also willing to grant such an injunction. See, *e.g.*, *Bond Safeguard Ins. Co. v. Dixon Builders I, L.L.C.*, 2012WL2988790 (Ohio-App. 2012) (trial court's grant of injunctive relief to surety preserved the status quo pending final adjudication of the case on the merits consistent with the purpose of a preliminary injunction). However, other states are not so inclined. See, *e.g.*, *31 Holdings I, LLC v. Argonaut Ins. Co.*, 640 S.W.3d 915, 929 (Tex.App. 2022) (reversing portion of trial court's temporary injunction order requiring appellants "to deposit or direct $3,630,500.00 as collateral.")

Faced with a court that does not grant preliminary injunctions to enforce the collateral clause because the potential damages are solely economic, the surety, once a loss is established, can move for summary judgment/partial summary judgment for specific performance. See, *e.g.*, *RLI Ins. Co. v. Nexus Services, Inc.*, 26 F.4th 133, 146 (4th Cir. 2022) (affirming district court's order granting summary judgment to surety requiring indemnitor to deposit $2.4 million in collateral). Additionally, the surety can, in most courts, still request injunctive relief to prevent the sale and/or distribution of hard assets, such as equipment, which otherwise could be sold for cash and the new owners reluctant to recognize any right of the surety to such assets.

B. Trust Assets[4]

Often the principal and/or indemnitors have placed assets into trust or, invariably, place assets previously not in a trust into one recently formed before the default or, finally, just before the default occurs with the understanding that things are

[4] Thank you to Marc Brown for the basics of this section.

going bad and he/she heard from some attorney back when that trusts are formed to protect assets from third-party creditors.

Certainly, trusts can be formed as part of succession planning, estate planning, and, as noted, asset protection. Although there are many types of trusts, most underwriters and claims attorneys deal with only two types: Revocable and Irrevocable. Revocable trusts can be changed during the lifetime of the beneficiaries and most have the beneficiaries as the trustees. Revocable trusts can have some protection against creditors and the underwriter should take this into account when dealing with indemnitors that have such and assets placed therein.

An irrevocable trust is somewhat the opposite. Once established, the rules governing the irrevocable trust are not readily changed. Often the trustees are separated from the beneficiaries. The benefit of this type of trust is that it often provides strong protection against creditors.

Trusts can be a valuable benefit in the underwriting process as repositories of assets. Trusts can be used to avoid probate, receive life insurance proceeds and/or assets to ensure the continuity of the principal, and to protect those assets from other creditors. However, to ensure availability to the surety for salvage, as a source of recovery, the underwriter must determine whether the trust involved can agree to indemnify the surety in case of loss. The resolution of this question depends on how the trust was set up initially. The underwriter should require a copy of all trust documents be provided to determine whether the trust can be an indemnitor.

Because each indemnitor is expected to make his/her assets available to indemnify the surety in case of a loss, assets placed in trust are presumably part of such assets. However, individual indemnitors may balk at providing their respective trusts as part of the required indemnity. An unwillingness to include trust assets for indemnity can signal a potential reluctance to reimburse the surety in the event of a loss. Certainly, in the case of trust set up for estate purposes, the indemnitors may be looking to protect assets for their minor children, a worthwhile endeavor. However, such assets should be free and clear and not necessary to establish a surety line of credit.

It could be that a trust has sufficient assets to support the surety line of credit with less than all of the assets under trust. In that case, the trust can be a limited indemnitor to a designated amount. But such a prospect is unavailable unless the trust at issue can be an indemnitor. If the trust is structured in a way that it cannot agree to indemnify the surety, no limitation is possible. For example, if the indemnitor is the settlor (the one who set up the trust for the beneficiaries) of an irrevocable family trust, execution of an indemnity agreement by the settlor making the trust an indemnitor may be subject to attack by the beneficiaries as contrary to the purpose of the trust.

As noted, the underwriter should review the trust document itself to make the determination as to whether the trust is available as an indemnitor. For example, many so-called "spendthrift trusts," which are trusts formed to protect the named beneficiaries, while containing assets that could be available in case of a loss are specifically governed to prevent such use. Because statutes and case law varies widely amongst the states, meaningful analysis of the availability of trusts ion the event of a loss can be prohibitive. Similarly, foreign asset protection trusts (FAPTs), trusts established in foreign offshore jurisdictions to avoid reach of creditors such as in Anguilla, the Bahamas, Turks and Caicos Islands, etc. are presumably unavailable to the surety. Execution against a FAPT is near impossible and prohibitively costly.

Business Trusts (a/k/a Unincorporated Business Organization "UBOs" or Massachusetts Trust) have been used in the past for construction firms. These trusts function like a traditional corporation but with limited liability to trustees and beneficiaries. Under such a trust, the beneficiaries are considered "investors" who hold transferable "trust certificates" much like shares. If structured properly, UBO's avoid double taxation on profits to the corporation and the shareholders. But the beneficiaries have no management authority, or otherwise deemed to be a partnership. Obtaining indemnity from such trusts can be difficult.

If a trust is revocable/amendable and the trust document(s) do not clearly authorize the trustee to bind the trust to an indemnity agreement, request an amendment to the Trust that clearly allows the trust to execute an indemnity agreement and specifically identifies the trustees' authority to execute the indemnity agreement on behalf of the trust. If a trust is irrevocable, and the trust documents do not clearly grant the trustee authority to bind the trust to an indemnity agreement, the trust may not be a

candidate as an indemnitor. In such a situation, ensure sufficient available assets otherwise and presume the assets in the trust will be unavailable to the surety.

In summary, while any particular trust may be a source of recovery for the surety, a place to "find the money," at the end of the day, ensuring that the trust has the assets reported and determining whether any particular trust can be an indemnitor can be problematic. Require current valuations, financial statements, tax returns, bank/investment statements, appraisals, etc. for the trust. Determine the proper signatories to allow the trust to be an indemnitor and ensure each required signature is obtained and witnessed by a notary or independent witness.

C. The March of the Advancing Homestead Exemption

Most likely the indemnitors' single largest asset, other than the principal itself, is their house and surrounding property. With the once again almost unstoppable increase in property values, the indemnitors' property looks to be a significant piece in the indemnity puzzle. However, homestead exemptions can thwart recovery in the event of a loss or a bankruptcy.

Homestead exemptions vary significantly by state. In summary, certain states allow the indemnitor to protect up to one hundred percent of the value of the homestead. Some states allow married couples to double that protection. Some states, however, still require the indemnitor to file a declaration of homestead before exempting the property, Some states require the property owner to follow the state homestead rules while others allow a choice between state and federal homestead exemptions. Below is a recent compilation of each state's homestead exemption amount and the amount for married couples/joint owners (if applicable).

State	Homestead Exemption	Married Couples / Joint Owners
New Jersey	No "state" exemption but can use federal exemption in BK	
Pennsylvania	[same]	
Kentucky	$5,000	
Tennessee	$5,000	$7,500
Virginia	$5,000	$10,000
Alabama	$15,000	$30,000

State	Homestead Exemption	Married Couples / Joint Owners
Illinois	$15,000	$30,000
Missouri	$15,000	
Indiana	$19,300	$38,600
Hawaii	$20,000	
Utah	$20,000	$40,000
Wyoming	$20,000	$40,000
Georgia	$21,500	$43,000
Maryland	$22,975	
W. Virginia	$25,000	$50,000
Michigan	$30,000	
Louisiana	$35,000	
No. Carolina	$35,000	$70,000
Oregon	$40,000	
Maine	$47,500	
So. Carolina	$58,255	$116,510
Nebraska	$60,000	
New Mexico	$60,000	$120,000
Alaska	$72,900	
Colorado	$75,000	$150,000
Connecticut	$75,000	$150,000
Mississippi	$75,000	
Wisconsin	$75,000	$150,000
Idaho	$100,000	
New Hampshire	$100,000	
North Dakota	$100,000	
Delaware	$125,000	
Vermont	$125,000	$250,000
Washington	$125,000	
Ohio	$136,925	
Arizona	$150,000	
New York	$165,550	$331,100
Montana	$250,000	
Minnesota	$390,000	
Massachusetts	$500,000	

State	Homestead Exemption	Married Couples / Joint Owners
Rhode Island	$500,000	
Nevada	$550,000	
California	$300,000 to $600,000 (depending on surrounding property values)	
Arkansas	Unlimited	
Florida	Unlimited	
Iowa	Unlimited	
Kansas	Unlimited	
Oklahoma	Unlimited	
So. Dakota	Unlimited	
Texas	Unlimited	

However, before relying on the above amounts, some states appear to be in a race to provide larger and larger homestead exemptions. For example, the Arizona legislature has elected to increase the homestead exemption from $150,000.00 to $250,000.00 effective January 1, 2022, with discussions of raising the amounts even more in the next legislative year.

Many agreements of indemnity contain the "homestead waiver" clause, which purports to act as an up-front waiver of the homestead. Unfortunately, as with the homestead exemption amount, the validity of such clauses varies. For example, in Kansas, such clauses are void. An "agreement to waive the benefit of the homestead exemption allowed them by the Constitution of Kansas, in the executory agreement here under consideration, is contrary to the public policy of this state and of no effect." *Iowa Mut. Ins. Co. v. Parr*, 189 Kan. 475, 481, 370 P.2d 400, 404 (1962); see also *Fid. & Deposit Co. of Maryland v. M. Hanna Constr. Co., Inc.*, 2015 WL 632047 (E.D.Tex. 2015)(homestead waiver language in Agreement of Indemnity in Texas is void as a matter of law) and *Transamerica Ins. Co. v. Avenell*, 66 F.3d 715, 722 (5th Cir. 1995)("the invalidities clause severs the homestead waiver provision from the Indemnity Agreement: No lien is created against the Avenells' homestead, but neither is the entire agreement invalidated by its presence.") and see C.C.P. § 703.040, "Prior waivers void" which reads, in part "[a] purported contractual or other prior waiver of the exemptions provided by this chapter or by any other statute, other than a waiver by failure to claim an exemption required to be claimed or otherwise made at the time enforcement is sought, is against public policy and void." Of course, a number of states allow the

operation of the "homestead waiver" clause. See, *e.g.*, *Rogers v. Great American Federal Sav. and Loan Ass'n*, 801 S.W.2d 36, 38 (Ark. 1990) ("This court has recognized waivers or releases of homestead rights for many years.") accord *RLI Ins. Co. v. Samco Constructions Co., Inc.*, 2015 WL 12684336, at *2 (E.D.Ark. 2015)(party can waive his or her homestead rights)

Further complicating the homestead laws are statutes and court cases that prevent the sale or execution on the property protected by the homestead. For example, prior to the recent Arizona Supreme Court decision in *In re McLauchlan*, 252 Ariz. 324, 502 P.3d 975 (2022), the Arizona Court of Appeals had held that the statutory homestead exemption prevented a judgment lien from attaching to home, or to proceeds of a short sale of a home. *Pac. W. Bank v. Castleton*, 246 Ariz. 108, 434 P.3d 1187 (App. 2018). This holding allowed numerous debtors with excess equity in their homes to stop any execution even though they had more than the debt plus their homestead.

In *McLauchlan*, the Arizona Supreme Court answered a question certified to it by the bankruptcy court as to whether a recorded judgment created a lien against a debtor's home (which had significant equity above the $150,000 homestead). Under the pre-2022 version of the statutes, some bankruptcy court judges and the *Castleton* decision held that recording a judgment created no lien against property which ultimately was identified as a person's homestead – allowing a $1 million free and clear home to be sold or refinanced without addressing a judgment creditor's lien. The *McLauchlan* decision explained the reasoning as follows:

> We agree with PWB that the plain language of the statutes encompasses judgment liens that may be applied against property sale proceeds in excess of the homestead exemption. Adding the prefatory language to § 33-964(B) (2007) clearly effected a substantive change in the law, creating an exception that did not previously exist to an otherwise generally applicable law. Within that exception, § 33-1103(A)(4) (2007) speaks precisely to the application of a judgment lien to proceeds in excess of the homestead exemption.
>
> * * *

> [W]e also disapprove similar verbiage in *Pacific Western Bank v. Castleton*, 246 Ariz. 108, 110–11 ¶¶ 11–14 (App. 2018), which relied largely on In re *Rand*.
>
> * * *
>
> McLauchlan's argument that the statutes shield his property from a judgment lien would effectively increase the amount of the homestead exemption to include surplus revenues from a voluntary sale above $150,000. As noted previously, *see supra* ¶ 7, § 33-1101 clearly limits the benefit to a single homestead exemption not exceeding $150,000 per person or married couple. Were we to allow McLauchlan to shield such proceeds against a judgment lien, it would create a windfall inconsistent with the statutory scheme.

In re McLauchlan, 502 P.3d at 978.

Each state varies, of course, in how it provides an amount for the homestead exemption and how judgment creditors must act to enforce a judgment despite the homestead. An indemnitor who present a house valued well in excess of any deeds of trust or mortgage against it does not necessarily provide a pot of gold at the end of the indemnity rainbow. The vagaries of state law must be researched before relying on equity in the residential property.

CONCLUSION

Thinking through the availability of assets after a loss versus simply compiling a list of assets to determine whether an account should be opened or a bond issued makes sense in today's underwriting process. Finding the money after a loss is incurred can be more difficult than placing it on a list of assets during the underwriting process. Perhaps putting such a negative outlook on a what should be positive outlook of a relationship with potential years of revenue in premiums earned will be met with concern. But from the claims perspective, and the experience of assets that have disappeared or have been transferred into trusts, of whatever kind, such a mind set only makes sense.

PANEL 9

THE BANKRUPTCY DATING GAME: WHAT HAPPENS WHEN A PRINCIPAL FILES FOR CHAPTER 11 BANKRUPTCY PROTECTION

Marguerite DeVoll | Watt, Tieder, Hoffar & Fitzgerald | McLean, VA

Paul Harmon | Travelers | Federal Way, WA

Bryce Holzer | Travelers | Federal Way, WA

Jennifer Kneeland | Watt, Tieder, Hoffar & Fitzgerald | McLean, VA

Sonia Linnaus | Liberty Mutual Surety | Orange, CA

PEARLMAN 2022

September 8-9, 2022

Sparkman Cellars Winery | Woodinville, WA

THE BANKRUPTCY DATING GAME:

WHAT HAPPENS WHEN A PRINCIPAL FILES FOR CHAPTER 11 BANKRUPTCY PROTECTION

Pearlman Conference September, 2022

Jennifer L. Kneeland | Watt, Tieder, Hoffar & Fitzgerald, LLP | McLean, VA

Marguerite Lee DeVoll | Watt, Tieder, Hoffar & Fitzgerald, LLP | McLean, VA

Paul Harmon | Travelers | Federal Way, WA

Bryce Holzer | Travelers | Federal Way, WA

Sonia Linnaus | Liberty Mutual | Orange, CA

The Bankruptcy Dating Game: What Happens When a Principal Files for Chapter 11 Bankruptcy Protection

Overview:

Presented in a skit format, "The Bankruptcy Dating Game: What Happens When a Principal Files for Chapter 11 Bankruptcy Protection" examines the impact on a surety's rights when one of its principals in the construction industry files for chapter 11 bankruptcy protection under 11 U.S.C. §§ 101, *et seq.* (the "Bankruptcy Code"). The skit focuses on a scenario where the debtor-principal decides to sell its assets during the course of the chapter 11 bankruptcy case through one of three methods under the Bankruptcy Code: (1) a sale of select assets under 11 U.S.C. § 363; (2) a sale of assets through the debtor's chapter 11 plan of reorganization; and (3) a sale of substantially all of the debtor's assets under 11 U.S.C. § 363.[1]

Among other issues that will be covered, the panelists/contestants will speak about the following issues:

1. Wrapping-Up Bonded Projects – How the Three Different Sale Options Affect Rights and Timing (pp. 4-5)
2. A Primer on Assumption and Assignment Rights under 11 U.S.C. § 365 of the Bankruptcy Code (pp. 5-6)
    a. What does it mean to invoke the right to cure under section 365 of the Bankruptcy Code?

       "If there has been a default in an executory contract … the trustee [debtor] may not assume such contract … unless, at the time of assumption of such contract …, the trustee [debtor] – (A) cures, or provides adequate assurance that the trustee [debtor] will promptly cure, such default …." 11 U.S.C. § 365(b)(1)(A).

    b. What does it mean to insist on adequate assurances of future performance under section 365 of the Bankruptcy Code?

       "If there has been a default in an executory contract … the trustee [debtor] may not assume such contract … unless, at the time of assumption of such contract …, the trustee [debtor] – (C) provides adequate assurance of future performance under such contract …." 11 U.S.C. § 365(b)(1)(C).

[1] Although the facts for this skit involve payment and performance bonds in the construction industry, many of the issues raised throughout the skit also are issues that may come up on other types of commercial and contract bonds when a principal files for bankruptcy protection.

c. How can a surety invoke these rights during the course of a chapter 11 bankruptcy case?

3. Exercising Rights of Equitable Subrogation and Surety Experiences When Protecting Contract Balances (pp. 6-9)

   a. How has the U.S. Supreme Court's pivotal holding in *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962) – that a surety's rights of equitable subrogation effectively act to keep contract funds from becoming estate property – developed?

   b. How does the right of equitable subrogation play-out when there are competing claimants (*e.g.*, a bank and a surety) to the same funds?

   c. How does the right of equitable subrogation interact with additional rights of assignment to allow sureties to offset contract funds from one project against another project?

4. A Surety's "Collateral Security" Rights and How Those Interact with the Bankruptcy Code: Surety Experiences When Holding Security and Perfected Lien Rights in Bankruptcy (pp. 10-11)

   a. Holding "collateral security" and titling issues – how words have different meaning in bankruptcy versus outside of bankruptcy.

   b. Types of collateral and perfection under Article 9 of the Uniform Commercial Code.

   c. Impact of Having a Security Interest on Debtor's Efforts to Sell Assets – A Primer on Section 363(f) and the Requirements for Debtor Obtaining Bankruptcy Court Approval to Sell its Assets Free and Clear of Security Interests, Liens, and other Encumbrances.

   d. Asserting the Surety's Claim in Bankruptcy Through the Claims Process

      i. Timing requirements (Fed. R. Bankr. P. 3002 and 3003; 11 U.S.C. § 502(b)(9));

      ii. Amount and Claims Estimation (11 U.SC. § 502(c));

      iii. Types of Claims (Secured, Unsecured, Priority, and Administrative);

      iv. How Much Detail Should be Included - No need to say more than necessary. *In re Falcon V, L.L.C.,* 620 B.R. 256 (Bankr. M.D. La. 2020), aff'd, 2021 WL 4486336 (M.D. La. Sept. 30, 2021), aff'd, -- F.4th --, 2022 WL 3274174 (5th Cir. Aug. 11, 2022).

September 2022 Pearlman Conference
THE BANKRUTPCY DATING GAME

This skit is a one-act play (of sorts). It requires 1 host and four volunteers. First, volunteer 1, the "contestant," SVP of Claims at EZ Pay Insurance Co. of America, Inc., must choose among three bankruptcy options. The contestant will be played by Paul Harmon. Next, volunteers 2, 3 and 4 will each play one of the three bankruptcy options described below.

The skit is designed to teach the differences between the 3 different ways that a debtor can sell assets in a chapter 11 bankruptcy and the impact of each sale on the surety's rights. The 3 different ways to sell property in this skit are: (1) section 363 sale of select assets; (2) a reorganization plan; and (3) a sale of substantially all assets.

The play takes place at EZ Pay Insurance Company of America, Inc. ("EZ Pay"). The "contestant" Sam Smith is an EVP of Claims with EZ Pay. Sam Smith wants to make the best choices possible to protect EZ Pay's interests.

EZ Pay has a customer that has gone into bankruptcy. EZ Pay's customer is called "Curtains." Curtains fabricates and installs curtain wall systems and utilizes a proprietary, one-of-a-kind method to perform its work. In fact, Curtains' work is so unique that it owns a U.S. Patent for the way that it fabricates and installs its curtain wall systems.

INTRODUCTION AND ANNOUNCEMENTS – (Host). Host will explain to the audience how the dating game will work.

Host – Well, folks, we hope that tonight's show is a real treat for the PEARLMAN CONFERENCE viewers. In honor of the close of another care-free and fun summer marked by the passing of the Labor Day Holiday this past Monday, we welcome you to the Insolvency Dating Game Show, guaranteed not to bankrupt your heart! <Host cheesy chuckles for effect>

For the best viewing experience possible, we ask that everyone have their cell phones handy as each of you will have a say in which of our insolvency options our contestant gets to choose today. At the end of the skit, you will be able to use your phone to scan a QR code and vote on which of the options you think Sam Smith should choose. The screen will show us the percentage of votes for each of the three options. The choice with the most votes WINS! Don't worry – your votes will remain anonymous!

Finally, we'll be asking audience members to take a stab at some Dating Game trivia questions along the way. You will also be able to use the same QR code to send in your answers and the percentage of votes for each of the choices will also appear on the screen.

To warm up and make sure that our voting system is working today, let's try a little Dating Game trivia.

First trivia question:

Which of these people appeared as one of the three dating contestants on the show and filed for bankruptcy protection:

A. Wayne Newton

B. Michael Jackson

C. Burt Reynolds

D. MC Hammer

E. Robert Downey, Jr.

(Audience members will be able to scan a QR code with their phones to select the answer that they believe is correct, which will then appear on screen.)

Host - I'm glad that our voting system is working.

Now, let's move on to the show.

Contestant – Played by Paul Harmon

Contestant EZ Pay Surety – Hello, my name is Paul Harmon. I am a Senior Claims Counsel at Travelers. Today, however, I am playing the role of Sam Smith, SVP of Claims at EZ Pay Insurance Co. of America, Inc. EZ Pay, as *everyone* knows is the top-notch, go-to surety for all your construction bonding needs. Some days I feel like the Maytag Repair Man. Our customers are, by and large, rock solid, and I rarely have to deal with insolvency issues and claims related to our principals. Today, however, is a different day.

I was just informed that one of EZ Pay's top tier customers, Curtains, filed a chapter 11 bankruptcy case.

Our customer, "Curtains," fabricates and installs curtain wall systems and utilizes a proprietary, one-of-a-kind method to perform its work. In fact, Curtains owns a U.S. Patent for the way that it fabricates its curtain wall systems.

EZ Pay issued bonds to two different obligees. First, we issued a payment bond and a performance bond in favor of obligee, the Port Authority of New York and New Jersey, on a curtain wall job at La Guardia Airport. The total penal sum on the La Guardia job is $5 million. This job is 85% done but there are some problems with payment to various subs on the job. Over the past 6 months I have received $800,000 in payment bond claims. I continue to investigate $500,000 worth of claims and EZ Pay has paid $300,000 in claims. The obligee, the Port Authority, however, seems happy with the work that Curtains has performed thus far.

We also issued a payment bond and a performance bond in favor of obligee, Crystal Towers. The Crystal Towers job is huge and the two bonds have a collective penal sum of $40 million. Curtains entered into a contract with Crystal Towers to fabricate and install curtain window systems in its entire 30-floor high-rise building that is under construction in San Francisco. The product is currently being fabricated by Curtains' sub, Glassworks GmbH, located in Hamburg, Germany. When the fabrication is complete, Glassworks GmbH, is supposed to ship the product to San Francisco where Curtains is to retrieve the materials and oversee installation.

When I received the claims on the La Guardia job, I secured a lien against Curtains' patent and EZ Pay is holding $500,000 in cash as collateral-security.

It seems that Curtains filed a chapter 11 case three weeks ago. I wish I had been informed sooner! Curtain's' main bankruptcy objective is to sell substantially of its business to someone else. I am trying to decide which method of selling assets in bankruptcy is best for EZ Pay. Given that we have such strong leverage – a lien against Curtains' patent and a half million dollars in the bank account, I think that I can sway Curtains to do the right thing…if only I knew what the right thing was….

HOST -– Well, Mr. Smith, it certainly seems as if EZ Pay is in a bit of a pickle. The good news is that we have three guests with us tonight who can help to explain a few options to you.

INTRODUCTION OF THE THREE DATING GAME GUESTS

Guest number 1/Bankruptcy Code Section 363 Sale of Select Assets – Hello, my name is Paul Grego. I am a Senior Claims Professional at Zurich. Today, however, I am playing the role of Bankruptcy Code section 363 sale of just a few of Curtains' assets followed by a reorganization.

A section 363 sale allows a debtor to sell its assets free and clear of liens, claims and encumbrances. I can be used to allow Curtains to sell some of its assets to raise money for its reorganization and reemergence from bankruptcy.

Guest number 2/Classic Reorg. – Hello, my name is Sonia Linnaus. I am Surety Claims Counsel at Liberty. Today, however, I am playing the role of Classic Reorg. I'm pretty flexible. My record time toward confirmation of a plan in Classic Reorg. was in the recently filed Belk Department Store bankruptcy. Belk was in and out in the same day. If all the creditors are on the same page, I can be the perfect match. I can also move slowly. After all, the Bankruptcy Code gives Curtains the exclusive right to file a plan for the first 120 days of its case. And, this 120-day period can be extended up to 18 months after the chapter 11 petition date for "good cause." (Guest number 2 air quotes good cause for comedic effect and says, which could mean just about anything….)

Guest number 3/ Sale of Substantially All Assets – Hello, my name is Marguerite Lee DeVoll. I am a Partner at Watt, Tieder, Hoffar & Fitzgerald. Today, however, I am playing the role of a Bankruptcy Code Section 363 Sale of Substantially All of Curtains' Assets. People often call me

Chapter 11 gone wrong, and I come with a twist that can sometimes be positive and sometimes be negative. A liquidating agent, plan trustee or chapter 7 trustee is usually placed in charge to liquidate assets, pursue claims, and make payments to creditors after the Section 363 Sale of all Assets is complete.

Question 1 - Host – OK contestants, the first question that we have for each of you is -- which one of you is going to give EZ Pay clarity about how its bonded jobs are going to get wrapped up the fastest and is there a tradeoff that EZ Pay will have to sacrifice for speed?

Guest 1/363 Sale (Piecemeal Sales) - I am 363 Sale, you need something to happen right away, I'm the answer. Sales happen quick in the bankruptcy court. And tradeoffs? Well, I'm sure EZ Pay won't care about the La Guardia Airport and Crystal Towers contracts being sold to various different third parties. After all, I'm sure whatever buyers choose to take over these contracts would finish the work and pay all outstanding bills on the job, right?

Contestant/EZ Pay – Hold on there. I am not cool with Newco performing on a job that EZ Pay bonded with Curtains, let alone the possibility of various Newcos taking over the jobs. EZ Pay would have no one to look to for indemnity.

Guest 1/363 Sale (Piecemeal Sales) – I understand where you're coming from EZ Pay. Just make sure that your obligees insist that all contract defaults are cured and that they receive adequate assurance of future performance from the buyers. Many sureties have taken the position that "adequate assurance of future performance" means that the buyer satisfy the condition in the contract that it post a new bond in favor of the obligee.

And, even if one of your bonded jobs gets assigned (with or without replacement bonding), at least it's just one job, right? Maybe all Curtains needs is a little gas in the tank to fund its reorganization and turnaround.

Guest 2/Classic Reorg- Good evening, I am Classic Reorganization, and let me tell you what 363 doesn't want you to know: 363's haste might result in waste! I'm the Classic Cola of bankruptcy. The original. I am a planner, versatile, and a multi-tasker. I can give you an *a la carte* plan that either makes cash payments to creditors, or sells some of Curtains' assets to fund the plan payments, or transfer some of Curtains' assets to particular creditors as payments of their debts, or *a prix* fix all-inclusive plan of reorganization that combines any or all of these.

Contestant/EZ Pay - That's all well and good Classic Reorg and that sure sounds fancy, but how soon will EZ Pay be informed of whether Curtains is going to keep performing on the La Guardia Airport and Crystal Towers jobs? If the work stops, EZ Pay wants to be prepared to act fast in order to minimize loss. Right now, my focus is on what is going to happen to those bonded contracts.

Guest 2/Classic Reorg - Oh, EZ Pay [sighs] Curtains will tell you what's going to happen with your bonded job when it feels like it. The best you can do is file a motion with the bankruptcy court for a date certain as to when the bonded contract will be assumed or assigned. Your obligee has got some power though, maybe you can get your obligee to file a motion for relief from the stay and

to compel rejection of the contract. You could step in your obligee's shoes too, of course. Bankruptcy courts tends to be deferential to debtors so if Curtains says that it's not quite "curtains" on your bonded jobs, you will probably have to sit on the sidelines and wait.

And, hey, remember, if Curtains rejects your bonded contract, you can pretty much bet that the mess will be placed at EZ Pay's feet to clean up. Are you sure you want to assure yourself of that result? Why not give Curtains a fighting chance to turn itself around?

Guest 3/Sale of Substantially All Assets - Hi EZ Pay – who knows, maybe I'm the best of your bad options? Just like Contestant 1 (Piecemeal Bankruptcy Sales), a sale of substantially all of Curtains' assets can move along quickly. This is a heck of a lot better than Classic Reorg. Who knows when things are going to happen under that option, Class Reorgs. can be like the slow boat to nowhere. I, on the other hand, can move quickly and all of Curtains' assets would be sold to one buyer. In order for Curtains' contracts to be transferred, the purchaser has to (i) cure all defaults under the contracts, and (ii) provide adequate assurance of future performance to the obligees. You can get your obligees to step forward and assert their rights under the Bankruptcy Code to receive cure of contract defaults and adequate assurance of performance.

Contestant/EZ Pay – Isn't this the same rule that Guest 1 (Piecemeal Sales) explained to me? How is a sale of substantially all of Curtains' assets different?

Guest 3/Sale of Substantially All Assets - Well, since you would only be dealing with one buyer, the compounding impact of all of EZ Pay's obligees asserting rights to cure and adequate assurances has a greater impact before the Bankruptcy Court. The chances of forcing replacement bonding and receiving adequate assurances are increased.

*******BREAK FROM SKIT TO DISCUSS THE BANKRUTPCY LAW AND TALK WITH PANELISTS ABOUT SURETY PREFERENCES AMONG THESE OPTIONS WHEN A PRINCIPAL FILES FOR BANKRUTPCY AND THE SURETY MUST PREPARE TO POSSIBLY BE A PERFORMING SURETY*********

- Quick primer on what the words *assumption* and *assignment* mean in bankruptcy.
- Debtors often forget about bonds that are associated with estate assets, going-concern businesses, etc. It requires a surety to be vigilant because it can lead a surety with duties to an obligee but no real principal or indemnitors look to for indemnification.
- The Bankruptcy Code gives two very important rights to all contract parties whose contract is subject to assumption and assignment that the surety can use to protect itself if it looks like it might need to be a performing surety. The first right is called the right to cure. Right to cure means that a contract counter-party – here the bond obligee/project owner – has the right to step-up and let the debtor and the court know about pre- and post-petition defaults under the contract. The debtor and, if the contract is being sold, the purchaser have to explain how these defaults will be cured in order to allow the assumption and assignment to go forward.

- The second right is called adequate assurances. All obligees whose contract is being assumed and assigned have a right to require adequate assurances from the party to whom assignment is proposed that they have the wherewithal to perform. This means enforcing the terms of their contract. In contract surety, the contract requires bonding. The proposed assignee must get bonding to replace the existing surety's bonds.
- The surety should insist that the obligee assert the right to require curing of contract defaults and the right to receive adequate assurances. One way to do this is by sending a letter explaining that the obligee is at a crossroads. Either the obligee can sit on these rights (to demand cure and adequate assurance), allow the assumption, waive its rights to be made whole for defaults or the right to require bonding of its contract, and risk impairment of suretyship. Or the obligee can enforce their rights and insist on cure of defaults and adequate assurances.

****

Question 2 Host – What a set of Hobson's choices. I'm not sure if any of our guests presents a clear-cut winner. Let's try a different question that gets to the heart of another issue. What about remaining contract balances on the La Guardia Airport and Crystal Towers jobs? Will the surety's equitable subrogation rights to those contract balances be recognized by the bankruptcy court? And, which one of you three contestants offers EZ Pay the cleanest path toward successfully exercising its equitable subrogation rights?

Guest 1/363 Sales (Piecemeal Sales) -Oh, you can bet that what my piecemeal buyers are looking for when they make their bids is the contract balance. What other reason would a buyer make a play for purchasing a contract? This is the case for piecemeal sales and for my colleague, Guest 3, the substantially all assets sale.

EZ Pay may prefer me, though. I heard EZ Pay say that it has paid on payment bond claims, and it has even more under investigation. Its rights of equitable subrogation are clearly triggered in the La Guardia Airport job and EZ Pay should take steps to protect its rights by filing an objection to the sale on the basis that the contract balance is dedicated to the surety to the extent of its performance.

With respect to the Crystal Towers job, there has been no default. Crystal Towers should insist (or the surety can insist through its obligee) that the buyer provide adequate assurance of future performance. The buyer should show that it has the financial wherewithal to perform the job. A good step toward providing satisfactory assurances would be for the buyer to seek assumption and assignment of Curtains' subcontract with Glassworks GmbH and demonstrate that it can pay for the fabrication and shipment of the glass curtain systems.

In both sales, La Guardia (if it is successful) and Crystal Towers, EZ Pay will need language in the sale order that the sale does not impair, affect, or limit the surety's rights in any manner whatsoever.

Guest 2/Classic Reorg – The bright spot that I bring to the table is that there will be plenty of time for EZ Pay to work through equitable subrogation arguments. And, hey, my objective is to keep Curtains in business, just slimmed down and ready to tackle its work with less debt. A healthy Curtains that stays in performance and pays its creditors is always in EZ Pay's best interests.

Contestant/EZ Pay – That all sounds well and good Classic Reorg. but what if Curtains does not agree that its contract balances are not part of the bankruptcy estate to the extent that EZ Pay experiences losses?

Guest 2/Classic Reorg – Well, EZ Pay, if we get into a disagreement about the character of my contract balances, you will need to get yourself a declaratory judgment that the funds are not property of Curtains' bankruptcy estate.

Contestant/EZ Pay – Sounds expensive…and time consuming.

Guest 2/Classic Reorg - Oh yes…it is…and the cards are sometimes stacked in my favor. Bankruptcy courts are courts of equity that often do not understand principles of equitable subrogation. After all, the idea of bankruptcy is to expand the estate to maximize payment to creditors, not take assets out of the estate. There have been some helpful cases decided by Bankruptcy Courts that accurately explain and uphold the principles of the U.S. Supreme Court's Pearlman decision, though.

Guest 3/Sale of Substantially All Assets - Despite Piecemeal's efforts to undermine my great looks and wonderful personality, I may still have something to offer EZ Pay though. At least one case out of the Eastern District of Virginia allowed a surety to offset losses from one project with the contract balance from another project.

The surety had two separate obligees. The court looked at both the rights of equitable subrogation and *Pearlman*'s progeny, as well as the rights under the surety's indemnity agreement, and allowed the surety to use the contract balance from one project where there were no losses to reduce the losses on the other project.

With a single buyer of EZ Pay's assets, the surety may be able to take Piecemeal's approach and sprinkle it with negotiations with the buyer to carve-out the contract balances on all projects up to EZ Pay's performance. It would save the buyer from having to come out of pocket themselves to resolve defaults on the project.

**********BREAK FROM SKIT TO DISCUSS THE BANKRUTPCY LAW AND TALK WITH PANELISTS ABOUT SURETY EXPERIENCES WHEN PROTECTING CONTRACT BALANCES AND ASSERTING EQUITABLE SUBROGATION RIGHTS IN BANRKUTPCY *********

Sureties are unique in the bankruptcy world because their rights stem from common law principles of suretyship and the U.S. Supreme Court's holding in *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132 (1962), that enforces these principles. In many instances, these rights are not codified in the Bankruptcy Code or are counterintuitive to what most bankruptcy attorneys (and bankruptcy courts) are familiar with – run of the mill secured creditors.

Bonded contract balance is "off the priority ladder" under principles of equitable subrogation. As such, a pre-petition creditor's lien does not attach to contract balances.

Question: Why isn't *Pearlman*, a U.S. Supreme Court case, recognized without question by bankruptcy courts?

Answer: This is due to several factors. One is timing – when does the surety incur a loss for purposes of invoking and asserting its right of equitable subrogation. Another is state law and the right to contract balances based upon state contract law.

- *In re Kappa Development and General Contracting, Inc.*, Case No. 17-5115-KMS, Adv. No. 17-06046-KMS, 2019 WL 2867110 (Bankr. S.D. Miss. July 2, 2019)
    - In *Kappa Development*, Kappa, the general contractor (the "Debtor"), executed a Promissory Note in favor of third-party defendant, The First, a national banking association (the "Bank"). As collateral for the loan, the Debtor pledged to the Bank a lien on accounts receivable, general intangibles and proceeds. The Debtor then entered into 2 unrelated government contracts for construction projects and third-party plaintiff, Hanover Insurance Company (the "Surety"), issued performance bonds and payment bonds for both projects. The Debtor defaulted on the Promissory Note, payments to subcontractors and suppliers on both projects, and a workers' compensation premium. The Bank perfected its lien and subsequently, the Surety paid the subcontractors and suppliers on both projects as well as the workers' compensation premium, pursuant to the executed bonds.
    - In applying the doctrine of equitable subrogation and ruling in favor of the surety, the bankruptcy court first found that the right of subrogation is not governed by the priority rules of the Uniform Commercial Code. The bankruptcy court further clarified that under the doctrine of equitable subrogation the surety's entitlement to money and property takes precedence and precludes property to which the surety is equitably subrogated from becoming property of the debtor's estate and therefore, remains unaffected by the Bank's security interest.

- *In re Jones Constr. & Renovation, Inc.*, 337 B.R. 579 (Bankr. E.D. Va. 2006)
    - *In re Jones* is the case that All Assets Sale discussed in their bid for Sam Smith's affection. It involved a chapter 7 debtor that obtained performance and payment bonds from a surety to bond two different projects involving two different obligees.
    - The bankruptcy court applied the doctrine of equitable subrogation to require a project owner/obligee to pay contract funds remaining on a contract to a surety <u>*even though the surety had yet to pay on any bond claims*</u>.
    - The court also recognized the surety's right under the assignment clause in its general agreement of indemnity, which was executed pre-petition, to enhance the surety's equitable subrogation rights. The court held that the rights effectively vested the ownership of any contract balances in the surety.
- *In re Pacific Marine Dredging and Construction*, 79 B.R. 924, 929 (Bankr. D. Or. 1987), the court held that a contractor who failed to pay labor and material obligations breached its contract and had no legal or equitable interest in withheld funds and therefore, the funds were not property of the bankruptcy estate.
- *In re Modular Structures, Inc.*, 27 F.3d 72 (3rd Cir. 1994), holding that because the contractor had not paid its subcontractors, it had no right to contract funds held by the project owner and therefore the project owner was not obligated to pay the funds into the bankruptcy court.

****

Host – Before I present my third and final question to our three guests, let's take a quick brain-break and switch to dating game trivia.

Second trivia question:

Which of these people appeared as a contestant on the show and lost twice:

A. Arnold Schwarzenegger

B. Tom Selleck

C. Steve Martin

D. Farrah Fawcett

E. Convicted serial killer Rodney Alcala

****

Host – Hey, EZ Pay, didn't you say you exercised your rights under your indemnity agreement and received $500,000 in collateral and a lien on Curtains' patent? How will the surety's rights as a lienholder in the patent and the holder of collateral security play out for each of the scenarios that our three guests present?

Guest 3/Sale of Substantially All Assets – Well, the whole point of a sale under section 363 of the Bankruptcy Code is to sell the asset free and clear of liens, claims and encumbrances. Curtains will have to sell its patent for enough to satisfy and pay off the full amount of EZ Pay's lien. The question becomes--- what is the amount of your lien, EZ Pay?

Contestant/EZ Pay – Gee, I'm not sure. My damage has not yet been fully liquidated, what can I do?

Guest 1/Piecemeal Sale – The rules for selling an asset free and clear of liens are the same no matter whether or not there is a sale of substantially all of Curtain's assets or just the patent by itself. And, in either case, EZ Pay will need to make sure that its objection to having Curtains' patent sold free and clear of its lien is lodged with the court.

And, EZ Pay, the amount of your claim is definitely a relevant question. Another important question is how much is the patent worth? If the patent is worth less than the amount of the sale, you will need to make sure that you are paid for the full value. If the patent has de minimis value, then EZ Pay was essentially holding worthless collateral.

Contestant/EZ Pay – What if we don't agree on how much the patent is worth?

Guest 1/Piecemeal Sale – Well, in that case, EZ Pay should seek to estimate its claim and obtain a court order requiring Curtains to escrow adequate sale proceeds. EZ Pay and Curtains will have to sort out the details later.

Contestant/EZ Pay – Once again – sounds expensive, onerous, and not exactly surety friendly.

Guest 2/Classic Reorg. – Hey EZ Pay, don't dismay, unless Curtains takes steps to avoid your lien against Curtains' patent it will ride through the bankruptcy case in a classic reorg. Just be sure to check the fine print in my plan and disclosure statement to ensure that your rights are protected.

**********BREAK FROM SKIT TO DISCUSS THE BANKRUTPCY LAW AND TALK WITH PANELISTS ABOUT SURETY EXPERIENCES WHEN HOLDING COLLATERAL SECURITY AND PERFECTED LIEN RIGHTS IN BANRKUTPCY *********

- How the collateral security is held and titled can be very important. The surety's ability to turn to the collateral security without court approval by seeking stay relief will depend on how it is held/set-up.
  - Cash in bank account.
  - Trust fund.
  - Letter of credit.
- Funds Control Accounts – Funds control accounts have the benefit of not naming the surety, and it is easy to explain to a bankruptcy court that these accounts are established simply to receive job funds that will be passed along to the various suppliers and

subcontractors who, under state trust fund statutes (and *Pearlman*) have rights to those funds.

- Third party administrators.
- "FBO" (for the benefit of) Principal's name pursuant to bond number X.
- Multiple accounts segregated by bond or project number.

- Question: Surety professionals tend to use the word "collateral," when holding "collateral security" under an indemnity agreement or their rights of equitable subrogation. When talking about bankruptcy, any advice on using the word "collateral?"
  - Answer: Yes. A surety must be mindful about how it titles and holds property received pursuant to rights of equitable subrogation and rights to impose a trust.
  - The titling and possession of the property can lead to questions and, sometimes litigation, over who has a superior right to the property. For example, in *Travelers Cas. & Sur. Co. of Am. v. Paderta*, 315 F.Supp.3d 1095 (N.D. Ill. 2018), a surety issued performance bonds on behalf of a contractor. The contract funds were deposited into the contractor's account at a bank, which had lent money to the contractor. The account was not designated as a trust account and included no other similar restriction or designation. When the contractor defaulted under its loan with the bank, the bank took the contract funds from the account. The surety had to sue the bank in order to recover the funds. The court ruled in the surety's favor, after the surety demonstrated that the funds were held in express trust for the benefit of various parties, to whom the surety was subrogated.
- Question: How should a surety prepare its bankruptcy claim for losses that have not yet been incurred as of the claims bar date?
  - Using the penal sum of the bonds because of the potential risk it will be called in the full amount, plus actual out-of-pocket damages.
- Also want to make sure the lien rights are perfected. Whether the rights are perfected depends on the type of security. UCC-1 financing statements. Possession and control for cash.
  - In this example, a security interest in the patent would be perfected by filing – pre-petition – a UCC-1 financing statement where the debtor is located. This generally means, in the case of a corporate debtor, where they are incorporated. But for belts and suspenders, we also file in the state where the debtor's principal office is located.
  - May also want to file a statement with the U.S. Patent and Trademark Office alerting potential purchasers of the security interest.
- Quick primer on section 363(f) of the Bankruptcy Code – Section 363(f) is the Bankruptcy Code section that gives the debtor the ability to sell its assets free and clear of all liens, interests, encumbrances, etc. There are five subsections that the Debtor can apply to argue that a sale should be free and clear.

- (f)(1) – applicable nonbankruptcy law permits sale of property free and clear
- (f)(2) – Consent. Silence does not mean consent, unless, however, the Bankruptcy Court enters an order that puts parties on notice that the failure to object will be deemed consent. This happened recently in *In re Armstrong Flooring, Inc.*, Bankr. D. Del., Bankr. Case No. 22-10426 (MFW), Adv. Pr. 22-5039422-50394 (MFW). There the debtor had a license to use the "Armstrong Flooring" name and branding from another Armstrong-entity, Armstrong Worldwide, that was not in bankruptcy. During the sale process, the court entered two orders with "speak now or forever hold your peace" provisions. Armstrong Worldwide failed to object to the sale to preserve its rights to assert its intellectual property rights, but then refused to consent to the closing on the sale to the approved purchaser. The debtor filed an adversary proceeding requesting a TRO and preliminary injunction to force Armstrong Worldwide to consent. One of the key factors in the court's granting the debtor's requested relief was Armstrong Worldwide's failure to object despite the "speak now or forever hold your peace" provisions in the orders.
- (f)(3) – sale price is greater than the aggregate value of all liens – generally means that the sale price must be greater than the face amount of all liens together (*e.g.*, the amount of the creditor's claim), not the economic value of the liens.
- (f)(4) – interest is in bona fide dispute.
- (f)(5) – holder of interest could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

- The lien or interest may ride through, but the surety may be undercollateralized with no principal or indemnitors to look to in order to be made whole. *In re Falcon V, L.L.C.,* 620 B.R. 256 (Bankr. M.D. La. 2020), aff'd, 2021 WL 4486336 (M.D. La. Sept. 30, 2021), aff'd, -- F.4th --, 2022 WL 3274174 (5th Cir. Aug. 11, 2022).

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Contestant/EZ Pay – Hmmm…I've made my decision. Can the audience guess what it is?

Host- Let's see what the audience thinks about these three date choices.

[polling of audience]

[If needed: Contestant, please discuss why you chose ______*? Hint – there is no right answer here.]*

PANEL 10

COMMERCIAL SURETY CONSIDERATIONS: ATTORNEY'S FEES RISKS AND PITFALLS

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Commercial Surety Considerations: Attorney's Fees Risks and Pitfalls

By: Paul K. Friedrich, Meredith E. Dishaw, and Gene F. Zipperle

I. Introduction

A fundamental rule of surety claims handling is to protect the penal limit of the bond. With this goal in mind, surety claims handlers and their counsel must be cognizant of and well-versed on issues which may pose a threat to achieving this objective. One legal issue which poses a substantial risk to the surety's ultimate liability is attorney's fees. The starting point for examining attorney's fees is the American Rule.

The American Rule:

When considering an award of attorney's fees, courts reference the bedrock principle known as the American Rule: "Each litigant pays his own attorney's fees, win or lose, unless a statute or contract provides otherwise." *Baker Botts L.L.P. v. ASARCO LLC,* 576 U.S. 121, 126, 135 S. Ct. 2158, 2164, 192 L. Ed. 2d 208 (2015). Each jurisdiction has its own version of the American Rule to varying degrees whether by statute or exceptions based on the common law.

Exceptions to the American Rule

As with most "rules," there are exceptions. The exceptions to the American Rule are: (1) the parties can contractually agree to pay attorney's fees under certain circumstances; (2) a statute can specifically allow the recovery of attorney fees under certain circumstances; and (3) other exceptions created through the common law, which generally rest upon equitable grounds seeking to deter and/or compensate.

1. Contracts

The first exception to the American Rule allows for a court to award attorneys' fees when there is a contractual provision authorizing such recovery. *See e.g.*, *Conway Construction Co. v. City of Puyallup*, 197 Wn. 2d 825, 838 (2021). Thus, an obligee or claimant may be able to recover its attorneys' fees and costs from the surety pursuant to the terms of a contract, whether it be in the bonded contract or the surety bond. The clearest application of the contractual exception to the American Rule occurs when the Bond form explicitly provides for the recovery of attorneys' fees. Certain manuscript bond forms may include a provision allowing for the claimant to recover attorneys' fees and costs in certain situations.

However, even where a bond form does not include an attorneys' fees provision, the surety may be obligated to pay such fees based on a contractual provision in a construction contract which is properly and explicitly incorporated by reference into a bond form. In one opinion, the United States District Court for the Southern District of New York examined whether the surety could be liable for the claimant's incurred attorneys' fees and costs under a modified AIA A312 Performance Bond. *Hicks & Warren LLC v. Liberty Mutual Ins. Co.*, 2011 WL 2436703 (S.D.N.Y. Jun. 16, 2011). The construction contract between the Owner, Hicks &

Warren ("HW"), and the principal, contained a dispute resolution clause mandating arbitration and included a prevailing party provision for the recovery of costs and reasonable attorneys' fees. *Id.* at *1. Paragraph 1 of the performance bond stated that the surety and the principal were "jointly and severally b[ound]…to HW for the 'performance of the construction contract,' which is 'incorporated therein by reference.'"[1] *Id.* While noting that not all provisions of an underlying contract are presumed to be incorporated into the Bond, including arbitration provisions, the Court denied the surety's motion for partial summary judgment seeking dismissal of HW's claim to recover its attorney fees' and costs awarded at the arbitration. *Id.* at *4, *6. In so ruling, the Court concluded, in part, that Paragraph 1 provided a basis for HW's recovery of its attorneys' fees and costs. *Id.* at *4.[2] In analyzing Paragraph 1, the Court noted that the surety agreed to be bound by the outcome of the arbitration between the principal and the obligee. *Id.* The Court found that the incorporation by reference language in Paragraph 1 of the Bond was unambiguous. *Id.* at *5. The Court further found:

> Paragraph 1 of the Bond incorporates by reference the terms of the Contract, without express limitations; thus [the surety's] liability under the Performance Bond is coextensive with [the principal's] under the Contract, including liability arising under [the attorney fee provision].

Id.

While the application of this decision is limited by its posture, the Court's analysis in reaching its conclusion does provide insight into likely arguments by claimants seeking to find a contractual basis for an award of attorneys' fees. It also must be noted that the mere incorporation by reference of an underlying construction contract, without more, may be insufficient to trigger a surety's liability for contractual attorneys' fees and costs. *See*, *e.g.*, *Contractors Equipment Maintenance Co., Inc. v. Bechtel Hanford, Inc.*, 2005 WL 2033307 (9th Cir. Aug. 24, 2005). In *Contractors Equipment Maintenance Co.,* the trial court awarded the obligee its attorneys' fees, costs, and prejudgment interest against the principal's performance and payment bond surety. *Id.* at *1. The Ninth Circuit, in an unpublished opinion, reversed. *Id.* at *2. The surety argued that its responsibilities to the obligee were limited by the rider to the performance bond. The Court noted that, under Washington law, "an intent to incorporate another document by reference must be reasonably clear from the language of the contract." *Id.* at *2 (citing *Santos v. Sinclair*, 76 Wn. App. 320, 884 P.2d 941, 943 (1994)). The Court noted that there was "a bare reference on the face of the bond to the subcontract." *Id.* However, the terms of the rider limited the surety's obligations to costs of performing the contract. *Id.* The Ninth Circuit concluded that the intent to incorporate the subcontract was not clear and, therefore, the trial court erred in relying on the subcontract as the contractual basis for attorneys' fees. *Id.*

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[1] Notably, in addressing the surety's liability in the event of the principal's default, the Bond included Paragraph 6, which stated: "[t]o the limit of the amount of this Bond,…[the surety] is obligated without duplication for: 6.1 The responsibilities of the Contract for correction of defective work and completion of the Construction Contract; 6.2 Additional legal, design professional and delay costs resulting from [the principal's] default." *Id.*at *1.

[2] The Court also concluded that Paragraph 6 of the Bond provided a possible basis for the surety's liability for HW's attorneys' fees and costs. *Id.* at *4.

In short, the language of the bonded contract and the bond, read together, will control whether the contractual exception to the American Rule applies such that the surety may be liable for a claimant's attorneys' fees and costs.

2. Statutes

The second exception to the American Rule are legislative enactments, which have significantly eroded the Rule in certain situations to allow an award of attorney fees to a prevailing party. Many of these fee-shifting statutes are meant to level the playing field in commercial settings where there is a power imbalance between the parties. For instance, small claim fee-shifting statutes, consumer protection statutes, bad faith statutes, unfair claims handling practices, wage and hour violations, and commercial and public works bond claim statutes.

Notably, while certain statutes may appear to create an exception to the American Rule, the Supreme Court has made it clear that "Congress must provide a sufficiently 'specific and explicit' indication of its intent to overcome the American Rule's presumption against fee shifting." *Hyatt v. Hirshfeld*, 16 F.4th 855, 859–60 (Fed. Cir. 2021) (quoting *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 260, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975)). Critically, the Court noted that the American Rule's presumption against fee shifting applies to all statutes. While no "magic words" are needed to override the American Rule, the requirement that legislative intent be "specific and explicit" is recognized as a high bar. *Key Tronic Corp. v. United States*, 511 U.S. 809, 815–21, 114 S.Ct. 1960, 128 L.Ed.2d 797 (1994).

In addition to statutes, there are also court rules that may allow for recovery of attorney's fees, such as discovery violations, offers of judgment, and sanctions for frivolous or bad faith actions in litigation. Federal and State Civil Rule 11 allow for the imposition of sanctions for certain frivolous and/or unreasonable conduct in litigation.

Additionally, certain state and federal statutes and local rules may provide for an award of fees or costs incurred in litigation.

For instance, LR Civ. P. 54.1, for the Northern and Southern Districts of West Virginia provides, in pertinent part:

> "Fees and costs shall be taxed and paid in accordance with the provisions of 28 U.S.C. §§ 1911-1929, and other controlling statutes and rules. If costs are awarded, the reasonable premiums or expenses paid on any bond or other security given by the prevailing party shall be taxed as part of the costs.

28 U.S.C. §1920 notes that costs may be assessed for:

(1) Fees of the clerk and marshal;

(2) Fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case;

(3) Fees and disbursements for printing and witnesses;

(4) Fees for exemplification and copies of papers necessarily obtained for use in the case;

(5) Docket fees under section 1923 of this *title [28 USCS § 1923*];

(6) Compensation of court appointed experts, compensation of interpreters, and salaries, fees, expenses, and costs of special interpretation services under section 1828 of this *title [28 USCS § 1828*].

a. eDISCOVERY

In *Online DVD Rental Antitrust Litigation*, 779 F. 3d 914 (9th Cir. 2015) Netflix requested $744,740.11 as costs for discovery-related tasks, and was ultimately awarded $710,194.23 by the district court. The court discussed whether the cost of ediscovery and the consultant fees associated with the same were recoverable costs under 28 U.S.C. 1920.

> The faithful production of electronically stored information may require processes such as optical character recognition (which renders material text-searchable), preservation of metadata, and conversion to a non-editable file format. Parties might agree to employ a particular file format or methodology for electronically stored information production, or the court might order them to produce electronically stored information with certain characteristics. *See In re Ricoh,* 661 F.3d at 1365 (parties agreed that a third party vendor would process and store e-mails in a secure document review database). The Federal Circuit held in *CBT Flint Partners* that obligated to accept) electronic documents in a particular format or with particular characteristics intact (such as metadata, color, motion, or manipulability), the costs to make duplicates in such a format or with such characteristics preserved are recoverable as "the costs of making copies ... necessarily obtained for use in the case." 28 U.S.C. § 1920(4).

737 F.3d at 1328. *See also Country Vintner,* 718 F.3d at 260 n. 19 ("If, for instance, a case directly or indirectly required production of [electronically stored] unique information such as metadata, we assume, without deciding, that taxable costs would include any technical processes necessary to copy [electronically stored information] in a format that includes such information."). When copies are made in a fashion necessary to comply with obligations such as these, costs are taxable so long as the copies are also "necessarily obtained for use in the case."

In *US Ethernet Innovations, LLC. V. Acer Inc*., 2015 WL 5187505 (N.D. CA. 2015), a case involving claimed amounts of approximately $720,000.00, the court analyzed what ediscovery costs were recoverable under 28 U.S.C. 1920 (4):

> The issue here is what kinds of costs attributable to producing electronic discovery are analogous to "exemplification and the costs of making copies" (and not for the parties' convenience or attributable to "intellectual effort" involved in document production) such that they are taxable under section 1920(4). The undersigned previously analyzed the issue in two cases and determined that certain expenses are taxable costs and certain are not. *See Plantronics, Inc. v.*

> *Aliph, Inc.,* No. C 0901714 WHA (LB), 2012 WL 6761576 (N.D.Cal. Oct. 23, 2012); *eBay Inc. v. Kelora Sys., LLC,* 2013 WL 1402736. Since that time, the Ninth Circuit addressed taxable costs for electronic discovery in *Resnick v. Netflix,* 779 F.3d 914, 929–30 (9th Cir.2015).
>
> Not all costs leading up to the production of electronic discovery are compensable. *Id.* at 928. Determining what costs are taxable requires common-sense judgments
> omitted); *see also Resnick,* 779 F.3d at 929–30 (declining to award costs for uploading data; processes necessary to preserve metadata for production could be compensable). guided by a comparison with a paper-document analogue. *Id.* at 929 (quotation omitted). The inquiry about what electronic processes are taxable turns on whether they are part of making copies "necessarily obtained for use in the case" or instead are solely for the convenience of counsel. *Id.*
>
> Applying this approach, the undersigned previously designated categories that it deemed compensable as "exemplification and ... copies of any materials where the copies are necessarily obtained for use in the case." *See* 28 U.S.C. § 1920(4). The categories include scanning and converting native files to readable files (including optical character recognition ("OCR") and generating blowbacks), Bates stamping, putting information on media (such as DVDs, CDs, hard drives, or thumb drives), and doing basic document organization such as slip sheets for page breaks. *See eBay,* 2013 WL 1402736, at *7. The court did not award costs for collection and data processing, holding that they are non-taxable costs that are either (a) for the convenience of the parties or (b) akin to "intellectual effort" involved in the production of documents or the research, analysis, and distillation of data. *Id.*; *Plantronics,* 2012 WL 6761576, at *13–15 (analyzing cases). Some costs might be compensable if they are part of the necessary efforts to make information readable. *See eBay,* 2013 WL 1402736, at *7 (holding that making computer data readable is what allows conversion to formats such as TIFF compensable and distinguishing other gathering and processing costs as non-compensable "intellectual effort" such as organizing, searching, and analyzing discovery documents)

Thus, under certain circumstances, ediscovery costs are recoverable.

Rimini Street, Inc. v. Oracle USA, Inc., No. 17-1625 **-** whereas the "American rule" generally provides that each party in litigation must bear its own costs, federal law sets out six exclusive categories of costs which a court may, in its discretion, award a prevailing party under 28 U.S.C. §§ 1920, including clerk and marshal fees, transcript fees, fees for printing and witnesses, certain fees for exemplification and copies, designated docket fees, and fees for court-appointed experts and interpreters. Section 505 of the Copyright Act allows the court in its discretion to allow the recovery of full costs by or against any party under 17 U.S.C. § 505. Oracle sued Rimini Street for infringing its copyright and prevailed in part. The district court awarded Oracle nearly $5 million in costs and nearly $12.8 million in additional expenses, including expert witness fees, jury consultant fees, and other expenditures not enumerated in Sections 1821 and 1920. The Ninth Circuit affirmed the award of these additional litigation expenses, holding that

the phrase "full costs" in the Copyright Act authorizes an award of costs beyond those categories set forth in Sections 1821 and 1920. The issue before the Supreme Court was whether the statutory provision permitting an award of "full costs" to the prevailing party expanded the definition of costs authorized as costs under 28 U.S.C. §§ 1821 and 1920. The Court reaffirmed that "costs" is a term of art that encompasses only the specific categories of costs enumerated in 28 U.S.C. §§ 1821 and 1920. A statute will not be interpreted as expanding the categories of recoverable costs unless Congress expressly so provides.

b. FILING FEES

Filing fees are generally recoverable under 28 U.S.C. §1920 (1) Fees of the clerk and marshal.

c. MEDIATION EXPENSES

Mediator fees are not referenced as taxable costs in 28 U.S.C. § 1920. There is also a noticeable lack of authority suggesting that the cost of a mediator is a taxable expense. *Am Props. v. Town of Chapel Hill,* 202 F. Supp. 2d 451, 2002 U.S. Dist. LEXIS 8888 (M.D.N.C. 2002) (holding that compensation for a mediator is not taxable as costs, as the Court has not found or been provided with any authority suggesting that the cost of a mediator is a taxable expense."); *Sea Coast Foods, Inc. v. Lu-Mar Lobster & Shrimp, Inc*., 260 F.3d 1054, 1061 (9th Cir. 2001) ("Nothing in 28 U.S.C. § 1920 provides for the cost of a mediator."); *George v. GTE Directories Corp.*, 114 F. Supp. 2d 1281, 1300 (M.D. Fla. 2000) (refusing to tax mediation costs when prevailing party cited no legal authority to justify such an expense); *Uni-Systems, Inc. v. Delta Airlines, Inc.,* 2002 U.S. Dist. LEXIS 5618, 2002 WL 505914, *4 (D. Minn. Mar. 28, 2002) ("The Court does not read § 1920 to allow taxation of miscellaneous mediation fees"); *Wayne v. Dallas Morning News*, 2000 U.S. Dist. LEXIS 4097, 2000 WL 343188, *3 (N.D. Tex. Mar. 31, 2000) (holding that mediation costs are not compensable), aff'd., 226 F.3d 641 (5th Cir. 2000).

d. COPY EXPENSES

28 U.S.C. § 1920 provides that a court may tax fees used for photocopies necessarily obtained for use in the case. *Kennedy v. Joy Techs., Inc.*, 484 F. Supp. 2d 502, 2007 U.S. Dist. LEXIS 30208 (W.D. Va. 2007). However, a prevailing party may only be reimbursed for copies of documents it has submitted to the court and provided to opposing counsel. *Id.* citing *Southpring, Inc. v. H3, Inc.,* No. 4:02CV038, 2005 U.S. Dist. LEXIS 29707, 13-14 (W.D. Va. Nov. 23, 2005). *Centennial Broad., LLC v. Burns,* 2007 U.S. Dist. LEXIS 45784, 2007 WL 1839736 (W.D. Va. June 22, 2007).

Where copy charges are not itemized and appear to be for copies produced in-house and the party seeking costs has not identified why these particular charges were incurred, these charges are not recoverable. Copies made for a party's own internal use and convenience are not taxable. *See Thomas v. Treasury Mgmt. Ass'n, Inc.,* 158 F.R.D. 364, 372 (D. Md. 1994). "The party seeking recovery of photocopying costs must come forward with evidence showing the nature of the documents copies, including how they were used or intended to be used in this case." *American Home Assurance Co. v. The Phineas Corp*., 2004 U.S. Dist. LEXIS 26858; 18

Fla. L. Weekly Fed. D 110 (M.D. Fla. 2004). The Court distinguished recoverable costs from non-recoverable stating:

> Copies attributable to discovery, copies of pleadings, correspondence, documents tendered to the opposing party, copies of exhibits, and documents prepared for the Court's consideration are recoverable. *DeSisto College, Inc. v. The Town of Howey-In-The-Hills, 718 F. Supp. 906, 913 (M.D. Fla. 1989)* (citation omitted). Copies obtained only for the convenience of counsel are not recoverable. See id. Extra copies of filed papers, correspondence, and copies of cases are considered obtained only for the convenience of counsel. *Id.*

American Home Assurance at 9.

Noting that the party seeking costs had not submitted a reasonable itemization to distinguish copies that were necessarily obtained for the litigation from those for the convenience of the party, the Court in *American Home Assurance* disallowed $30,000 of $37,568.21 requested costs for copying noting that the party requesting the costs. *See also Harvey v. City of Bradenton,* 2006 U.S. Dist. LEXIS 21405 (M.D. Fla. 2006) (disallowing as costs copying expenditures where requesting party did not submit enough detail to allow the Court to determine that the requesting party reasonably believed that the copies were necessary) *and see Long v. Athos Corp.,* 2006 U.S. Dist. LEXIS 40943 (M.D. Fla. 2006).

Thus, in order to determine whether the copy expenses are taxable as costs, it must be determined whether the copy expenses were used to create documents submitted to the court.

e. DEPOSITION AND TRANSCRIPT EXPENSES

These are generally recoverable under 28 U.S.C. §1920 (2) fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case.

f. MAIL, PHONE AND FACSIMILE EXPENSES

Costs reflecting postage and long distance telephone calls are incidental expenses of litigation and therefore not allowable costs under Fed. R. Civ. P. 54(d) or 28 U.S.C. § 1920. Costs for federal express and for messenger service are similar to postage costs, and, as such, are not allowable. Facsimile transmissions occur by way of telephone lines, so, likewise, the charges for facsimile transmissions are also not allowable. *O'Bryhim v. Reliance Std. Life Ins. Co.*, 997 F. Supp. 728, 1998 U.S. Dist. LEXIS 4095 (E.D. Va. 1998).

28 U.S.C. § 1920 does not explicitly list mailing expenses as a taxable cost. Furthermore, courts have generally not allowed the inclusion of mailing expenses as a taxable cost, absent special circumstances. *Matter of Penn Central Transp. Co.*, 630 F.2d 183, 192 (3d Cir. 1980) (holding that courier and messenger costs are not taxable costs);*Wahl v. Carrier Mfg. Co., Inc.*, 511 F.2d 209, 217 (7th Cir. 1975) (finding that charges for telephone calls and postage are not ordinarily recoverable as costs); *Hollenbeck v. Falstaff Brewing Corp.,* 605 F. Supp. 421, 439 (E.D. Mo. 1984) (holding that Federal Express costs, telephone expenses, and postage expenses

did not qualify as taxable costs); *El-Fadl v. Central Bank of Jordan*, 163 F.R.D. 389, 390 (D.D.C. 1995) (noting that "the overwhelming weight of authority" has "declined to award costs for courier services, postage, telephone or fax charges"); *Embotelladora Agral Regiomontana,* 952 F. Supp. at 418 (holding that postage charges and telecopy charges are not taxable costs); *O'bryhim v. Reliance Std. Life Ins. Co.*, 997 F. Supp. 728, 1998 U.S. Dist. LEXIS 4095 (E.D. Va. 1998) (finding that the prevailing party was not entitled to recover telecopy, Federal Express, Express Mail, and postage expenses, absent a showing of exceptional circumstances).

g. TRAVEL EXPENSES

Attorneys' travel expenses are not recoverable under 28 U.S.C. § 1920. *Cincinnati Ins. Co. v. Dynamic Dev. Group, LLC,* 336 F. Supp. 2d 552, 2004 U.S. Dist. LEXIS 19181 (M.D.N.C. 2004). Further, courts have found that travel expenses incurred by the prevailing party are not taxable as costs. *Centennial Broad., LLC v. Burns,* 2007 U.S. Dist. LEXIS 45784, 2007 WL 1839736 (W.D. Va. June 22, 2007) ("Costs such as travel expenses, delivery service, secretarial overtime, long-distance phone calls, postage, meals, etc., while properly billable to a client, are not properly taxed as costs by the Court."); *Lasher v. Day & Zimmerman Int'l, Inc.*, 2008 U.S. Dist. LEXIS 74414, 2008 WL 4449953 (D.S.C. Sept. 26, 2008) (finding that the travel expenses incurred by defense counsel in attending depositions was not taxable as a cost against the plaintiff).

h. RESEARCH (WESTLAW/LEXIS) AND PACER EXPENSES

The cost of legal research services is not listed as an allowable expense in 28 U.S.C. § 1920. Historically, courts do not allow costs claimed for Westlaw, Lexis-nexis and pacer. *O'Bryhim v. Reliance Std. Life Ins. Co.*, 997 F. Supp. 728, 1998 U.S. Dist. LEXIS 4095 (E.D. Va. 1998) (disallowing costs claimed for Westlaw use); *Am Props. v. Town of Chapel Hill,* 202 F. Supp. 2d 451, 2002 U.S. Dist. LEXIS 8888 (M.D.N.C. 2002) (holding that the cost of legal research services is not listed as an allowable expense in 28 U.S.C. § 1920 and is more properly characterized as a component of attorneys' fees, not as a taxable cost of litigation.) *United States v. Merritt Meridian Constr. Corp.,* 95 F.3d 153 (2d Cir. 1996) (holding that attorneys' fees would include expenses for computerized legal research and thus not allowing computerized legal research as a separate taxable cost); *Haraco, Inc. v. Am. Nat. Bank & Trust Co. of Chicago,* 38 F.3d 1429, 1440-41 (7th Cir. 1994) (holding that the costs of computerized research should be characterized not as taxable costs but as attorneys' fees); *Jones v. Unisys Corp.*, 54 F.3d 624, 633 (10th Cir. 1995); *Leftwich v. Harris-Stowe State Coll.*, 702 F.2d 686, 695 (8th Cir. 1983) (holding that the costs of computerized research was a component of attorneys' fees that "cannot be independently taxed as [an] item of cost") See also *Duckworth v. Whisenant*, 97 F.3d 1393, 1399 (11th Cir. 1996), *Schultz v. Sch. Bd. of Miami-Dade County*, 2003 U.S. Dist. LEXIS 26675 (D. Fla. 2003), *and see ADF International, Inc. v. Baker Mellon Stuart Construction, Inc*. 2001 U.S. Dist LEXIS 25720 (M.D. Fla. 2001).

i. COMPUTER AND EQUIPMENT RENTAL AND TECHNICAL SUPPORT

In *Goodwall Construction Company v. Beers Construction Company*, 824 F. Supp. 1044 (N.D. Ga 1992) the Court reviewed a request for costs that included "the rental and setup of AV

monitors, VCRs and related equipment for use in the courtroom at trial." *Goodwall Construction Company v. Beers Construction Company*, 824 F. Supp. 1044, 1062-1064 (N.D. Ga 1992). In Goodwall, the Court disallowed the costs for said equipment and rental, noting that:

> Essentially, plaintiffs seek to be reimbursed for costs associated with providing videotape and picture evidence at trial. Plaintiffs choose to present this type of evidence, rather than documentary evidence, because plaintiffs believe this form of evidence will help its case before the jury. Nothing requires plaintiffs to present non-documentary evidence. Although the court agrees that presenting evidence in these types of non-documentary format are often quite compelling and helpful both to the court and the jury, Congress, however, has not specifically provided for the recovery of costs except for copies of exemplifications and documentary evidence necessary for use in the case. Therefore, the court is compelled to interpret §1920 narrowly, absent clear congressional intent to the contrary, and preclude the taxing of such costs.
>
> Because § 1920 does not specifically encompass demonstrative evidence fees for use in the case, these costs are disallowed."
> Goodwall at 1063-1064.

The Court's holding in *Goodwall* demonstrates that those expenses are not appropriate to be assessed as costs under 28 U.S.C. 1920.

> Icon did not default on its obligations. To allow the bond claim to proceed would ignore their decision.
>
> *Id.* at 5.

j. BLOCK BILLING.

Several courts have discussed the difficulty of determining an award of attorney fees based upon such billing records:

> Block billing, which bundles tasks in a block of time, makes it extremely difficult for a court to evaluate the reasonableness of the number of hours expended. See Role Models America, Inc. v. Brownlee, 353 F.3d 962, 971, 359 U.S. App. D.C. 237 (D.C. Cir. 2004). The court may reduce the requested fee based on this lack of specificity. Fischer v. SJB-P.D. Inc.., 214 F.3d 1115, 1121 (9th Cir. 2000)(district courts may reduce hours where requests are poorly documented). See Lee v. Commissioner, 2009 U.S. Dist. LEXIS 85857, 2009 WL 3003858, *1 (D. Or. Sept. 17, 2009) (reducing EAJA award by 10 percent to account for block billing); Gadberry v. Astrue, 2009 U.S. Dist. LEXIS 83920, 2009 WL 2983086, *1-2 (D. Or. Sept. 15, 2009)(reducing EAJA fee request by 10 hours to account for block billing); Brandt, 2009 U.S. Dist. LEXIS 50268, 2009 WL 1727472 at *4 (reducing EAJA block billed hours by 50 percent to account for poorly documented billing); Taylor v. Albina Community Bank, 2002 U.S. Dist. LEXIS 25580, 2002 WL 31973738, *5 (D. Or. Oct. 2, 2002) (reducing attorney fees by

> half due to block billing and excessive hours). See also *Message from the Court Regarding Attorney Fee Petitions*, Dated Feb. 11, 2009, found at ord.uscourts.gov/court-policies (stating that fee petitions which contain inadequate detail or fail to separate time for individual tasks may be denied, at least in part).

Neil v. Commissioner of Social Security, 2011 U.S. Dist. Lexis 106378 at 9, (D.C. Or. 2011).

STATUTES AND REGULATIONS DIRECTLY EFFECTING THE SURETY.

Example:

49 USC 13906 - Security of motor carriers, motor private carriers, brokers, and freight forwarders.

(1)REQUIREMENTS.—
(A)In general.—
The Secretary may register a person as a broker under section 13904 only if the person files with the Secretary a surety bond, proof of trust fund, or other financial security, or a combination thereof, in a form and amount, and from a provider, determined by the Secretary to be adequate to ensure financial responsibility.
(B)Use of a group surety bond, trust fund, or other surety.—
In implementing the standards established by subparagraph (A), the Secretary may authorize the use of a group **surety bond**, trust fund, or other financial security, or a combination thereof, that meets the requirements of this subsection.
This section authorizes the use and issuing of a BMC-84 federal broker bond. The bond itself does not authorize the recovery of attorney fees by the claimant.

(2)SCOPE OF FINANCIAL RESPONSIBILITY.

(A)Payment of claims.—A **surety bond**, trust fund, or other financial security obtained under paragraph (1) shall be available to pay any claim against a broker arising from its failure to pay freight charges under its contracts, agreements, or arrangements for transportation subject to jurisdiction under chapter 135 if—
(i) subject to the review by the surety provider, the broker consents to the payment;
(ii) in any case in which the broker does not respond to adequate notice to address the validity of the claim, the surety provider determines that the claim is valid; or
(iii) the claim is not resolved within a reasonable period of time following a reasonable attempt by the claimant to resolve the claim under clauses (i) and (ii), and the claim is reduced to a judgment against the broker.

(B)Response of surety providers to claims.—If a surety provider receives notice of a claim described in subparagraph (A), the surety provider shall—

(i) respond to the claim on or before the 30th day following the date on which the notice was received; and
(ii) in the case of a denial, set forth in writing for the claimant the grounds for the denial.

(C) Costs and attorney's fees. In any action against a surety provider to recover on a claim described in subparagraph (A), the prevailing party shall be entitled to recover its reasonable costs and attorney's fees.

The issue we typically run into is the attorney for the claimant arguing that this provision allows the recovery of attorney fees in an action by the claimant against the broker under section 49 USC 13906 (2) (A) (iii).

Provision (C) Costs and attorney fees states that in any action **against** a surety provided to recover on a claim described in subparagraph (A) the **prevailing party** shall be entitled to recover its reasonable costs and attorney fees. In my view this means that the claimant i.e. the motor carrier must have sued the surety directly because the motor carrier did all of the above i.e. (i)(ii) and (iii) and the surety still did not pay the motor carrier.

The statute does not define what constitutes a prevailing party. Case law interpreting what party is the "prevailing" party in any particular litigation is generally done a case-by-case basis.

In contrast, federal regulations applying to NVOCC's (Non-vessel-operating common carrier) which is substantially similar to the above provisions does not contemplate an award of attorney's fees at all in any litigation by a claimant against the required NVOCC bond (FMC-84). See PART 515—LICENSING, FINANCIAL RESPONSIBILITY REQUIREMENTS, AND GENERAL DUTIES FOR OCEAN TRANSPORTATION INTERMEDIARIES.

Takeaway: make sure you check the underlying statutes and regulations when dealing with state or federally authorized bonds to determine if there is an applicable attorney fees provision.

WHEN THINGS GO BAD

Arete Ventures, Inc., v. University Of Kentucky, 2020 WL 4499072 (certiorari denied on April 20, 2022)

Surety that issued performance bond to the state university brought a declaratory judgment action to obtain a judgment that it was not liable for damages caused by the faulty construction of the university's equine isolation barn. The university brought a counterclaim for breach of the bond and bad faith. The amount of the construction contract was approximately $820,000.00.

Judgment was entered against the surety and the general contractor. The university was seeking $983,430.71 in attorney fees, consultant fees and court costs.

The court first focused on the statute requiring the performance bond:

KRS 45A.190(2), which requires performance bonds in construction contracts

involving a cost greater than $40,000. The statute reads as follows:

> When a construction contract is awarded in an amount in excess of forty thousand dollars ($40,000), the following bonds shall be furnished to the Commonwealth, and shall be binding on the parties upon the award of the contract:
>
> (a) A performance bond satisfactory to the Commonwealth executed by a surety company authorized to do business in this Commonwealth, or otherwise supplied, satisfactory to the Commonwealth, in an amount equal to one hundred percent (100%) of the contract price as it may be increased; and
>
> (b) A payment bond satisfactory to the Commonwealth executed by a surety company authorized to do business in the Commonwealth, or otherwise supplied, satisfactory to the Commonwealth, for the protection of all persons supplying labor and material to the contractor or his subcontractors, for the performance of the work provided for in the contract. The bond shall be in an amount equal to one hundred percent (100%) of the original contract price.

The legislature declined to include language limiting the surety's liability to *only* the penal sum. If the legislature intended to cap recovery, it would have included the cap in the statute. The trial court even pointed out that the legislature *did* put a cap on recovery for fiduciary bonds, illustrating its ability to decide when it desired caps and when it did not. *See* KRS 62.070. Because KRS 45A.190 does not include language of limitation, we must look elsewhere if we are to be persuaded by the appellants. [KRS 62.070 deals with public officials bonds]

Next, it reviewed the langue of the performance bond:

> The bond under the terms of which Auto-Owners is obligated to UK says Auto-Owners contracted to:
>
> > satisfy all claims and demands incurred under such contract, and shall fully indemnify and save harmless [Arete] from ***all costs*** and damages which it may suffer by reason of failure to do so, ***including attorneys' and consultants' fees***, and shall reimburse and repay [UK] all outlay and expenses which [UK] without limitation, may incur in making good any default, then this obligation shall be void, otherwise to remain in full force and effect.
>
> (Emphasis added). This language does not limit the amount of attorney fees in any way. Rather, the language is expansive and comprehensive. Nothing in the bond imposes limits.

The court went on to note that:

> The construction contract, which imposed specific obligations on the surety was still incorporated in the bond.... [the surety] thus agreed to be bound by the Contract although it did not sign it.

> The construction contract expressly provides for recovery of attorney fees against both the general contractor and the surety.... [the university] is entitled to an attorney-fee award against [the general contractor] and [the surety]."
>
> [The university] had the express right to make corrections [to {the general contractor's} defective construction] and to '***recover all amounts*** for such corrections, ***including costs and attorney's fees***, from the General Contractor or ***surety***.' "

Based on the above analysis, the court of appeals held as follows:

> With regard to performance bonds, it has been held that if the contract is incorporated into the bond, the bond and the underlying contract should be read together to determine the intention of the parties as to what and who is covered under the bond." *ABCO-BRAMER, Inc. v. Markel Ins. Co.*, 55 S.W.3d 841, 844 (Ky. App. 2000) (citing *Royal Indemnity Co. v. International Time Recording Co. of New York*, 255 Ky. 823, 75 S.W.2d 527 (1934); *Federal Union Surety Co. v. Commonwealth*, 139 Ky. 92, 129 S.W. 335 (1910); *Blair & Franse Const. Co. v. Allen*, 251 Ky. 366, 65 S.W.2d 78 (1933)). Under Kentucky law, a contract is construed as a whole, and all writings that are part of the agreement are construed together. *Id.* at 845 (citing *Cook United, Inc. v. Waits*, 512 S.W.2d 493 (Ky. 1974)). In this case, the penal amount of the bond will cap [the surety's] liability at the penal amount **only for damages attributable to defective construction** by the principal, [general contractor], **but there is additional liability for the full amount of attorney fees and costs awarded to the obligee**, [the university]. We see no error of law here.

3. Other Recognized Exceptions

Most jurisdictions recognize a variety of exceptions to American based upon equitable grounds, which include, but are not limited to: (1) bad faith or misconduct of a party; (2) common fund theory; and (3) actions by a third person subjecting a party to litigation. In the context of surety claims, surety professionals are most likely to encounter threats or exposure to an award of fees arising out of allegations, albeit without merit in most instances, that a surety engaged in bad faith or other wrongful conduct. Oftentimes, claimants' counsel will make allegations of surety bad faith in an effort to harass the surety and/or leverage favorable settlement.

According to the United States Supreme Court, a court's inherent equitable powers authorize the award of attorney fees in cases of bad faith. *Hall v. Cole*, 412 U.S. 1, 4-5, 93 S. Ct. 1943, 36 L. Ed. 2d 702 (1973). Compensating one subjected to bad faith litigation arises from the inherent, supervisory, and equitable power of the courts. *Roadway Express, Inc. v. Piper*, 447 U.S. 752, 765, 100 S.Ct. 2455, 65 L.Ed.2d 488 (1980).

One Washington decision identifies three forms of bad faith: (1) prelitigation misconduct; (2) procedural bad faith; and (3) substantive bad faith. *Rogerson Hiller Corp. v. Port of Port Angeles*, 96 Wash. App. 918, 927, 982 P.2d 131 (1999). Prelitigation misconduct refers to

obdurate or obstinate conduct that necessitates legal action to enforce a clearly valid claim or right. *Rogerson Hiller Corp.,* 96 Wash. App. at 927. Procedural bad faith covers dilatory and obstreperous conduct during the course of litigation. *Gabelein v. Diking District No. 1 of Island County*, 182 Wash. App. 217, 237, 328 P.3d 1008 (2014); *Rogerson Hiller Corp.,* 96 Wash. App. at 928. Substantive bad faith represents filing a frivolous lawsuit or asserting a frivolous defense with the intention to harass. *Id.* at 929.

Jurisdictions disagree as to when prelitigation bad faith merits an award of reasonable attorney fees. Some courts further divide prelitigation conduct into two sub-subclassifications: (1) bad faith misconduct that forms the facts behind the cause of action on which the plaintiff sues, or substantive bad faith; and (2) an unreasonable refusal to recognize the plaintiff's rights such that the plaintiff must sue to enforce a clear valid claim. *Shimman v. International Union of Operating Engineers, Local 18*, 744 F.2d 1226 (6th Cir. 1984). In this setting, the term "substantive" bad faith assumes a different meaning from the third category of bad faith of bringing a frivolous suit or defense as mentioned in *Rogerson Hiller Corp.,* 96 Wash. App. at 929.

Some courts only award fees under the second sub-subcategory of prelitigation bad faith. *Montgomery Cellular Holding Co. v. Dobler*, 880 A.2d 206, 228 (Del. 2005); *Shimman v. International Union of Operating Engineers, Local 18*, 744 F.2d 1226 (6th Cir. 1984); *Towerridge, Inc. v. T.A.O., Inc.*, 111 F.3d 758, 765 (10th Cir. 1997). Other courts appear to award fees under both categories of prelitigation bad faith. *Xyngular v. Schenkel*, 890 F.3d 868, 873 (10th Cir. 2018); *McQuiston v. Marsh*, 707 F.2d 1082 (9th Cir. 1983); *Kerin v. U.S. Postal Service*, 218 F.3d 185, 195 (2d Cir. 2000); *Richardson v. Communications Workers of America, AFL-CIO*, 530 F.2d 126, 132 (8th Cir. 1976); *Rolax v. Atlantic Coast Line Railroad Co.*, 186 F.2d 473 (4th Cir. 1951); *Schlein v. Smith*, 160 F.2d 22 (D.C. Cir. 1947); *Sierra Club v. U.S. Army Corps of Engineers*, 590 F. Supp. 1509, 1514 (S.D.N.Y. 1984), *aff'd in part, rev'd in part on other grounds*, 776 F.2d 383 (2d Cir. 1985).

Commentators and federal decisions promote fees for prelitigation bad faith when a defendant causes unnecessary litigation by unjustifiably resisting an indisputable claim. *Haycraft v. Hollenbach*, 606 F.2d 128, 133 (6th Cir. 1979). Clearly established rights should be respected and accorded without the intervention of the court system. Jane P. Mallor, *Punitive Attorneys' Fees for Abuses of the Judicial System*, 61 N.C. L. REV. 613, 633 (1983). When the defendant resists the plaintiff's clearly established right without justification for doing so, its obstinacy gives the plaintiff no choice but to seek judicial assistance in enforcing his right. Jane P. Mallor, *Punitive Attorneys' Fees for Abuses of the Judicial System*, 61 N.C. L. REV. 613, 632 (1983). In these circumstances, the defendant creates unwarranted expenses not only for his opponent but for the public and the courts. *Haycraft v. Hollenbach*, 606 F.2d 128, 133 (6th Cir. 1979). Thus, an award under these circumstances vindicates the court's integrity. The United States Supreme Court has likened such an award to a remedial fine imposed for civil contempt. *Hutto v. Finney*, 437 U.S. 678, 691, 98 S. Ct. 2565, 57 L. Ed. 2d 522 (1978). The award incentivizes the defendant to act properly and promptly in the future so that litigation will not be needed. *Hutto v. Finney*, 437 U.S. 678, 691, 98 S.Ct. 2565, 57 L.Ed.2d 522 (1978).

An illustrative decision is *Vaughan v. Atkinson*, 369 U.S. 527, 82 S. Ct. 997, 8 L. Ed. 2d 88 (1962), which began the equitable exception for an award of reasonable attorney fees and costs in federal court. Clifford Vaughan, a seaman, brought suit in admiralty against his former employer when the employer failed without justification to respond to his claim for maintenance and cure. Vaughan sent the employer medical records establishing his illness and need for medical care. The Supreme Court emphasized the role that the employer's bad faith played in the award for fees. Because of the employer's callous attitude and recalcitrance in neither admitting nor denying the claim, it forced Vaughan to hire an attorney to obtain relief owed to him under the law.

Although couched in terms of an award for compensatory damages, later United States Supreme Court decisions recognize *Vaughan v. Atkinson* as the precursor of the exception, for bad faith conduct of the defendant, to the American rule. *Summit Valley Industries v. Local 112, United Brotherhood of Carpenters and Joiners of America*, 456 U.S. 717, 721, 102 S. Ct. 2112, 72 L. Ed. 2d 511 (1982); *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 259, 95 S.Ct. 1612, 44 L.Ed.2d 141 (1975); *F.D. Rich Co. v. United States ex rel. Industrial Lumber Co.*, 417 U.S. 116, 129, 94 S. Ct. 2157, 40 L. Ed. 2d 703 (1974); *Hall v. Cole*, 412 U.S. 1, 5, 93 S.Ct. 1943, 36 L.Ed.2d 702 (1973); *Newman v. Piggie Park Enterprises*, 390 U.S. 400, 402 n.4, 88 S. Ct. 964, 19 L. Ed. 2d 1263 (1968). This recognition illustrates the uselessness between distinguishing between attorney fees as damages and as costs, a distinction made by some courts.

In the surety-specific context, another exception to the American rule that might well be added to the above lists is the *Olympic Steamship* rule allowing attorney fees incurred by an insured in compelling an insurer to assume the burden of legal action or obtain the full benefit of his or her contract. *Olympic S.S. Co. v. Centennial Ins. Co.,* 117 Wash.2d 37, 53, 811 P.2d 673 (1991). Although one of the rationales behind the *Olympic Steamship* rule is based on a theory of implied contract, the rationales explicitly relied upon by the *Olympic Steamship* court were the equitable notions regarding the disparity in bargaining power between insureds and insurers, and attorney fees as damages. *Olympic S.S.,* 117 Wash.2d at 52–53, 811 P.2d 673.

Although *Olympic Steamship* fees were originally borne out of the insurer-insured relationship, the Washington State Supreme Court extended its application to the surety-obligee relationship in the landmark decision known as *Colorado Structures*. *Colorado Structures, Inc. v. Ins. Co. of the W.,* 161 Wash. 2d 577, 606, 167 P.3d 1125 (2007). The *Colorado Structures* court went one step further and awarded reasonable attorney's fees in excess of the penal sum of the bond reasoning that:

> Without the application of *Olympic Steamship* and awarding attorney fees in addition to the policy limits of a surety bond when appropriate, an insurer would have absolutely no incentive to refrain from litigation over even the most clear coverage provisions.

Id. 161 Wash. 2d at 607. Notably, however, *Olympic Steamship* fees are limited to coverage disputes as opposed to claims disputes. The distinction between as coverage dispute versus as claims dispute is aptly explained as follows:

> Generally, when an insured must bring suit against its own insurer to obtain a legal determination interpreting the meaning or application of an insurance policy, it is a coverage dispute. This case would be in the nature of a claims dispute if West had agreed to pay under the bond, but had a factual dispute with Structures as to the amount of the payment.

Id. The equitable arguments in *Colorado Structures* were recently applied in California in *Karton v. Ari Design & Constr., Inc.,* wherein the Court assessed a $90,000.00 prevailing party fee award against a license bond surety because the surety tendered defense to its bond principal instead of negotiating an early resolution, reasoning that:

> [T]o avoid the costs and risks of litigation, Wesco could have negotiated settlement of its own liability or used interpleader procedures to deposit the amount of its bond in court. Instead, Wesco elected to gamble that it and Ari could avoid liability altogether on the merits. Having lost that gamble, [Wesco] is not in a position to complain about liability for court costs…

61 Cal. App. 5th 734, 753, 276 Cal. Rptr. 3d 46, 60 (2021), *as modified on denial of reh'g* (Mar. 29, 2021), *review denied* (June 23, 2021). While the Court relied on a statutory fee award against the bond principal in assessing fees against the surety, the Court's reasoning highlights the equitable considerations underpinning the Court's holding. The Court in *Gaff v. Washington Int'l Ins. Co.,* reached a similar conclusion wherein it awarded damages up to the penal sum of the surety's motor vehicle dealer bond, plus litigation costs in the amount of $9,416.00, under Code of Civil Procedure 1032, based upon the surety's decision to litigate as opposed to negotiate a settlement and/or interplead the bond proceeds into the court registry. 2021 WL 2411078 (Cal. Ct. App. June 14, 2021).

The foregoing decisions highlight how courts may employ a combination of statutory and/or equitable bases, in derogation of the American Rule, to assess attorney's fees against sureties in excess of the bond penal sum despite express contractual and/or statutory caps on the surety's liability.

II. Conclusion

In summary, surety claim professionals must be cognizant of the exceptions to the American Rule in applicable jurisdictions and retain counsel with a comprehensive understanding of the myriad bases upon which a court may award attorney's fees. Even in circumstances where neither the governing statute nor the bond provide for an award of attorney's fees and the bond itself may contain an express cap on the surety's liability, the surety may still be exposed to attorney's fees in excess of the bond penal sum.

PANEL 11

THE SURETY'S FINANCING DECISION: CASH FLOW TOOLS FROM AN ACCOUNTING PERSPECTIVE

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The Surety's Financing Decision: Cash Flow Tools from an Accounting Perspective

Price Jones, Nick Femia, Mark Woodbury, and Elliot Scharfenberg

We have all seen it before. The principal has run into several problem projects with difficult obligees, is besieged by payment bond claims, has tapped his line of credit at the bank, and now is looking to the surety for financing in the hopes of getting the problem projects across the finish line. The principal has been fighting to stay afloat for months and believes that if he can just get a cash infusion, he will be able to untie the knot, pay everyone back, and go on with his business. How is the surety supposed to evaluate this request? What accounting/financial information does a surety need to assist in making their decision to fund or not to fund the principal?

This paper presents a case study for a surety that is considering financing its principal and focuses on the accounting factors that tilt the decision in one direction or another. This is a broad and nuanced topic, and each situation presents new and unique challenges. However, for the sake of simplicity, we have limited this paper to a few conditions. Our hypothetical principal is a small contractor with annual revenues of approximately $20 million that self-performs some of his work. All of the projects the contractor is working on are bonded by the same surety and are all anticipated to be completed within a year. Our principal employs a bookkeeper but does not have an experienced construction accountant. We have also been told that our principal is in a wind down phase and will not be soliciting new work.

I. The Initial Financing Analysis

Too often when a principal seeks financing from the surety, the principal does not know what is relevant to its financing request and will not have his documents prepared or in a usable form for the surety. The surety's accountants or accounting consultants are then put in the position of asking targeted questions and gathering information from the principal to assist the surety in evaluating whether financing is in the surety's best interest. While not an exhaustive list, the following are key items the accountant and the surety's engineering consultants will develop to assist the surety in its decision-making process.

a. Cost to Complete

Cost to complete, in many cases, may be the most important component of the cash flow analysis for the surety. The estimated cost to complete reported by the principal is often outdated and understated. Like many of the items to be discussed below, the principal often has an optimistic perspective of the cost to complete. Based on experience, the surety and its consultants may add a contingency to the cost to complete reported by the principal after meeting with the principal's field personnel, visiting the project sites, reviewing work in place, and estimating the cost of the balance of the work to complete.

As a standard form of due diligence, the surety and its consultants should review the original contract documents and change orders to understand the current work scope and the remaining scope of work in order to prepare an independent estimate of the cost of complete.

The surety's engineering consultant should perform a detailed review of the workmanship of its principal, as the cost of the potential "rework" can quickly inflate principal's estimated cost to complete.

The remaining work to be performed by the principal's subcontractors is an important component of the cost complete. The surety's consultant should review the scope of subcontractors' work against the work completed by the subcontractors, and the remaining contract balance of each of the major subcontractors and suppliers, to make sure the costs are properly recorded in the cost to complete. The consultant should also review both approved and pending change orders of the principal's subcontractors to ensure they are included in the subcontractors' balance to complete. The conservative nature of accounting would dictate to include any subcontractor pending change orders that have a probability of being executed. Especially if these change orders are not going to be passed through to the obligee, therefore resulting in a net additional cash requirement to the surety.

"General Conditions" costs going forward are also an important component of the cost to complete of a construction project. The surety and its consultant should review the General Conditions reported by the principal to verify these costs are consistent with those reported on previous financial statements.

b. Affirmative Claims

The surety and its consultants should review the principal's affirmative claims and supporting documentation for merit. The principal often oversells affirmative claims, and the recoveries are far less than what was anticipated by the principal. To evaluate these claims, the consultant and outside legal counsel should review the underlying contract between the principal and owner and the factual support for the affirmative claim.

The timing of affirmative claim recoveries is also an important consideration when preparing a cash flow analysis. The timing of the submission of the claim, the review and processing of the claim, and the timing of potential payment of the claim are critical to forming adjustments to projected cash flow.

The surety should first verify the status of the principal's affirmative claim. Many times, the affirmative claim has yet to be submitted to the owner. The timing of this submission should be reviewed in conjunction with the underlying contract. There may be provisions in the contract discussing when a claim must be submitted and the documentation that must be provided. The contract must be reviewed by the surety and its consultant because some obligees may not entertain claims until certain conditions are met. If the principal has not complied with the provisions of the contract (i.e., submitted within a certain timeframe), depending on applicable law, it may preclude the claim from being submitted and therefore would reduce the claim to zero.

As discussed above, the surety and its consultants should review the supporting documentation for merit. After this review, the affirmative claim of the principal may be discounted to accurately reflect a realistic receivable from the obligee. The principal's claim

often contains aggressive positions that will be reduced during negations and change order review. As a result of the review process, there may be a lengthy period before a decision on the affirmative claim is agreed to. This extended process may result in a significant time delay on the collection of the funds to be received.

Not only can the claim review process of the obligee delay the receipt of funds, but also the actual payment process of the claim. There may be additional provisions in the underlying contract that can delay the timing of the recovery by the principal to the point that it is excluded in its entirety from the twelve-month cash flow projections.

c. Obligee's Claims Against the Principal

Again, the surety and its consultants should be aware of the provisions of the bonded contracts regarding any liquidated damages, actual damages, and back charges that may be assessed by the owner against the principal. Damages for delay on the project can quickly reduce or even eliminate the unpaid contract balance, thus increasing the influx of cash required by the surety to fund the completion effort.

Subcontractor liens on the project may also affect cash flow and receivables. Therefore, it is not only important to be aware of the accounts payables on the project when calculating projected cash outflows, but also outstanding obligee claims and their effect on unpaid obligee contract balances which could restrict the inflow of cash on the project.

d. Accounts Payable and Payment Bond Claims

The possibility of accounts payable being understated must always be considered by the surety and its consultants. In addition to outstanding balances reported by either the principal or its subcontractors and suppliers, the principal may have disputes with its subcontractors or suppliers regarding workmanship on the project, potential back charges, or claims on other projects that may result a reduction on the accounts payable reported by the principal. Although these conditions are important to be aware of, they may not always reduce the reported accounts payable. Disputes between a principal and its subcontractors and suppliers may be resolved expediently or can extend for some time. The surety and its consultants must objectively review claims for merit and act prudently using the documentation provided so that the funds required to complete the project and resolve substantiated claims can be established.

At an absolute minimum, the surety and its consultants should request a copy of the most recent accounting closed month's accounts payable aging by project and the last submitted payment requisitions for the major subcontractors and most recent supplier statements on the project. Adjustments should be made for any unrecorded accounts payable, as well as payment bond claims received by the surety in excess of the recorded accounts payable.

Any outstanding payables that are remain outstanding for over 30 days, depending on the owner's payment cycle, should be investigated, as they may result in issues for the surety on the project. The surety and its consultants should work with the principal to review the backup documentation of the payables and payment bond claims that may be filed by the vendors and

subcontractors; and this information must be contemplated in a cash flow analysis. Also as mentioned in the above section, liens may be filed by the subcontractors and suppliers on the project due to nonpayment which may restrict the incoming cash flow on the project. Depending on the jurisdiction, and the terms of the bonded contract, the obligee may be entitled to withhold some percentage in excess of the value of the lien until the lien is released or bonded off.

e. Accounts Receivable and Likelihood of Collection:

Principals tend to be more optimistic than the surety and its consultants with respect to collection of accounts receivables. All aged receivables greater than 60 days old, and of a material value, should be investigated to determine if collectible or, from the surety's perspective, be considered uncollectible and not considered in its cash flow projections.

Retainage accounts receivable on completed projects greater than 60 days is typical, as it takes time for project owners to formally accept the project and administratively close out the project. It is recommended that, as part of the cash flow project preparation process, the surety and its consultants review the terms and conditions of the bonded contract concerning the release of retainage. Retainage accounts receivable reaching or exceeding 90 days old require investigation, as it may indicate a collectability problem.

Non-Retainage accounts receivables greater than 60 days old require investigation, as this could indicate the project owner has issues with the principal's performance or is possibly experiencing financial difficulties. The surety's engineering consultant may be able to obtain pertinent information during their site visits or communications with the owner.

f. The Principal's Lenders and Other Business Obligations

The principal's bank obligations, in this case a fully drawn line of credit (LOC), and potential actions by the bank may impact the principal's ability to complete the projects even if surety agrees to offer financial assistance. When a surety finances the principal, it generally finances all of the principal's obligations, including the principal's obligations to its secured creditors. Therefore, the surety will want to consider the principal's obligations to its bank because a default on the principal's secured obligations may create other financial consequences and complications for the surety.

The renewal date of the LOC can be critical to surety's ability to finance the principal through completion of the projects. If the renewal date is coming up shortly, it is likely the bank will not renew the LOC based on principal's possible insolvent financial situation as reflected on their financial statements. Even if the LOC renewal is a few years in the future, the bank relationship could be problematic if the LOC agreement calls for monthly financial reporting and contains certain covenants that the principal may not be able to adhere to based on its financial condition.

If the bank does not renew the LOC or if the principal is in violation of one or more of the loan covenants, the bank may call the line, sweep or freeze the principal's accounts, or initiate liquidation actions against the LOC collateral, such as the principal's equipment or office

building. The bank sweeping the account of bonded funds (which may be trust funds, depending on the jurisdiction) may result in a lengthy and expensive legal fight for the surety to recover those bonded funds from the bank. Prior to any bank actions, the surety may attempt to negotiate and enter into a forbearance agreement with the bank allowing principal to complete the projects without any bank interference. Negotiating a forbearance agreement can be difficult, as the bank will want to protect their position in ways that may not align with the surety's financial interests.

Many self-performing principals lease some or all of their equipment. Assuming this is the case with our principal, the surety may need to fund and project the principal's past due and going-forward payments to the equipment lessors.

g. Payroll and Prevailing Wage Issues

The first funding ask from a financially troubled principal is typically for the next payroll cycle, which may be only a few days away. The surety must make a quick decision as, given the current shortage of construction labor, employees will quickly search for other employment if the principal misses a payroll. Many times, sureties consider this as "look see" money giving them further time to review and investigate principal's financial condition, as well as the construction status of the projects. Although, in the big picture, the surety would likely be obligated to pay at least some of the unpaid payroll as payment bond claims, the payroll allocable to home office are not typically payment bond obligations.

One of the quickest ways for a financially troubled principal to improve its cash flow is to delay paying its payroll tax obligations. This may work fine for 3 or 6 months until the IRS forwards a payment demand notice, which includes interest and penalties. The principal's non-compliance with the payment demand notice may result in the IRS placing a lien on principal's bank accounts (effectively freezing all funds) for the past due amounts or other actions detrimental to the principal's ability to continue operating as a viable entity. However, the IRS is generally agreeable to entering into an installment payment written agreement for the principal to pay the delinquent payroll obligations, but this can get expensive with interest and penalties. The surety's consultants' due diligence includes determining the status of payroll tax obligations and including any past due amounts or future installment payments in its cash flow projections.

A small sized principal under financial duress may be tempted to pay less than prevailing wage rates in order to free up cash flow. Therefore, it is imperative for the surety and its consultants to determine whether payroll hourly rates being paid in accordance with the contractual prevailing wage rates on any prevailing wage projects. As part of this process, the surety's consultants should include any prevailing wage underpayments in the cash flow in order to avoid incurring unprojected future labor costs.

h. Past Due Insurance Premiums

Most project owners will not allow principals to perform on their projects without the contractually required insurance in force. In addition, if insurance is terminated due to non-payment by the principal or any other reason, project owners may default the principal,

depending on the terms and conditions of the contract. In a surety finance situation, past due insurance premiums and going-forward premiums must be accounted for in the cash flow projection and must be funded in a timely manner to eliminate any insurance coverage-related project delays.

II. Protecting the Surety's Interests If the Surety Finances

After evaluating the information received from the principal and the surety having performed its due diligence, the surety may decide that financing the principal is in its best financial interest. However, that decision is not the end of the analysis. The surety will have to make additional decisions regarding the terms under which the surety is willing to finance, how the surety expects to be repaid, and how the contract receivables will be treated. In this section, we will give an overview of the legal protections a surety will want to include or consider in a financing agreement. Then we will address the costs and benefits of implementing a funds control procedure.

a. Financing Agreement

The surety's legal relationship with its principal is governed primarily by the general indemnity agreement. Typical indemnity agreements contain at least some language concerning the financing of the principal, but those provisions are often barebones and are appropriate only for look-see money. Before a surety decides to finance its principal, it should consider entering into a formal financing agreement with the principal and the indemnitors. Each situation will be different, but the following are considerations that should be taken into account before financing the principal.

Assignment of Contract Rights and Other Collateral. While the general indemnity agreement typically gives the surety an assignment of contract funds and other collateral, the surety may be able to improve its position by taking further assignments of contract receivables, insurance proceeds, or real property. Even if these were already assigned pursuant to the general indemnity agreement, an express agreement reduces the risk of litigation in the event that the surety needs to foreclose on its security interests. In certain situations, mortgages should be considered, as well as new security agreements.

Letters of Default and Direction. As part of the financing process, having the principal execute letters of direction and voluntary default to the obligees, and for the indemnitors to consent to same, can assist the surety in controlling the money and having flexibility to take over problem projects if the principal is not able to complete the project on its own. Even if these letters are not sent, having these letters executed and having the express authority to send these letters can improve the surety's position.

Express Promise to Pay. Almost every financing agreement will include a ratification of the indemnitors' obligations to repay any amounts financed by the surety. The surety can use the financing agreement to add additional indemnitors or just to make the legal obligations relative to repayment clear and agreed.

Of course, there are many other items for a surety to consider before financing, but due to the limitations of this article, we will not go into further detail here. Suffice is to say that it is generally in the best interest of the surety to engage a lawyer's services, whether inside or outside counsel, to help navigate the surety through this process.

b. Funds Control

If the surety elects to finance the principal, one of the surety's first decisions is to determine whether the bonded receipts should continue to be forwarded to and controlled by the principal or whether surety directs the project owners to forward all future payments to a surety-controlled escrow account usually managed by a third-party escrow agent.

Most principals will argue the best route is to keep the status quo and not alert employees, owners, subcontractors, vendors, and their bank that the principal is having financial difficulties and that the surety is providing financial assistance. Although, the principal's argument is not without some merit, it is generally in the surety's best interest to hire an escrow agent to manage the cash with input from both the surety and principal. While there are some disadvantages to using funds control, such as additional costs and disbursement time, it is usually in the surety's best interest to use funds control. The following are some of the primary advantages of using a third-party escrow agent.

1) The account is owned by the escrow agent with the surety listed as the beneficiary.
2) Surety and/or escrow agent typically sign the checks.
3) Real time reporting can be generated through internet access to the escrow account bank activity.
4) Eliminates the possibility of principal disbursing funds not approved by surety (i.e., diverting funds to pay personal obligations).
5) Allows for surety to have complete control of funds and disbursements including overhead costs which is a typical discussion topic between the principal and surety.
6) Eliminates co-mingling of project funds if principal were to begin work on new projects either non-bonded or bonded by another surety.
7) Protects bonded funds as principal's lending bank is not able to sweep the account.
8) In the event of a complete failure by the principal or their filing of bankruptcy, bonded funds are in an account controlled by surety.

PANEL 12

PASS THROUGH CLAIMS/FALSE CLAIMS ACT/LIQUIDATING CLAIMS

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Protecting the Surety in the Context of Pass-Through Claims and Liquidating Agreements

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Introduction:

When a surety takes over a project there are a myriad of issues that it must address. One of the most important is the prosecution of pass-through claims. A pass-through claim is generally defined as a claim of a "damaged party against an allegedly responsible party with whom it has no contractual relationship. These claims are presented by or through an intervening party in privity with both. The most common example of a pass through claim is a claim by a subcontractor arising out of the actions of the owner that is passed through to the owner by the prime contractor." See Faddis Concrete, Inc. v. Brawner Builders, Inc., Civil Action No. ELH-15-3975, 2017 U.S. Dist. LEXIS 150054, at *18-19 (D. Md. Sep. 15, 2017) (citing Carl A. Calvert & Carl F. Ingwalson, Jr., Pass Through Claims and Liquidation Agreements, Constr. Law., Oct. 1998, at 29).

The prosecution and payment of a pass-through claim is typically governed by a liquidating agreement, which can be set forth in the contractual documents, a separate agreement or both. Liquidating Agreements can also be subject to the implied duty of good faith and fair dealing, and compliance with the False Claims Act, or any similar state statute or contractual claim certification requirement. As a result, a surety must be well versed in its contractual and legal obligations, so as to avoid and account for the various pitfalls common in pursuing and prosecuting pass-through claims.

Properly navigating a pass-through claim also depends greatly on whether a surety is acting as a subcontractor or a general contractor. When acting as a subcontractor, pass-through claims are often the most fruitful means of recouping losses for a surety; meaning a surety will need to ensure that a quality claim is crafted, its contractual right to damages are preserved and that the general contractor complies with its duties to present and prosecute the claim on behalf of the surety/subcontractor.

When acting as a general contractor, pass-through claims are a vital tool to limit a surety's exposure to subcontractors; meaning a surety will need to ensure that it is protecting the rights of *all* of its subcontractors' pass-through claims, so as to avoid exposing itself to direct liability for those claims. At the same time, a surety acting as a general contractor must make certain that the pass-through claims it is prosecuting do not undermine or contradict the surety's own claim to an owner. When passing through a litany of other subcontractors' claims, a surety must also always be cognizant of the False Claims Act, and any state corollaries.

Accordingly, a surety must understand how to handle a pass-through claim in a variety of different situations. And whether acting as a subcontractor or a general contractor, it is imperative for a surety to retain counsel and a claims professional that understand how to properly navigate the prickly task of prosecuting pass-through claims.

A. Jurisdictions that Recognize Pass-Through Claims

As set forth above, a pass-through claim is generally a claim asserted by a subcontractor against an owner or its agents, which is prosecuted by a general contractor as the party in privity with the owner. See Bruner & O'Connor 8:51 pages 124-129.

Pass-through claims have "long been permitted" under Federal Law. Interstate Contracting, 135 S.W.3d at 610-11 (citing Interstate Contracting v. City of Dall., 320 F.3d 539, 543 (5th Cir. 2003); Severin v. United States, 99 Ct. Cl. 435, 444 (1943) (Whaley, C.J., dissenting), cert. denied, 322 U.S. 733 (1944); Mitsui & Co. v. Puerto Rico Water Res. Auth., 528 F. Supp. 768, 779 (D.P.R. 1981). Federal pass-through claims were generally governed by the Severin Doctrine. The Severin Doctrine provided that a pass-through claim could not be pursued by a general contractor if the subcontract contained a clause "that completely exculpated the [general] contractor from liability." Interstate Contracting, 135 S.W.3d at 611-12 (citing Severin, 99 Ct. Cl. at 442-43). The Severin Doctrine, however, has since been softened, and now federal courts "often interpret releases and contracts generously to let contractors pursue their subcontractors' claim [and] allow the contractor and subcontractor to liquidate the contractor's liability to the amount actually recovered from the owner." Interstate Contracting, 135 S.W.3d at 612-13.

On the state level, currently 20 states have addressed the validity of pass-through claims and 19 of them have recognized and interpreted such claims as liberally or more liberally than federal law. See Interstate Contracting Corp., 135 S.W.3d at 613-14 (reciting the position of the states that have addressed pass-through claims and ultimately holding that such claims are recognized in Texas). The 19 states that have confirmed the validity of pass-through claims include California (Howard Contracting, Inc. v. G.A. MacDonald Constr. Co., 71 Cal. App. 4th 38 (Cal. Ct. App. 1998)), New York (N. Moore St. Developers, LLC v. Meltzer/Mandl Architects, P.C., 23 A.D.3d 27 (App. Div. 1st Dept. 2005)), New Jersey (Buckley & Co. v. State, 140 N.J. Super. 289, (N.J. Super. Ct., Law Div. 1975)), Massachusetts (Old Colony Reg'l Vocational Tech. High School Dist. v. New England Constr., Inc., 5 Mass. App. Ct. 836 (Mass. App. Ct. 1977)), Florida (Public Health Trust of Dade County v. M.R. Harrison Constr. Corp., 454 So. 2d 659 (Fla. Dist. Ct. App. 1984)), Michigan (Kensington Corp. v. State, 74 Mich. App. 417, 420 (1977)), Virginia (Tyger Constr. Co. v. Commonwealth, 17 Va. App. 166, 435 S.E.2d 659, 662, 10 Va. Law Rep. 347 (Va. Ct. App. 1993)), and Texas (Interstate Contracting, 135 S.W.3d 605).

Connecticut, on the other hand, has interpeeted pass-through claims more restrictively than federal law. Worth Constr. Co. v. State Dep't of Pub. Works, No. HHDCV07501827, 2010 Conn. Super. LEXIS 2867, at *32 (Super. Ct. Aug. 10, 2010). In Worth, the court explained that while Connecticut law is "consistent with the Severin Doctrine to the extent that it allows and requires the general contractor to admit liability to the subcontractor and incorporate the subcontractor's claim into its own . . . the federal precedent does not mandate that the general contractor's admission of liability be unconditional and liquidated to a sum certain." Id.

As a result of this jurisdictional variation, a surety acting as a subcontractor must be diligent in ensuring that its pass-through claims are governed by a liquidating agreement that is permissible under the governing law.

B. Liquidating Agreements:

The terms governing pass-through claims are found in "liquidating" or "pass-through" agreements. Liquidating agreements "are meant to establish the ground rules of claim presentation and prosecution. They outline respective duties of cooperation. They determine who will be the main party responsible for the success of the claim. They provide for payment or reimbursement of costs, markups and attorneys' fees." 2 Matthew Bender Construction Law P 7.10 (2022).

Liquidating agreements "need not take any particular form. They may be memorialized in the subcontract or in a separate written agreement and may be assembled from several documents executed over a period of years" N. Moore St. Developers, LLC v Meltzer/Mandl Architects, P.C., 23 AD3d 27, 32 (App. Div. 1st Dept. 2005); (Sehulster Tunnels/Pre-Con v Traylor Bros., Inc./Obayashi Corp., 111 Cal App 4th 1328, 1348-49 (2003) ("by contract or settlement agreement, a general contractor and a subcontractor can agree that the contractor will pass through the subcontractor's claims against the contractor to the owner"); Interstate Contracting Corp., 135 S.W.3d at 610 ("a liquidation agreement may be included in the subcontract or may take the form of a separate agreement").

When a Surety takes over a Project, it may already be bound by a liquidating provision in the bonded contract. It is important for a surety to immediately familiarize itself with those provisions because a principal may have already submitted a pass-through claim or, in the case of a general contractor, be the custodian of subcontractor pass-through claims. To the extent pass-through claims that preexisted a surety's takeover have been prejudiced by the inactions of a principal in custody of those claims, a cause of action against the surety for breach of contract against may exist. Am. Elec. Co., LLC v Parsons RCI, Inc., 2015 US Dist LEXIS 57740 (D. Haw. Apr. 30, 2015).

For example, if a surety acting as a general contractor discovers that its principal was in custody of pass-through claim that it failed to pursue in accordance with certain limitations periods or contractual notice requirements, the surety may lose the protections of the liquidating agreement, which limited the surety's liability to amounts actually received from the owner. Instead, a surety may be held directly liable to the claimant for the full sum of the claim, regardless of whether the surety was compensated by the owner. Under the same scenario, a surety acting as a subcontractor may have a cause of action against a general contractor for a failure to comply with the terms of a liquidating provision and be in a position to recoup sums against the general contractor irrespective of how the owner treated the claim.

In the event a surety finds itself in a position to negotiate the terms of a liquidating agreement, it must do so with care. A surety should attempt to set forth the precise obligations a general contractor is undertaking on behalf of a subcontractor; a subcontractor's remedies in the event the general contractor decides not to pursue the pass-through claim; and the manner in

which monies will be divided among claimants in the event an owner resolves multiple pass-through claims by way of an unallocated, lump sum payment to a general contractor. This final obligation, the distribution of a lump sum payment to the general contractor, is something that all pass-through agreements should provide for, so as to avoid a later dispute with the general contractor See 2 Matthew Bender Construction Law P 7.10 (2022).

Berkley Regional Insurance Company v. Safeco Insurance Company of America, 16-cv-02383 ERK (E.D.N.Y. 2022) highlights the need for specificity in a liquidating agreement. In Berkley, a general contractor passed through a variety of subcontractor claims, together with its own claim, in the sum total of $30 million. The owner resolved the $30 million omnibus claim with an unallocated $9 million payment. The general contractor admitted that there was no way to know what portions of the claim the owner was paying for when it remitted the $9 million. Consequently, the general contractor took an aggressive position with its subcontractors, in which it tried to deprive them of a portion of the settlement funds due to alleged deficiencies with their claims, or by claiming that they were "rejected" by the owner. But there was no way to prove that any of those deficiencies actually mattered in the remittance of the $9 million, or that the claims were rejected. The absence of ironclad terms to establish how sums would be divided in such a situation led to costly litigation for a surety acting as a subcontractor seeking its fair share of the settlement.

The foregoing highlights the importance of negotiating for all eventualities in a liquidating agreement. However, it is not just the express terms of the liquidating agreement that govern, as some jurisdictions have also used the implied duty of good faith and fair dealing to explain the manner of performance required under liquidating agreements.

C. **Duty of Good Faith and Fair Dealing**:

The duty of good faith and fair dealing is recognized as an implied contractual duty in many jurisdictions, but not all. See Jonathan Neil & Assocs., Inc. v. Jones, 33 Cal. 4th 917, 937 (2004) (internal quotation and citation omitted) (explaining "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement"); QBE Ins. Corp. v. Chalfonte Condo. Apartment Ass'n, 94 So. 3d 541, 548 (Fla. 2012); Rekhter v. Dep't of Soc. & Health Servs., 180 Wash. 2d 102, 112-13, 323 P.3d 1036, 1041 (2014); but see Alabama v. North Carolina, 2009 U.S. LEXIS 9166, at *37 (Apr. 2, 2009) (explaining that "it is not clear that the duty of good faith and fair dealing applies to compacts between sovereign States"); Barrow-Shaver Res. Co. v. Carrizo Oil & Gas, Inc., 590 S.W.3d 471, 491 (Tex. 2019) (holding that Texas has "long held that there is not an implied covenant of good faith and fair dealing in every contract").

Generally, the rule "embraces a pledge that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract." Brown v. Erie Ins. Co., 2022 NY Slip Op 04459, ¶ 1 (App. Div. 4th Dept.) (internal citation and quotation omitted); QBE Ins. Corp., 94 So. 3d at 548. It is jurisdictionally dependent whether the breach of the duty can exist as an independent cause of action *without* a separate, corresponding breach of contract claim. Compare Anexia, Inc. v. Horizon Data Sols.

Ctr., LLC, 2022 NY Slip Op 50320(U), ¶ 2, (Sup. Ct., New York County 2022); with QBE Ins. Corp., 94 So. 3d at 548; Rekhter v. Dep't of Soc. & Health Servs., 180 Wash. 2d at 112.

Recently, select courts have begun interpreting the duty of good faith and fair dealing within the context of liquidating agreements. In New York, courts have confirmed that the duty of good faith and fair imposes a duty on the general contractor to "present the subcontractor's claim to the owner in a fair and serious manner." Rad & D'Aprile Inc. v. Arnell Constr. Corp., 49 Misc. 3d 189, 201 (Sup. Ct., Kings County 2015), aff'd sub nom Rad & D'Aprile, Inc. v. Arnell Constr. Corp., 159 A.D.3d 971 (App. Div. 2d Dept. 2018); accord Rad & D'Aprile, Inc. v. Arnell Constr. Corp., 2019 NY Slip Op 30941[U] (Sup. Ct., Kings County 2019) aff'd Rad & D'Aprile, Inc. v. Arnell Constr. Corp., 203 A.D.3d 855 (App. Div. 2nd Dept. 2022). To do so, the general contractor is required to "take reasonable steps so that [the subcontractor's] eventual recovery from the [owner is] protected." Id. [citations and quotations omitted]; accord Rad & D'Aprile, Inc., 2019 NY Slip Op 30941[U]. A general contractor's failure to do so constitutes a breach of the parties' agreement. See id; Levinson & Santoro Electric Corp. v American Home Assur. Co., 2013 NY Slip Op 31245[U], at *12 (Sup. Ct., Queens County 2011) (holding a general contractor liable for breaching a liquidating agreement after the evidence demonstrated that the general contractor had resolved the subcontractor's claims for a lesser sum than it had previously accepted from the owner, and did not provide the subcontractor the correct portion of funds from a global settlement with the owner).

In Rad, the trial court granted summary judgment to a subcontractor on the issue of the general contractor's liability under a pass-through provision, despite the fact that generally contractor had actually pass-through the subcontractor's claim to the owner. 2019 NY Slip Op 30941[U], at *31-32. There, the general contractor entered into a settlement agreement with the owner, but claimed that none of the settlement funds were for the subcontractor's claim. Id. In granting the subcontractor's motion on liability, the court explained that the general contractor had breached its duty to protect the subcontractor's claim by, among other things, failing to inform the subcontractor of its settlement with the owner and allowing the subcontractor to preserve or protect its claim. Id. at *29-30. Likewise, in Levinson, the court found that the evidence supported a finding that a general contractor had breached the duty of good faith and fair dealing, despite the fact that the general contractor undertook the mechanical act of transmitting the pass-through claim to the owner. 2013 NY Slip Op 31245[U], at *12. In fact, the Levinson general contractor even recovered monies for the pass-through claim but was nonetheless deemed to have breached its duty by, among other things, achieving a resolution that was inconsistent with other claims. Id.

Massachusetts courts have also interpreted the duty of good faith and fair dealing within the context of liquidating agreements. See Certified Power Sys., Inc. v. Dominion Ener. Brayton Point, 2011 Mass.Super. LEXIS 317 at *183 (Dec. 30, 2011) (MacDonald, J.); Commercial Masonry Corp. v. Barletta Eng'g Corp., Nos. 126435, PLCV2008-00514-B, 2014 Mass. Super. LEXIS 40, at *60-61 (Mar. 12, 2014)). While recognized in Massachusetts, the Courts have held that the affected subcontractor must show that it had a valid pass-through claim in order for the breach to be compensable. See Certified, 2011 Mass.Super. LEXIS 317 at *183 (holding that the duty of good faith and fair dealing was breached by a general contractor when it resolved pass-

through claims as part of a global settlement without authority to do so, but that the breach was not compensable because the subcontractor failed to prove it had a valid pass-through claim).

While the caselaw in this area is still developing and not prominent outside of these jurisdictions, a surety acting as a general contractor would be wise to notify its pass-through claimants of developments with its claim, potential settlements and any intent to abandon pursuit of a claim. On the other hand, a surety acting as a subcontractor must be careful to preserve a claim against a general contractor for breach of the duty of good faith and fair dealing, as it provides an alternative avenue recovery to breach of contract.

D. False Claims Act

When a Surety is preparing a pass-through claim, or agreeing to pass one through on behalf of a subcontractor, it should make certain with its consultant and attorney that the claim does not run afoul of the False Claims Act.

The False Claims Act "was originally passed in 1863 after disclosure of widespread fraud against the Government during the War Between the States. It seems quite clear that the objective of Congress was broadly to protect the funds and property of the Government from fraudulent claims." Rainwater v. United States, 356 U.S. 590, 592, 78 S. Ct. 946, 948, 2 L.Ed.2d 996, 998-99 (1958).

In order to recover damages for violation of the False Claims Act, the government must establish the following elements:

> (1) the contractor presented or caused to be presented to an agent of 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.

Young-Montenay, Inc. v. United States, 15 F.3d 1040, 1043 (Fed. Cir. 1994)

"While the FCA does not require proof of specific intent to defraud, it does require that the person or entity acted with knowledge. 31 U.S.C. § 3729(b)." Liquidating Tr. Ester Duval of KI Liquidation, Inc. v. United States, 116 Fed. Cl. 338, 379-80 (2014). The statute defines "knowing" or "knowingly" to "mean that a person" "with actual knowledge of the information" either "acts in deliberate ignorance of the truth or falsity of the information" or "acts in reckless disregard of the truth or falsity of the information." Id. The requisite scienter in a FCA claim is present in "not just those who set out to defraud the government, but also those who ignore obvious deficiencies in a claim." Gulf Group Enters. Co. v. United States, 114 Fed. Cl. 258, 314 (2013). "An innocent mistake or mere negligence," however, is not enough to trigger FCA liability. Id. at 316. It is reckless when a company submits a request for payment that had not first been reviewed. United States v. Krizek, 111 F.3d 934, 942 (D.C. Cir. 1997).

While the False Claims Act only applies to Federal contracts, there are many state corollaries and even city specific statutes within the states. The below is a small sampling of State corollaries of Fales Claims Act:

Florida:
§ 68.081. Florida False Claims Act; short title.
Sections 68.081-68.092 may be cited as the "Florida False Claims Act."

California:
California's False Claims Act (Gov. Code, § 12650 et seq.).

New York:
New York City has its own false claims act that applies to claims filed with the city. NYC Administrative Code 7-804.

The New York false claims act applies to claims made to state entities. New York State False Claims Act. N.Y. State Fin. Law §§ 187 – 194.

Texas:
Texas has a false claims act, the Texas Medicaid Fraud Prevention Act ("TMFPA") (Tex. Hum. Res. Code §§ 36.001 et seq.), but it only appears to apply to Medicaid claims.

When preparing a pass-through claim, a Surety must make certain to identify false claim statutes and abide by the rules prescribed thereunder. It, therefore, becomes essential to have an experience claim's consultant to ensure the claims being submitted have merit.

E. Conclusion

The foregoing demonstrates that pass-through claims can be both treacherous and fruitful for a surety. It is important for a surety handling pass-through claims to retain the services of an experienced claims professional and counsel to protect the Surety's interests, while also maximizing the Surety's potential recovery.

PANEL 13

CONTRACTING MECHANISMS AND CONSIDERATIONS ON HIRING A COMPLETION CONTRACTOR

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PEARLMAN 2022

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Sparkman Cellars Winery | Woodinville, WA

CONSIDERATIONS ON HIRING A COMPLETION CONTRACTOR

R. Brent McSwain, Vice President of The Sage Group

Warren Buffet's maxim—"Price is what you pay; value is what you get"—applies to hiring completion contractors as well as buying securities. The lowest price may not result in the lowest cost because lower costs typically mean lesser services, which may result in higher costs. There are a number of factors to consider when hiring a completion contractor that may affect the costs ultimately incurred besides the price of the completion contract.

The typical project after a default is often delayed and over budget. However, the surety typically does not contemplate that the completion contractor will encounter new sources of delay and cost overruns during completion. Such delays can occur because of actions for which the owner or another party is responsible. As such, avenues for recovery of those new costs resulting from delay proactively should be considered by the surety at the time of re-procurement. To recover the losses resulting from new impacts and problems, it is necessary to determine the causal reasons for the new costs. The ability both to determine the causes of the impacts and recover the cost of those impacts is affected by decisions made in the selection of the completion contractor.

Analyzing and presenting requests for time extensions is difficult and expensive without schedules that have been updated timely and properly utilized during the project before any default. Recovering additional costs is difficult and expensive without the necessary cost controls that allow analysis and identification of additional costs. Recovery of unexpected costs and delays starts with analysis of the cost records, project schedules, and documentation. Proper use of cost accounting systems to capture accurate cost data compared to the budget assists the contractor in managing the project and identifying impacts. Conversely, when the cost records, schedules, and documentation are insufficient, management of the project suffers and identification and recovery of impacts after the fact is more difficult and costly to determine.

Hire a Qualified Completion Contractor

Effective performance of the completion work starts with hiring a completion contractor that is experienced in the type of work being performed and is proficient in the use of cost accounting, scheduling, and documentation tools for the management of successful projects. The surety should ensure that the completion contractor it is considering has a proper cost module for its accounting system. A proper cost module records the costs incurred against the budgets for the direct labor, material, subcontractor, and change order costs when these actual and committed costs are being incurred.

The completion contractor also should show it uses appropriate scheduling systems that can produce schedules with sufficient activity ID coding to track periodic progress, including impacts and delays. The completion contractor should be proficient in using fragnets inserted into the schedule contemporaneously when the delays occur. The surety should require the completion contractor issues monthly schedule reports documenting the work progress as well as the schedule impacts on the final project completion date, while assigning delay responsibility to any offending party. To document the events causing impact and delay, the completion contractor should organize, identify, and ensure that all pertinent documentation, including email correspondence located on individual computers, is available for claim development and potential litigation.

Without the proper cost information, schedule, and documentation, the identification and analysis of increased costs and schedule delays becomes problematic and cost recovery becomes

more difficult—and costly—to prove. By ensuring the completion contractor has the tools and experience necessary to administer and document the work, the surety will be better positioned to recover costs for which others may be responsible.

Demand Proper Job Cost Accounting

The heart of any damage analysis is the cost report. The surety should insist that the completion contractor have a sufficient job cost accounting system and proficiency in implementing good cost accounting policies and procedures. The cost report should be generated by a cost accounting system that tracks costs to detailed cost codes for both self-performed and subcontracted work. When additional, unexpected costs occur, analysis can determine what cost codes overran the budgeted amounts. This analysis will preserve key evidence to support the surety's right to recover costs for which others may be responsible. Of course, no surety expects to have to make a claim against the owner, architect or subcontractors on a project that requires a completion contractor but that does not mean the surety cannot assure better results by requiring its completion contractor has the proper tools when needed.

The contractor's accounting department typically manages the cost report system and enters the expenditures as they are paid. The contractor's staff, usually the project manager, is typically responsible for validating all budgets entered into the cost report, assuring that the proper cost codes are funded. When change orders are approved, the project manager is responsible for providing the budget adjustments to the accounting department by specific cost code. When invoices are received, the project manager should code the invoice with the appropriate cost code for the accounting department's use.

Though simplistic in execution, mismanagement of the cost report is not uncommon, resulting in additional time, effort, and cost to later determine not only the category of loss, but the amount of the loss because the original budgets are wrong, the change order budgets were not entered, or the subcontractor cost code budgets do not reflect the agreed-on subcontract amounts. Even if a completion contractor has a proper job cost accounting system, that does not mean the contractor is proficient using that system. Often, mistakes are made in how the accounting system is used, not in the system itself. As such, the surety should:

- confirm what type of cost accounting system is being used by the completion contractor prior to selecting that firm and
- confirm whether the completion contractor can show a track record of properly administering job cost report and tracking overall project costs.

In some instances, completion contractors arbitrarily may increase their budgets to eliminate the appearance of cost overruns, simply to make the losses "disappear" so they do not have to explain them. Doing so may be a lost opportunity because the loss on a cost code may be the result of a recoverable cost due to the action or inaction of another party. When the loss is eliminated artificially, the ability to identify and assert the loss becomes problematic.

By properly administering the job cost accounting system, the competent completion contractor and the surety can rely on the validity of the cost report. The accounting department can run not only summary cost reports, but a multitude of other reports for loss analysis purposes. In contrast, contractors still using spreadsheets to record costs instead of using accounting systems becomes problematic if neither the original nor change order budgets are incorporated by cost code. If no budgets exist, the completion contractor cannot manage the work to a budget, but is simply recording expenditures for the surety to pay. This contractor may not be aware it is incurring losses until it has actually overrun the total cost anticipated. As a result, the completion contractor may fail to issue contractually required notices of those impacts. When loss analysis is required, it is difficult and costly to recreate the required budgets as adjusted for change orders. In those instances, the budgets almost always have to be prepared on a summary level basis, not allowing individual

cost code loss analysis. As a result, the credibility of the loss analysis may come into question.

The surety can eliminate this credibility issue by insisting the contractor demonstrate that a sufficient job cost accounting system will be used, as well as provide a detailed discussion on its use policy and procedures for proper budget, change order, and expenditure management. Losses can be mitigated if managed.

Demand Proper Change Order and Schedule Delay Management

The root cause of many claims can be excessive owner-issued change orders. In many cases, the unpaid direct cost change orders are either not timely resolved, resolved for less than anticipated, remain unpaid, or are rejected. The surety should require that its completion contractor explain its change order management policy and procedures and provide staffing resources necessary to properly manage the change order process.

The surety should request the completion contractor's past change order logs to understand whether or not the contractor is sufficiently prepared to manage the change order process. The surety should also insist that contractor explain how it tracks change order costs in its cost report. When change order costs are commingled with the base contract costs, it can create significant challenges if the costs need to be separated for either loss analysis or billing purposes. Because change order management is essential to both cost and schedule management, the surety should determine whether its selected completion contractor is appropriately experienced and staffed to administer the change order process.

A completion contractor may be experienced in pricing change orders timely but ignores the schedule impact of the change on the base contract work. If critical path delay has either occurred or is expected, the completion contractor is likely entitled to general conditions costs for the extended duration. The surety should validate whether the chosen completion contractor has experience in providing schedule delay analysis of changes to the work. If the completion contractor cannot determine with reasonable certainty the critical path schedule impact resulting from a specific change, then the completion contractor is not proficient in schedule delay management. The surety should request the completion contractor's scheduling policy and procedures to ensure the surety's rights are protected when critical path schedule delays occur.

The ability to show entitlement to both delay costs and the increased general conditions costs due to extended duration is dependent on:

- accurate schedule progress and delay analysis;
- the documentation produced by the completion contractor contemporaneously throughout performance; and
- proper job cost budget and cost reporting.

The surety's ability to recover these types of losses is dependent on the completion contractor's ability to properly administer both the cost and schedule for the work.

The surety needs to verify that the completion contractor has policies and procedures to properly document and provide notice of delay. When the owner ignores the delay and no time extensions are approved, increased contractor cost will result from both the increased general conditions costs resulting from the delay as well as the direct costs resulting from the contractor constructively accelerating the work to mitigate the delay. To recover the losses, the surety needs to ensure its contractor is experienced in:

- documenting and providing notice of delay;
- calculating the delays through schedule analysis;
- pricing the extended duration costs properly; and
- properly tracking acceleration costs.

Otherwise, loss recovery will again be difficult and expensive.

Demand Adherence to Proper Scheduling Protocols

The surety should ensure the completion contractor has expertise in properly developing and statusing the project schedule. Though other scheduling software exists, contractors often use Primavera P6, Microsoft Project Manager, and ASTA scheduling software as their preferred choice. However, as with job cost accounting systems, just having the software in place is not enough – the completion contractor must be proficient in its use. The surety should ensure that the contractor's staff charged with using the scheduling software understands proper schedule development and protocols in its use.

Typical issues that affect the ability to develop a strong delay claim include:

- poorly developed baseline schedules;
- improperly statusing or calculating the monthly schedules;
- overuse of constraints;
- incorrect or missing logic connections;
- improperly sequenced or stacked work;
- missing required work scope; and
- poor duration development.

Schedules often fail to include sufficient time for:

- submittal review and approval;
- shop drawing development and review;
- fabrication; and
- jurisdictional review.

A poorly developed or incomplete schedule may result in credibility problems if the schedule issues resulted in significant self- inflicted delay commingled with the delay the surety asserts affected the completion. Unraveling schedule issues during a delay analysis can be very time consuming and costly. Much of the time and expense can be avoided if the contractor lives up to its responsibility to implement proper procedures and protocols.

Because extended duration general conditions costs can be a significant cost component of any delay claim, it is imperative that the contractor develop good baseline schedules and maintain those schedules monthly as accurately as possible throughout the performance period. The reliability of the schedule and the delays incorporated in the progress updates are relied on to support recovery entitlement of both direct costs and general conditions. If not properly developed, the schedule will be attacked as insufficient and used against the surety claiming additional costs due to delay. The goal is to prevent that argument from arising in the first place. As such, the surety should ensure that the completion contractor is experienced in:

- schedule development;
- schedule management; and
- schedule delay analysis.

Good management of the schedule and changes thereto by the completion contractor during performance greatly increases the surety's ability to mitigate the impact of delay.

To supplement the monthly schedule progress updates, it is good practice to insist that the completion contractor issue monthly schedule narrative reports to the owner advising the owner of the schedule status and if the owner was the cause of any delay in that period. The schedule reports confirm the delays reported and can be identified by an expert when the delay analysis is being performed. The monthly schedule narratives can also confirm that timely notice was provided to the owner of the delays for which the surety is trying to recover additional costs.

What to do to Avoid or Mitigate Claims

If losses and delays may have resulted from the owner's late and incomplete designs, the owner's interference or maladministration, or because the completion contractor and its subcontractors simply failed to perform, determination of the root causes of such losses and delays is required to determine whether pursuing claims and litigation to recover the losses is warranted. One of the best ways for a surety to both avoid unexpected delays and added costs is to hire a completion contractor who manages the work using both current cost accounting software and techniques, including

accurate cost records and appropriate scheduling software and delay analysis, as well as issuing monthly reports. Completion contractors who manage the work in this manner tend to find and solve problems early when the problems arise, allowing the surety to reduce completion costs and to recover when warranted.

PANEL 14

ETHICS: GONE FISHIN' – NAVIGATING THE WATERS, AVOIDING THE SNAGS, AND SMOOTH(ER) SAILING WITH THE JOINT DEFENSE AND COMMON INTEREST PRIVILEGES

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PEARLMAN 2022

September 8-9, 2022

Sparkman Cellars Winery | Woodinville, WA

Gone Fishin': Navigating the Waters, Avoiding Snags, and Smooth(er) Sailing with the Joint Defense and Common Interest Privileges

28th Annual Pearlman Gathering
September 9, 2022

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I. INTRODUCTION

This paper will discuss an increasingly utilized exception to the waiver provisions of the attorney-client privilege known as the "common interest privilege." As will be discussed in this paper, varying jurisdictions have expanded and contracted this doctrine over time, so this paper will explore some of these jurisdictional differences and the key points in which they differ so that practitioners can hone-in on the critical research points when invoking or challenging the privilege. Furthermore, as this paper is being presented in conjunction with an oral presentation for Continuing Legal Education at the 28th Annual Pearlman Gathering on September 9, 2022, this paper will explore particular applications of the common interest privilege in situations involving insurance companies, sureties, and communications with consultants.

The Pearlman Gathering takes place in wine country on the hills above the Puget Sound, Washington, known by many as a fishing hub of the Western United States. Like the wary fisherman, carefully knotting lines and ebbing with every swale of the sea, the skilled legal practitioner must equally navigate the common interest privilege, scrupulously analyzing the parties to the communication, the nature of the content, and the timing with respect to the dispute to determine whether a privilege actually applies. Failure to do so may leave the practitioner afoul of a reef or empty-netted.

II. What are the Joint Defense Privilege and Common Interest Privilege?

Most practitioners are familiar with the attorney-client privilege—it is one of the most fundamental and critical privileges in the practice of law. Black's Law Dictionary defines it as a privilege that protects confidential communications between an attorney and a client for the purpose of giving or receiving legal advice from discovery in litigation.[1] Rather than an ethics rule of *confidentiality*,[2] the attorney-client privilege is a rule of evidence, governed either by state common law or a state's evidence code.[3] Therefore, it is important to keep in mind that when discussing the attorney-client privilege and the common interest privilege, we're discussing issues for application in a legal proceeding regarding discovery and evidence. Although ancient and venerable, the attorney-client privilege is also a roadblock to the fact-finding and truth-seeking goals of the civil process. Thus, some jurisdictions are wary of expanding the privilege and have, therefore, limited the application of the common interest privilege. This will be discussed in further detail herein.

Courts will find that the attorney-client privilege has been waived under many circumstances. Perhaps most frequently, the privilege can be waived if the communication is

[1] *Attorney-Client Privilege*, Black's Law Dictionary (11th ed. 2019).

[2] *C.f.* Model Rule of Professional Conduct 1.7.

[3] *See, e.g.*, Fla. Stat. § 90.502. The same is true in federal practice. F.R.E. 501 provides that in a civil case, state law governs privilege generally where state law supplies the rule of decision. Therefore, if California state law governs the dispute, but the case is venued in Florida, California privilege law will govern issues of privilege. *See Shaklee Corp. v. Gunnell*, 110 F.R.D. 190, 192 (N.D. Cal. 1986). In cases containing both federal and state claims, courts balance the competing federal interests and principles of comity to determine which privilege law controls the federal claim. *See Jones v. Murphy*, 256 F.R.D. 510 (D.C. Md. 2008). However, F.R.E. 502 does set forth specific provisions regarding waiver and limitations.

shared with a third party, *i.e.*, someone other than the attorney and the client. For example, if a privileged email between an attorney and a client is later forwarded by either the client or the attorney to a third party, then any privilege is typically waived.[4] Because there can often be a need for lawyers to engage outside individuals for the purpose of providing the client the best and fullest representation, many exceptions to the rule that the sharing of an otherwise privileged communication can destroy the privilege have been carved out.

One of the earliest exceptions to the waiver provisions of the attorney-client privilege was the co-client privilege. Under this privilege, where multiple clients retain the same attorney(s) to represent them, communications among the multiple clients and the shared attorney(s) remain insulated from discovery.[5] In this way, each additional client of the same attorney is not considered a third party who can trigger waiver and thereby destroy the privilege.

The next expansion was the joint defense privilege. The joint defense privilege allows one group of clients and their counsel to communicate with another group of clients and their separate counsel—all without allowing their common adversary (the plaintiff) to discover those communications. The joint defense version of the attorney-client privilege applies during live litigation, as to both defendants in the same case and defendants in related, but separate, cases.[6] Additionally, "[t]he joint defense privilege applies when different law firms represent different clients who share common interests and choose to work as a team to further those interests. Those interests need not be identical; such a requirement would essentially deprive most clients of the benefit of joint defense agreements because the interests of different clients are rarely precisely identical …direct communications between or among various clients do not become privileged by the joint defense privilege; rather, privileged communications *with counsel* that are transmitted by counsel to joint defense counsel or their clients simply remain privileged through the joint defense privilege."[7]

These expansions can generally be characterized as a recognition that two parties to a lawsuit, although third parties to each other vis-à-vis the attorney, share the attorney-client privilege. A fundamental consideration in creating this exception for joint parties was that they share an interest in the litigation, and, therefore, should be able to freely share information in a joint setting with counsel.

The logical extension of this waiver exception is the common interest privilege. The common interest privilege allows one group of clients and their counsel to communicate confidentially with another group of clients and their separate counsel—but this time without the requirement of active litigation (in most courts, at least).[8] The common interest privilege is an exception to the waiver rule of the attorney-client privilege. As an evidentiary privilege, the validity of an assertion of a common interest privilege might not be tested until litigation arises,

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[4] *See, e.g.*, *Semsysco GmbH v. GlobalFoundries, Inc.*, 2019 WL 1243089 (N.Y. Sup. Ct. Mar. 18, 2019) (finding waiver where a client forwarded otherwise-privileged email to third parties); *Bousamra v. Excela Health*, 210 A.3d 967 (Pa. 2019) (finding waiver where an attorney forwarded otherwise-privileged email to a public relations company).

[5] *See In re Teleglobe Commc'ns Corp.*, 493 F.3d 345, 365 (3d Cir. 2007).

[6] *Transmirra Prods. Corp. v. Monsanto Chem. Co.*, 26 F.R.D. 572 (S.D.N.Y. 1960).

[7] *Rhodes v .AIG Domestic Claims, Inc.*, 20 Mass. L. Rptr. 491 (Sup. Ct. Suffolk County 2006).

[8] RESTATEMENT (THIRD) OF THE L. GOVERNING LAWS. § 76 (Am. L. Inst. 2000).

but the allegedly privileged communications can occur long before any such litigation arises or is even anticipated.[9]

The joint defense privilege, therefore, is historically tied to litigation, whereas the common interest privilege is not. However, courts sometimes refer to these privileges interchangeably. And in New York, the state's highest court has held that the common interest privilege only applies to communications related to either pending or anticipated litigation,[10] further highlighting the interchangeability of the modern privileges.

Three characteristics highlight the common interest privilege. First, the communicating parties must share a *common* interest. Second, that shared interest must be a *legal* interest. Third, the communications must, at least in some fashion, include an *attorney*.

Regarding commonality, although the privilege evolved historically from parties on the same side of the "v" in a litigated case, some courts have found that a common interest can be found among plaintiffs against defendants; such as, against a third-party defendant or a defendant cross-claimant.[11] For example, the Florida Third District Court of Appeal in *Visual Scene* reasoned that the privilege will apply to any litigant who has a common legal interest with another litigant, but only to the extent that the communications are made in confidence and concern the parties' common interest.[12] The court concluded: "[t]o extend the common interests privilege to parties aligned on opposite sides of the litigation for another purpose is not inconsistent with any policy underlying the attorney-client privilege and merely facilitates representation of the sharing parties by their respective counsel. Sharing parties on opposite sides of litigation, being uncertain bedfellows, run a greater than usual risk that one may use the information against the other should subsequent litigation arise between them, yet there is no sound reason not to protect from the rest of the world … information intended by [them] to be kept confidential and to be used to further the common litigation interests."[13]

Some courts have found that commonality can be found among non-litigants altogether, in the context of mergers or other transactions in which parties' legal interests are aligned.[14] Some jurisdictions differ, however, and have held that commonality can only be found among litigants or prospective litigants.[15] The District Court for the Northern District of Illinois in *In re JPMorgan Chase & Co. Securities Litigation* reasoned: "Prior to the merger, these organizations stood on opposite sides of a business transaction. From a business standpoint and from a legal

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[9] *See, e.g.*, *In re Regents of the Univ. of Cal.*, 101 F.3d 1386, 1391 (Fed. Cir. 1996) ("The privilege need not be limited to legal consultations between corporations in litigation situations … Corporations should be encouraged to seek legal advice in planning their affairs to avoid litigation as well as in pursuing it."); *but see Ambac Assur. Corp. v. Countrywide Home Loans Inc.*, 27 N.Y.3d 616 (2016) (common interest exception applies only to communication related to litigation, either pending or anticipated because the privilege hinders the truth-finding process and therefore must be strictly construed).

[10] *Ambac Assur. Corp.*, fn9, *supra*.

[11] *Visual Scene, Inc. v. Pilkington Bros., plc.*, 508 So. 2d 437 (Fla. Dist. Ct. App. 1987).

[12] *Id*. at 441.

[13] *Id*. at 441-42.

[14] *See Hewlett-Packard Co. v. Bausch & Lomb, Inc*., 115 F.R.D. 308, 311 (N.D. Cal. 1987).

[15] *See In re JPMorgan Chase & Co. Securities Litigation*, 2007 WL 2363311 (N.D. Ill. 2007) (commonality for purposes of the common interest privilege does not exist in the context of mergers, where the interests at play are zero sum).

standpoint, the merger parties' interests stood opposed to each other. They had no common interest, and indeed, their interests were in conflict—each company wanted to get the best deal from the other company, and to the extent that one succeeded in its goal, the other suffered."[16] Practitioners should be keen to the courts' focus on *timing*: before merger, the parties were negotiating at arm's length and were, thus, adverse, despite their best hopes to negotiate a deal. In the context of any dispute, as the matter evolves, the commonality of interests between parties may wax and wane.

Regarding a *legal* interest, this requirement jives with the general requirement of the attorney-client privilege, that communications must be legal in nature to realize the protection. In *Sandoz Inc. v. Lannett Company, Inc.*,[17] the District Court for the Eastern District of Pennsylvania reviewed emails in which business executives were commenting on the draft comments of a consultant, even where the company's attorney was copied on the emails, the documents were not privileged because the executives' comments "appear[ed] business related and no legal advice [was] apparent from the face of the chains."[18] Other jurisdictions are generally in agreement that a "shared common business interest is insufficient to afford protection."[19]

The more nuanced issue is whether mixed legal and business communications are afforded a protection. Communications often are not either purely legal or purely not legal in nature. Courts must determine whether the legal nature of the communications is salient enough to trigger protection. The majority view is that the legal nature of the communications must *predominate* over other interest, such as business or personal interests.[20] The minority view takes a more expansive view of the privilege and does not require the communications to be predominately about legal interests.[21]

Finally, the parameters of the common interest privilege concern who and who cannot communicate. Since the privilege is an extension of the attorney client privilege, an attorney-client relationship must exist for the privilege to vest. Thus, courts have held that the common interest privilege only applies where each separate client group has its own attorneys. If a group of clients and their attorneys communicate with an unrepresented party, then there can be no common interest privilege because the unrepresented party is simply a third party who destroys

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[16] *Id. See also SCM Corp. v. Xerox Corp.*, 70 F.R.D. 508, 524–25 (D. Conn. 1976) ("On that issue the parties were not commonly interested, but adverse, negotiating at arm's length a business transaction between themselves.").
[17] 570 F. Supp.3d 258 (E.D. Pa. 2021).
[18] *Id.*
[19] *Executive Risk Indem., Inc. v. Cigna Corp.*, 2006 WL 2439733 (Pa. Comm. Pls. 1st Dist. 2006).
[20] *See, e.g.*, *Allied Irish Banks, PLC v. Bank of Am., N.A.*, 252 F.R.D. 163, 171 (S.D.N.Y. 2008); *Executive Risk Indem., Inc. v. Cigna Corp.*, 2006 WL 2439733 (Pa. Comm. Pls. 1st Dist. 2006) ("Of course the privilege extends only to counsel and parties who have entered into a joint defense agreement and share a common interest in legal strategy. A shared common business interest is insufficient to afford protection.").
[21] *See* RESTATEMENT (THIRD) OF THE L. GOVERNING LAWS. § 76 cmt. e (AM. L. INST. 2000) (the privilege applies to "legal, factual, or strategic" communications); *Hewlett-Packard Co.*, 115 F.R.D. at 310, (broad view to facilitate due diligence); *In re Grand Jury Subpoena Duces Tecum*, 112 F.3d 910, 922 (8th Cir. 1997) (accord).

the privilege and creates a waiver.[22] Some courts also hold that the privilege only applies when two attorneys communicate with each other.[23] Others require only the presence of one attorney.[24]

III. The Privilege in Practice

For purposes of this paper and the Pearlman Gathering, three practical applications of the common interest privilege will be discussed: (1) the common interests of an insurer and insured; (2) the common interests of a surety and its principal and/or consultant in performance bond scenarios; and (3) matters involving consultants in general.

As a technical matter, insurer/insured scenarios reflect more that of co-clients than different parties represented by different attorneys, as in the common interest privilege scenario. In this vein, some courts have recognized that third-party claimants are not entitled to communications exchanged among the insured, its counsel, and the insurer.[25] Thus, the insurer is often not considered a third-party that destroys the privilege. Common interest privilege case law regarding sureties and their principals is sparse, so it is unclear whether a similar maxim would carry over. The surety, after all, mitigates risk for the obligee, not the principal, whereas the insurer mitigates the risk of the insured. Thus, it is uncertain whether a court would find the communications among surety counsel and the principal's counsel sufficiently aligned to apply the privilege.

One of the only cases to discuss the common interest privilege in the context of sureties is *GEC, LLC v. Argonaut Insurance Company*,[26] an unreported 2020 decision from the District Court for the District of the U.S. Virgin Islands. The case involved a claim on a performance bond issued by a surety, wherein the surety hired a claims consultant to investigate the merits of the claim in order to determine whether to accept or deny it. After investigating the claim and giving notice to the obligee of denial and the reasons for it, the surety was sued by the obligee for breaching the performance bond. In the course of discovery, the surety argued that various emails exchanged with its claims consultant in investigating the performance bond claim were privileged by the common interest privilege and shielded from discovery. The District Court disagreed with the surety for the critical reason that the surety's communications with its consultant reflected discussions and decisions that were ultimately disclosed to the obligee in the claim denial notice. Although the court acknowledged that the surety's counsel directed the consultant in preparing its findings, which were relied upon by the surety, since the findings were disclosed to the obligee as the adverse party, confidentiality was destroyed. The court

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[22] *Cavallaro v. United States*, 153 F. Supp. 2d 52, 61 (D. Mass. 2001), *aff'd*, 284 F.3d 236 (1st Cir. 2002) (rejected common interest privilege because one party was not represented by counsel); *Libbey Glass, Inc. v. Oneida, Ltd.*, 197 F.R.D. 342, 348 (N.D. Ohio 1999) (rejected common interest privilege because only one party involved an attorney directly).

[23] *In re Teleglobe Commc'ns Corp.*, 493 F.3d 345, 364 (3d Cir. 2007) ("[T]he communication must be shared with the *attorney* of the member of the community of interest. Sharing the communication directly with a member of the community may destroy the privilege.").

[24] *United States v. Schwimmer*, 892 F.2d 237 (2d Cir. 1989).

[25] *See* Discovery Order No. 57, *In re Blue Cross Blue Shield Antitrust Litig.*, MDL No. 2406, No. 2:13-cv-20000-RDP (N.D. Ala. July 6, 2017).

[26] 2020 WL 974867 (D.V.I. Feb. 28, 2020).

reasoned that the surety could not claim the full scale of the consultant's communications with the surety as privileged when those communications, whether directly or indirectly, were already disclosed to the obligee. The court then permitted the surety to disclose redacted versions of the emails to the extent that they contained privileged portions separate from what was already disclosed in the claim denial. In so ruling, the court relied on several principles: (1) the common interest privilege operates in derivation of discovery; (2) it is only available when counsel share information to coordinate legal strategies; and (3) the privilege is waived when disclosure of a confidence is made to an unrelated third party by one sharing a common interest with another and this occurs with the knowledge, awareness, or consent of the other.[27]

The *GEC* decision is instructive to sureties and their counsel for two important reasons. First, it illustrates that the common interest privilege does in fact apply between sureties and their consultants, as the court recognized that portions of the communications that were not disclosed in the claim denial could still be redacted. Second, it instructs that *post facto* disclosures of the *content* contained in previously confidential communications can destroy the privilege, so practitioners should be discerning in the extent of content disclosed in claim denial letters or other communications with adverse parties.

Other courts have considered the common interest as applicable to consultant communications. Some jurisdictions require the consultant's presence on the communication to be "either indispensable to the lawyer giving legal advice or facilitating the lawyer's ability to give legal advice to the client."[28] In *Sandoz Inc. v. Lannett Company, Inc.*, the consultant was an active participant and was soliciting legal advice from the attorney. The "active engagement between the attorney and consultant for the purpose of legal advice" persuaded the District Court for the Eastern District of Pennsylvania that the communications were privileged.[29] However, in analyzing separate documents at issue, the court found that the privilege was waived because the documents were business related and not exchanged among attorneys for the various parties.

In considering questions of timing and the parties involved (*i.e.* presence of an attorney or not), practitioners should understand whether the applicable privilege is the attorney-client/common interest privilege or the work product doctrine. In order for the work product doctrine to apply (*i.e.* whether the document was prepared in anticipation of litigation), courts consider if "in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained *because of* the prospect of litigation."[30] Documents "prepared in the ordinary course of business or that would have been created in essentially similar form irrespective of the litigation" are not protected by the work product privilege.[31] Consultants are included in the definition of the work product doctrine as parties who share in the privilege: the work product doctrine protects documents made in anticipation of litigation and created "by or for another party or its representative including the other party's attorney, consultant, surety, indemnitor, insurer, or agent."[32] Thus, even if the common interest privilege is inapplicable in communications with a consultant for lack of

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[27] *See Shamis v. Ambassador Factors Corp.*, 34 F. Supp. 2d 879, 893 (S.D.N.Y. 1999).
[28] *Sandoz Inc. v. Lannett Company, Inc.*, 570 F. Supp. 3d 258 (E.D. Pa. 2021), citing *BouSamra v. Excela Health*, 653 Pa. 365, 395 (2019).
[29] *Id*.
[30] *Schaeffler v. United States*, 806 F.3d 34, 43 (2d Cir. 2015).
[31] *Id*.
[32] *See Jones v. Tauber & Balser, P.C.*, 503 B.R. 510 (N.D. Ga. 2013).

attorney presence, the work product doctrine may shield disclosure. Although the parameters of the work product doctrine are beyond the scope of this paper, practitioners should be mindful that the common interest privilege is absolute, whereas the work product doctrine is a qualified privilege. Therefore, when in doubt, practitioners should fight for application of the common interest privilege.

IV. Jurisdictional Examples

As this paper is being presented to a nationwide audience of attorneys at the Pearlman Gathering, many of whom have multi-jurisdictional practices, we conclude this paper with an examination of how various jurisdictions have dealt with the common interest privilege. Keep in mind that this doctrine is always evolving, so practitioners should always consult the latest case law.

In matters of federal equal employment opportunity law, two unreported decisions shed light on the federal approach. In *EEOC v. DiMare Ruskin, Inc.*,[33] the District Court for the Middle District of Florida held that the common interest privilege protects communications between an individual, or the individual's attorney, and an attorney representing a person or entity that shares a common interest with the individual regarding a legal matter of common interest. Similarly, in *EEOC v. Chemtech International Corp.*,[34] the District Court for the Southern District of Texas held that the common interest privilege, as an extension of the attorney-client privilege, is a joint prosecution privilege that extends to communications between a party and the attorney for a co-litigant. Thus, the federal approach appears to adopt the "one-attorney" rule: the communications need not be among attorneys, but can be by a co-litigant to the other litigant's attorney. Compare this to Pennsylvania's "two attorney" rule adopted in *Sandoz* where the privilege was destroyed because the communication was not made among attorneys.[35]

New York has developed two noteworthy requirements for the common interest privilege. First, as discussed previously, the privilege only applies to communications related to litigation, either pending or anticipated, because the privilege hinders the truth-finding process and therefore must be strictly construed.[36] Second, the party claiming the privilege must be a litigant. In *Yemeni v. Goldberg*,[37] the trial court found that a testifying witness, could not claim the privilege because he was not a party to the case, and his communications with the defendants' attorneys and interest in the outcome of the litigation was a personal/business interest to which he could claim no common legal interest.

In Texas, courts of appeals have generally applied the attorney-client privilege to joint defense situations where multiple defendants, represented by separate counsel, work together in a common defense. Texas, like New York, requires that the communications be made in the

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[33] 2012 WL 12067868 (M.D. Fla. Feb. 15, 2012).
[34] 1995 WL 608333 (S.D. Tex. May 18, 1995).
[35] *Sandoz*, 570 F. Supp. 3d 258, *supra*. In *Sandoz*, the District Court was applying Pennsylvania state law (laid down in *BouSamra*) to reach its conclusion because the civil claim involved questions of state law, rather than federal statutory law.
[36] *Ambac Assur. Corp.*, 27 N.Y.3d 616, *supra* at fn9.
[37] 12 Misc. 3d 1141 (Sup. Ct. Nassau County 2006).

context of a pending action.[38] Although criticized, the pending action requirement limits the privilege "to situations where the benefit and the necessity are at their highest, and restrict[s] the opportunity for misuse."[39] Thus, in jurisdictions like Texas, which have a pending action requirement, no commonality of interest exists absent actual litigation. Accordingly, the Texas privilege is not a "common interest" privilege that extends beyond litigation. Nor is it a "joint defense" privilege, as it applies not just to defendants but to any parties to a pending action. Rule 503(b)(1)(C)'s privilege is more appropriately termed an "allied litigant" privilege.[40] For the allied litigant doctrine to apply, the following elements should be present: (1) separately represented parties; (2) a pending action; and (3) a communication involving a common legal interest made by or to a lawyer of one of the parties. As discussed previously, Florida in *Visual Scene* similarly developed an "allied litigant" version of the privilege, applying it to communications between litigants on opposite sides of the "v" in the case caption, where the parties' legal interests are aligned as to the subject matter of the communication.[41]

To conclude, this paper illustrates the variance among jurisdictions in the parameters of the privilege. Like the fisherman, carefully scouting fishing holes, meticulously weaving knots, rising early for the morning bite, ebbing through storms, and avoiding wrecks, the legal practitioner must equally evaluate the differing factors involved in the communication, such as timing, content, parties involved, and setting in determining whether the common interest privilege applies to communications. This paper should now set the practitioner on a course for smooth sailing.

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[38] *See* Tex. R. Evid. 503(b)(1)(C) (protecting from disclosure communications between a client "to a lawyer representing another party in a pending action and concerning a matter of common interest therein") (emphasis added).
[39] *United States v. Duke Energy Corp.*, 214 F.R.D. 383, 388 (M.D.N.C.2003).
[40] *See In re XL Specialty Ins. Co.*, 373 S.W.3d 46 (Tex. 2012).
[41] *Visual Scene, Inc.*, 508 So. 2d 437, *supra* at fn11.