WELCOME TO

PEARLMAN 2018

Pearlman 2018

Building Relationships – Keeping Them Strong



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

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

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

Thank you, again, for joining us this year.

All the best –

R. Jeffrey Olson
Chairman/Director Pearlman Association

Special Recognition

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

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

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

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

Lastly, a special thanks to **Courtney Carron** and **Cherie McCalmon** who help put together the name tags, download the materials to thumb drives, and lots of other tasks that help make Pearlman great. Thank you, Courtney and Cherie.

Schedule of Events

Wednesday, September 5th

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

Hospitality Reception Entertainment
Hosted by Faux Law Group and Williams Kastner

Thursday, September 6th

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

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

8:00-8:15 **Welcome/Introductory Remarks**
R. Jeffrey Olson
Co-Chairs: Richard Tasker, Jim Curran, Paul Harmon

8:15-9:00 **Scollick v. Narula: Industry Panel Review of Recent Reported Decision on FRCP 15(a) Motion**
Robert Niesley, Dan Pope, Maureen O'Connell, Tiffany Schaak

9:00-9:30 **Hidden Risks in Specifications, LEED, Design and Other Pitfalls**
Mike Spinelli, Ellen Cavallero, Kurt Faux

9:30-10:00 **Subcontractor Default Insurance and Expedited Resolution Bonds**
Jon Bondy, Chris Morkan, Bryce Holzer

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

10:15-10:30 **The Pearlman Case**
Greg Smith

10:30-11:15 **Underwriting 101**
Keith Langley, Bryan Bullinger, George Crittenden

11:15-12:00 **International Bonds and Foreign Contractors Coming to the U.S.**
Richard Tasker, John McDevitt, Luis Aragon, Gina Shearer

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

1:15-1:50 **Dealing with Bad Cases**
Stacie Brandt, Larry Rothstein, Keri-Ann Baker

1:50-2:35 **Experiences at National Insurance Crime Bureau**
Mike Timpane, Dale Zlock, Bill Healy, John Fallat

2:35-3:00 **Bankruptcy: What's Changing**
Jan Sokol, Chad Schexnayder, John Fouhy, Nina Durante

3:00-3:15 **Break**

3:15-3:55 **Extra Contractual Claims and How to Avoid Them**
Meredith Dishaw, Paul Friedrich, Andrew Torrance, Tom Duke, John Egbert

3:55-4:45 **Supplementation: How to Respond**
William McConnell, Darrell Leonard, Patrick Hustead, Jennifer Fiore

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

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

SPECIAL ENTERTAINMENT
Mike Pipkin, Sam Barker

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

Cocktails
Hosted by Krebs Farley, PLLC

Friday, September 7th

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

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

Bloody Mary Bar
Hosted by SMTD Law LLP

Espresso Bar
Hosted by Partner Engineering and Science, Inc.

8:30-8:40 **Welcome/Program Introduction**
R. Jeffrey Olson, Richard Tasker, Jim Curran, Paul Harmon

8:40-9:10 **When to Settle Around Your Principal**
Trish Wager, Greg Weinstein, R. Jeffrey Olson, Marc Brown, Rod Tompkins

9:10-9:40 **Productivity Loss: Calculation and Proof**
Jason Fair, Bill Schwartzkopf, Jim Carlson

9:40-10:05 **Risk Assessment in Litigation and Pre-Litigation: Emphasis on Fee Shifting**
Shauna Szczechowicz, Brittany Rose, Marla Thompson, Leigh Anne Henican, Rosa Martinez-Genzon

10:05-10:20 **Break**

10:20-10:35 **UCC Article 9: Rights of the Surety**
Ed Rubacha, David Pinkston

10:35-10:50 **Overview of the New AIA A201 (2007 v. 2017): Emphasis on Dispute Resolution**
Gene Zipperle, Jack Costenbader, Ken Humphrey

10:50-11:05 **When Your Principal is De-Barred, Now What**
David Kash, Todd Bauer, Christine Bartholdt

11:05-11:45	**Fees, Costs, and Interest Under the GAI** Cassandra Hewlings, Sunny Lee, Ranae Smith
11:45-12:00	**Closing Comments** R. Jeffrey Olson
12:00	**Lunch – On Your Own**
12:15	**Bus Service to/from Harbour Pointe Golf Club** **Hosted by Law Offices of Larry Rothstein** Bus leaves Willows Lodge at 12:15PM
1:00	**Sign In/Warm Up** – Harbour Pointe Golf Club
1:30	**Scramble Tournament – Shotgun Start** Harbour Pointe Golf Club, 11817 Harbour Pointe Blvd, Mukilteo, WA 98275
	Beverage Cart **Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP,** **Benchmark Consulting Services, LLC, and The Sutor Group**
7:00	**Dinner** – Harbour Pointe Golf Club **Hosted by Ward, Hocker & Thornton, PLLC,** **Chiesa Shahinian & Giantomasi PC, and** **Kerr Russell and Weber, PLC**
	Cocktails **Hosted by Stewart Sokol & Larkin, LLC**
7:45	**Awards – Scholarships – Closing**
8:00	**Buses return to Columbia Winery and Willows Lodge**

Saturday, September 8th - "On Your Own"

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

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

Woodinville Wine Tour

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

Program Co-Chairs

JAMES D. CURRAN

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

RICHARD E. TASKER

Richard E. Tasker is President of Sage Associates, Inc., as well as Sage Consulting Associates, Inc., and Sage Contractor Services. He has been a Construction and Surety Consultant since the mid-1970's and has been involved with hundreds of contractor defaults and construction disputes. He began his career in the Northeast, working for a time in the Midwest and Rocky Mountain region, and for the past +15 years has resided in California. Mr. Tasker has represented most of the top 20 largest sureties and many smaller volume surety companies. He has been designated in many areas of construction including forensic schedule analysis, efficiency and productivity, construction accounting, procurement, means and methods, and standards of care. He is active and has often presented at industry functions including ABA, NBCA, SCI, NASBP, and WSSC, and is honored to see his many friends and speak again at the 2018 Pearlman.

PAUL HARMON

Paul Harmon has been with Travelers Bond & Specialty Insurance since 2007, handling performance, payment and commercial surety claims. Mr. Harmon also provides business support to Travelers underwriters through contract review and risk analysis. Prior to joining Travelers, Mr. Harmon received his bachelor's degree from the University of California, San Diego in 2004 and received his J.D. from the University of Oregon School of Law in 2007. Mr. Harmon is a member of the Washington State Bar Association.

Presenters/Biographies

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

LUIS ARAGON

Luis Aragon is Surety Claim Counsel for Liberty Mutual Insurance Company. Prior to Liberty Mutual, Luis spent over two years as a surety attorney in the Seattle office of Watt Tieder Hoffar & Fitzgerald. Luis has a B.A. in History with Honors and a B.S. in Biochemistry, both from the University of Washington. Luis also received his J.D. from the University of Washington. Luis simply cannot find it in himself to leave Seattle. Outside of work, Luis has a wife who is a better lawyer than he is, and two amazing young daughters. When the ladies let him out of the house, he enjoys playing soccer. He is an exceptionally mediocre golfer.

KERI-ANN C. BAKER

Keri-Ann C. Baker is an of counsel attorney with the Law Offices of Charles G. Evans. She specializes in real estate, environmental, tribal and surety law. Keri-Ann found her way to the last frontier after twelve years of practice in south Florida. She works with numerous clients on challenging construction projects in remote locations throughout the state of Alaska. She loves to solve tricky problems, help her clients limit their exposure and capture repayment quickly and efficiently. Keri-Ann is avid reader, loves to fish, hike and camp. When she is not at work you can find her somewhere outside hiking, paddle boarding or skiing.

CHRISTINE BARTHOLDT

Christine Bartholdt is Senior Surety Claims Counsel with Liberty Mutual Surety in the Seattle claims office. She is a 1994 graduate of William Mitchell College of Law. After relocating from Minneapolis, she practiced law in Seattle prior to joining Safeco Surety in 1999.

TODD M. BAUER

Todd M. Bauer is Executive Vice President of Guardian Group, Inc. and has more than 30 years of construction and general management experience. Todd received his Bachelor of Science degree from the University of Southern California and received his graduate degree from the University of Texas at Austin. He is affiliated with numerous industry organizations. Todd assists numerous clients with claims investigation and settlement, forensic accounting, takeover and completion of defaulted contracts, bond claim analysis, affirmative claim preparation, delay claim analysis, scheduling, and accounting audits as well as provided litigation support and has acted as an expert witness. In addition, Mr. Bauer's expertise includes project management of schools, residential housing, airports, highways, underground conduit, hospitals, power plants, subdivisions, gas processing plants, prisons, landscaping, computer systems, manufacturing processes, as well as roofing, glazing and electrical projects. Mr. Bauer is also the President of Completion Contractors, Inc., Guardian's general contracting subsidiary, and holds a Commercial California Contractors "B" license. He is also licensed by The U.S. Treasury as a U.S. Customs Broker, and provides expertise in the investigation and resolution of U.S. Customs and FMC bond claims. Mr. Bauer has also acted as lead on Claim Department outsourcing and claims runoff assignments for surety companies and state's Departments of Insurance.

JONATHAN BONDY

Jonathan Bondy is a member of Chiesa Shahinian & Giantomasi PC, which maintains offices in New York City and West Orange, New Jersey. He received his Bachelor of Science in Economics from the Wharton School of Business of the University of Pennsylvania in 1988, and a Juris Doctor degree in 1991 from the Benjamin N. Cardozo School of Law, Yeshiva University, where he was a member of the Moot Court Honor Society. Mr. Bondy previously served as an Assistant District Attorney in Kings County (Brooklyn), New York. He concentrates his practice in surety and fidelity law, and commercial and construction litigation. He is a member of the New York and New Jersey State Bar Associations and the Fidelity and Surety Law Committee of the Tort, Trial and Insurance Practice Section of the American Bar Association. He is admitted to practice in New York and New Jersey, the United States Court of Appeals for the Second Circuit, and the United States District Courts for the Southern and Eastern Districts of New York and the District of New Jersey. He has previously spoken on surety and construction law issues before the Fidelity and Surety Law Committee of the American Bar Association's Tort, Trial and Insurance Practice Section, the Surety Claims Institute, the Northeast Surety & Fidelity Claims Conference, and the Commercial Finance Association.

STACIE L. BRANDT

Stacie L. Brandt is a partner in the Orange County office of Booth, Mitchel & Strange LLP. She specializes in surety litigation, emphasizing construction, prevailing wage, and probate matters. She is a member of the California Bar Association and admitted to practice before all state and federal courts in California.

Ms. Brandt received her juris doctorate in 1993 from the University of San Diego School of Law where she was a member of the San Diego Law Review and editor-in-chief of the law school newspaper. She received a Bachelor of Science degree in mechanical engineering from Cornell University in 1979. Ms. Brandt worked for a number of years for major chemical companies, and long ago was a member of the Society of Woman Engineers (1975-1979) and the Society of Plastics Engineers (1979-1990).

MARC BROWN

Marc Brown is presently Managing Director & Counsel in the Western Region of Travelers Bond & Specialty Insurance Claim, where he oversees a team of attorneys and claim representatives and provides business support to the Western Region underwriting team. Marc has 25 years of experience in Surety Claims. Prior to embarking on his Surety career, he was in private practice in the Seattle area, representing general contractors, subcontractors, and owners in construction disputes. He is a graduate of the Seattle University School of Law and Brigham Young University and is admitted to practice in the State of Washington.

BRYAN BULLINGER

Bryan received his Bachelor's and MBA at Gonzaga, graduating in 2006 and 2009 respectively. His career began at Travelers in mid-2006 on the P&C side in the call center, but after a year and a half he moved over to underwriting for Guardian Life Insurance in Spokane where he spent the next 4 years. In 2012 he stumbled across the surety world and landed a role as a trainee in the Travelers Federal Way home office. After about 2 years in Fed Way he was transferred to the Travelers Southern California region where he handled a book ranging from San Diego to El Centro to Palmdale. He also met his wife while living in Orange County, and in late 2016 convinced her to move with him back to Seattle when the opportunity surfaced. They have been living in the Northgate area now since January 2017, and he just passed his 6 year anniversary working in the surety world.

Finally he's a Taurus that enjoys long walks on the beach.

JIM CARLSON

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

ELLEN CAVALLARO

Ellen Cavallaro is an Assistant Vice President of Berkley Surety Group LLC. She has a BA from Fordham University, an MA from Columbia University, and JD from Fordham University School of Law. She is admitted to the practice of law in New York. She is a former Vice Chair of the Surety and Fidelity Law Committee of the American Bar Association, and Secretary of the Surety Claims Institute.

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 40 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.

His professional trade organizations include:

- American Arbitration Association
- American Institute of Constructors
- American Concrete Institute
- American Bar Association - Associate
- Atlanta Surety Claims Association
- Construction Specification Institute
- Chicago Surety Claims Association
- Escrow Agent's Fidelity Corporation
- National Bond Claims Association
- Pearlman Association
- Philadelphia Surety Claims Association
- Surety Claims Association of Los Angeles
- Surety Claims Institute

GEORGE CRITTENDEN

George Crittenden is Assistant Vice President Underwriting Officer for Core Contract Surety in the Western Region for Liberty Mutual Surety handling the Seattle and Spokane offices.

George began his career with USF&G in Kansas City in 1985. In 1989 George went to American States Insurance serving various field offices in Kansas, Alabama and Minnesota over an 8 year period. In 1997 Safeco purchased American States. In 2006 while at Safeco George was promoted from contract manager in Kansas City to Assistant Vice President Underwriting Officer in the Seattle Home Office. In 2008 Liberty purchased Safeco. As a Home Office Underwriting Officer, George has worked with offices in Boston, Philadelphia, San Francisco, Cincinnati, St. Louis, Kansas City, Richmond, Seattle and Spokane.

George graduated from Emporia State University (KS) in 1984 with a B.S. in Business Administration, and he has earned his CPCU, AFSB and AIM designations.

JAMES D. CURRAN

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

MEREDITH DISHAW

Meredith Dishaw is an associate in the Seattle office of Williams Kastner and part of the Construction and Surety Practice Teams. Her practice focuses on representing public and private owners, contractors, and sureties throughout the construction process, with a particular focus on commercial construction litigation. Ms. Dishaw has represented clients in federal and state courts throughout the country and in private arbitration proceedings in various construction-related matters, including payment, performance and supply bond claims, prompt payment claims, mechanic's lien claims, indemnity issues, latent and patent defects in construction and design, and contract and warranty claims.

Ms. Dishaw's practice also focuses on defending sureties and insurers from common law and statutory bad faith and extra-contractual claims.

THOMAS H. DUKE

Thomas H. Duke is Senior Surety Claims Counsel for AmTrust Surety in the Claims Department and is licensed to practice law in the State of Texas. He has more than 25 years of combined legal experience as an Assistant United States Attorney in the Southern District of Florida and in private practice as a civil trial attorney. Before joining AmTrust, Tom was in private practice for 16 years specializing in surety law. Tom received his Juris Doctor from the Fredric G. Levin School of Law and Bachelor of Arts in English from the University of Florida. He also has a Masters of Divinity with Languages degree from Southeastern Baptist Theological Seminary. Tom is married to Suzanne, his wife of 36 years. They have two children, Rachel and Haden, both of whom are married, and one grand-daughter, Juliet Faye.

NINA M. DURANTE

Nina M. Durante is Senior Surety Claims Counsel with Liberty Mutual Insurance Company in its Commercial Claims Department. She is based in Seattle, WA. For most of her professional career, Nina has worked in the surety industry handling a variety of claims, including contract, fidelity and miscellaneous matters. In 2013, Nina joined Liberty's newly created Commercial Claims Region where she handles a variety of large commercial claims, bankruptcies, and contract claims.

Nina received her B.A. in Political Science from Seattle University and her J.D. from the University of Puget Sound School of Law (now, Seattle University School of Law). She is an active member of the Washington State Bar Association and the American Bar Association - TIPS section.

JOHN T. EGBERT

John T. Egbert is the owner of Global Construction Services, Inc., a company which specializes in construction consulting and surety claims. Services provided to the surety industry include evaluating performance bond claims, estimating the cost to compete, preparation of re-let packages, evaluating payment bond claims, monitoring the work of a completion contractor, and assisting with project closeout and warranty issues. John also performs project scheduling, evaluates schedule delays and impacts, prepares Time Impact Analyses, calculates damages, prepares construction claims, and offers expert witness services at mediations, arbitrations and trials.

John graduated from the U.S. Coast Guard Academy and holds two graduate degrees in engineering from Stanford University.

JASON FAIR

Jason R. Fair is an Associate in the Los Angeles office of Robins Kaplan LLP. Mr. Fair's practice focuses on assisting clients in the construction, fidelity, and surety fields. Mr. Fair guides and counsels sureties, general contractors, subcontractors, and owner/developers through complex default scenarios and he strives to apply pragmatic and cost-effective strategies to mitigate losses and complete troubled projects while resolving project disputes. Mr. Fair is experienced in handling federal, state, and private construction projects, including issues ranging from bidding processes and protests to general delay, productivity, and efficiency claims, as well as termination, takeover, and completion agreements and surety financing agreements.

Mr. Fair also assists clients in general litigation matters, including business, commercial, and property disputes. He handles all stages of litigation in both state and federal court and he counsels clients through the alternative dispute resolution process.

Mr. Fair received his B.A. from University of California, Los Angeles and his J.D. from Loyola Law School where he was a member of the St. Thomas More Law Honor Society. Mr. Fair is admitted to practice in California and U.S. District Court, Central District of California.

Mr. Fair is a member of ABA Tort Trial & Insurance Practice Section, Fidelity and Surety Law Committee, Century City Bar Association, Riverside County Bar Association, and San Bernardino County Bar Association.

JOHN L. FALLAT

John L. Fallat was admitted to the California Bar after graduating cum laude from the California Western School of Law in 1984. He has been practicing surety bond defense since 1986 when he joined the Oakland defense firm of Bennett, Samuelson, Reynolds, and Allard in defending among notary public surety bonds for the Kirby brothers who then owned Western Surety Company, now part of CNA. He then joined Williams & Martinet in San Francisco where he expanded his surety bond practice to include all types of claim and lawsuits. He started his own practice in 1989 representing sureties throughout California with an emphasis on commercial claims. The firm currently has two associates and three paralegals. He considers himself very fortunate to have stumbled into this field which has enabled him to raise a family in Marin County and be free to represent clients in other civil litigation such as consumer class actions, employment litigation, and real estate disputes.

KURT FAUX

Kurt Faux is the president and founder of the Faux Law Group, practicing in Nevada, Utah, and Idaho. Mr. Faux received a B.A. from Brigham Young University-Hawaii, magna cum laude, in 1982. He obtained a J.D. from Brigham Young University, J. Reuben Clark Law School in 1986, where he was an editor for the Law Review. Mr. Faux has represented sureties for over 30 years, and is a frequent presenter to various groups regarding surety and construction issues.

JENNIFER FIORE

As a principal in Dunlap Fiore, LLC, Ms. Fiore specializes in construction law, business law, litigation, public finance as well as Federal and State regulatory and administrative law matters.

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

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

JOHN M. FOUHY

John M. Fouhy is a Claim Counsel for Travelers Casualty & Surety Company of America in Federal Way, WA, where he has worked since 2010. He graduated with a B.B.A. from Pacific Lutheran University in 2005, and received his J.D. from the University of Oregon School of Law in 2009. He is admitted to practice in Washington State.

PAUL K. FRIEDRICH

Paul K. Friedrich is an attorney with Williams Kastner and is a member of the firm's Construction Litigation & Surety Practice Team. His practice involves representing sureties and insurers in all aspects of bond claims with a particular emphasis on construction law. A significant portion of his practice is devoted to prosecuting indemnity and subrogation matters on behalf of his surety clients. Mr. Friedrich has a proven track record of success for his clients at both the trial court level and on appeal.

PAUL C. HARMON

Paul C. Harmon has been with Travelers Bond & Specialty Insurance since 2007, handling performance, payment and commercial surety claims. Mr. Harmon also provides business support to Travelers underwriters through contract review and risk analysis. Prior to joining Travelers, Mr. Harmon received his bachelor's degree from the University of California, San Diego in 2004 and received his J.D. from the University of Oregon School of Law in 2007. Mr. Harmon is a member of the Washington State Bar Association.

BILL HEALY

Bill Healy is a contract surety Underwriting Director in Travelers' western regional home office in Federal Way, Washington. Bill started his surety career in 1992 in San Francisco with Fidelity & Deposit Company after graduating from U.C. Davis. He joined Travelers in San Francisco in March of 1998 and then transferred to the Federal Way office in July, 2011.

LEIGH ANNE HENICAN

Leigh Anne Henican is the Surety Claims Manager at The Gray Casualty & Surety Company in New Orleans, Louisiana. She has over nine years of experience in insurance defense, with more than five years of experience solely devoted to handling surety bond claims. Since becoming the Claims Manager at Gray in 2015, she has reengineered the entire ecosystem of claims handling at the organization. Her efforts have included a focus on negotiation rather than litigation, which has led to a dramatic decrease loss ratios, including a reduction in the number of open claims by more than 50% and a reduction in third party legal expenses by more than 35% in the past three years. Leigh Anne earned her B.A. in Political Science and Public Relations from the University of Alabama in 2005 and her J.D. from Loyola University New Orleans College of Law in 2009.

CASSANDRA R. HEWLINGS

Cassie Hewlings is an associate with Krebs Farley, PLLC in New Orleans, Louisiana, having joined the firm in 2015. Cassie primarily focuses her practice on complex commercial litigation, construction litigation, and surety and fidelity law. She also has experience in professional malpractice, securities litigation, general tort litigation, and representing attorneys in disciplinary matters. Cassie graduated summa cum laude and Order of Coif from Tulane University Law School in 2013. While in law school, she served as Articles and Online Editor for the Tulane Law Review and was a published member as well. Prior to attending law school, Cassie worked in journalism for various media companies in Colorado.

BRYCE HOLZER

Bryce Holzer is Claim Counsel for Travelers Bond and Specialty Insurance in Federal Way, WA. Bryce graduated from Washington State University with a B.A. in Economics, summa cum laude, in May, 2007. After working for the Boing Company as an Industrial Engineer, Bryce attended the University Of Washington School Of Law and graduated in March of 2011. Bryce worked in private practice prior to joining Travelers in August 2012. Bryce is a member of the Washington State Bar Association.

KEN HUMPHREY

Ken Humphrey, born in Pasadena, California, graduated from UC Santa Barbara, and received his JD at Loyola Law School Los Angeles in 1990. He worked as a trial lawyer for Bolton, Dunn & Yates from 1990 to 1999 performing all aspects of civil litigation including construction defects, insurance bad faith, insurance coverage issues, premises and product liability, and personal injury actions. He represented public entities, self-insured entities, insurance companies, as well as corporations and individuals.

In 1999 he joined Amwest Insurance Group, Inc.'s in-house law firm as a Senior Litigator before starting his own firm in 2002. In that time, he handled hundreds of surety defense and complex litigation matters including those involving contract and commercial bonds, license and permit bonds, probate bonds, and collection and subrogation cases. He also has significant experience in insurance company liquidation and rehabilitation law. He has taken over 25 cases to trial or arbitration, and argued matters before the California Court of Appeal.

PATRICK Q. HUSTEAD

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

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

DAVID W. KASH

David W. Kash is a partner in the firm of Koeller Nebeker Carlson & Haluck, LLP in its Phoenix, Arizona office. Mr. Kash received his BSC with honors (Accounting) from DePaul University in 1977 and his JD from Chicago-Kent College of Law with honors in 1981. He is admitted to practice in both Arizona and Illinois, he is AV rated by Martindale Hubbell, he is a member of Arizona Finest Lawyers, is recognized as a Southwest Super Lawyer, and selected to The Best Lawyers in America. He is a trial attorney and his practice includes construction and surety law. Mr. Kash is a past Chair of the International Association of Defense Counsel (IADC) Fidelity & Surety and ADR Committees. He is a past board member and past President of The Foundation of the IADC. He has authored a variety of legal articles and given several presentations. He has been a frequent speaker at Pearlman Association Gatherings. Many of his articles can be accessed online or by request to David.Kash@knchlaw.com.

KEITH A. LANGLEY

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

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

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

SUNNY LEE

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

DARRELL LEONARD

Darrell Leonard is Team Lead and Senior Claims Counsel for Zurich American Insurance Company. Mr. Leonard graduated with honors from The University of Texas School of Law and currently serves as Chair-Elect of the Fidelity & Surety Law Committee for ABA TIPS.

ROSA MARTINEZ-GENZON

Rosa Martinez-Genzon is a partner at Anderson, McPharlin & Conners in Los Angeles. Her practice focuses on the representation of sureties in claims involving contract and commercial bonds. She has extensive experience in claims investigation, default analysis and negotiation, consultation, claims handling and resolution of bond claims through litigation, mediation and arbitration. She has successfully handled a wide range of cases on construction projects, including bid disputes, wage and labor claims, delay, default and completion of projects. She is knowledgeable and has presented and written articles regarding the interplay of insurance policies and construction bonds. Ms. Martinez-Genzon is also experienced in the pursuit of salvage recoveries through adverse litigation in both civil and bankruptcy proceedings. She also represents the interests of sureties in administrative hearings, including hearings before the California Labor Commission involving nonpayment of wages and fringe benefits.

BILL MCCONNELL

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

JOHN A. MCDEVITT

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

CHRIS MORKAN

Chris Morkan oversees the claim activities of Hudson's Subcontract Default Insurance product as well as its other construction and property related insurance lines, including surety. He is also responsible the operations of Napa River Insurance Services which provides fee based claim management solutions, risk management, and funds control services.

ROBERT C. NIESLEY

Robert C. Niesley is a Senior Partner in the Irvine, California office of Watt, Tieder, Hoffar & Fitzgerald, LLP. Rob has specialized in surety and construction law for over 30 years, representing firm clients throughout the United States and internationally. Rob has tried cases in both state and federal courts, the Court of Federal Claims, and many arbitration forums. Rob has extensive government contracts experience representing sureties, and their principals, in their dealings with many branches of the federal government, but mostly the United States Army Corps of Engineers. Since most cases get settled, Rob has mediated and/or negotiated to settlement thousands of cases. With offices in Virginia, California, Illinois, Washington and Florida, Watt Tieder's national surety and construction practice aggressively represents its clients with skilled lawyers in almost any forum in the United States.

MAUREEN O'CONNELL

Maureen has over thirty years of experience in the surety industry, sixteen years working for surety companies as an underwriter/manager and sixteen years as a surety broker for Arthur J. Gallagher. Prior to joining Gallagher, Maureen was the Regional Surety Manager of the San Francisco offices for Fireman's Fund and Kemper Surety. She began her surety career with Safeco Insurance Company.

In addition to her management role at Gallagher, Maureen is a Surety Producer and Account Executive. Maureen handles many large construction accounts including, general builders, general engineering contractors and developers throughout the Western United States.

Maureen received a 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.

Maureen is on the Board of Directors of the California Surety Federation, National Association of Surety Bond Producers and Women in Construction, West Coast and is an active member of CFMA, AGC, United Contractors and Surety and Fidelity Association of America.

R. JEFFREY OLSON

Jeff Olson is a Senior Surety Claims Counsel for Liberty Mutual. Jeff has worked in the surety claims field since 2000, handling primarily performance and payment bond claims. Jeff also became the President of the Pearlman Association in 2015. Jeff enjoys spending time with his family and getting in a round of golf every so often. He claims a 10 handicap. Jeff has been a licensed attorney in the state of Washington since 1996.

DAVID L. PINKSTON

David L. Pinkston is a shareholder in the firm of Snow, Christensen & Martineau in Salt Lake City, Utah. Originally a native of Southern California, he graduated cum laude in 1993 from the J. Reuben Clark Law School at Brigham Young University, where he served as the Lead Articles Editor of the B.Y.U. Law Review from 1992-93. He was also a member of the American Inns of Court I. He received a B.A. (cum laude and University Honors) from Brigham Young University in 1990. After graduation from law school, he was admitted to the Utah State Bar and joined Snow, Christensen & Martineau in 1993. He is also admitted to practice before the United States Court of Appeals for the Tenth Circuit, as well as the Ute Indian Tribal Court of the Uintah and Ouray Reservation. In addition to being a member of the firm's Construction practice group, he is also a member of Snow Christensen's Bankruptcy and Creditors' Rights practice group, representing primarily creditors in bankruptcy and related litigation. Mr. Pinkston's practice also involves contract and other complex commercial litigation.

DANIEL POPE

Daniel Pope is Vice President/Senior Underwriting Officer with Zurich. He has more than 25 years in the surety industry, 12 of those years with Zurich. Dan currently has lead underwriting responsibility for a diverse portfolio of national contractors in the western region. Dan has held various home office and field underwriting roles in addition to surety claims and project management roles throughout his surety career. Dan has underwritten the full spectrum of surety products but spent the majority of his career in contract surety. Dan earned a Juris Doctor from Cleveland Marshall College of Law and a Bachelor of Arts from the College of Wooster.

BRITTANY ROSE

Brittany Rose is a Claim Counsel for Travelers Bond & Specialty Insurance in Federal Way, Washington. She graduated from Loyola Marymount University in 2005 with a B.A. in English, and she received her J.D. from Seattle University School of Law in 2011. She is admitted to practice law in Washington State.

LARRY A. ROTHSTEIN

Larry A. Rothstein has practiced surety and construction litigation for forty years. He has taken a dozen surety trials to jury verdict, winning all of them. In 2008, he was a featured participant in a mock surety bad faith trial presented at the ABA Surety and Fidelity Law mid-winter meeting. He has authored numerous articles on surety claims and recent developments and is a frequent presenter at numerous surety conferences. Mr. Rothstein received his undergraduate degree from UCLA and J.D. from Southwestern University School of Law. He has been selected as a Super Lawyer® seven straight years. He practices in Westlake Village, CA.

EDWARD RUBACHA

Edward Rubacha is a partner with the Phoenix, Arizona law firm of Jennings Haug Cunningham, practicing in the firm's Surety Section. Ed has a B.S.E.E. from Purdue University, an M.B.A. from Arizona State University, and a J. D., cum laude, from Arizona State. Ed joined Jennings, Haug in 1987. Ed's practice includes representing sureties in all phases of bonding, including underwriting and claims litigation, including issues concerning bonding on Indian reservations. Ed represents a number of sureties in Arizona, California, Colorado, and on various reservations throughout the western United States. Ed is admitted to practice each of those states, in both state and federal court, and in a number of tribal courts. Ed has published three articles on the topic of bonding and contracting on the reservation and is a frequent speaker on that unique area of the law.

TIFFANY SCHAAK

Tiffany Schaak begun her surety career in the claims department for American Bonding Company in 1994 and is now the Western Regional Home Office Counsel for Liberty Mutual Group in Seattle, WA. Ms. Schaak earned a Bachelor of Arts degree in Finance from the University of Puget Sound and a Juris Doctorate, cum laude, from Seattle University School of Law. Ms. Schaak also has received the Associate in Fidelity and Surety Bonding designation from The Institutes as well as the Chartered Property Casualty Underwriting designation.

CHAD SCHEXNAYDER

Chad L. Schexnayder is a commercial and surety litigator. His firm, Jennings, Haug & Cunningham, LLP based in Phoenix, Arizona has represented the surety industry for more than 80 years. He is a graduate of Washington University in St. Louis, (A.B., cum laude, 1981) and the Sandra Day O'Connor College of Law at Arizona State University (J.D., cum laude, 1984). He currently serves in the Law Division (Bankruptcy Co-Chair) of the ABA/TIPS Fidelity and Surety Law Committee. Chad is a frequent author and speaker to surety and construction industry groups, and has most recently spoken at the Spring 2018 FSLC meeting in Santa Fe, New Mexico and co-authored Chapter 12, Navigating In and Around Bankruptcy, in the Third Edition of *Managing and Litigating The Complex Surety Case* (ABA 2018).

WILLIAM SCHWARTZKOPF

William Schwartzkopf heads the construction disputes practice at Sage Consulting Group, a consulting firm based in Denver, Colorado, that specializes in construction claims and contract surety defaults. He has testified as an expert witness in various courts and arbitration forums throughout the United States, Canada, Mexico, and Iceland. Within the United States, he has testified in many state and federal courts, as well as in various boards of contract appeals, dispute review boards, and arbitration panels.

Previously, he was a Vice President and General Manager of an Engineering News-Record Top 150 building contractor, Vice President and General Counsel for an Engineering News-Record Top 10 specialty contractor, as well as the Vice President of Operations for a regional commercial development company.

Mr. Schwartzkopf is also the author of *Calculating Lost Labor Productivity in Construction Claims* and *Practical Guide to Construction Contract Surety Claims*, both published by Wolters Kluwer Construction Law Library.

As a registered Professional Engineer, Mr. Schwartzkopf is a member of the National Society of Professional Engineers. He is licensed (inactive) in the Nebraska State Bar and is a member of the American Bar Association and both its Forum Committee on the Construction Industry and the Surety and Fidelity Section of the Tort and Insurance Practice Section. He received both a Bachelor of Science in Electrical Engineering and a Juris Doctorate from the University of Nebraska.

GINA D. SHEARER

Gina Shearer is an Associate Attorney at Clark Hill | Strasburger. She devotes her practice primarily to construction and surety matters, with particular emphasis on bankruptcy, oil and gas plugging and abandonment obligations, payment and performance bond obligations, construction defect disputes, and enforcing rights against indemnitors. She also represents parties in complex commercial litigation in federal and state trial and appellate courts, as well as before tribunals and federal agencies.

Gina is a displaced Chicagoan who found herself in Texas fifteen years ago for what she thought was a short stay to complete her education. She received a Bachelor of Science in Business Administration from the University of Texas at Dallas, *magna cum laude*, in 2007, and then obtained her J.D. from Southern Methodist University in 2010. While in law school she studied at University College, Oxford during the summer and was president of the Corporate Law Association. She stumbled into the surety industry by chance, but has happily spent her whole career immersed in surety. Once she got to know her fellow surety industry professionals better, she felt compelled to join the circus to maintain her sanity. She now has a backup career as an amateur aerial acrobat and regularly performs silks, rope, contortion, static and duo trapeze acts.

GREGORY H. SMITH

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

RANAE SMITH

Ranae Smith is a Senior Surety Claims Specialist for Liberty Mutual Surety's Claim Department/Western Region in Seattle. Ranae Joined Liberty in 2014. Her prior surety experience included working as a Paralegal/Legal Assistant with a commercial collection agency for over 20+ years, where she handled the legal aspects against contractors licensing bonds.

JAN D. SOKOL

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

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

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

MICHAEL W. SPINELLI, ESQ., AIA

Mr. Spinelli is a founding partner in the construction-consulting firm of Cashin Spinelli & Ferretti, LLC. Having received a B.S. in Architectural Technology from the New York Institute of Technology, Mr. Spinelli is a Registered Architect licensed to practice in the states of New York, Connecticut and Texas. Mr. Spinelli is Past-President of the Long Island Chapter of the American Institute of Architects, and the Past-Vice President of Government Affairs for AIA New York State.

Mr. Spinelli is also an attorney admitted to practice in the State of New York. Having earned his J.D. *summa cum laude* from Touro College Jacob D. Fuchsberg Law Center where he was an Honors Program scholar, Mr. Spinelli is an adjunct professor of graduate studies at the State University of New York (SUNY), Farmingdale College, where he teaches *The Legal Aspects of Engineering, Architecture, and the Construction Process*. Mr. Spinelli also serves as the Co-Editor of the New York State Bar Association's *Municipal Lawyer* newsletter.

SHASHAUNA SZCZECHOWICZ

Shashauna Szczechowicz, a partner at Wolkin Curran, primarily practices out of Wolkin Curran's San Diego office. She specializes in representing surety clients in all aspects of litigation involving surety bond claims. Ms. Szczechowicz assists sureties with developing cost effective strategies to minimize risk and loss.

Ms. Szczechowicz regularly represents surety clients in the defense of complex construction surety bond claims. Her experience includes litigating public and private construction disputes involving sureties, such as negotiating completion obligations in bond default situations, analyzing and defending against public works wage claims, enforcing payment defenses, securing collateral, and pursuing indemnity rights.

Ms. Szczechowicz has significant experience with commercial bonds involving probate estates, trusts, conservatorships and guardianships. She has represented sureties throughout California in a variety of probate matters, including defending against surcharge actions, locating and securing assets, preparing inventories and accountings, and obtaining orders discharging the bond.

Ms. Szczechowicz's practice also includes bankruptcy experience representing sureties in pursuing secured claims, lifting the automatic stay and protecting cash collateral, and litigating adversary proceedings, including objections to debtor's discharge.

RICHARD E. TASKER

Richard E. Tasker is President of Sage Associates, Inc., as well as Sage Consulting Associates, Inc. and Sage Contractor Services. He has been a Construction and Surety Consultant since the mid-1970's and has been involved with hundreds of contractor defaults and construction disputes. He began his career in the Northeast, working for a time in the Midwest and Rocky Mountain region, and for the past +15 years has resided in California. Mr. Tasker has represented most of the top 20 largest sureties and many smaller volume surety companies. He has been designated in many areas of construction including forensic schedule analysis, efficiency and productivity, construction accounting, procurement, means and methods, and standards of care. He is active and has often presented at industry functions including ABA, NBCA, SCI, NASBP, and WSSC, and is honored to see his many friends and speak again at the 2018 Pearlman.

MARLA D. THOMPSON

Marla D. Thompson began her career in surety underwriting in 1988, transitioned to surety claims in 1989 and has spent the past 30 years with surety companies in positions of claims management, collection and collateral management, subrogation and loss mitigation management. Over the years she developed research methods and tools for skip tracing, data verification and asset searches. In February 2017 she founded and launched her company Surety Solutions to provide surety companies with commercial surety claims management, delivering extraordinary expertise with California Contractors License Bond claims in particular, recovery & AR programs, skip tracing, data verification and asset searches. In 2018 Marla designed and formulated VIPER [Verify-Identify-Pursue] an online instant search tool and provides customized searches and reports. Surety Solutions services surety companies, attorneys, home security firms, private investigators, and other groups and industries with first-party recovery & AR programs as well as data verification, asset and other record searches through VIPER Reports.

MICHAEL J. TIMPANE

Mike Timpane is a partner with SMTD Law, LLP, and manages SMTD's Northern California office located in Oakland. Mike began his career in 1984, and has focused his practice on litigating surety and construction matters for 34 years. Mike is also an active private mediator and is a AAA arbitrator as well.

RODNEY J. TOMPKINS, SR., CCP

Rodney J. Tompkins Sr. is a managing partner and President of RJT Construction Inc., Consulting Services. Rod brings over 48 years of experience in a variety of types of Construction, Surety claims and Construction Consulting to the industry. RJT focuses on Surety claims and completion, complex project and surety loss mitigation, case management, scheduling, estimating, accounting, litigation, and construction processes and methodology. Rod has also been qualified as an Expert and has testified in State Courts, Federal Courts, AAA Arbitrations and Mediations. Rod is the qualifier for RJT's General Engineering and Building Contractors Licenses in California, Oregon and Louisiana. RJT has also been the recipient of the AGCC Constructor Award, California Preservation Foundation Award, and the AGCC Safety Award of Excellence.

Rod also has completed various advanced training programs from the AGC, FMI, AAA, and holds classification of Certified Cost Professional (CCP) from the American Association of Cost Engineers International (AACEi).

ANDREW W. TORRANCE

Andrew W. Torrance is an attorney with 30 years of experience in private practice representing contractors, insurance carriers and bonding companies. He is licensed to practice in Washington and Alaska. For the past seven years he has been employed at Liberty Mutual as Senior Surety Counsel for the Western Region managing bond claims.

PATRICIA WAGER

Patricia Wager is a Partner with Torre, Lentz, Gamell, Gary & Rittmaster, LLP. She received her undergraduate degree in Political Science from Vassar College and her law degree, from Albany Law School of Union University. Tricia is responsible for handling litigation matters with an emphasis on complex surety claims, payment and performance bond defense, and all aspects of construction defaults. In addition, she currently serves as a co-chair of the ABA TIPS Fidelity and Surety Law Committee's Law Division, and is a Vice-Chair of the ABA TIPS Fidelity & Surety Law Committee.

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, 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 Masters of Science in history from Edinburgh University, and a J.D. from Southern Methodist University Dedman School of Law.

GENE F. ZIPPERLE JR.

Gene F. Zipperle Jr., is a partner of the Louisville, Kentucky, office of the law firm of Ward, Hocker Thornton, PLLC., with offices in Lexington and Louisville, Kentucky. He is admitted to practice in the state and federal courts in Kentucky and Indiana, and federal courts in Ohio, North Carolina and Florida. Gene concentrates his practice in the areas of surety and fidelity law including bid, payment and performance bond claims and litigation, as well as protecting and prosecuting of the surety's indemnity rights. Gene also represents sureties and insurers in other business and commercial contexts, including coverage issues, estate and probate, and miscellaneous bond matters, particularly transportation related bonds. Gene is an active member of the Defense Research Institute's Fidelity and Surety Law

Committee, National Bond Claims Association and Eastern Bond Claims Review and ABA TIPS Fidelity and Surety Law Committee. He has presented at The Pearlman, National Bond Claims Association annual meeting, the Eastern Bond Claims Review annual meeting, and the National Association of Independent Sureties. Gene has also written articles for several industry publications.

DALE ZLOCK

Dale Zlock is currently a Special Agent with the National Insurance Crime Bureau focusing on the investigation of commercial claims in Washington, Oregon and Alaska. He is also assigned as an NICB representative to PSATT (Puget Sound Auto Theft Task Force). His 39-year investigatory career has been evenly split between public and private service. The majority of this career has been focused on the investigation of financial and organized crime, including supervisory and management positions.

Mr. Zlock has a Bachelor of Science degree in Information Technology Management and holds certifications as Criminal Analyst, Fraud Examiner and Fire Investigator (IFSAC-WA). He is also a published author and lecturer in the use of Visual Analytics to further investigations as diverse as Gambling Licensure, Asian Organized Crime, Insurance Fraud and Fire Investigations. As part of his current position he conducts training on the investigation of auto theft, staged accidents, and insurance fraud to law enforcement and insurance companies.

Sustaining Members

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

Please visit our website at www.alberfrank.com.

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

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

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

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

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

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

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

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

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

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

Please visit our website at www.boothmitchel.com.

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

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

Please visit our website at www.bfrhawaii.com.

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

Accountants, Field Inspectors and Claims experts, Cashin Spinelli & Ferretti is well poised to offer Surety consulting and litigation support services to the industry.

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

Please visit our website at www.csfllc.com.

Chiesa Shahinian & Giantomasi PC

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

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

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

Please visit our website at www.csglaw.com.

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

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

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

Please visit our website at www.clarkhillstrasburger.com.

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

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

Please visit our website at: www.dunlapfiore.com

ERNSTROM & DRESTE LLP

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.

FA Fasano Acchione & Associates, LLC.

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.

1-888-TO-GUARDIAN

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.

JHC JENNINGS HAUG CUNNINGHAM LAWYERS

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

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

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

Please visit our website at www.jhc.law.

Jennings Strouss
Attorneys at 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.

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

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. www.knchlaw.com

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KREBS | FARLEY PLLC

ATTORNEYS AT LAW

The nationally recognized attorneys of Krebs Farley, 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, PLLC seek pragmatic solutions for our clients.

Please visit our website at www.kfplaw.com.

LANGLEY | LLP

ATTORNEYS & COUNSELORS

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

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

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

Law Offices of
Charles G. Evans

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

Law Offices of John L. Fallat

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

Please visit our website at www.fallat.com.

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

Our experts speak over 30 languages and we have 42 offices on 4 continents. Our work spans more than 130 countries and 800 industries, and we frequently work with law firms, government entities, multi-national corporations, small businesses, insurance companies and independent adjustment firms.

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

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

Please visit our website at www.manierherod.com.

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

Please visit our website at www.partneresi.com.

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

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

Please visit our website at www.pcacg.com.

RJT CONSTRUCTION, INC.
CONSULTING SERVICES

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.

Roberts, Taylor & Sensabaugh, Inc.

Through a broad range of services, Roberts, Taylor & Sensabaugh assists its clients in minimizing the inherent risks in the construction process. We approach each task of surety and fidelity consulting, project and program management, construction oversight, construction claims services, and litigation support with the highest level of quality, detail, and professionalism. The education, experience, analytical and accounting skills of our staff provide the expertise to deal with complex construction issues.

RTS and its staff are dedicated to investigative excellence. Providing services worldwide, we endeavor to provide exceptional services to our clients with honesty and integrity.

Please visit our website at www.roberts-taylor.com.

ROBINS KAPLAN LLP

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

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

Please visit our website at www.robinskaplan.com.

Robinson+Cole

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

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

Please visit our website at www.rc.com.

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

The firm's employees and associates offer a broad mix of expertise and skills. Surety claims work is facilitated by knowledge, patience, focus, and relationships. We focus on our client's business and objectives, working hard to assist sureties "deliver on the promise" and resolve claims. Cost to benefit is always a paramount consideration at Sage Associates as is a long term focus both in the assignment and with our relationship with our clients.

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

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

Please visit our website at www.sageconsulting.com.

SALAMIRAD, MORROW, TIMPANE & DUNN LLP
ATTORNEYS AT LAW

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

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

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

Please visit our website at www.scmlaw.com.

STEWART SOKOL & LARKIN LLC

ATTORNEYS AT LAW

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

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

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

Please visit our website at www.lawssl.com.

THE HUSTEAD LAW FIRM

A Professional Corporation

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

Please visit our website at www.thlf.com.

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

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

Please visit our website at www.tlggr.com.

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

Please visit our website at www.vertexeng.com.

WHT PLLC

WARD, HOCKER & THORNTON

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
ATTORNEYS AT LAW LLP

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™

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

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

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

Please visit our website at www.williamskastner.com.

WOLKIN • CURRAN, LLP

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

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

Please visit our website at www.wolkincurran.com.

Wright, Constable & Skeen LLP
Attorneys At Law

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

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

Wright, Constable & Skeen has been named to the "2012 Top Ranked Law Firms™ in the U.S." by Lexis Nexis® Martindale-Hubbell®, as published in Fortune magazine. WC&S was recognized as a U.S. law firm of 21 or more attorneys where at least one out of every three lawyers, including associates, achieved the AV®Preeminent™ Peer Review Rating℠.

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Driving Directions

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

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

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

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

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

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

Harbour Pointe Golf Club to SeaTac Airport

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

Willows Lodge to SeaTac Airport

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

Notes

Notes

SESSION 1

SCOLLICK V. NARULA:

INDUSTRY PANEL REVIEW OF RECENT REPORTED DECISION ON FRCP 15(a) MOTION

Robert C. Niesley | Watt, Tieder, Hoffar & Fitzgerald | Irvine, CA

Maureen O'Connell | Gallagher & Co. | San Francisco, CA

Daniel Pope | Zurich American Insurance Co. | Owings Mills, MD

Tiffany Schaak | Liberty Mutual Surety | Seattle, WA

PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

WATT TIEDER
WATT, TIEDER, HOFFAR & FITZGERALD, L.L.P.

MEMORANDUM

TO: Pearlman Association

FROM: Robert C. Niesley

DATE: September 6, 2018

RE: Case Note - United States ex rel Scollick v. Narula, 2017 WL 3268857 (D.D.C. July 31, 2017)

In a case of first impression, *Scollick* v. *Narula*, 2017 WL 3268857 (D.D.C. July 31, 2017) ('"*Scollick*"), a federal district court granted the plaintiff's motion for leave to amend a Complaint, pursuant to FRCP 15(a), allowing a Qui Tam plaintiff-relator to assert, among other claims, his causes of action under the federal False Claims Act, 31 U.S.C. 3729 et seq. ("FCA"), against two sureties and a bond broker that issued surety bonds to two allegedly fraudulent Service-Disabled Veteran-Owned Small Businesses ("SDVOSB").

It is important to note at the beginning of this discussion that the *Scollick* case is ongoing and unresolved. A FRCP 15(a) motion is filed early in the procedural history of a case. By rule, all factual allegations of the proposed Amended Complaint must be accepted as true, even if far-fetched or false. The district court is legally required to liberally review the allegations of the proposed Amended Complaint.

The published *Scollick* ruling is in no way a finding that the sureties or broker committed a FCA violation or any other wrongdoing. The *Scollick* ruling is simply an early pleadings motion that is allowing the plaintiff-relator's case to survive another day. Discovery will be conducted. Further motions have and will be filed. Perhaps one day there will be a trial to determine the truth, or lack thereof, of the allegations in the Amended Complaint.

With that admonition, then why are we bothering to write about and discuss the case? As stated above, the *Scollick* case is one of first impression and the business of suretyship involves, among many things, an analysis of risk. Does the *Scollick* case make underwriting contractors allegedly qualified for government set aside work too risky? Does the normal underwriting process create FCA risk? Should sureties underwrite government set aside contractors differently or at all? Perhaps underwriters should ask more questions, or fewer? There is no clear answer to many of these questions, but the panel discussion on September 6, 2018 will have industry leaders from the legal, underwriting and broker sides of the surety business to discuss or debate what *Scollick* means to them. The opinions expressed in the panel discussion are in no way representative of the surety industry or the employers of the individual speakers, but rather are an attempt to have a thoughtful discussion about the lessons of *Scollick.*

In advance of your attendance at our September 6, 2018 panel discussion, please read this memorandum for a summary of the *Scollick* case. If you're interested in more detail, I have attached a complete copy of the *Scollick* opinion as Exhibit "A." For the surety geeks among you, I have attached a copy of the proposed Amended Complaint under review by the court in the *Scollick* opinion as Exhibit "B.". Happy reading.

A. GENERAL FACTUAL OVERVIEW

The Court adopts as true the following factual summary from the Amended Complaint:

"The factual allegations of the case center around an alleged scheme to defraud the United States government by submitting bids to obtain government construction contracts. Plaintiff-relator [, a disgruntled ex-employee,] claims that the defendants participated in this scheme by fraudulently claiming or obtaining [SDVOSB] status, HUBZone status, or section 8(a) status for certain companies to bid on and obtain set-aside contracts, when in fact the bidders did not qualify for the statuses claimed. Plaintiff-relator alleges that defendants, as part of this scheme, falsely certified these statuses, made false claims regarding past performance, hid certain aspects of the management and control of the companies at issue, and hid or falsified certain information regarding the employees of the companies at issue.

The central actors in this scheme are Neil Parekh, Ajay K. Madan, Vijay Narula, Centurian Solutions Group ("CSG"), and Citibuilders Solutions Group ("Citibuilders"). Parekh, Narula, and Madan allegedly engaged in conspiracy to defraud the government by bidding on SDVOSB construction contracts although none of them were service disabled veterans. Accordingly, Parekh, Narula, and Madan established CSG as a "front company" for the purpose of allowing them to bid on and obtain SDVOSB set-aside contracts. To qualify for SDVOSB status, defendant Gogia – a service disabled veteran – was allegedly falsely identified as a 100% service disabled owner of CSG, although he did not actually exercise any control or ownership over CSG. Parekh, Narula, Madan, and Gogia also falsely identified that CSG operated out of a HUBZone when in fact it did not. Plaintiff-relator alleges that CSG then submitted false claims and statements to the government. Plaintiff-relator claims that the CSG bids contained falsified information regarding past performance, and false representations concerning CSG's employees. Finally, plaintiff-relator claims that CSG obtained millions of dollars in government contracts as a result of this fraudulent scheme, and lists the specific contracts allegedly fraudulently obtained.

With regard to Citibuilders, plaintiff-relator alleges that Parekh established Citibuilders to branch out his fraudulent SDVOSB contracting activity. According to the Amended Complaint, Parekh falsely certified Citibuilders as a service-disabled veteran-owned entity – utilizing defendant Goodweather's service-disabled veteran status even though Parekh was the de facto owner and controller of Citibuilders, and misrepresented Citibuilders' past performance and project personnel. Plaintiff-relator claims that Citibuilders obtained millions of dollars in government contracts as a result of this fraudulent scheme, and lists the specific contracts allegedly fraudulently obtained. Plaintiff-relator claims that the creation of Citibuilders by Parekh caused a rift between himself, Narula and Madan. Plaintiff-relator claims that Narula is the alter ego of OST, that Neil Parekh, Dilip Parekh, CB, and Citibuilders are all alter egos of each other, that Narula, Neil Parekh, Madan, OST, and CB are joint-alter egos of CSG, and that Neil Parekh, Goodweather, and Citibuilders are all joint alter egos."

B. FACTS SPECIFIC TO INSURANCE DEFENDANTS

Specific to the insurance defendants, the Court adopts as true the following facts from the Amended Complaint:

"Under the Miller Act, contractors bidding for government construction contracts are required to post bid bonds, performance bonds, and payment bonds, and the bid bond company is required to ensure that the contractor will perform the work. Centennial is an insurance broker, Schendel is the president of Centennial, and Hudson and Hanover are insurance companies that provided surety bonds to the defendants.

The bid proposals submitted here were dependent upon the issuance of surety bonds and performance bonds by Centennial, "as the agent and attorney-in-fact for Hudson Insurance Company and Hanover Insurance Company." Plaintiff-relator claims that Centennial and Schendel were the lawful agents of and attorneys-in-fact for Hanover and Hudson and that Schendel was responsible for causing Hudson and Hanover to issue bid and performance bonds to CSG and Citibuilders. Plaintiff-relator claims that Schendel had a long-standing relationship with Neil Parekh and that Centennial knew that OST, SCH, and CB Construction shared a single office and that Parekh and Narula were in functional control of CSG. [emphasis added]

Plaintiff-relator alleges that the contracts at issue required Citibuilders and CSG to obtain bid bonds and performance bonds, without which the fraudulent activity could not be carried out. He claims that Schendel and Centennial knew the details of the bid proposals submitted by OST, SCG, and CB. He also claims that Hudson and Hanover "by and through its agent and attorneys in fact Centennial" understood that OST, CSG, and CB shared common ownership, requiring Narula, Parekh, and Gogia to execute corporate resolutions acknowledging this fact. In addition, Schendel and Centennial allegedly "understood that Parekh, Narula, and Madan had ownership interests in CSG and deliberately disregarded this fact when issuing bonds in connection with the false certifications contained in the bidding proposals submitted to the government." Finally, the Complaint alleges that Hudson and Hanover knew that bonds were required for the contracts at issue and "[b]ut for Defendant Schendel, Centennial acting as agents and attorney-in-fact to Hudson and Hanover for the purpose of issuing bid bonds and performance bonds, the fraudulent bid submissions made by CSG and Citibuilders would not have been awarded."

. . .

Plaintiff-relator's Amended Complaint supplements the previously alleged facts with new details regarding the insurance defendants' knowledge. It alleges that the insurance defendants 'facilitated [the CSG and Citibuilders] fraud schemes by obtaining facts and that the Bonding Defendants knew or should have known violated the government's contracting requirements, but the Bonding Defendants not only concealed those facts from the government, they also issued surety bonds to CSG and Citibuilders, which gave the misleading appearance that CSG and Citibuilders were qualified to bid on these SDVOSB construction contracts. Specifically, the Amended Complaint sufficiently alleges that the insurance defendants knew or should have known that CSG and Citibuilders were violating the government's contracting requirements by alleging that the insurance defendants engaged in an underwriting process during which they conducted an on-site inspection of OST's offices. After this tour, the insurance defendants ‘necessarily understood that CSG was a shell company dependent on the resources and capabilities and capital of CB and OST and the experience and knowledge and financial backing of Parekh, Narula, and Madan,” and the underwriting and due diligence would reasonably have revealed that SCG did not possess the necessary construction history or financial capabilities to carry out the scope of contracting activity ultimately undertaken in the name of CSG. The Amended Complaint further alleges that the underwriting and due diligence reasonably led to the conclusions that “Parekh, Narula, and Madan exerted dominance and control over CSG,” that “Gogia lacked the skill, knowledge, resources and past performance to engage in the scope of contracting activity undertaken by the CSG conspirators,” and that “CSG was not a service-disabled small business operating out of Harrisburg.”

C. LEGAL DISCUSSION/RULING OF COURT ON 15(a) MOTION BY INSURANCE DEFENDANTS.

There are eighteen (18) defendants in the case. Our focus herein is upon only four (4) defendants, the two sureties, Hanover and Hudson, and the broker, Centennial and Schendel. The Amended Complaint alleges four (4) theories of liability against the insurance defendants under the FCA, as follows: (1) submitting or causing to be submitted false or fraudulent claims to the United States (“presentment claims”); (2) making or causing to be made or used false statements or records material to false or fraudulent claims (“false statement claims”); (3) knowingly avoiding or decreasing obligations to the United States (“reverse false claims”); and (4) conspiracy to violate the FCA.

1. Presentment Claims.

The Amended Complaint does not allege that the insurance defendants directly made false claims to the United States. Rather, the Amended Complaint relies upon a theory of “indirect presentment,” e.g. the actions of the insurance defendants were critical and directly led to the presentment by others of false claims. In short, the insurance defendants were “enablers.”

The elements of a presentment claim are (1) the defendant submitted a claim to the government, (2) the claim was false, and (3) the defendant knew the claim was false. The Court found that the Amended Complaint satisfactorily alleged facts against the insurance defendants to support a cause of action for indirect presentment. *Scollick, at* 6.

Pointing to the allegations in the Amended Complaint of the thoroughness of the underwriting process; normal underwriting due diligence; knowledge of the physical offices of the principals; knowledge of the management and finances of the principals; and the close, long-standing relationship between the broker, Schendel, and one of the alleged wrongdoers, Parekh, the court found that the requisite “knowledge” of CSG’s and Citibuilders’ fraud, i.e. that they were fraudulently asserting status as SDVOSBs.

2. False Statement Claims.

A false statement claim is very similar to a presentment claim, except that a false statement claim requires a false “statement,” as opposed to a false claim for payment. The elements of a false statement claim are that the defendants made the statements “knowingly,” that is by having (1) actual knowledge, (2) acting in deliberate ignorance, or (3) acting in reckless disregard. *Scollick, at 7.*

Relying upon the same allegations of knowledge as in the presentment allegations, the court ruled that the plaintiff-relator had also satisfactorily alleged allegations of false statement claims against the insurance defendants. The insurance defendants had knowledge of the fraud of CSG and Citibuilders,and continued to do business with them in furtherance of the fraud. But for the issuance of the surety bonds, CSG and Citibuilders never could have carried out this fraud on the United States.

3. **Reverse False Claims.**

A reverse false claim occurs when a person "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the United States, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the United States. In other words, a reverse false claim occurs when no payment was made to the government because of an identified wrongful act or failure to act. 31 U.S.C. 3729 §3729(a)(1)(G).

Interestingly, the two sureties lost their challenge to the reverse false claim allegations, while the brokerage and its president won. The court found that, as a result of issuing their bonds for the several projects, the sureties had an independent obligation to pay the United States in the event of a default and claim on the bonds. Thus, it was in the best interest of the sureties for there to not be any claims on the bonds. Each time the sureties "knew that the government made a payment that violated the service-disabled veteran-owned specification, they knowingly avoided an obligation to compensate the government for that loss." *Scollick at 30.*

Unlike the sureties, the broker did not have an independent payment obligation to the United States, so the alleged concealment of FCA violations did not benefit the broker in the same way as the sureties that issued the bonds. The allegation of reverse false claims against the broker was rejected at the pleadings stage.

4. **Conspiracy**

The insurance defendants attacked the conspiracy claim by arguing that none of the other three FCA claims were valid, so, therefore, a conspiracy to commit those invalid claims could not be actionable. Since the court found that the plaintiff-relator could state FCA causes of action for presentment claims, false statement claims, and reverse false claims, the court also allowed the conspiracy claim to survive.

D. CONCLUSION

After the *Scollick* decision was published, many of the defendants answered and discovery has commenced. Hanover filed a motion to dismiss under FRCP 12(b)(6), which has been unresolved since October 2017.

EXHIBIT "A"

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, ex. rel. ANDREW SCOLLICK, **Plaintiff-Relator,** **v.** **VIJAY NARULA, et al.,** **Defendants.**	)	**Case No: 14-cv-01339-RCL**

MEMORANDUM OPINION

I. INTRODUCTION

Plaintiff-relator Andrew Scollick originally brought this case against eighteen defendants for violations of the False Claims Act ("FCA") in connection with a scheme to obtain certain set-aside government contracts through fraudulent means. Plaintiff-relator alleged four causes of action against all of the defendants: (1) submitting or causing to be submitted false or fraudulent claims to the United States in violation of 31 U.S.C. § 3729(a)(1)(A) (presentment claims); (2) making or causing to be made or used false statements or records material to false or fraudulent claims in violation of 31 U.S.C. § 3729(a)(1)(B) (false statement claims); (3) knowingly avoiding or decreasing obligations to the United States in violation of 31 U.S.C. § 3729(a)(1)(G) (reverse false claims); and (4) conspiracy to violate the FCA in violation of 31 U.S.C. § 3729(a)(1)(C).

The following defendants moved to dismiss for failure to state a claim: Hudson Insurance Co., Hanover Insurance Co., Centennial Surety Associates, Inc., Michael Schendel, Ajay K. Madan, Vijay Narula, Optimal Solutions and Technologies, Inc. ("OST"), CB Construction Group, Inc. ("CB"), Dilip Parekh, Shobha N. Mehta, Melvin G. Goodweather, Citibuilders Solutions

Group, and Guatam Chitnis.[1] On October 14, 2016, this Court granted in part and denied in part the motions. *See United States ex. rel. Scollick v. Narula*, 215 F. Supp. 3d 26 (D.D.C. 2016). The Court found that plaintiff-relator failed to state a claim against defendants Hudson Insurance Co., Hanover Insurance Co., Centennial Surety Associates, Inc., Michael Schendel, CB Construction, Dilip Parekh, Shobha N. Mehta, Melvin G. Goodweather, and OST and granted their motions to dismiss. *Id.* at 30.

It found, however that "plaintiff-relator has stated claims against defendants Citibuilders, Ajay K. Madan, and Vijay Narula for certain FCA violations—presenting false claims in violation of 31 U.S.C. § 3729(a)(1)(A), making false statements in violation of 31 U.S.C. § 3729(a)(1)(B), and conspiracy in violation of 31 U.S.C. § 3729(a)(1)(C) (Counts I, II, IV)." *Id.* Plaintiff-relator "fail[ed] to state a claim for reverse FCA violations (31 U.S.C. § 3729(a)(1)(G)) against any of the defendants," including defendants Citibuilders, Madan, and Narula. *Id.* at 36.

Plaintiff-relator now moves, pursuant to Federal Rule of Civil Procedure 15(a), for leave to amend his Complaint in order to address the pleading shortcomings in his original Complaint. *See* Mot. for Leave to Amend, ECF No. 131. He asserts the same four causes of action under the FCA. The following defendants have filed oppositions: 1) Hudson Insurance [ECF No. 133]; 2) Centennial Surety Associates and Michael Schendel [ECF No. 137]; Vijay Narula, Ajay Madan, and OST [ECF No. 138]; Shobha Mehta [ECF No. 145]; Hanover Insurance [ECF No. 146]; and Melvin Goodweather [ECF No. 157]. The defendants argue that plaintiff-relator's motion should be denied because the Amended Complaint fails to cure the pleading deficiencies previously identified by this Court, and therefore that amendment would be futile.

[1] Defendants Amar Gogia, Centurion Solutions Group, LLC ("CSG"), and Neil Parekh did not move to dismiss, instead filing Answers to the Complaint.

II. BACKGROUND

The factual background of this case is set forth in this Court's prior opinion regarding defendants' motions to dismiss. *See United States ex. rel. Scollick v. Narula*, 215 F. Supp. 3d 26 (D.D.C. 2016). The Court need not repeat all of the details here, but, for clarity, will include an excerpt from that opinion regarding the general background of this case:

> The factual allegations in this case center around an alleged scheme to defraud the United States government by submitting bids to obtain government construction contracts. Plaintiff-relator claims that the defendants participated in this scheme by fraudulently claiming or obtaining service-disabled veteran-owned small business ("SDVOSB") status, HUBZone status, or section 8(a) status for certain companies to bid on and obtain set-aside contracts, when in fact the bidders did not qualify for the statuses claimed. Plaintiff-relator alleges that defendants, as part of this scheme, falsely certified these statuses, made false claims regarding past performance, hid certain aspects of the management and control of the companies at issue, and hid or falsified certain information regarding the employees of the companies at issue.
>
> The central actors in this scheme are Neil Parekh, Ajay K. Madan, Vijay Narula, Centurion Solutions Group ("CSG"), and Citibuilders Solutions Group ("Citibuilders"). Parekh, Narula, and Madan allegedly engaged in conspiracy to defraud the government by bidding on SDVOSB construction contracts although none of them were service disabled veterans. Accordingly, Parekh, Narula, and Madan established CSG as a "front company" for the purpose of allowing them to bid on and obtain SDVOSB set-aside contracts. To qualify for SDVOSB status, defendant Gogia—a service disabled veteran—was allegedly falsely identified as a 100% service disabled owner of CSG, although he did not actually exercise control or ownership over CSG. Parekh, Narula, Madan, and Gogia also falsely identified that CSG operated out of a HUBZone when in fact it did not. Plaintiff-relator alleges that CSG then submitted false claims and statements to the government. Plaintiff-relator claims that the CSG bids contained falsified information regarding past performance, and false representations concerning CSG's employees. Finally, plaintiff-relator claims that CSG obtained millions of dollars in government contracts as a result of this fraudulent scheme, and lists the specific contracts allegedly fraudulently obtained.
>
> With regard to Citibuilders, plaintiff-relator alleges that Parekh established Citibuilders to branch out his fraudulent SDVOSB contracting activity. According to the Complaint, Parekh falsely certified Citibuilders as a service-disabled veteran-owned entity—utilizing defendant Goodweather's service-disabled veteran status even though Parekh was the de facto owner and controller of Citibuilders, and misrepresented Citibuilders' past performance and project personnel. Plaintiff-relator claims that Citibuilders obtained millions of dollars in government contracts as a result of this fraudulent scheme, and lists the specific contracts allegedly fraudulently obtained. Plaintiff-relator claims that the creation of Citibuilders by Parekh caused a rift between himself and Narula and Madan. Plaintiff-relator claims that Narula is the alter ego of OST, that Neil Parekh, Dilip Parekh,

> CB, and Citibuilders are all alter egos of each other, that Narula, Neil Parekh, Madan, OST, and CB are joint-alter egos of CSG, and that Neil Parekh, Goodweather, and Citibuilders are joint alter egos.
>
> Finally, Plaintiff-relator claims that similar fraud was committed in the name of a third company, KCGI. Specifically it alleges that Narula, Parekh, Madan, Guatam Chitnis, and Anita Chitnis schemed to use KCGI to defraud the government by seeking Small Business Administration section 8(a) contracts and/or service disabled contracts. On December 21, 2015 plaintiff-relator, with the consent of the U.S. government, filed a notice of voluntary dismissal with respect to KCGI, Guatam Chitnis, and Anita Chitnis.

Id. at 30–32 (internal citations omitted). The Amended Complaint tells essentially the same story in greater detail and with additional allegations. Where necessary, the Court will discuss the new allegations with respect to the defendants at issue.

The Court found that plaintiff-relator failed to state a claim for any FCA violations against defendants Hudson, Hanover, Centennial, Schendel, Mehta, Goodweather, OST, CB Construction, and Dilip Parekh. It found that plaintiff-relator sufficiently stated claims for the presentment of false claims, making false statements, and conspiracy in violation of the FCA, but failed to state a claim for reverse false claims against defendants Citibuilders, Narula, and Madan. Defendants Amar Gogia, CSG, and Neil Parekh did not move to dismiss, but this Court sua sponte dismissed the reverse false claim count against them as well.

Plaintiff now brings claims in the Amended Complaint under the same four causes of action: (1) submitting or causing to be submitted false or fraudulent claims to the United States in violation of 31 U.S.C. § 3729(a)(1)(A) (presentment claims) (Count I); (2) making or causing to be made or used false statements or records material to false or fraudulent claims in violation of 31 U.S.C. § 3729(a)(1)(B) (false statement claims) (Count II); (3) knowingly avoiding or decreasing obligations to the United States in violation of 31 U.S.C. § 3729(a)(1)(G) (reverse false claims) (Count III); and (4) conspiracy to violate the FCA in violation of 31 U.S.C. § 3729(a)(1)(C) (Count IV). He has removed defendants Dilip Parekh, KCGI, Inc., Guatam Chitnis, and Anita

Chitnis from the Amended Complaint. He brings Counts I, II, and IV against all of the remaining defendants. He only brings Count III (reverse false claims) against defendants Hudson, Hanover, Centennial, and Schendel (the "insurance defendants"). As noted above, only defendants Hudson, Hanover, Centennial, Schendel, OST, Mehta, and Goodweather oppose plaintiff-relator's attempt to assert these claims. After reviewing the relevant legal standards, the Court will examine whether leave should be granted as to each of these defendants.

III. LEGAL STANDARDS

A. Leave to Amend

Parties have a right to amend their pleadings once as a matter of course. FED. R. CIV. P. 15(a)(1). After this, a party may amend if the opposing party consents, or if the court grants leave. FED. R. CIV. P. 15(a)(2). Courts "should freely give leave when justice so requires." *Id.* Whether to grant leave is within the discretion of the District Court. *Foman v. Davis*, 371 U.S. 178, 182 (1962). Reasons for denying leave to amend include "undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, [or] futility of amendment." *Id.* "An amendment would be futile if it merely restates the same facts as the original complaint in different terms, reasserts a claim on which the court previously ruled, fails to state a legal theory, or could not withstand a motion to dismiss." *Robinson v. Detroit News, Inc.*, 211 F. Supp. 2d 101, 114 (D.D.C. 2002).

If a party alleges that amendment would be futile because the amended complaint could not withstand a motion to dismiss, the court's "review . . . is, for practical purposes, identical to review of a Rule 12(b)(6) dismissal based on the allegations in the amended complaint." *In re Interbank Funding Corp. Sec. Litig.*, 629 F.3d 213, 216 (D.C. Cir. 2010) (internal quotation marks omitted). To survive a 12(b)(b) motion to dismiss "a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face. A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (internal citations and quotation marks omitted). Plaintiffs must provide more than labels, conclusions, or "formulaic recitation of the elements of a cause of action." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007). "Factual allegations must be enough to raise a right to relief above the speculative level." *Id.*

As this Court previously explained, "Federal Rule of Civil Procedure 9(b) applies to FCA actions." *Scollick*, 215 F. Supp. 3d at 35. Thus,

> An FCA plaintiff "must state with particularity the circumstances surrounding the defendants' allegedly false claims, as required by Rule 9(b) of the Federal Rules of Civil Procedure." [*United States ex rel. Totten v. Bombardier Corp.*, 286 F.3d 542, 544 (D.C. Cir. 2002)]. The "time, place, and contents of the false representations" must be pleaded with specificity, as these are the "element[s] of fraud about which the rule is chiefly concerned." *Id.* "[A]n FCA plaintiff must identify the 'who, what, when, where, and how of the alleged fraud.'" *United States v. Kellogg Brown & Root Servs., Inc.*, 800 F.Supp.2d 143, 153 (D.D.C. 2011). In sum, "[c]ombining Rules 8 and 9(b), we require that 'the pleader . . . state the time, place and content of the false misrepresentations, the fact misrepresented and what was retained or given up as a consequence of the fraud," and that he "identify individuals allegedly involved in the fraud." *U.S. ex rel. Williams v. Martin-Baker Aircraft Co.*, 389 F.3d 1251, 1256 (D.C. Cir. 2004).

Id.

B. Elements of FCA Claims

This Court previously identified the elements of the four FCA violations at issue. They are as follows:

> The elements of presentment claims are as follows: "(1) the defendant submitted a claim to the government, (2) the claim was false, and (3) the defendant knew the claim was false." *Pencheng Si v. Laogai Research Found.*, 71 F.Supp.3d 73, 91 (D.D.C. 2014) (internal quotation marks omitted). The elements of a false statement claim are nearly the same as those for a presentment claim, with the exception that a false statement claim "requires evidence that the defendant made a false statement to the government, as opposed to the

> submission of a false claim for payment." *Id.* at 87. Defendants must make these claims or statements "knowingly," that is, "by (1) having actual knowledge, (2) acting in deliberate ignorance, or (3) acting in reckless disregard." *U.S. ex rel. K & R Ltd. P'ship v. Massachusetts Hous. Fin. Agency*, 530 F.3d 980, 983 (D.C. Cir. 2008).
>
> A reverse false claim occurs when a person "knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." 31 U.S.C. § 3729(a)(1)(G). In contrast to the claims described above, "[a] reverse false claim is any fraudulent conduct that 'results in no payment to the government when a payment is obligated.'" *Pencheng Si*, 71 F.Supp.3d at 88. "Whereas a traditional false claim action involves a false or fraudulent statement made to the government to support a claim for money from the government, a typical reverse false claim action involves a defendant knowingly making a false statement in order to avoid having to pay the government when payment is otherwise due." *Id.*
>
> Finally, to state a claim for conspiracy under the FCA, the plaintiff-relator must allege "(1) that 'an agreement existed to have false or fraudulent claims allowed or paid' to the government, (2) that each alleged member of the conspiracy 'joined that agreement,' and (3) that 'one or more conspirators knowingly committed one or more overt acts in furtherance of the object of the conspiracy.'" *Id.* at 89 (quoting *United States ex rel. Miller v. Bill Harbert Int'l Constr., Inc.*, 608 F.3d 871, 899 (D.C. Cir. 2010)). An action for conspiracy cannot exist absent underlying tortious conduct, and therefore "there can be no liability for conspiracy where there is no underlying violation of the FCA." *Id.*

Id. at 35–36.

Presentment and false statement claims can rest on a theory of direct presentment/making of false statements or indirect presentment/making of false statements. Indirect presentment or false statements occur when a defendant causes a false claim to be presented or a false statement to be made. The Court previously summarized the law surrounding indirect presentment/false statements as follows:

> To determine whether a defendant who did not actually submit a claim or make a false statement "has 'caused' the submission of a false claim or false statement, a court must look at the degree to which that party was involved in the scheme that results in the actual submission." *United States ex rel. Tran v. Computer Scis. Corp.*, 53 F. Supp. 3d 104, 127 (D.D.C. 2014). Courts should therefore consider whether the plaintiff has alleged that the defendant's conduct was "at least a substantial factor in causing, if not the but-for cause of, submission of false claims." [*United States v. Toyobo Co., Ltd.*, 811 F. Supp. 2d 37, 48 (D.D.C. 2011)] (finding that the causation requirement was satisfied by allegations that the non-submitting defendant, a fiber manufacturer, marketed the fiber to vest manufacturers

for use and "induced with the prospect of refunds, rebates, and reimbursements . . . manufacturers and other companies in the [fiber] supply chain to continue producing [fiber-related] products—and selling them to the government—when questions arose" regarding the fiber's suitability). Courts have credited indirect presentment and false statement claims in the following circumstances: "when the non-submitting party takes advantage of an unwitting intermediary, thereby causing that party to submit a false claim;" when "the non-submitter was the driving force behind an allegedly fraudulent scheme;" when "they had agreed to take certain critical actions in furtherance of the fraud;" and when the "non-submitter continued to do business with an entity upon becoming aware that that entity was submitting false claims." *Tran*, 53 F.Supp.3d at 126–27. Because the FCA "penalizes a person for his own acts, not for the acts of someone else," *United States v. Bornstein*, 423 U.S. 303, 312 (1976), failure to act is insufficient. "Courts generally require that the defendant affirmatively act in order to impose liability under the FCA, particularly when a plaintiff alleges that the defendant 'caused' the submission of false claims." *United States ex rel. Landis v. Tailwind Sports Corp.*, 51 F. Supp. 3d 9, 50 (D.D.C. 2014).

IV. ANALYSIS

Plaintiff-relator argues that his Amended Complaint cures the pleading deficiencies identified by this Court and now sufficiently alleges claims for the presentment of false claims, making false statements, and conspiracy against all of the defendants, and alleges a reverse false claims violation against defendants Hudson, Hanover, Centennial, and Schendel (the insurance defendants). The Court will consider in turn whether these claims are sufficiently alleged against the defendants who have raised oppositions to plaintiff-relator's motion.

A. OST

The Court previously summarized the facts alleged in plaintiff-relator's original Complaint regarding defendant OST as follows:

> OST is a corporation located in Washington, D.C. Vijay Narula is the president and CEO of OST. Ajay K. Madan is the chief operating officer of OST and is a 49% owner of CSG. Narula is alleged to be the alter ego of OST, and Narula, Madan, and OST are alleged to be (some of) the alter egos of CSG. Regarding OST, the Complaint alleges that CB's business operations were relocated to OST's office, that CSG's business operations occurred out of OST's headquarters, and that Narula, Madan, and Parekh prepared CSG bid proposals while working out of OST's office space. It alleges that OST never qualified for SDVOSB or HUBZone status and was not a small business enterprise. The Complaint further alleges that CSG's bid proposals "include[d] statements pertaining to work alleged to have been completed at defendant OST's corporate headquarters . . . [but] CSG never

> performed any such construction activity." Narula allegedly "would personally provide past performance survey responses [regarding the OST project] to the government."

Scollick, 215 F. Supp. 3d at 32 (internal citations omitted).

1. Vicarious Liability

Plaintiff-relator originally alleged, in part, that defendant Narula was the alter ego of OST and that Narula, Neil Parekh, Madan, OST, and CB were joint-alter egos of CSG. This Court found that despite plaintiff-relator's "attempt to hold some of the defendants liable for the actions of CSG, Citibuilders, and KCGI . . . [by] alleg[ing] that many of the defendants [were] alter egos of each other and [were] therefore jointly and severally liable for each other's conduct," he "failed to sufficiently allege facts showing that the alter ego doctrine applie[d]." *Id.* at 36. Specifically, plaintiff-relator relied on legal conclusions that the defendants had "such a unity of interest and ownership that the individuality of each entity ceased and they functioned as a single entity," and failed to "identify the specific factual allegations in the Complaint that show commingling, manipulation, and diversion [of funds and assets]." *Id.* at 37. Importantly, he "failed to allege any facts showing that an inequitable result would follow if the corporate veil remains unpierced." *Id.*

Plaintiff-relator now argues that OST is vicariously liable for the acts of its agents and employees (specifically, Narula and Madan) under a theory of *respondeat superior*. "[A] corporation is liable under the FCA for the fraudulent acts of its agents even if the corporation received no benefit from its fraud." *U.S. ex rel. McCready v. Columbia/HCA Healthcare Corp.*, 251 F. Supp. 2d 114, 118 (D.D.C. 2003) (Lamberth, J.). "Under the doctrine of *respondeat superior*, an employer may be held liable for the acts of his employees committed within the scope of their employment." *Boykin v. D.C.*, 484 A.2d 560, 561 (D.C. 1984).

The Court finds that plaintiff-relator has sufficiently alleged that OST is liable under a theory of *respondeat superior*, and therefore that amendment on this point would not be futile.

Plaintiff relator alleges that defendants Narula and Madan are senior executives of OST. Specifically, that Narula is the founder, president, and CEO of OST and that defendant Narula is OST's COO. Am. Compl. ¶¶ 13, 17, 50, 51, ECF No. 131-1. He also alleges that "[a]t all times relevant to this Amended Complaint, Narula and Madan acted within the scope of their OST authority and/or with apparent OST authority to carry out each act in furtherance of the fraud and conspiracy to commit fraud undertaken in the name of CSG." *Id.* ¶ 51.[2] Plaintiff-relator includes lengthy allegations regarding a scheme by Narula and Madan on behalf of OST, along with defendants Parekh and Gogia, to form a limited liability company, defendant CSG, and to use CSG to submit fraudulent bids. *See* Am. Compl. ¶¶ 36, 44–49, 54, 56–58.

He also alleges that OST is liable for acts committed by other, non-defendant, employees, including OST's Senior Proposal Manager Bryan Van Gilder, OST's Marketing Manager Sujana Pathak, and OST Director Ronald Rhodes. *Id.* ¶¶ 40, 50. With respect to these employees, plaintiff-relator alleges that "[i]n his official OST capacity Mr. Van Gilder was responsible for the preparation and finalization of government contracting proposals. In his capacity as OST's SPM, Van Gilder was tasked with responsible for the preparation and finalization the first fraudulent response to a government contract solicitation made in the name of CSG [Solicitation No. VA-245-10-RP-0076]." Am. Compl. ¶ 40. He alleges that "OST's Marketing Manager, Sujana Pathak, and OST's Director, Ronald Rhodes, were involved with the preparation and review of the CSG Halls & Walls Solicitation Response, and did so with the knowledge and support of OST's CEO, Vijay Narula." *Id.* ¶ 42. In addition, "[t]he final draft of the CSG Halls & Walls Solicitation

[2] Plaintiff-relator also alleges that "Narula and OST constitute alter-egos of each other. They have such a unity of interest and ownership that the individuality of each ceased with respect to every act in furtherance of the CSG conspiracy." Compl. ¶ 51. To the extent that plaintiff-relator seeks to amend his complaint to assert a theory of alter ego liability, his motion shall be denied for the same reasons regarding failure to allege alter ego liability stated in this Court's prior opinion.

Response was circulated by Bryan Van Gilder, via OST's internal email system, to OST's CEO's Vijay Narula, OST's Marketing Manager Sujana Pathak, and an OST Director, Ronald Rhodes." *Id.* ¶ 43. Based on these allegations, and the fact that the defendants have failed to argue that *respondeat superior* does not apply,[3] plaintiff-relator has successfully alleged a theory of vicarious liability under the doctrine of *respondeat superior*.

2. *Presentment of False Claims/Making False Statements*

Furthermore, the Court finds that the Amended Complaint sufficiently states a claim against OST for presenting false claims and making false statements in violation of 31 U.S.C. § 3729(a)(1)(A)–(B). This Court previously noted that plaintiffs may bring claims under the FCA for indirect presentment or false statements where the defendant has caused a false claim to be presented or caused a false statement to be made. *Scollick*, 215 F. Supp. 3d at 39. "To determine whether a defendant who did not actually submit a claim or make a false statement 'has "caused" the submission of a false claim or false statement, a court must look at the degree to which that party was involved in the scheme that results in the actual submission.' *United States ex rel. Tran v. Computer Scis. Corp.*, 53 F. Supp. 3d 104, 127 (D.D.C. 2014). Courts should therefore consider whether the plaintiff has alleged that the defendant's conduct was 'at least a substantial factor in causing, if not the but-for cause of, submission of false claims.' *Toyobo Co.*, 811 F. Supp. 2d at 48." *Id.*

The Court finds that plaintiff-relator's Amended Complaint sufficiently alleges that defendant OST's conduct was at least a substantial factor in the submission of false claims, even where it did not itself directly present false claims or make false statements in the name of OST.

[3] Defendants Narula, Madan, and OST only argue that plaintiff-relator has failed to sufficiently allege alter ego status.

Plaintiff-relator alleges that "OST's offices and employees were used to prop up CSG." Am. Compl. ¶ 44. He states that CSG employees worked out of OST's office space and were provided OST email addresses and phone lines. *Id.* He states that "OST provided human resources, IT support, accounting support, corporate bonding, office space, printers, faxes, phone lines (CSG's 'Magicjack' port identifying a false 540 area code ran on OST's computer system), an email server, computer stations and office supplies necessary for OST to solicit and service government contracts in the name of CSG." *Id.* In addition, he claims that 1) "OST . . . covered the salary of a CSG employee;" 2) "OST's Sujana Pathak worked to locate additional construction opportunities for CSG and circulated potential construction opportunities to Ajay Madan, Neil Parekh and Andrew Scollick;" 3) "OST employees regularly prepared 'pipeline' reports that would track the date CSG bid on a contract, the government entity soliciting the bid, the contract description and contract price;" 4) "[a]n OST team was created to prepare and assemble the Halls & Walls Solicitation Response . . . [which] functioned as the prototype for the subsequent solicitation responses submitted in the name of CSG;" 5) "OST executed and transmitted to Hudson Insurance Company and Hanover Insurance Company a signed, sealed, and notarized agreement of indemnity as well as corporate resolutions extending OST's bond to contracts submitted in the name of CSG;" 6) "CSG's day-to-day business decisions were carried out within OST's headquarter where Parekh, Madan, Narula, CB and OST were co-located;" 7) "[t]he drafting and submission of CSG's bids occurred out of OST's Washington, D.C., offices under the direction and control of Narula, Madan, and Parekh;" 8) "CSG's contracting solicitations were controlled by Parekh (on behalf of himself and CB), as well as Narula and Madan (on behalf of themselves and OST);" and 9) "[t]he daily management and oversight over all CSG's SDVOSB construction activity was done by Parekh and CB Construction. OST's back office management was provided by Madan, Narula, and OST." *Id.* ¶¶ 45–49, 54, 56–58. These allegations are sufficient to show that OST "was the driving force behind an allegedly fraudulent scheme." *Scollick*, 215 F. Supp. 3d at 39.

Furthermore, the Amended Complaint sufficiently alleges that OST knowingly defrauded the government by seeking SBA Section 8(a) contracts for KCGI and concealing OST's involvement. To qualify for such contracts "a business must be owned by socially or economically disadvantaged individuals, in business for at least two years with the owners having a net worth of under $250,000." Am. Compl. ¶ 200. The Complaint alleges that a plan was devised for "OST to gain a 60% stake in any SDVOSB contracts KVGI could obtain and a 40% share of the Section 8(a) contract profits." Am. Compl. ¶ 201. Thus, OST and Narula were to gain profits that were intended to be received by socially or economically disadvantaged individuals. The Amended Complaint alleges that OST "entered into an indemnification agreement with Merchants Bonding Company to bond the set aside contracts obtained by KGCI." *Id.* ¶ 202. Although defendants argue that plaintiff-relator has failed to allege why such conduct is fraudulent, the Amended Complaint states that the defendants then allegedly concealed this fact. *Id.* ¶ 205. Therefore, plaintiff-relator has sufficiently stated that such conduct is fraudulent.

Finally, in its opposition, the defendant states that plaintiff-relator does not allege that OST directly presented false claims or made false statements to the government. However, the Amended Complaint does allege that Narula, on behalf of himself and OST, filled out and submitted performance survey questionnaires in which he made false statements regarding work allegedly performed by CSG for OST. *See* Am. Compl. ¶¶ 112–21. These allegations are sufficient to allege that OST directly made false statements to the government.

3. Conspiracy

The Amended Complaint brings a conspiracy count against defendant OST. OST has not, however, argued that plaintiff-relator has failed to sufficiently plead conspiracy. Therefore, plaintiff-relator will be granted leave to assert this claim against defendant OST.

In sum plaintiff-relator will be granted leave to amend to assert Counts I, II, and IV against defendant OST.

B. Shobha Mehta

This Court previously described defendant Mehta's involvement in the scheme—as explained by the original Complaint—as follows:

> Dr. Mehta is the aunt of Neil Parekh. The Complaint alleges that, as part of the scheme, the defendants falsified past performances of CSG. Specifically, it claims that defendants used a renovation project at Dr. Mehta's office as a credential of past performance that was necessary to bid and win contracts for medical centers. Plaintiff-relator alleges that Dr. Mehta's office was never renovated and that "[t]he defendants manufactured the Mehta Project and cut and pasted reference to the Mehta Project in various solicitations and bid proposals with differing size and costs of that project to fit the particular contract requirements under bid." He claims that the defendants conspired with Dr. Mehta to allow them to identify her office as an example of CSG's past performance and that Dr. Mehta "would provide past performance survey information to the government falsely attesting to work CSG never performed."

Scollick, 215 F. Supp. 3d at 33 (D.D.C. 2016) (internal citations omitted).

As previously noted, this Court found that plaintiff-relator largely failed to allege that many of the defendants directly presented false claims or made false statement, or that they were a substantial factor in the submission of false claims or false statements. *Id.* at 38–40. With respect to defendant Mehta specifically, the Court found that although plaintiff-relator alleged that she made a false statement to the government—*i.e.*, that "Dr. Mehta would provide past performance survey information to the government falsely attesting to work CSG never performed"—"[t]his allegation . . . fail[ed] to meet the heightened pleading standard under Rule 9(b) . . . [because] it

[did] not identify with specificity when these statements were made, how they were made, or what facts were misrepresented." *Id.* at 40.

1. False Statements

Plaintiff-relator now argues that he has amended the complaint to present the factual bases of defendant Mehta's liability, specifically that Dr. Mehta made false statements to the government and caused false statements to be submitted in furtherance of the conspiracy. The Amended Complaint again alleges that the defendants stated that they had completed work at Dr. Mehta's office (the "Mehta Project") as a credential of past performance to bid on and win contracts. Am. Compl. ¶¶ 93–96, 105–11 (listing the specific solicitations that used the Mehta Project as a credential of past performance). But, CSG's assertion "that it engaged in construction activities for Dr. Mehta is entirely false as the location specified was built in the 1980's and had yet to be renovated." *Id.* ¶ 97.

With respect to Dr. Mehta specifically, it alleges that, beginning in April 2010, she completed performance satisfaction surveys sent by VA contracting officers and stated that the work completed by CSG was outstanding, and that she verified this false information in phone calls from government contract officers. *Id.* ¶¶ 97–101. The Amended Complaint gives the following example: "on September 22, 2010, Dr. Mehta completed a customer satisfaction questionnaire that claimed her office had been renovated between January 2009 and May 2009 at a cost of $1,236,000. Dr. Mehta responded to this survey claiming that CSG's overall performance on a fictitious million plus dollar renovation was 'exceptional' and that she would hire CSG again." *Id.* ¶ 103. The Amended Complaint alleges that Dr. Mehta "knew that CSG claimed in some of its submissions that the renovations of Dr. Mehta's office occurring at 5021 Seminary Road, Alexandria, VA (the location specified by CSG) exceeded $1 million dollars. That office location, however, consisted of a single room approximating 200 square feet and had not been renovated since it was originally constructed, upon information and belief, back in the 1980's." *Id.* ¶ 102.

Thus, the Amended Complaint alleges that CSG falsely claimed that it had completed work at Dr. Mehta's office, when in fact it had not, that Dr. Mehta knew that CSG falsely used the Mehta Project as a credential of past performance, and that she falsely asserted in satisfaction surveys and phone calls that this work had been done and was "exceptional" or "outstanding." These allegations cure the deficiencies previously identified by this Court; they describe when the statements were made, how they were made, and what facts were misrepresented. This is sufficient to state a claim for making false statements in violation of the False Claims Act, 31 U.S.C. § 3729(a)(1)(B). Plaintiff-relator does not appear to be asserting that defendant Mehta violated 31 U.S.C. § 3729(a)(1)(A) by presenting or causing to be presented false *claims* to the government.

2. *Conspiracy*

The Court also finds that plaintiff-relator has sufficiently stated a claim against Dr. Mehta for conspiracy in violation of the False Claims Act. The Court previously found that "[t]here be no conspiracy when there is no underlying FCA violation." *Scollick*, 215 F. Supp. 3d at 43. Plaintiff-relator has now sufficiently alleged the existence of underlying FCA violations. "[T]o state a claim for conspiracy under the FCA, the plaintiff-relator must allege '(1) that "an agreement existed to have false or fraudulent claims allowed or paid" to the government, (2) that each alleged member of the conspiracy "joined that agreement," and (3) that "one or more conspirators knowingly committed one or more overt acts in furtherance of the object of the conspiracy."'" *Id.* at 36.

Plaintiff-relator has alleged the existence of an agreement and that Dr. Mehta joined the agreement. The Amended Complaint alleges that "[u]pon information and belief, one or more of the CSG conspirators approached Dr. Mehta to obtain her assistance in furthering the conspiracy by agreeing to submit materially false performance questionnaires to the VA." Am. Compl. ¶ 93. Plaintiff-relator has alleged that Dr. Mehta committed an overt act in furtherance of the conspiracy—specifically, as explained above, that she falsely affirmed that CSG had performed work at her office that was never actually performed. The Court thus finds that the Amended Complaint sufficiently states a claim for conspiracy against Dr. Mehta.

C. Melvin Goodweather

Plaintiff's original Complaint alleged the following with respect to defendant Melvin G. Goodweather:

> Defendant Goodweather is a service disabled veteran allegedly falsely identified as the sole owner and CEO of Citibuilders, although he was subservient to Neil Parekh. He is alleged to be an alter ego of Neil Parekh and Citibuilders. The Complaint claims that Parekh utilized Goodweather's service disabled veteran status to establish Citibuilders as a SDVOSB entity, but that Citibuilders was under the direct control of Parekh who was the de facto owner.

Scollick, 215 F. Supp. 3d at 33. Plaintiff-relator now argues that the Amended Complaint sufficiently alleges that defendant Goodweather indirectly caused the submission of false claims and statements and participated in a conspiracy to violate the False Claims Act.

1. Presentment of False Claims/Making False Statements

The Amended Complaint expands on the allegations regarding defendant Goodweather. It alleges that Goodweather formed Citibuilders and "establish[ed] himself as its sole owner, President, and CEO of that entity knowing that he would never function in those capacities." Am. Compl. ¶ 143; *see also id.* ¶ 150–51. It alleges that he "establish[ed] a bank account in the name of Citibuilders knowing that control of the back account would be provided to Parekh; provided documentation of his service disabled veteran status so that Parekh could obtain SDVOSB government contracts; and execut[ed] bonding agreements so as to provide Parekh with the bonding needed to carry out the fraud scheme; . . . [and] handed day-to-day operation and control of Citibuilders to Parekh." *Id.* ¶¶ 143, 146. Goodweather allegedly received payment for such actions. *Id.* ¶ 149. The Amended Complaint then alleges that "Citibuilders was certified and registered in the VIP Database, CCR, and ORCA as a SDVOSB," that "Goodweather knew or reasonably should have known that such certifications were falsely obtained," and that "Goodweather knew or reasonably should have known that turning control of Citibuilders over to Parekh made the SDVOSB claim included in each contract proposal submitted to the VA materially false." *Id.* ¶¶ 146, 148.

Defendant Goodweather takes issue with the fact that many of the allegations in the Amended Complaint are made "upon information and belief" or state that Goodweather "should have known" or "reasonably knew." Under Rule 9(b), "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally." FED. R. CIV. P. 9(b). Furthermore, "the *Twombly* plausibility standard . . . does not prevent a plaintiff[/relator] from 'pleading facts alleged upon information and belief' where the facts are peculiarly within the possession and control of the defendant, or where the belief is based on factual information that makes the inference of culpability plausible." *United States ex rel. Conteh v. IKON Office Sols., Inc.*, 103 F. Supp. 3d 59, 66 (D.D.C. 2015) (quoting *Arista Records, LLC v. Doe 3*, 604 F.3d 110, 120 (2d Cir. 2010) and citing *U.S. ex rel. Williams v. Martin-Baker Aircraft Co.*, 389 F.3d 1251, 1258 (D.C. Cir. 2004)). The allegations at issue here both relate to defendant Goodweather's knowledge and intent, and the relevant facts are within the possession and control of defendant Goodweather. Therefore, the Court finds that plaintiff-relator's allegations that defendant Goodweather "should have known" or "reasonably knew," and his allegations that rely on information and belief are proper.

Given this conclusion, the Amended Complaint sufficiently alleges that defendant Goodweather indirectly caused the submission of false claims and statements. First, the Amended Complaint lists nine specific contracts that were bid on and awarded to Citibuilders between 2012 and 2014, and includes the contract and solicitation numbers, the agency information, the contract title or description, the date the contract was awarded, and pricing information. Am. Compl. at 42–44. Thus, defendant Goodweather's argument that the Amended Complaint fails to allege that Citibuilders made SDVOSB solicitations fails. The allegations described above clearly indicate that such solicitations were made.

The Amended Complaint also sufficiently alleges that defendant was a substantial factor in the submission of such false claims. As explained above, defendant Goodweather allegedly worked with Parekh to create Citibuilders using defendant Goodweather's status as a service disabled veteran so that Citibuilders and Parekh could obtain SDVOSB contracts, and then established a Citibuilders bank account, provided the necessary documentation of his service disabled status, executed bonding agreements, and handed operation and control to Parekh. Without these actions on the part of defendant Goodweather, Citibuilders would not have been able to allegedly fraudulently register as an SDVOSB or bid on and obtain SDVOSB contracts. The Court finds that plaintiff-relator has alleged facts showing that defendant Goodweather "agreed to take certain critical actions in furtherance of the fraud" and "continued to do business with [Citibuilders] upon becoming aware that [Citibuilders] was submitting false claims," which is sufficient to establish that defendant Goodweather's conduct was a substantial factor in causing the submission of false claims. Plaintiff-relator has sufficiently stated a claim for the presentment of false claims and statements in violation of the FCA, 31 U.S.C. § 3729(a)(1)(A)–(B).

The Amended Complaint similarly sufficiently alleges that defendant Goodweather made false certifications in violation of the FCA, 31 U.S.C. § 3729(a)(1)(A). Under the FCA, "liability can attach when the defendant submits a claim for payment that makes specific representations about the goods or services provided, but knowingly fails to disclose the defendant's noncompliance with a statutory, regulatory, or contractual requirement" and "the omission renders those representations misleading." *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 1995 (2016). Federal regulations concerning SDVOSB set-aside contracts state that the following:

> the management and daily business operations of the concern must be controlled by one or more service-disabled veterans . . . . Control by one or more service-disabled veterans means that both the long-term decisions making and the day-to-day management and administration of the business operations must be conducted by one or more service-disabled veterans.

13 C.F.R. § 125.13(a). Furthermore,

> A service-disabled veteran . . . must hold the highest officer position in the concern (usually President or Chief Executive Officer) and must have managerial experience of the extent and complexity needed to run the concern. The service-disabled veteran manager . . . need not have the technical expertise or possess the required license to be found to control the concern if the service-disabled veteran can demonstrate that he or she has ultimate managerial and supervisory control over those who possess the required licenses or technical expertise.

Id. § 125.13(b). Finally,

> In the case of a limited liability company, one or more service-disabled veterans (or in the case of a veteran with permanent or severe disability, the spouse or permanent caregiver of such veteran) must serve as managing members, with control over all decisions of the limited liability company.

Id. § 125.13(d).

The Amended Complaint alleges that Citibuilders was registered as an SDVOSB and bid on and obtained SDVOSB set aside contracts even though the management and daily operations were not controlled by a service-disabled veteran and Goodweather never intended to and did not function as the president, CEO, or owner of Citibuilders as required by the regulations. These allegations are sufficient to state a claim for false certification under *Escobar* because defendant Goodweather knew of and failed to disclose Citibuilders' noncompliance with regulatory requirements and such omissions rendered Citibuilders' representations as an SDVOSB misleading.

Defendant Goodweather also argues that the Amended Complaint fails to plead that he acted with the requisite scienter. The FCA requires the "knowing" submission of false claims or statements, which means that a person "(i) has actual knowledge of the information; (ii) acts in deliberate ignorance of the truth or falsity of the information; or (iii) acts in reckless disregard of the truth or falsity of the information." 31 U.S.C. § 3729(b). Again, however, elements such as knowledge and intent may be alleged generally under Rule 9(b) and "information and belief" pleadings are acceptable where the facts are within the possession of the defendant. The Amended Complaint alleges the following: 1) "Citibuilders was certified and registered in the VIP Database, CCR, and ORCA as a SDVOSB. Upon information and belief, Goodweather knew or reasonably should have known that such certifications were falsely obtained;" 2) "Goodweather knew or reasonably should have known that turning control of Citibuilders over to Parekh made the SDVOSB claim included in each contract proposal submitted to the VA materially false;" 3) Goodweather knowingly established Parekh as the de facto President, CEO, and owner of Citibuilders for using Goodweather's disabled veteran status to obtain SDVOSB government contracts;" 4) "[u]pon information and belief, Goodweather knew (or reasonably should have known) that Citibuilders was soliciting SDVOSB contracts;" 5) "[u]pon information and belief, Goodweather knew or reasonably should have known that the proposals Citibuilders submitted to the VA were materially false because they alleged past performance on the part of Citibuilders that did not exist;" 6) "Goodweather knew or reasonably should have known that Citibuilders' responses to VA solicitations were false because they claimed that Citibuilders qualified as a SDVOSB," and 7) "[u]pon information and belief, after knowing that the deposits made into the Citibuilders bank account were obtained from payments made against SDVOSB contracts that were obtained through fraud." Am. Compl. ¶¶ 146, 148, 150, 158–61. These allegations are sufficient to establish the element of scienter.

2. Conspiracy

Finally, the Court finds that the Amended Complaint sufficiently alleges conspiracy in violation of the FCA. Again, "to state a claim for conspiracy under the FCA, the plaintiff-relator must allege '(1) that "an agreement existed to have false or fraudulent claims allowed or paid" to the government, (2) that each alleged member of the conspiracy "joined that agreement," and (3) that "one or more conspirators knowingly committed one or more overt acts in furtherance of the object of the conspiracy."'" *Scollick*, 215 F. Supp. 3d at 36.

a) Elements of Conspiracy Claim

The Amended Complaint sufficiently alleges that an agreement existed to have false or fraudulent claims allowed or paid to the government and that defendant Goodweather joined that agreement. Specifically, it states that "[d]efendant Parekh entered a separate conspiracy with Melvin Goodweather to utilize Goodweather's status as a disabled veteran to establish a LLC for the sole purpose of obtaining SDVOSB set aside contracts." Am. Compl. ¶ 142. It then describes the ways in which Goodweather and Parekh worked together to establish Citibuilders as an SDVOSB with defendant Goodweather as president and CEO, knowing that defendant Goodweather would not actually engage in the oversight and management of Citibuilders, and knowing that such actions resulted in the submission of false claims and certifications. The

Amended Complaint also alleges that defendant Goodweather engaged in overt acts in furtherance of the conspiracy by setting up Citibuilders as previously described. Am. Compl. ¶ 143.

b) Intracorporate Conspiracy Doctrine

Defendant Goodweather argues that the intracorporate conspiracy doctrine applies to the conspiracy claim brought against him. Under the intracorporate conspiracy doctrine "there is no conspiracy if the conspiratorial conduct challenged is essentially a single act by a single corporation acting exclusively through its own directors, officers, and employees." *Scollick*, 215 F. Supp. 3d at 44 (quoting *Kelley v. D.C.*, 893 F. Supp. 2d 115, 119–20 (D.D.C. 2012)). However, the "doctrine only applies if the individual defendants were acting within the scope of their shared employment." *Id.* For example, the doctrine does not apply "where an entity's employees are pursuing their own personal interests, rather than the interests of the corporate entity." *Kenley v. District of Columbia*, 83 F. Supp. 3d 20, 33 (D.D.C. 2015).

This Court previously found that "Neil Parekh is alleged to have committed acts apparently outside the scope of his Citibuilders employment in furtherance of the alleged scheme, for example in his capacity as an officer of CSG. Therefore, defendant Citibuilders' intracorporate conspiracy doctrine argument is misplaced and plaintiff-relator has stated a claim for conspiracy." *Scollick*, 215 F. Supp. 3d at 44–45. Here, the Amended Complaint alleges that "after knowing that the deposits made into the Citibuilders bank account were obtained from payments made against SDVOSB contracts that were obtained through fraud, Goodweather purposefully diverted large cash payments from the Citibuilders' bank account into a private account under his personal control." Am. Compl. ¶ 158. This is sufficient to allege that defendant Goodweather was acting for his own personal interest, rather than the interest of Citibuilders. The intracorporate conspiracy doctrine is therefore inapplicable.

D. Insurance Defendants

The insurance defendants are Hudson Insurance Co., Hanover Insurance Co., Centennial Surety Associates, Inc., and Michael Schendel.[4] This Court previously summarized the original Complaint's allegations regarding the insurance defendants as follows:

> Under the Miller Act, contractors bidding for government construction contracts are required to post bid bonds, performance bonds, and payment bonds, and the bid bond company is required to ensure that the contractor will perform the work. Centennial is an insurance broker, Schendel is the president of Centennial, and Hudson and Hanover are insurance companies that provided surety bonds to the defendants.
>
> The bid proposals submitted here were dependent upon the issuance of surety bonds and performance bonds by Centennial, "as the agent and attorney-in-fact for Hudson Insurance Company and Hanover Insurance Company." Plaintiff-relator claims that Centennial and Schendel were the lawful agents of and attorneys-in-fact for Hanover and Hudson and that Schendel was responsible for causing Hudson and Hanover to issue bid and performance bonds to CSG and Citibuilders. Plaintiff-relator claims that Schendel had a long-standing relationship with Neil Parekh and that Centennial knew that OST, CSG, and CB Construction shared a single office and that Parekh and Narula were in functional control of CSG.
>
> Plaintiff-relator alleges that the contracts at issue required Citibuilders and CSG to obtain bid bonds and performance bonds, without which the fraudulent activity could not be carried out. He claims that Schendel and Centennial knew the details of the bid proposals submitted by OST, CSG, and CB. He also claims that Hudson and Hanover "by and through its agent and attorneys-in-fact Centennial" understood that OST, CSG, and CB shared common ownership, requiring Narula, Parekh, and Gogia to execute corporate resolutions acknowledging this fact. In addition, Schendel and Centennial allegedly "understood that Parekh, Narula, and Madan had ownership interests in CSG and deliberately disregarded this fact when issuing bonds in connections with the false certifications contained in the bidding proposals submitted to the government." Finally, the Complaint alleges that Hudson and Hanover knew that bonds were required for the contracts at issue and "[b]ut for Defendant Schendel, Centennial Surety Associates, Inc., acting as agents and attorney-in fact to Hudson Insurance Company and Hanover Insurance Company for the purpose of issuing bid bonds and performance bonds, the fraudulent bid submissions made by CSG and Citibuilders would not have been awarded."

Scollick, 215 F. Supp. 3d at 33–34 (internal citations omitted).

[4] Plaintiff-relator refers to this group of defendants as the "bonding defendants." For consistency with this Court's prior opinion, it will continue to refer to this group as the "insurance defendants."

The Court found that plaintiff-relator failed to sufficiently allege that the insurance defendants indirectly caused the submission of false claims or statements because, according to the allegations in the Complaint, they "did not take advantage of unwitting submitters (CSG, Citibuilders, and KCGI), . . . did not envision the scheme or push the other defendants to enact it, . . . [did not] agree[] to bonding in furtherance of the fraud alleged, . . . [and did not] continue[] to do business with the other defendants upon becoming aware that the other defendants were submitting false claims." *Id.* at 40–41. Turning to the reverse false claims allegations, the Court found that plaintiff-relator failed to state a claim against the insurance defendants for the following reasons:

> The allegation that the insurance defendants should have denied issuance of the surety bonds does not equate to an allegation that the defendants actually owed any payment to the government in connection with the bonds. Moreover, the Complaint contains no allegations that the insurance defendants knew the bids were fraudulent—it merely states that they knew the details of the bid proposals and that Parekh, Narula, and Madan had ownership interests in CSG. Furthermore, although the Complaint states that under the Miller Act, bid bond companies are required to ensure that the contractor will undertake the contract, that the contractor will complete the project in accordance with the specifications, and will ensure that those who furnish labor and materials will be paid, there are no allegations that any of those actions were not taken here. The Complaint does not state with any particularity what obligations were owed by which insurance defendants, and how such obligations were avoided or decreased.

Id. at 42. The Court also concluded that plaintiff-relator failed to state a claim for conspiracy. *Id.* at 43.

1. Presentment of False Claims/Making False Statements

Again, the Amended Complaint does not allege that the insurance defendants directly presented false claims or made false statements to the government. Rather, plaintiff-relator relies on a theory of indirect presentment. He argues that the actions of the insurance defendants were critical actions that directly led to the submission of false claims and that they continued to do business with the other defendants upon becoming aware that the other defendants were submitting false claims. The Court finds that the Amended Complaint sufficiently alleges such theories of indirect presentment.

a) Knowledge

The Court first addresses the issue of the insurance defendants' knowledge. The original Complaint alleged

> that Centennial knew that OST, CSG, and CB shared an office, that Parekh and Narula were in functional control of CSG, that Parekh, Narula, and Madan had ownership interests in CSG and disregarded this fact, that Schendel had a relationship with Parekh, and that Schendel and Centennial knew of the details of each bid proposal submitted by OST, CSG, and CB. It also allege[d] that Hudson and Hanover knew that OST, CSG, and CB shared common ownership and therefore required Narula, Parekh, and Gogia to execute corporate resolutions acknowledging this fact, and that they knew that surety bid bonds were required

Scollick, 215 F. Supp. 3d at 40–41. The Court found that, based on these allegations regarding knowledge, "no facts [were] alleged that would allow the inference that the insurance defendants agreed to bonding in furtherance of the fraud alleged." *Id.* at 41. With respect to allegations that the insurance defendants continued to do business with the other defendants upon becoming aware that the other defendants were submitting false claims, this Court found that "[t]he allegation that the insurance defendants knew the contents of the bid proposals does not mean the insurance defendants knew the content included false claims." *Id.*

Plaintiff-relator's Amended Complaint supplements the previously alleged facts with new details regarding the insurance defendants' knowledge. It alleges that the insurance defendants "facilitated [the CSG and Citibuilders] fraud schemes by obtaining facts that the Bonding Defendants knew or should have known violated the government's contracting requirements, but the Bonding Defendants not only concealed those facts from the government, they also issued surety bonds to CSG and Citibuilders, which gave the misleading appearance that CSG and Citibuilders were qualified to bid on these SDVOSB construction contracts." *Id.* ¶ 198. Specifically, the Amended Complaint sufficiently alleges that the insurance defendants knew or should have known that CSG and Citibuilders were violating the government's contracting requirements by alleging that the insurance defendants engaged in an underwriting process during which they conducted an on-site inspection of OST's offices. *Id.* ¶ 176. After this tour, the insurance defendants "necessarily understood that CSG was a shell company dependent on the resources and capabilities and capital of CB and OST and the experience and knowledge and financial backing of Parekh, Narula, and Madan," and the underwriting and due diligence "would reasonably have revealed that CSG did not possess the necessary construction history or financial capabilities to carry out the scope of the contracting activity ultimately undertaken in the name of CSG." *Id.* ¶¶ 177–78. The Amended Complaint further alleges that the underwriting and due diligence reasonably led to the conclusions that "Parekh, Narula, and Madan exerted dominance and control over CSG," that "Gogia lacked the skill, knowledge, resources and past performance to engage in the scope of contracting activity undertaken by the CSG conspirators," and that "CSG was not a service-disabled small business operating out of Harrisonburg." *Id.* ¶¶ 180–82. It also alleges that "[t]he underwriting and due diligence by the Bonding Defendants to provide bonding to Citibuilders would have revealed that Goodweather was not in control of that entity and that Citibuilders constitutes a separate shell company Parekh established for the purpose of obtaining SDVOSB contracts." *Id.* ¶ 194. These allegations go beyond those in the original Complaint regarding knowledge of CSG's and Citibuilders' ownership and control. They are now sufficient to allege that the insurance defendants had knowledge of CSG's and Citibuilders' fraud, *i.e.*, that they were fraudulently asserting status as SDVOSBs.

b) Indirect Presentment of False Claims/False Statements

Given this knowledge, the Amended Complaint sufficiently alleges that the insurance defendants continued to do business with CSG and Citibuilders even though they were aware that

CSG and Citibuilders were committing fraud. Plaintiff-relator describes solicitations made by and contracts awarded to CSG between 2010 and 2016, and solicitations made by and contracts awarded to Citibuilders between 2012 and 2014. Am. Compl. at 23–27, 42–44. It alleges that "[b]onds were issued on the Citibuilders SDVOSB construction contracts by Hanover Insurance Company and Hudson Insurance Company through their agent and attorney-in-fact Schendel, Centennial," and that "[t]he Bonding Defendants reviewed every SDVOSB contracting action pursued in the name of CSG and issued bonding against all of them." *Id.* ¶¶ 164, 190. As explained above, the allegations are sufficient to show that the insurance defendants had knowledge that CSG and Citibuilders were fraudulently asserting status as SDVOSBs. These allegations are sufficient to allege that the insurance defendants "continued to do business with [CSG and Citibuilders] upon becoming aware that [CSG and Citibuilders] [were] submitting false claims," which, as this Court previously explained, is grounds for alleging an indirect presentment claim. *Scollick*, 215 F. Supp. 3d at 39.

The Amended Complaint also sufficiently alleges that the insurance defendants took critical actions in furtherance of the fraud. This Court previously acknowledged that "bonding was a necessary step in submitting the bids at issue." *Scollick*, 215 F. Supp. 3d at 40. But, this Court also found that "no facts are alleged that would allow the inference that the insurance defendants agreed to bonding in furtherance of the fraud alleged," because the original Complaint only alleged the facts regarding knowledge described above. *Id.* The Amended Complaint has cured those deficiencies regarding the knowledge of the insurance defendants. It now sufficiently alleges facts showing that the insurance defendants knew that CSG and Citibuilders were fraudulently asserting status as SDVOSBs. Because the actions of the insurance defendants were critical to CSG's and Citibuilders' ability to bid on and obtain the contracts at issue, and because the facts alleged now show that the insurance defendants knew that CSG and Citibuilders did not in fact qualify as SDVOSBs, this Court concludes that the Amended Complaint sufficiently alleges that "to take certain critical actions in furtherance of the fraud" which is a theory of indirect presentment under the FCA. *Scollick*, 215 F. Supp. 3d at 39.

2. *Reverse False Claims*

Section 3729(a)(1)(G) prohibits "knowingly mak[ing], us[ing], or caus[ing] to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceal[ing] or knowingly and improperly avoid[ing] or decreas[ing] an obligation to pay or transmit money or property to the Government." 31 U.S.C. § 3729(a)(1)(G). Reverse false claims occur when "the defendant's alleged deception 'results in no payment to the government when a payment is obligated.' In contrast to typical false claims actions, 'a typical reverse false claim action involves a defendant knowingly making a false statement in order to avoid having to pay the government when payment is otherwise due.'" *Scollick*, 215 F. Supp. 3d at 41 (internal citations omitted).

With respect to reverse false claims, this Court previously found that plaintiff-relator failed to state a claim against the insurance defendants for the following reasons:

> The allegation that the insurance defendants should have denied issuance of the surety bonds does not equate to an allegation that the defendants actually owed any payment to the government in connection with the bonds. Moreover, the Complaint contains no allegations that the insurance defendants knew the bids were fraudulent—it merely states that they knew the details of the bid proposals and that Parekh, Narula, and Madan had ownership interests in CSG. Furthermore, although the Complaint states that under the Miller Act, bid bond companies are required to ensure that the contractor will undertake the contract, that the contractor will complete the project in accordance with the specifications, and will ensure that those who furnish labor and materials will be paid, there are no allegations that any of those actions were not taken here. The Complaint does not state with any particularity what obligations were owed by which insurance defendants, and how such obligations were avoided or decreased. There is simply no allegation in the Complaint that the insurance defendants had an obligation to pay the government the full amount of the bonds.

Id. at 42 (internal citations omitted). Plaintiff-relator now argues that the insurance defendants

> agreed to compensate the government for losses sustained should the specifications found in the contract, including the specification that the construction activity be paid a service-disabled, veteran-owned small business entity, fail to occur. The Bonding Defendants exercised due diligence to obtain facts from the other defendants that the Bonding Defendants knew or should have known violated the government's service-disabled, veteran-owned contracting requirements. For example, each time the Bonding Defendants knew that the government made a payment that violated the service-disabled, veteran-owned specification they knowingly avoided an obligation to compensate the government for that loss. The Bonding Defendants also knowingly concealed information and committed other acts that facilitated the fraudulent scheme and caused the other defendants to violate the FCA.

Pl.'s Mot. 6, ECF No. 131.

The insurance defendants argue that plaintiff-relator is essentially alleging that the insurance defendants' obligation to pay arose out of their concealment of the fraud. However, "[a] reverse false claim may not rest . . . on the argument 'that an obligation arose out of Defendants' concealment of their allegedly fraudulent activity,' because 'by this logic, just about any traditional false statement or presentment action would give rise to a reverse false claim action.'" *Scollick*, 215 F. Supp. 3d at 41. The Court disagrees. Plaintiff-relator alleges that "[t]he bonding agreements were separate instruments entered between the United States government and although submitted with the contract, did separately obligate the Bonding Defendants to compensate the government for losses sustained if the specifications found in the contract, including the specification that the construction activity be paid a service-disabled, veteran-owned small business entity." Am. Compl. ¶ 236. Thus, the insurance defendants' obligation arose out of these agreements, not out of an obligation to repay the government as a result of the fraud.

Defendant Hudson also argues the following: 1) the Amended Complaint fails to plead that the insurance defendants knew that CSG and Citibuilders were not properly SDVOSB certified; 2) the specification in the contract that the construction activity be paid to an SDVOSB certified company is not contained in the bond forms; and 3) the Amended Complaint fails to plead that the government suffered a loss as a result of the alleged reverse false claims. All of these are unavailing. First, this Court has already found that the Amended Complaint sufficiently alleges that the insurance defendants knew that CSG and Citibuilders were not properly SDVOSB certified. Second, although the specific statement that the construction activity be paid to an SDVOSB certified company is not contained in the bond forms, Standard Form 25 states that the performance guarantee extends to "all the understanding, covenants, terms, conditions, and agreements of the contract."[5] The "understanding, covenants, terms, conditions, and agreements" of the contracts at issue require that the contract is awarded to and performed by an SDVOSB. Thus, Standard Form 25 includes by implication the specification that the contracts be awarded to and performed by SDVOSBs. Finally, although the government may not have experienced a financial loss, it still experienced a loss according to Circuit precedent, which states that "where the defendant fraudulently sought payments for participating in programs designed to benefit third-parties rather than the government itself, the government can easily establish that it received nothing of value from the defendant and that all payments made are therefore recoverable as damages." *United States v. Sci. Applications Int'l Corp.*, 626 F.3d 1257, 1279 (D.C. Cir. 2010). The intended third party beneficiaries here are actual SDVOSBs who are eligible for SDVOSB set aside contracts. The Amended Complaint alleges that CSG and Citibuilders—who did not qualify as SDVOSBs—sought payments for contracts awarded pursuant to this SDVOSB set aside program. Thus, it has sufficiently alleged that the government received nothing of value here.

The Court finds that, based on the above, plaintiff-relator has stated a claim for reverse false claims in violation of 31 U.S.C. § 3729(a)(1)(G) against defendants Hudson and Hanover. The Court finds, however, that plaintiff-relator has failed to state a claim under 31 U.S.C. §

[5] Standard Form 25 is available for download at https://www.gsa.gov/portal/forms/download/115986

3729(a)(1)(G) against defendants Schendel and Centennial. According to the Amended Complaint, Centennial "is an insurance broker the agent of and attorney-in-fact for Hudson and Hanover insurance companies" and "helped secure the bonding the Defendants required to bid and obtain government construction contracts." Am. Compl. ¶ 19. Defendant Schendel is the president of Centennial. *Id.* ¶ 20. Unlike Hudson and Hanover, which were the actual insurance companies that provided the surety bonds to the CSG and Citibuilders, Centennial and Schendel were simply brokers. There are no allegations that would allow this Court to infer that Centennial and Schendel issued the bonds and incurred any obligation to the government.

3. Conspiracy

The insurance defendants' only argument regarding the conspiracy claims is that because the Amended Complaint fails to state a claim for the presentment of false claims, for making false statements, or for reverse false claims, there can be no conspiracy claim. Because this Court has found that the Amended Complaint does in fact state claims for the presentment of false claims, for making false statements, or for reverse false claims, the insurance defendants' argument fails and plaintiff-relator may assert his conspiracy claim against them.

V. CONCLUSION

As demonstrated by the foregoing analysis, plaintiff-relator has largely cured the pleading deficiencies previously identified by this Court. Plaintiff-relator's motion for leave to amend will be granted in part and denied in part. Given, the above analysis, plaintiff-relator will be granted leave to amend his complaint to assert Count I (presentment of false claims in violation of 31 U.S.C. § 3729(a)(1)(A)) against defendants OST, Melvin Goodweather, Hudson Insurance, Hanover Insurance, Centennial Surety Associates, and Michael Schendel. Plaintiff-relator will be granted leave to amend his complaint to assert Count II (making false statements in violation of

31 U.S.C. § 3729(a)(1)(B)) against defendants OST, Shobha Mehta, Melvin Goodweather, Hudson Insurance, Hanover Insurance, Centennial Surety Associates, and Michael Schendel. Plaintiff-relator will be granted leave to amend his complaint to assert Count III (reverse false claims in violation of 31 U.S.C. § 3729(a)(1)(G)) against defendants Hudson Insurance and Hanover Insurance. Plaintiff-relator will be granted leave to amend his complaint to assert Count IV (conspiracy in violation of 31 U.S.C. § 3729(a)(1)(C)) against defendants OST, Shobha Mehta, Melvin Goodweather, Hudson Insurance, Hanover Insurance, Centennial Surety Associates, and Michael Schendel.

This Court previously found that plaintiff-relator stated a claim for presentment of false claims (Count I), making false statements (Count II), and conspiracy (Count III) against defendants Citibuilders, Ajay Madan, and Vijay Narula. The Court found, however, that plaintiff-relator failed to state a claim against defendants Citibuilders, Madan, and Narula for reverse false claims (Count III). Plaintiff-relator does not assert Count III against these defendants in the Amended Complaint.

Defendants Amar Gogia, CSG, and Neil Parekh did not move to dismiss, instead filing Answers to the Complaint. This Court, however, sua sponte dismissed the reverse false claims count (Count III) against Gogia, CSG, and Parekh. The Amended Complaint does not assert Count III against these defendants.

The Court previously found that the original Complaint failed to state claims against defendant CB Construction and dismissed it from the case. In the Amended Complaint, plaintiff-relator brings Counts I, II, and IV against CB. CB has not filed an opposition to plaintiff-relator's motion for leave to file an amended complaint. Therefore, Counts I, II, and IV may proceed as alleged in the Amended Complaint against defendant CB Construction.

Plaintiff-relator has removed defendants Dilip Parekh, KCGI, Inc., Guatam Chitnis, and Anita Chitnis from the Amended Complaint. These defendants remain dismissed from this action.

In sum, Counts II (making or causing to be made or used false statements or records material to false or fraudulent claims in violation of 31 U.S.C. § 3729(a)(1)(B)) and IV (conspiracy to violate the FCA in violation of 31 U.S.C. § 3729(a)(1)(C)) may proceed against all of the defendants named in the Amended Complaint. Count I (submitting or causing to be submitted false or fraudulent claims to the United States in violation of 31 U.S.C. § 3729(a)(1)(A)) may proceed against all defendants named in the Amended Complaint except defendant Shoba Mehta. Count III (knowingly avoiding or decreasing obligations to the United States in violation of 31 U.S.C. § 3729(a)(1)(G)) may proceed against defendants Hudson and Hanover.

A separate Order accompanies this Memorandum Opinion.

Date: July 31, 2017

Royce C. Lamberth
Royce C. Lamberth
United States District Judge

EXHIBIT "B"

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

<table>
<tr><td>UNITED STATES OF AMERICA, ex rel.
ANDREW SCOLLICK
1505 N. Rhodes Street #4
Arlington VA 22209

Plaintiff-Relator,

BRINGING THIS ACTION ON BEHALF
OF THE UNITED STATES OF AMERICA

c/o
CHANNING D. PHILLIPS
UNITED STATES ATTORNEY
United States Attorney's Office
555 4th Street, NW
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and

ATTORNEY GENERAL OF
THE UNITED STATES
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v.

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8321 Old Courthouse Rd, Suite 260
Vienna, VA 22182

AMAR GOGIA
650 Garbers Church Road
Harrisonburg, VA 22801-8412

MELVIN G. GOODWEATHER
820 Emerald Dr.
Alexandria, VA 22308</td><td>)
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AMENDED COMPLAINT

JURY TRIAL DEMANDED</td></tr>
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AJAY K. MADAN)
4621 24th Rd N)
Arlington, VA 22207-3514)
)
OPTIMAL SOLUTIONS AND)
TECHNOLOGIES, INC.)
2001 M Street, NW)
Suite 3000)
Washington, D.C. 20036,)
)
CSG, LLC)
650 Garbers Church Road)
Harrisonburg, VA 22801-8412)
)
CITIBUILDIERS SOLUTIONS GROUP, LLC)
1111 19th Street North, Suite 2001)
Arlington, VA 22209)
)
CB CONSTRUCTION GROUP, INC.)
1410 35th Street NW)
Washington, D.C. 20007,)
)
SHOBHA N. METHA, MD)
5021 Seminary Road)
Alexandria, VA 22311)
)
CENTENNIAL SURETY ASSOCIATES, INC.)
1514 Jabez Run, Suite 100)
Millersville, MD 21108)
)
MICHAEL SCHENDEL)
1514 Jabez Run, Suite 100)
Millersville, MD 21108)
)
HUDSON INSURANCE CO.)
17 State Street, 29th Floor)
New York, NY 10004)
)
HANOVER INSURANCE CO.)
440 Lincoln Street)
Worcester, MA 01653)
)
Defendants.)
)

This is an action commenced by *qui tam* relator Andrew Scollick ("Plaintiff-Relator") on behalf of himself and in the name of the United States of America to recover from the above-named Defendants damages and civil penalties and equitable relief arising from false claims presented to the federal government, conspiracy, and other violations of the federal False Claims Act ("FCA"), 31 U.S.C. §3729, *et seq.*, as amended. This action seeks to recover damages and equitable and other relief, sustained by and penalties owed to the United States and damages otherwise sustained by third parties, including service disabled veterans, because of an ongoing and continuing fraudulent scheme or schemes knowingly entered into and/or knowingly facilitated by each of the Defendants in violation of the FCA, as alleged herein.

JURISDICTION AND VENUE

1. Plaintiff-Relator Andrew Scollick ("Relator") hereby alleges causes of action under the *qui tam* provisions of the False Claims Act, 31 U.S.C. § 3729, *et seq.*, arising from the Defendants' actions to defraud agencies of the United States government, including but not limited to, the U.S. Department of Veterans Affairs ("Veterans Affairs" or "VA"), and the Small Business Administration ("SBA").

2. The Plaintiff-Relator has not made any public disclosures of the allegations contained herein at any time prior to the unsealing of the original complaint.

3. Pursuant to the requirements of 31 U.S.C § 3730(b), Plaintiff-Relator has voluntarily provided the federal government with a written disclosure statement, containing substantially all of the allegations made herein.

4. Plaintiff-Relator is an original source of all the allegations contained herein as defined by the False Claims Act, 31 U.S.C. § 3730(e)(4)(B), he has direct and independent knowledge of the information contained herein and he has voluntarily provided such information

to the government prior to bringing this action.

5. Jurisdiction over all stated causes of action is conferred upon this Court by 31 U.S.C. § 3729 and 3732 and 28 U.S.C. § 1331 and 1345, in that this action arises under the laws of the United States.

6. Venue is proper in the United States District Court for the District of Columbia pursuant to 28 U.S.C. § 1391(b) and (c) and 31 U.S.C. § 3732, because this Court has jurisdiction over at least one Defendant who can be found in, resides, transacts business, or has performed acts proscribed by 31 U.S.C. § 3729 in the District of Columbia, and the False Claims Act provides for nationwide jurisdiction of such claims under 31 U.S.C. § 3732(a). Each Defendant also caused false claims to be made or falsely certified in this jurisdiction.

7. Plaintiff-Relator has complied with all conditions precedent to bringing this action.

PARTIES

8. Plaintiff-Relator Andrew Scollick ("Scollick" or "Relator") is an adult who resides at 1505 N Rhodes St., Unit 4, Arlington, VA 22209. Relator was hired by Defendant Neil Parekh in December 2008. Parekh established a corporate entity known as CB Construction Group, Inc. ("CB"), and Scollick was on the CB payroll between July 2010 and April 2012, when he was transferred to the Citibuilders Solutions Group LLC payroll. Relator's employment relationship with Parekh and Citibuilders terminated in August 2012.

9. Defendant Optimal Solutions Technologies, Inc., ("OST") is a corporation with its principal place of business located at 2001 M Street, NW, Suite 3000, Washington, D.C. 20036. OST has satellite offices across the United States, including Virginia, Maryland, Pennsylvania, and Texas. OST also has components in India.

10. Defendant CB Construction Group, Inc., ("CB") claims as its corporate address 1410 35th Street NW, Washington, D.C. 20007. However, CB's actual principle place of business was OST's office space located at 2001 M Street, NW, Washington, D.C., 20036. In January 2012 OST relocated its offices to 1676 International Drive, Suite 1100, McLean VA, 22102, and CB's principal business operations were located there until May 2012. Beginning in May 2012, CB's business operations separated from OST and were relocated to 4620 Lee Highway, Suite 206, Arlington, VA, 22207. CB is controlled by defendant Neil Parekh.

11. Defendant Centurion Solutions Group, LLC ("CSG") is falsely registered as a HUBZone, service-disabled veteran-owned minority-owned small business. CSG's registered agent is Amar Gogia. CSG was established in or around January 2010 by defendants Narula, Madan, Parekh and Gogia for the purpose of bidding on and obtaining HUBZone, service-disabled veteran-owned, minority-owned and small business government contracts. Defendant CSG listed its principal place of business as 650 Garbers Church Road, Harrisonburg, VA 22801, which is Gogia's home address. Gogia's home address is identified as CSG's principal place of business because it falls within a HUBZone; however, CSG's real principal place of business was located within office space OST rented at 2001 M Street, NW, Washington, D.C. In January 2012 CSG's principal place of business was relocated to OST's offices located at 1676 International Drive, Suite 1100, McLean, VA, 22102.

12. Defendant Citibuilders Solutions Group LLC ("Citibuilders") is falsely registered as a service-disabled veteran-owned small business with its principle place of business located at 1111 19th Street North, Suite 2001, Arlington, VA, 22209. This LLC was formed for the purpose of bidding and obtaining service-disabled veteran-owned, minority-owned, and small business government contracts. Defendant Goodweather is listed as the CEO of Citibuilders.

13. Defendant Vijay Narula ("Narula") is sued in his personal and official capacities and resides at 8403 Driscoll Drive, Bowie, MD, 20720. He is the president and CEO of OST.

14. Defendant Neil Parekh ("Parekh") is sued in his personal and official capacities and resides at 2001 19th Street North, Suite 2001, Arlington, VA 22209. He is identified as the president and 45% owner of CB Construction.

15. Defendant Amar Gogia ("Gogia") is sued in his personal and official capacities and resides at 650 Garbers Church Road, Harrisonburg, VA 22801-8412. Gogia is a relative of Ajay Madan. For a limited liability company ("LLC") to qualify as a service-disabled veteran-owned small business ("SDVOSB") for the purpose of bidding on and being awarded SDVOSB government set aside contracts, the LLC must be owned, controlled, and under day-to-day management by a service-disabled veteran. Gogia qualifies as a disabled veteran. He entered a conspiracy to misuse his disabled veteran status so that Defendants Parekh, Narula, Madan, OST and CB could present CSG as a SDVOSB and obtain SDVOSB set aside contracts through fraudulent means. To accomplish this, Gogia entered the conspiracy so that he could be falsely identified as the president, founder, and 100% owner of CSG. However, Gogia was not the true owner and never exercised control of daily operations or disposition of CSG profits. Instead, Gogia functioned mostly as a CSG site supervisor subservient at all times to either Neil Parekh, Ajay Madan, and/or Vijay Narula.

16. Defendant Melvin G. Goodweather ("Goodweather") resides at 820 Emerald Dr., Alexandria, VA 22308. He is sued in his personal capacity and in his capacity as the President and/or CEO of CSG. Goodweather practiced law in the District of Columbia and is a registered corporate lobbyist.

17. Defendant Ajay K. Madan ("Madan") is sued in his personal capacity and official

capacity as chief operating officer ("COO") of OST. Madan resides at 4621 24th Rd N, Arlington, VA 22207-3514. He is identified as a 49% owner of CSG.

18. Defendant Shobha N. Mehta, M.D. ("Dr. Mehta") is an obstetrician and sole practitioner who practices out of an office located at 5021 Seminary Road, Suite 106, Alexandria, VA, 22311. Dr. Mehta is the aunt to defendant Parekh. Dr. Mehta committed overt acts in further of the conspiracy, including submitting falsified customer satisfaction surveys to the VA.

19. Defendant Centennial Surety Associates, Inc. ("Centennial"), resides at 1514 Jabez Run, Suite 100, Milersville, Maryland, 21108. Centennial is an insurance broker the agent of and attorney-in-fact for Hudson and Hanover insurance companies. Centennial helped secure the bonding the Defendants required to bid and obtain government construction contracts.

20. Defendant Michael Schendel ("Schendel") is sued in his personal and official capacities and is the president of Centennial Surety Associates, Inc. ("Centennial"). His office is located at 1514 Jabez Run, Suite 100, Millersville, Maryland, 21108.

21. Defendant Hudson Insurance Company ("Hudson"), is located at 17 State Street, 29^{th} Floor, New York, NY 10004. Hudson, with the assistance of its agent Centennial, knowingly facilitated the fraud scheme and knowingly caused false claims to be submitted to the government by providing surety bonds the Defendants required to bid on and obtain government construction contracts when Hudson knew, or should have known, that the Defendants were concealing material information from the government. Had the government known about the information concealed by the Defendants and known to Hudson, the government would not have entered the contracts at issue or paid the claims at issue in this case. Furthermore, premiums and fees knowingly derived from the fraud scheme, and thereby indirectly charged to the

government, were paid to Hudson. Had the government known about the fraud scheme it would not have accepted the bid bonds and performance bonds and the fees derived therefrom would not have been obtained.

22. Defendant Hanover Insurance Company ("Hanover") is located at 440 Lincoln Street, Worcester, MA 01653. Hanover, with the assistance of its agent Centennial, knowingly facilitated the fraud scheme and knowingly caused false claims to be submitted to the government by providing surety bonds the Defendants required to bid and obtain government construction contracts when Hanover knew, or should have known, that the Defendants were concealing material information from the government. Had the government known about the information concealed by the Defendants and known to Hanover, the government would not have entered the contracts at issue or paid the claims at issue in this case.

FACTS

23. The allegations contained in the above paragraphs are hereby realleged as set forth fully above.

Government Concern over Service Disabled Veterans

24. For a veteran who suffers a disability while in military service, the United States government has deemed it its moral obligation to provide the disabled veteran a range of benefits designed to ease the economic and other losses and disadvantages incurred because of the disability. These benefits include government assistance for entering the federal procurement marketplace.

25. A company that qualifies as a Service-Disabled Veteran-Owned Small Business ("SDVOSB") becomes eligible for set-asides in federal contracts.

Government Imposed SDVOSB Requirements

26. For a limited liability company ("LLC") to qualify as service-disabled veteran-owned small business concern ("SDVOSB"), it must be owned, controlled, and under day-to-day management by a service-disabled qualified individual. Ownership of a LLC means that one or more service-disabled veterans must directly own at least 51% of each class of membership making up the LLC, and that "the long-term decision making and the day-to-day management and administration of the business operations must be conducted by one or more service-disabled veterans." 13 C.F.R. §§125.9(a) and 125.10(a); *also see* 48 C.F.R. § 852.219-10 (a)(1).

27. A service-disabled veteran must likewise hold the highest officer position and must have the managerial experience of the extent and complexity needed to run the concern, *see* 13 C.F.R. § 125.10(b), with one or more service-disabled veterans serving as the managing member with "control over all decisions of the limited liability company," 13 C.F.R. § 125.10(d).

28. A SDVOSB prospective contractor must complete an application package consisting of representations, certifications, and personal documents as required by the Department of Veterans Affairs ("VA"). The VA reviews the application and determine whether the prospective contractor qualifies for SDVOSBC status.

29. After the VA determines that a contractor meets the SDVOSBC qualifications that contractor must register as a SDVOSB company. The registration pages are placed into the VA's Vendor Information Pages database ("VIP database"). Registration includes creating an electronic record ("VIP record"). This registration process requires the registrant to certify that all the information contained in its VIP record is true. 38 C.F.R. § 74.2. Thereafter, the participant must submit a new application each year certifying its accuracy to remain eligible. 38 C.F.R. § 74.1.

30. Any sole proprietor, corporation, partnership or other entity desiring to do business with the federal government ("prospective contractor") must be registered in the Central Contracting Registry ("CCR") database prior to award of a contract or agreement. FAR § 4.1102. The contractor is thereafter responsible for ensuring the accuracy of all information on its CCR record, and must renew it at least annually. A prospective contractor must remain active in the CCR to avoid discontinuation of payments.

31. The Online Contractor Representation and Certification Application ("ORCA") is a component module of the Business Partnership Network ("BPN"). In addition to the information provided to the government by a prospective contractor when it registers with the CCR, the prospective contractor must provide an answer to each component question of the ORCA. Certain information contained in the prospective contractor's CCR information and all representations and certifications constituting the prospective contractor's ORCA answers are compiled into the prospective contractor's ORCA record in the form of a table.

32. Included among the certifications and representations attested to by a business submitting an ORCA record is a field into which the prospective contractor may input "Yes" or "No," asking whether the prospective contractor is a SDVOSBC. A "Yes" response is a statement that the declarant prospective contractor is a SDVOSB, as defined in 13 C.F.R. § 125.8. Only business concerns which meet the criteria set forth in 13 C.F.R. § 125.8 are qualified to input "Yes" in this field, for only they meet the necessary criteria of a SDVOSBC.

The CSG Conspiracy

33. Defendants Narula, Parekh, and Madan were neither veterans nor disabled and OST and CB did not qualify as and were not certified as SDVOSB.

34. OST was not located in a HUBZone and no longer qualify as a small business

when the underlying CSG contracts that are the subject of this complaint were awarded.

35. Although Gogia qualified for disabled veteran status, he did not have the finances, managerial experience, or knowledge of government contracting needed to seek, obtain, or qualify for any of the SDVOSB set-aside contracts awarded to CSG.

36. Parekh (on behalf of himself and CB), Narula and Madan (on behalf of themselves and OST), and Gogia entered into a conspiracy to form a limited liability company, CSG, and thereafter registered and certified it as a SDVOSB entity for obtaining government contracts. These registrations and certifications were recorded in the ORCA, CCR, and VIP system of records. These registrations and certifications were obtained by falsely asserting that Gogia, owned 100% of CSG and was in control of CSG's day-to-day business activity. The CSG conspirators therefore knowingly and purposely made, used, or caused to be made or used, a false record material to a false or fraudulent claim in violation of 31 U.S.C. §§ 3729(a)(1)(A), (B) and (C).

37. CSG's majority ownership, operational and financial control and the distribution of CSG profits and resources, were controlled by Parekh (on behalf of himself and CB), and Madan and Narula (on behalf of themselves and OST).

38. Gogia was never in control of CSG and was, at all times relevant to this complaint, subservient to Narula, Madan, and Parekh.

39. The initial financing needed to launch CSG government contracting operations was in the form of an August 4, 2010, wire transfer in the amount of $211,612.34 from a Bank of America checking account held in Madan's name. This sum was wired into the newly established CSG checking account (Bank of America, Account No. 4350 0183 3728).

OST Involvement in the CSG Conspiracy

40. Bryan Van Gilder was employed by OST as its Senior Proposal Manager (SPM) and reported to Narula. In his official OST capacity Mr. Van Gilder was responsible for the preparation and finalization of government contracting proposals. In his capacity as OST's SPM, Van Gilder was tasked with responsible for the preparation and finalization the first fraudulent response to a government contract solicitation made in the name of CSG. This CSG contracting proposal was submitted in response to a Service-Disabled Veteran-Owned (SDVO) Small Business set-aside contracting solicitation offered by the United States Department of Veteran Affairs, known as Halls & Walls (VAMC Baltimore), Solicitation No. VA-245-10-RP-0076. (CSG's response to this government solicitation is hereinafter referred to as the "Halls & Walls Solicitation Response"). The Halls & Walls Solicitation Response was submitted in the name of CSG on April 7, 2010.

41. The drafting of the Halls & Walls Solicitation Response is of critical importance to the success of the CSG Conspiracy because all the future solicitation responses were based off this initial draft and the next version prepared by OST.

42. OST's senior management knew of, approved of, and played a critical role preparing the Halls & Walls Solicitation Response. In addition to OST's SPM, OST's Marketing Manager, Sujana Pathak, and OST's Director, Ronald Rhodes, were involved with the preparation and review of the CSG Halls & Walls Solicitation Response, and did so with the knowledge and support of OST's CEO, Vijay Narula.

43. The final draft of the CSG Halls & Walls Solicitation Response was circulated by Bryan Van Gilder, via OST's internal email system, to OST's CEO's Vijay Narula, OST's Marketing Manager Sujana Pathak, and an OST Director, Ronald Rhodes. This draft was also

shared with Neil Parekh and the Plaintiff-Relator.

44. OST's offices and employees were used to prop up CSG. All the CSG full-time office employees (i.e., Plaintiff-Relator, David Rubando, Tom Starkweather, Sami Ralli, and Neil Parekh) worked out of OST's office space; were provided OST email accounts (e.g. Plaintiff-Relator's email address was AScollick@ostglobal.com, Neil Parekh's email address was NPrekh@ostglobal.com); and OST phone lines. OST provided human resources, IT support, accounting support, corporate bonding, office space, printers, faxes, phone lines (CSG's "Magicjack" port identifying a false 540 area code ran on OST's computer system), an email server, computer stations and office supplies necessary for OST to solicit and service government contracts in the name of CSG. The totality of the resources OST provided to prop up CSG was essential to carry out the fraudulent scheme and conspiracy to commit fraud and was known to OST's CEO Vijay Narula, OST's COO Ajay Madan, and by OST's CFO Anil Chaudhry.

45. OST also covered the salary of a CSG employee. Carol Rogers was a direct employee of CSG between 2011 and 2012. However, upon information and belief, OST transmitted $100,000 from its corporate account into CSG's company account to pay Carol Rogers' salary.

46. OST's Sujana Pathak worked to locate additional construction opportunities for CSG and circulated potential construction opportunities to Ajay Madan, Neil Parekh and Andrew Scollick.

47. OST employees regularly prepared "pipeline" reports that would track the date CSG bid on a contract, the government entity soliciting the bid, the contract description and contract price. These reports were regularly circulated to Vijay Narula, Ajay Madan, and Neil

Parekh.

48. An OST team was created to prepare and assemble the Halls & Walls Solicitation Response. The creation of the Halls & Walls Solicitation Response was a critical step in furtherance of the CSG conspiracy because this document incorporated the materially false information that was thereafter repeated in all the other SDVOSB solicitation responses transmitted in the name of CSG. In other words, the Halls & Walls Solicitation Response functioned as the prototype for the subsequent solicitation responses submitted in the name of CSG that are the subject of this complaint. The Halls & Walls Solicitation Response is fraudulent because of, but not limited to, the following:

a) It was prepared by OST employees, out of OST's Washington, D.C. office, but submitted in the name of Centurion Solutions Group, LLC, utilizing a Harrisonburg, VA address;
b) falsely states that CSG "is a Service-Disabled Veteran-owned (SDVO) Small Business based in Harrisonburg, VA with more than 15 years of experience providing interior renovations for our government and industry customers." However, CSG did not exist prior to January 23, 2010, and was never controlled by a service disabled veteran and therefore never qualified as a SDVO Small Business;
c) falsely states that CSG "utiliz[es] an in-house crew for most of our work;"
d) falsely states that CSG has "in-depth construction experience specifically within the medical industry;"
e) falsely states that CSG has "a significant price advantage because of the volume of flooring products sold and installed through our company on a yearly basis;"
f) falsely states that "Team Centurion has their own in-house flooring crew;" and
g) falsely sets forth past performance claims from the Mehta Medical Group;

h) falsely sets forth past performance claims from FBR Interior Renovations, and

i) falsely sets forth past performance claims from CVENT.

49. OST executed and transmitted to Hudson Insurance Company and Hanover Insurance Company a signed, sealed, and notarized agreement of indemnity as well as corporate resolutions extending OST's bond to contracts submitted in the name of CSG.

50. As a corporate entity, OST exclusively acted through its executives, employees, and agents. Based on the totality of facts pertaining to OST employees set forth in the Amended Complaint, OST is jointly and severally or vicariously liable for the actions carried out by its employees, including OST's CEO and President Vijay Narula, COO Ajay Madan, OST's SPM Bryan Van Gilder, OST's Marketing Manager Sujana Pathak, and OST Director Ronald Rhodes.

51. Narula is the founder, an owner, the president and CEO of OST and at all times controlled and dictated OST's business structure and personnel. At all times relevant to this Amended Complaint, Narula and Madan acted within the scope of their OST authority and/or with apparent OST authority to carry out each act in furtherance of the fraud and conspiracy to commit fraud undertaken in the name of CSG. Narula and OST constitute alter-egos of each other. They have such a unity of interest and ownership that the individuality of each ceased with respect to every act in furtherance of the CSG conspiracy.

52. A checking account was established in the name of CSG (Bank of America, Account No. 4350 0183 3728). Neil Parekh was a signatory to the CSG bank account and issued checks and otherwise engaged in the electronic transfer of funds from CSG's account into a CB account.

53. An example of Parekh's signature authority over CSG's check account is CSG check No. 1006, a payroll check issued by Parekh to Gogia.

54. CSG's day-to-day business decisions were carried out within OST's headquarters where Parekh, Madan, Narula, CB and OST were co-located. Gogia did not have an office or presence in that location.

55. Defendants Narula, Madan, and Parekh controlled the likeness of Gogia's signature, which they could affix to documents as they saw fit.

56. The drafting and submission of CSG's bids occurred out of OST's Washington, D.C., offices under the direction and control of Narula, Madan, and Parekh, and were routinely by Neil Parekh as CSG's "Managing Director."

57. CSG's contracting solicitations were controlled by Parekh (on behalf of himself and CB), as well as Narula and Madan (on behalf of themselves and OST).

58. The daily management and oversight over all CSG's SDVOSB construction activity was done by Parekh and CB Construction. OST's back office management was provided by Madan, Narula, and OST.

59. Evidence of Gogia's lack of control and domination over CSG includes Parekh's signing CSG's August 22, 2010, federal tax form 8655 (Reporting Agent Authorization), where he is identified as CSG's "Managing Director/Principal."

60. Gogia predominately functioned as a local CSG site manager and was supervised by Parekh. A prime example of Gogia's subservient position is the May 31, 2011, email Parekh sent to Gogia threatening to remove Gogia as the site supervisor of the CSG Wichita contract if Gogia's job performance did not improve. Parekh's email states in part: "If there is not significant improvement on [the 587A7-10-105 Wichita Msc Proj #1] over the next couple of weeks I will have no choice but to replace you on this project."

61. Additional examples that Parekh and not Gogia controlled CSG's operations is an

email exchange between Parekh and Gogia dated February 15, 2012, in which Gogia seeks Parekh's approval to pay CSG employees ("Neil – we are now 3 weeks behind on payment to Philadelphia workers, and 2 weeks behind on payment to Chillicothe workers. You still refuse to approve any payments. . . Checks are ready to go. We cannot hold our site laborers hostage, especially when we still need them to continue working. We also cannot afford any other complaints with DOL or the VA. Please approve immediately"). Another example is an August 6, 2010 email from Parekh to Gogia and relator "requiring you both" to make sure that the CSG proposals going out were full and complete.

62. Parekh routinely electronically transferred large sums of money out of the CSG checking account and into a CB checking account he controlled. This is demonstrated by comparing CB bank statements with the wire transfers identified in the CSG checking account statements. By way of example, a comparison between CSG's and CB's checking account statements demonstrates that between November 2010 and November 2011 Parekh transferred over $1,000,000 out of CSG's Bank of America checking account and into CB's Chevy Chase/Capital One checking account. The transfers documented in these bank statements are as follows:

Date	Amount of Transfers
11/18/2011	$12,500
11/17.2011	$35,000
10/27/2011	$22,700
10/14/2011	$25,000
09/08/2011	$25,000
09/05/2011	$38,500

09/02/2011	$ 7,500
09/01/2011	$35,000
08/15/2011	$25,000
08/01/2011	$15,000
07/28/2011	$35,000
07/10/2011	$30,000
06/04/2011	$25,000
05/11/2011	$15,000
05/06/2011	$15,000
05/02/2011	$12,500
04/26/2011	$20,000
04/20/2011	$15,000
04/15/2011	$50,000
04/04/2011	$25,000
03/28.2011	$25,000
03/23/2011	$15,000
03/22/2011	$25,000
03/22/2011	$20,000
03/21/2011	$25,000
03/07/2011	$5,000
03/04/2011	$15,000
03/02/2011	$15,000

02/26/2011	$10,000
02/25/2011	$10,000
02/23/2011	$10,000
02/23/2011	$5,000
01/24/2011	$10,000
01/06/2011	$20,000
01/02/2011	$15,000
12/20/2010	$50,000
12/19/2010	$25,000
12/19/2010	$20,000
12/17/2010	$15,000
12/16/2010	$25,000
12/15/2010	$20,000
12/13/2010	$25,000
12/13/2010	$25,000
12/09/2010	$15,000
12/06/2010	$15,000
12/03/2010	$10,000
12/03/2010	$10,000
12/01/2010	$10,000
11/23/2010	$10,000
11/17/2010	$10,000
11/13/2010	$10,000

11/12/2010	$10,000
TOTAL $	$1,013,700.00

63. CSG utilized credit cards issued to CB (Capital One Bank Visa, account Number ending in 7940) to conduct CSG business. The CB Visa cards used to conduct CSG business were issued in the names of Dilip Parekh (card ending in 7940), Neil Parekh (card ending 1119), Martin Tubb (card ending in 0054), Amar Gogia (card ending in 6186) and several others. Construction supplies, travel, lodging and other costs directly pertaining to CSG's government contracting activity were charged against these credit cards.

64. Additionally, an American Express credit card issued to Dilip Parekh against the CB account (ending in 73007) was used to bill CSG costs, and a Home Depot credit card in the name of CB was also used to conduct CSG business.

65. Neil Parekh signed all the awarded CSG SDVOSB contracts as CSG's "Managing Director." Yet, Parekh was not a CSG paid employee in 2010. In the second quarter of 2011 Parekh became a paid CSG employee and, thereby, according to Parekh's 2011 Form W-2, diverted $67,884.62 to himself.

66. Neil Parekh's established CSG's Go Daddy account and possessed and controlled CSG's Go Daddy user name and password. He shared that information with Narula, Madan, and OST.

67. Relator observed first-hand that Gogia was never in control of CSG.

68. Defendant Parekh branched out his fraudulent SDVOSB contracting activity by establishing a second contracting entity known as Citibuilders Solutions Group LLC ("Citibuilders").

69. With respect to Citibuilders, Parekh conspired with Goodweather to set up a separate LLC that would take the format developed by the CSG conspirators and use it to seek out SDVOSB contracts in the name of Citibuilders. Parekh cut Narula, Madan, and OST out of the newly formed Citibuilders conspiracy.

70. The creation of the Citibuilders conspiracy caused a rift between Parekh on the one hand and Narula, Madan, Gogia and OST on the other. The rift resulted in Madan seizing Parekh's computer upon learning that Parekh took the format the CSG conspirators developed and cut Narula, Madan, Gogia and OST out from the contracts Citibuilders obtained. Emails transmitted between Parekh, Narula, and Madan on December 28, 2011, and January 31, 2012, include discussions concerning Madan's confiscation of Parekh's computer appear.

71. Evidence that Gogia was not in control of CSG's finances is demonstrated in a December 27, 2011, email communication Parekh transmitted to Narula. In that email, Parekh pleads with Narula that he "urgently need[s] a payment from CSG to CB" that "last week when we met I put in another $35,000 of my own money because Ajay [Madan] took over all the accounts meaning we never received any payments for Nov or Dec. CSG has since received over $250,000 in payments from the government and there have been no payments to CB even though CB covers the payroll and up to Nov was also paying the credit cards." Gogia was not even copied on the email.

72. On January 6, 2012, Narula acknowledges to Parekh that "I did not put in the request for CSG to pay CB." Narula's ability to withhold CSG payments to Parekh evidences his control over CSG. This email chain further reflects a January 16, 2012, communication from Narula to Parekh advising Parekh that there "are payments up to $1M from CSG to CB" and that they needed "to tally the books on both sides" before Narula would approve payments from CSG

to CB.

73. On January 18, 2012, Madan emails Gogia, Parekh, and Narula explaining that Gogia and Parekh would perform the "front end review" and that Madan and Gogia would "perform a backend review." On January 20, 2012, Parekh, with the knowledge and approval of Narula and Madan, initiated payroll and other payments electronically from CSG's account to CB's checking account.

74. Payroll and payments disputes continued to erupt between Parekh, Madan, and Narula. On February 15, 2012, Gogia emailed Parekh seeking Parekh's approval of CSG payrolls. Gogia states to Parekh "You still refuse to approve any payments" and further states "[w]e cannot hold our site laborers hostage, especially when we still need them to continue working" and closes by asking Parekh to "[p]lease approve immediately."

75. Parekh, Narula, and Madan worked towards reaching an agreement as to how CSG's projects and profits would be handled moving forward.

76. A "one pager" memo was prepared outlining some of the accounting, operations, outstanding debts, bonding, loan repayments, project close out and how CB and CSG would separate.

77. On March 1, 2012, Narula, Parekh and Madan exchanged emails discussing the reconciliation of issues outlined in the "one pager." The email includes multiple recommendations demonstrating that the control and operation of CSG was for the benefit of Parekh, Madan, and Narula, and the CSG was a front organization in which "surplus income [was to] be distributed equally [between Parekh, Madan and Narula] after [CSG] projects are complete." Gogia was not copied on this email.

78. In an email dated March 8, 2012, Parekh advised Gogia that Gogia could not pay

expenses to a CSG employee "without my approval" and he further authorized Gogia to continue using CB credit cards until CSG got its own cards.

79. On March 22, 2012, Parekh emailed Madan complaining that files were removed and placed under Madan's "lock and key" and that this was the "second time" Madan confiscated CSG property without notification.

80. Parekh, Narula, and Madan agreed that Parekh would prepare a monthly update on CSG projects that he would share with them.

81. On April 9, 2012 Narula, Madan, and Parekh exchanged an email concerning the resumption of Gogia's CSG salary. Gogia was not copied on the email.

82. On April 12, 2012, Parekh prepared a governance document asking Narula and Madan to reinstate access to CSG's check wiring and bank transactions and further proposing that "CB to use CSG's qual[ification]s and pay CSG a fee based on receivables."

83. On May 22, 2012, Parekh emailed Narula concerning the immediate short term financial needs pertaining to CSG, OST, and CB.

84. On June 13-14, 2012, Narula, Parekh, and Gogia exchange emails concerning CSG's Wichita project and the processing of a payment of $170,000 to Madan.

85. On July 16, 2012, Parekh signed a check in the amount of $25,000 directly paying a CSG subcontractor for work performed on the Chillicothe contract previously awarded to CSG.

86. Hundreds of responses to solicitations seeking SDVOSBC contract awards were made in the name of CSG. This resulted in CSG obtain millions of dollars in government SDVOSB contracts, including but not limited to over $6.4 million in federal government contracts from the Veteran Affairs Administration ("VA"). The contracts known to have been awarded to CSG by the VA are as follows:

	Contract Award Date	Contract Price	Final Price
Solicitation Number: VA25810RA0191 Agency: Department of Veterans Affairs Office: VA New Mexico Health Care System Location: Department of Veterans Affairs New Mexico Health Care System Contract Number: VA258-C-0436	8/24/10	$517,397.00	$503,774.00
Solicitation Number: VA786A10IB0081 Agency: Department of Veterans Affairs Office: VA National Cemetery Administration Construction Support Division Location: VA National Cemetery Administration Contract Number: VA786A-C-0355	8/31/10	$377,000.00	$400,042.00
Solicitation Number: VA25610IB0291 Agency: Department of Veterans Affairs Office: VA Gulf Coast Veterans Health Care System Location: Department of Veterans Affairs Gulf Coast Veterans Health Care System Contract Number:VA256-C-0984	9/17/10	$122,599.00	$139,579.00
Solicitation Number: VA26310IB0325 Agency: Department of Veterans Affairs Office: VA Nebraska Western Iowa Health Care System (Omaha Division) Location: Department of Veterans Affairs Nebraska Western Iowa Health Care System Contract Number: VA263-C-1066	9/22/10	$57,000.00	$65,155.00
Solicitation Number: VA25510RP0476 Agency: Department of Veterans Affairs Office: VA Heartland Network Location: Department of Veterans Affairs Heartland Network Contract Number: VA255-C-1536	9/24/10	$1,277,000.00	$1,287,005.00

Solicitation Number: VA24410RP0390 Agency: Department of Veterans Affairs Office: Lebanon VAMC Location: Department of Veterans Affairs Medical Center Contract Number: VA244-C-1556	9/29/10	$672,236.00	$68,598.00
Solicitation Number: VA25610RP0445 Agency: Department of Veterans Affairs Office: Oklahoma City VAMC Location: Department of Veterans Affairs Medical Center Contract Number: VA256-C-1169	10/29/10	$731,727.00	$731,727.00
Solicitation Number: VA25011IB0093 Agency: Department of Veterans Affairs Office: Chillicothe VAMC Location: Department of Veterans Affairs Medical Center Chillicothe Ohio (Women's Clinic)-VA-250-11-IB-0093	6/21/11	$731,910.00	$741,588.00
Solicitation Number: VA25011IB0114 Agency: Department of Veterans Affairs Office: Chillicothe VAMC Location: Department of Veterans Affairs Medical Center Chillicothe Ohio (East Entry)- VA-250-11-IB-0114	6/22/11	$167,000.00	$166,557.00
Solicitation Number: VA26311IB0345 Agency: Department of Veterans Affairs Office: VA Central Iowa Health Care System (Des Moines) Location: Department of Veterans Affairs Central Iowa Health Care System, Des Moines IA-Remodel Dom Phase II-Contract Number: VA-263-11-IB-0345	6/30/11	$179,800.00	$185,482.00

Solicitation Number: VA25511RP0378Z Agency: Department of Veterans Affairs Office: VA Heartland Network PROJECT 589-11-7968 - WOMEN'S HEALTH RESTROMM 7 PRIVACY, CONST. Location: Department of Veterans Affairs Heartland Network Kansas City MO- Women's Health and Privacy Corrections- Contract Number: VA-255-11-RP-0378	7/25/11	$187,942.00	$187,942.00
Solicitation Number: VA24611IB0278 Agency: Department of Veterans Affairs Office: Durham VAMC Location: Department of Veterans Affairs Medical Center Durham NC- Renovate CLC Restrooms Contract Number: VA-246-11-IB-0278	9/23/11	$77,100.00	$78,116.00
Solicitation Number: VA24410IB0398 Agency: Department of Veterans Affairs Office: Philadelphia VAMC Location: Department of Veterans Affairs Medical Center Philadelphia PA- Upgrade CLC Courtyards and Corridors- Contract Number VA-244-10-IB-0398	9/30/10	$837,107.00	$850,229.00
Solicitation Number: VA246-12-B-2478 Agency: Department of Veterans Affairs Office: Salisbury NC VAMC Title: Fire Damper Repairs Contract Number: VA24612C0085	8/30/12	$78,830.00	$78,830.00
Solicitation Number: VA246-12-B-1975 Agency: Department of Veterans Affairs Office: Beckley WV VAMC Title: Ceiling Tile Replacement Bldg 1 Contract Number: VA24612C0077	8/29/12	$139,212.00	$139,212.00
Solicitation Number: VA246-13-B-0242 Agency: Department of Veterans Affairs Office: Salisbury NC VAMC Title: Improvements to Building 6 Theatre Contract Number: VA24613C0047	3/19/13	$176,981.00	$176,981.00

Solicitation Number: VA246-12-B-2719 Agency: Department of Veterans Affairs Office: Salisbury NC VAMC Title: Hospice CLC Improvements Contract Number: VA24612C0090	8/27/13	$303,256.00	$303,256.00
Solicitation Number: VA246-13-B-0512 Agency: Department of Veterans Affairs Office: Salisbury NC VAMC Title: Exterior Masonry and Tuck Pointing Contract Number: VA24613C0113	6/27/13	$349,249.00	$348,493.00
CSG's SDVOSBC Revenue from VA Contracts as of 7/29/14:			***$6,452,566.00***

87. Upon information and belief CSG continued to seek and obtain SDVOSBC contract funds through at least 2016.

88. All the contracts submitted were fraudulent because CSG did not qualify as a SDVOSBC and because they included material false statements. In fact, all the contract proposals submitted by CSG to the VA:

a. falsely certified service-disabled veteran-owned status;

b. falsely certified small business status;

c. falsified CSG's past performance;

d. hid Narula's, Madan's, and Parekh's direct control over CSG;

e. hid the fact that CB employees worked the CSG contracts;

f. hid the fact that Parekh, Narula, and Madan with the support of other OST staff employees were responsible for preparing the CSG submission presented to the United States government;

g. made material false statements about the knowledge and experience of CSG employees;

h. falsified OSHA certifications for certain employees; and

i. falsified the number of employees ready and available to staff a project.

Materially False Misrepresentations as to CSG's Past Performance

89. The CSG Conspiracy was not limited to the fraudulent representation of CSG as a SDVOSBC. The fraud engaged in by the CSG conspirators extended to the submission of material false statements in all the responses to solicitations CSG made to the VA.

90. The VA contract solicitation bid on by specified past performance criteria CSG would have to demonstrate to qualify for the contract. The past performance criteria often differed from solicitation to solicitation based on the scope and cost of the contract action. Past performance questionnaires were an important part of the VA's contract award decision. The CSG conspirators knew and understood that the past performance examples it provided to the VA contracting officer were material to the VA's decision to award a contract to CSG and would be evaluated based on the results of the past performance questionnaires returned to the VA contracting officer assigned to the contract award.

91. The CSG conspirators intentionally and knowingly manufactured false past performance examples that were tailor-made to increase CSG's chances of winning the VA contract.

92. CSG had no prior past performance. As such, the CSG conspirators had to falsify examples of claimed past performance and had to bring into the conspiracy individuals who would execute and return falsified performance questionnaires back to a VA contracting officer.

93. Upon information and belief, one or more of the CSG conspirators approached Dr. Mehta to obtain her assistance in furthering the conspiracy by agreeing to submit materially false performance questionnaires to the VA.

94. The CSG conspirators used the Mehta Project as a key credential of past

performance to bid and win contracts for construction activity at VA medical centers, including Veterans Affairs medical building contracts.

Dr. Mehta Commits Overt Acts in Furtherance of the CSG Conspiracy

95. Dr. Mehta committed overt acts in furtherance of the CSG conspiracy. CSG responded to the VA contract solicitations by including work it allegedly performed for Dr. Mehta. CSG identified Dr. Mehta as the owner "Mehta Medical Group." Dr. Mehta is a solo practitioner and, upon information and belief, is not a member of a medical group such that CSG's claim that the work was performed for the "Mehta Medical Group" is false and misleading.

96. As part of the contracting procedure, a VA contracting officer would transmit a performance survey questionnaire to Dr. Mehta. The questionnaire would identify that the VA was seeking past performance information about Centurion Solutions Group, would typically identify that the work project pertained to medical office renovations, would identify the date that CSG allegedly performed the renovations, the total contract value, and would request the questionnaire recipient to rate a dozen or more aspects of CSG's performance.

97. The assertion in the CSG response to the VA contract solicitations that it engaged in construction activities for Dr. Mehta is entirely false as the location specified was built in the 1980's and had yet to be renovated.

98. In furtherance of the CSG conspiracy, Dr. Mehta completed the customer satisfaction survey claiming that the CSG work performance was outstanding.

99. Dr. Mehta is believed to have signed and submit her falsified past performance survey reports to a VA contracting officer. Such submissions commence in or about April 2010.

100. Dr. Mehta's involvement in the CSG conspiracy continued over a period of years.

Dr. Mehta routinely retuned a customer satisfaction and, upon information and belief, did so for each VA contract awarded to CSG. Each such submission constituted an act in furtherance of the CSG conspiracy.

101. Dr. Mehta also answered phone calls from government Contract Officers verifying the false information provided in the proposals and any other questions they may have had.

102. The material misrepresentations made by Dr. Mehta knew that CSG claimed in some of its submissions that the renovations of Dr. Mehta's office occurring at 5021 Seminary Road, Alexandria, VA (the location specified by CSG) exceeded $1 million dollars. That office location, however, consisted of a single room approximating 200 square feet and had not been renovated since it was originally constructed, upon information and belief, back in the 1980's.

103. By way of example, on September 22, 2010, Dr. Mehta completed a customer satisfaction questionnaire that claimed her office had been renovated between January 2009 and May 2009 at a cost of $1,236,000. Dr. Mehta responded to this survey claiming that CSG's overall performance on a fictitious million plus dollar renovation was "exceptional" and that she would hire CSG again.

104. Depending on the past performance criteria, the CSG contracting proposals specified different size and cost of the Mehta construction project.

105. In response to solicitation No.VA-255-10-RP-0476; (Construct Misc. Projects - Wichita, KS), the CSG technical submission states that the Mehta Project cost $1,150,000 for renovating 2,300 square feet.

106. In response to Solicitation No. VA-244-10-RP-0390 (Renovate 17-2B, Primary Care - Lebanon, PA), the CSG proposal claims that the Mehta Project cost $263,000.

107. The VA issued Solicitation No. VA-255-11-RP-0378 (Woman's Health and Privacy Corrections - Kansas City, MO). The CSG response to this solicitation claims that the Metha Project cost $235,000.

108. In response to Solicitation No. VA-259-10-RP-0172 (bid but not awarded) the CSG proposal claimed that Mehta Project cost $568,000.

109. The Mehta Project was also used by CSG to claim experience with "negative air machines" and high efficiency particulate air ("HEPA") filters. This experience was necessary to bid and win large building projects where exposure to airborne hazardous materials was a concern. The Mehta Project likewise did not involve negative air machines or HEPA filters.

110. As part of the solicitation process, the VA established technical requirements that had to be established satisfied in a contractor's response to the solicitation. The failure to satisfy the technical specifications disqualified the contractor from further consideration. The technical requirements to the VA solicitations CSG chose to respond required proof of past performance similar is scope to the work specified in the solicitation. If a prospective contractor failed to satisfy the technical requires as to past performance that contractor would be disqualified from the competition.

111. The CSG conspirators needed Dr. Mehta to provide falsified past performance so that CSG's responses to the VA solicitation were not rejected for failing to provide evidence of past performance. To meet the past performance criteria set forth in a solicitation the CSG conspirators would change the cost and the scope of the past performance they claimed for the Mehta Project. In addition to the fact that the claimed renovation of the Mehta Medical Group never occurred, the CSG proposals changed the cost claimed to have been expended by Dr. Mehta to coincide with past performance criteria established in the solicitation. Dr. Mehta would

separately confirm to the VA contracting officer by submitting a completed questionnaire confirming that the construction had taken place and that CSG's performance on that contracting action excellent.

Falsified Past Performance Submitted by OST

112. In furtherance of the CSG conspiracy, material false statements were made concerning alleged past performance CSG supposedly completed at defendant OST's corporate headquarters located at 2001 M Street NW in Washington, D.C. ("OST Renovations").

113. CSG contract proposals identified the OST Renovations as a key aspect of CSG's past performance. But CSG never performed the OST Renovations. Instead, the space OST occupied at 2001 M Street, NW, consisted of subleased, fully furnished office space that had never been renovated by OST.

114. As part of the contracting procedure, a performance survey questionnaires were transmitted to Narula. The questionnaire would identify that the questionnaire was sought on behalf of a federal agency, the VA, to confirm CSG's past performance on the OST Renovations.

115. In furtherance of the CSG conspiracy, Narula, on behalf of himself and OST, would fill out, sign and return to the VA contracting officer a customer performance questionnaire declaring that CSG work performance to be outstanding. Acting on behalf of the CSG conspirators, Narula commenced submitting the false declarations as to CSG's past performance in 2010 and continued doing so for a period of years.

116. As founder and CEO of OST, Narula had personal knowledge that the claim that CSG had carried out renovations of office space that Narula occupied was false. Narula, on behalf of himself and OST, caused the false statements concerning the OST Renovations to be incorporated into the CSG contracting proposals.

117. Narula, on behalf of himself and OST, understood that as part of the CSG conspiracy the scope and time and monetary value of the OST Renovation claim would be freely altered to coincide with the past work performance criteria established for a given VA contract solicitation. By way of example of such knowledge, in a June 7, 2011, email exchange, Narula was transmitted a past performance questionnaire for the CSG proposal responding to VA Solicitation No. VA-236-11-RP-0291. In his email response to this email Narula asked "What is scope and time frame you want me to fill?", thereby acknowledging his personal knowledge that the CSG claims as to the scope of the work performed were being altered to address the past performance criteria sought by the VA about the solicitation.

118. Upon information and belief, all the CSG contract proposals transmitted to the VA that resulted in a contract being awarded to CSG included material false assertions that CSG had completed the OST Renovations and that, depending on the past performance criteria objectives specified by the VA, the CSG proposals were materially altered to claim that the OST Renovation fit within those criteria.

119. Because of these actions, every time the VA awarded the contracts at issue herein to CSG the underlying proposal that CSG submitted to the VA the OST Renovation was knowingly used as a false measure of CSG's past performance.

120. Because of these actions, each time Narula, personally and on behalf of OST, transmitted a past performance questionnaire survey to a VA contracting officer falsely attesting to the fact that OST Renovation had occurred and that CSG's work performance on that project was outstanding constituted a separate act that Narula, acting on behalf of OST, took in furtherance of the CSG conspiracy.

121. Past performance claims about the OST Renovations appearing in CSG's

responses to a VA contract solicitation were altered to falsely state the dollar value and size of the construction undertaken as were the time frames and start and completion dates. These material alterations were made to falsely demonstrate compliance with bidding specifications found in the contract solicitations that required the bidder to establish past performance that differed in the scope, duration and date of completion. These material alterations were routinely carried out by Defendants Parekh, CSG, Narula and OST, and on behalf of the CSG conspirators. This falsification of compliance with past performance specifications is demonstrated by the following examples:

a. In response to solicitation No. VA-255-11-RP-0378, the CSG proposal claims that the OST Renovations cost $3,100,000 for the "design/build of 16,000 SF, 12,000 SF, and 2,500 SF shell condition spaces";

b. In response to Solicitation No DTMANM-11-R-00006, the CSG proposal claims that the OST Renovations cost was $3,100,000 for the "design/build of 16,000 SF, 12,000 SF, and 2,500 SF shell condition spaces";

c. In response to Solicitation No. VA-256-10-RP-0333 (bid but not awarded) the CSG proposal claimed that the OST renovation cost $1,296,500 for the "design/build of 16,000 SF, 12,000 SF, and 2,500 SF shell condition spaces";

d. In response to Solicitation No. VA-259-10-RP-0172 (bid but not awarded) the CSG proposal claimed that the OST renovation cost $750,000 for the "design/build of 16,000 SF, 12,000 SF, and 2,500 SF shell condition spaces".

Falsified CVENT Past Performance

122. The CSG contract proposals transmitted to the VA included past performance claims that CSG had performed for CVENT ("CVENT Project"). The CVENT Project was

completed by Citibuilders, Inc., a company established by Parekh in or about 2005. CSG was not the CVENT project contractor.

123. The site supervisor on the CVENT Project from inception to completion was the beginning to the of the CVENT project end The Citibuilders, Inc., site supervisor assigned to the Relator, Andrew Scollick. The Relator has firsthand knowledge of the size and cost of that project, and has personal knowledge that the CVENT project was contracted out to Citibuilders in 2009 before CSG came into existence. Relator has personal knowledge that the actual cost of the CVENT Project was $120,000 and that the scope of work was limited to renovating less than 3,000 square feet.

124. Relator has direct personal knowledge that the CSG proposals submitted to the VA falsely allege that CSG was the contractor on the CVENT Project and has personal knowledge that statements as to the cost of that project were materially altered in the CSG proposals to comply with past performance criteria established by the VA with respect to specific contract solicitations.

125. By way of example, in the solicitation No.VA-255-10-RP-0476; (Construct Misc. Projects – Wichita, KS) ("Wichita Solicitation"), the solicitation identifies that the government would not consider a contractor's proposal unless the contractor submitted proof of past performance that it functioned as the "prime contractor" on a project with a "dollar magnitude equal to, or greater than $1,00,000.00." In response to this solicitation the CSG conspirators falsely stated in the CSG proposal that the cost of CVENT project was $1,477,000. This claim by the CSG conspirators is materially false because as CSG was not the prime contractor (Citibuilders was the prime contractor) and because the actual dollar magnitude of the CVENT project was $120,000. The time frame of when the CVENT project was alleged to have occurred

also knowingly altered by the CSG conspirators to meet VA guidelines for "Recent Past Performance" which typically demanded that the project had be completed within one year prior of solicitation.

126. CSG proposals knowingly submitted and in furtherance of the CSG conspiracy also included false assertions that the CVENT Project included the construction of a sliding partition to minimize disruption and that CSG brought in "our HEPA air purifier with an extra carbon filter which took the device to stage 4 and eliminated any noxious glue fumes" are false. Relator has firsthand knowledge that the project utilized an ineffective plastic sheet barrier and not a sliding partition and that a HEPA filtration system was never used on the CVENT Project and that this failure resulted in CVENT employees becoming ill and having to be evacuated, and that CVENT's HR department sent several employees home due to the inhalation of noxious fumes. Employees from the mortgage company on the floor above also had to be evacuated.

127. In response to Solicitation No. VA-244-10-RP-0390 (Renovate 17-2B, Primary Care - Lebanon, PA), CSG's technical proposal is identically worded to the Wichita Solicitation with the exception that the cost of the CVENT project was changed to $896,500. The reason for this material alteration was because the VA's technical requirements required past performance had to be between $500,000 and $1,000,000. The made up $896,500 amount fit within this criterion whereas the $1,477,000 cost figure CSG identified for the same project did not.

128. In response to Solicitation No. VA-259-10-RP-0172 (bid but not awarded) the CSG proposal claimed that CVENT project cost $896,500.

Falsified FBR Renovation Past Performance

129. In furtherance of the CSG conspiracy, material false statements were made concerning alleged past performance CSG supposedly completed for FBR Capital Markets

Corporation, located at 1001 19th Street North, Arlington, VA ("FBR interior renovations").

130. CSG did not perform the FBR interior renovations work. The CSG past performance claims for the FBR interior renovations work altered the claimed cost of that renovation. By way of example, CSG's response to Solicitation No. VA-244-10-RP-0390 (Renovate 17-2B, Primary Care, Lebanon, PA), claimed the cost of the FBR interior renovation was $537,000. However, when CSG responded to another VA solicitation, Solicitation No. VA-256-10-RP-0333 (bid but not awarded) CSG cut and pasted the exact content with the exception that the FBR interior renovation cost $837,000 as opposed to $537,000.

131. The started/completed dates for the FBR projects were also changed to meet VA guidelines for "Recent Past Performance" that typically required that the project had to be completed within one year of the date of the solicitation.

False Representations Concerning CSG's Employees

132. The CSG bids knowingly and falsely claim in furtherance of the CSG conspiracy that CSG employed people who were not employed by CSG and these CSG bids knowingly falsified the background, knowledge, and experience of employees who were employed by CSG.

133. CB formally issued separate letters of hire to David Rubando, relator Andrew Scollick, and Martin Tubb. The formal start date of employment for all three individuals is September 27, 2010. Unlike Rubando and the relator, Mr. Tubb was eventually placed on CSG's payroll; however, in December 2010, Mr. Tubb left CSG's employ in less than favorable terms and had no intention of ever returning to work for CSG or the defendants. In essence, Mr. Tubb leaving CSG's employ was final and there was no expectation on the part of CSG or the defendants that he would ever return.

134. Mr. Tubb was employed by the defendants between September and December

2010. Following Mr. Tubb's departure both the CSG and Citibuilders response to solicitations continued to list Tubb as the site supervisor or other site management position on the proposals submitted, and did so in at least 50 separate responses to VA contract solicitations. For example, in VA-255-11-RP-0378 (Kansas City, MO) (Women's Health and Privacy Corrections) was submitted on June 13, 2011, listing Mr. Tubb as the proposed "Site Superintendent/Quality Control Officer" knowing that Mr. Tubb was unwilling to work for CSG.

135. Defendants OST, CB, Parekh, Narula and Madan knew that following Tubb's departure that the continued submission of Mr. Tubb's name constituted a material misrepresentation to the government that was undertaken for the purpose of obtaining government contracts under false pretenses.

136. In furtherance of the CSG conspiracy CSG also knowingly submitted Mr. Tubb's name as a proposed site manager when he was already functioning as such on an existing awarded contract. For example, Mr. Tubb was selected as the site supervisor for Solicitation No. VA-256-10-IB-0291 (Biloxi, MS), which was awarded on September 17, 2010. However, right before Thanksgiving 2010, Parekh falsely stated to Mark Wesson, the VA contracting officer in Biloxi, and to the Contract Officer's Technical Representative, Brandon O'Neal, that Mr. Tubb had experienced a "family emergency" requiring him to leave the project. In fact, CSG had identified Mr. Tubb as the site supervisor in a separate VA contract, Solicitation No. VA-258-10-RA-0191 (Albuquerque, New Mexico), and he was dispatched to that project after in late November 2010.

137. CSG, CB, and OST, by and through Parekh, Narula and Madan, knowingly submitted a false bid on Solicitation No. VA-255-10-RP-0476 (Wichita, KS) in September 2010 by listing Tubb as the "Safety Compliance" project officer, a role Defendants knew Tubb would

never fill, and, in fact, did not fill after the contract was awarded.

138. Mr. David Rubando is falsely identified as a CSG employee on all bid proposals submitted by and awarded to CSG. This is a materially false statement made in violation of the False Claims Act. The CSG conspirators, including CB, OST, Parekh, Narula and Madan, knew that at all times Mr. Rubando worked for and was exclusively on the CB payrolls.

139. For example, with respect to bid proposals on VA-255-10-RP-0476 and VA-244-10-RP-0390, David Rubando is claimed to have been employed as the Overall Project Manager of CSG for the past 1.5 years. Both statements are false as Mr. Rubando was never employed by CSG and because he was not hired even by CB until September 2010. Mr. Rubando remained exclusively employed by CB until he left the company in or about December 2013.

140. CB and OST, through the actions of Parekh, Narula, and Madan, knowingly and falsely stated when pursuing government contracts that the Relator, Andrew Scollick, was an employee of CSG. They knew that the Relator was employed by CB and thereafter by Citibuilders. The claim that the Relator was employed by CSG is a material false statement submitted to the government for the purposes of securing government contracts.

The Citibuilders Conspiracy

141. Melvin Goodweather is a veteran of the United States Air Force who left the Air Force to become registered corporate lobbyist. Goodweather is an attorney whose past work legal work with the Air Force and private sector provided him was a background in government contracting. Goodweather qualifies as a service disabled veteran.

142. Defendant Parekh entered a separate conspiracy with Melvin Goodweather to utilize Goodweather's status as a disabled veteran to establish a LLC for the sole purpose of obtaining SDVOSB set aside contracts.

143. Goodweather engaged in overt acts in furtherance of the conspiracy. Such overt acts include Goodweather forming a LLC known as Citibuilders Solutions Group, LLC ("Citibuilders"); establishing himself as its sole owner, President, and CEO of that entity knowing that he would never function in those capacities; establishing a bank account in the name of Citibuilders knowing that control of the back account would be provided to Parekh; provided documentation of his service disabled veteran status so that Parekh could obtain SDVOSB government contracts; and executing bonding agreements so as to provide Parekh with the bonding needed to carry out the fraud scheme.

144. Goodweather is and has always been a signatory on the Citibuilders' bank account.

145. Goodweather continues to hold himself out as the owner, President, and CEO of Citibuilders and has withdrawn money from the Citibuilders bank account knowing that those funds were obtained through fraud.

146. Citibuilders was certified and registered in the VIP Database, CCR, and ORCA as a SDVOSB. Upon information and belief, Goodweather knew or reasonably should have known that such certifications were falsely obtained.

147. Lacking knowledge of the construction business and having no prior experience managing a construction project, Goodweather necessarily handed day-to-day operation and control of Citibuilders to Parekh.

148. Goodweather knew or reasonably should have known that turning control of Citibuilders over to Parekh made the SDVOSB claim included in each contract proposal submitted to the VA materially false.

149. Goodweather understood that he would be obtain payments and, upon information

and belief, did obtain payment, in exchange for allowing the Citibuilders LLC to be established, for agreeing to claim at the time of formation that he was the true President, CEO, and owner of that entity, for providing Parekh with his service disabled credential and for turning control and dominion over Citibuilders to Parekh so that SDVOSB contracts could be obtained in the name of Citibuilders.

150. Goodweather knowingly established Parekh as the de facto President, CEO, and owner of Citibuilders for using Goodweather's disabled veteran status to obtain SDVOSB government contracts.

151. Goodweather never intended to engage in oversight and management of Citibuidlers. He reasonably knew from the outset that he was being identified as that entity's President, CEO, and sole owner of Citibuilders so that Parekh could use that credential to obtain SDVOSB contracts; he reasonably knew from the outset that he would never function as the President, CEO, or owner of Citibuilders; that he reasonably knew from the outset that Citibuilders was created so that Parekh could obtain SDVOSB contracts from the government; he reasonably knew that by providing proof of his service disabled veteran status was done to allow Citibuilders to obtain SDVOSB government contracting funds and that millions of dollars of SDVOSB contracting funds were deposited into the Citibuilder's bank account.

152. Goodweather understood that by retaining legal ownership of Citibuilders and retaining his position as president and CEO of company that he was responsible for the government contracting activity engaged in by Citibuilders and was responsible for the proper reporting of Citibuilders' income and profits.

153. Goodweather direct participation in the Citibuilders conspiracy included the overt act of establishing Citibuilders LLC, and providing Parekh with proof of his disabled veteran

status.

154. Goodweather reasonably understood that Citibuilders was established for the purpose of obtaining SDVOSB set aside contracts and that Goodweather's service disabled status would be used for that purpose.

155. Goodweather's access to the Citibuilders bank account provided him with full and complete knowledge of the millions of dollars in VA government contracting funds that were deposited into the Citibuilders bank account.

156. Between 2012 and 2014, Citibuilders obtained at over $6 million in set aside SDVOSB funds from the federal government. A listing of Citibuilders' fraudulently awarded contracts known to have been awarded between 2012 and 2014 are as follows:

Citibuilders Solutions Group, LLC	**Date of Award**	**Original price**	**Final price**
Program Source: 14-4556 Department/Agency: Department of the Interior: Geological Survey Product/Service: Z1AA: MAINTENANCE OF OFFICE BUILDINGS Description: MILL&PAVE PARKING LOTS&ROAD Herndon VA- Mill and Pave Parking Lots and Road- ING12PX01800	9/13/12	$128,741.00	$135,705.00
Solicitation Number: VA246-14-B-0071 Agency: Department of Veterans Affairs Location: Salisbury NC VAMC Title: Replacement of Windows Stationwide Contract Number: VA24614C0033	6/30/14	$2,144,000.00	$2,144,000.00
Solicitation Number: VA244-12-B-1357 Agency: Department of Veterans Affairs Location: Philadelphia PA VAMC Renovate Laboratory and Ac 19 Contract Number: VA24412C0529	9/27/12	$1,777,000.00	$1,790,568.00

Solicitation Number: VA24612B2836 Agency: Department of Veterans Affairs Office: Salisbury VAMC Location: Department of Veterans Affairs Medical Center Salisbury NC- Building 21 Basement Improvements Contract Number: VA24612C0126	9/24/12	$279,000.00	$279,000.00
PIID/MOD: VA786A12C0082 / 0 Program Source: 36-0129 Department/Agency: Department of Veterans Affairs Product/Service: Y1PZ: CONSTRUCTION OF OTHER NON-BUILDING FACILITIES Richmond VA- Remove Underground Service Tank Contract Number: VA786A12C0082	9/26/12	$23,005.00	$23,005.00
PIID/MOD: VA24612C0125 / 0 Program Source: 36-0162 Department/Agency: Department of Veterans Affairs Product/Service: Z1DA: MAINTENANCE OF HOSPITALS AND INFIRMARIES Description: TUNNEL RENOVATIONS Salisbury NC- Tunnel Renovations Contract Number VA24612C0125	9/26/12	$278,384.00	$306,338.00
Solicitation Number: VA25012B0639 Agency: Department of Veterans Affairs Office: Brecksville (Cleveland) VAMC Location: Department of Veterans Affairs Medical Center Cleveland OH - Renovate Dietetics Admin Space Project 541-12-113 Contract No. VA25012C0107	9/28/12	$627,000.00	$650,947.00

RECONSTRUCT/EXPAND SOUTH PARKING LOT Solicitation Number: VA26313B1756 Agency: Department of Veterans Affairs Office: Fargo VAMROC Location: Department of Veterans Affairs Medical and Regional Office Center Fargo ND- Reconstruct and Expand South parking Lot- Contract No. VA26313C0153	6/26/13	$447,000.00	$664,600.00
Solicitation Number: VA24413Q0801 Agency: Department of Veterans Affairs Office: Erie VAMC Location: Department of Veterans Affairs Medical Center Erie PA- Replace Canteen Floor Contract Number: VA24413C0359	7/19/13	$72,000.00	$88,540.00
Citibuilders Solutions Group- Total Revenue to Date 7/29/2014			*$6,082,703.00*

157. Goodweather, as owner, President, and CEO of Citibuilders, controlled the allocation of company profits and he permitted and otherwise allowed such profits to be diverted to Parekh and CB.

158. Upon information and belief, after knowing that the deposits made into the Citibuilders bank account were obtained from payments made against SDVOSB contracts that were obtained through fraud, Goodweather purposefully diverted large cash payments from the Citibuilders' bank account into a private account under his personal control.

159. Upon information and belief, Goodweather knew (or reasonably should have known) that Citibuilders was soliciting SDVOSB contracts.

160. Upon information and belief, Goodweather knew or reasonably should have known that the proposals Citibuilders submitted to the VA were materially false because they

alleged past performance on the part of Citibuilders that did not exist.

161. Goodweather knew or reasonably should have known that Citibuilders's responses to VA solicitations were false because they claimed that Citibuilders qualified as a SDVOSB.

162. Parekh knew that the Citibuilders contracting actions were materially false because they:

a. Falsely certified service-disabled veteran status;

b. Falsified past performance experience;

c. Hid that Parekh was in control of Citibuilders;

d. Hid that CB employees were claimed to be employed by Citibuilders;

e. Made material false statements about the knowledge and experience of Citibuilders employees;

f. Falsified OSHA certifications for certain employees; and

g. Falsified the number of employees who were ready and available to staff a project.

163. The fraud knowingly committed in the name of Citibuilders is ongoing and continuous.

Participation of the Bonding Defendants

164. Bonds were issued on the Citibuilders SDVOSB construction contracts by Hanover Insurance Company and Hudson Insurance Company through their agent and attorney-in-fact Schendel, Centennial. Together these entities are referred to as the "Bonding Defendants."

165. Pursuant to the Miller Act, (40 U.S.C. §3131), contractors who bid on government construction contracts are required to post bid bonds, performance bonds and

payment bonds.

166. A "bid bond" is required to ensure that a contractor will in fact undertake the contract if its bid is accepted; a "performance bond" is a guarantee that the contractor will complete the project in accordance with the specifications set forth in the contract; and the "payment bond" ensures that those who furnish labor and materials for the project will be paid.

167. The Miller Act requires performance bonds for the protection of thegovernment. The construction contract cannot be awarded and cannot commence unless the required bonding is in place.

168. Federal acquisition regulations ("FAR") Subpart 28.2 requires that the surety company hold a certificate of authority from the Department of the Treasury.

169. 31 CFR Part 223 sets forth the financial information the surety must provide in order to be issued a certificate of authority.

170. Federal acquisition regulations specify that bid bonds are to be submitted on Standard Form 24, payment bonds on Standard Form 25, and performance bonds on Standard Form 25A. The failure to supply proof on bonding is fatal to a contractor's ability to bid on or be awarded a construction contract.

171. Surety bonds differ from insurance in that the issuer of the bond is to be indemnified and reimbursed for any loss, fees, or other expenses incurred on behalf of a contractor.

172. Surety bonding is subject to underwriting.

173. The key concepts to surety underwriting are referred to as the "three Cs"-- Character, Capacity and Capital. Under the three Cs, underwriting activity will focus on an evaluation of the contractor's manpower, expertise, past experience, net worth, cash flow,

assets, income, work history, banking relationships and the nature of the projects to be bonded.

174. Obtaining construction bonding is a difficult undertaking for the contractor. The fact that bonding was obtained by a contractor provides a government contracting officer with reasonable assurances that the contractor's structural organization and financial ability can satisfy the obligations set forth in the construction contract.

175. Centennial, by and through Michael E. Schendel, Debra L. Stewart, Catherine M. Mathews, Belinda M. Ferclot and/or Anthony J. Pung, were the lawful agents and the attorney-in-fact for Hanover Insurance Company and Hudson Insurance Company.

176. As part of the underwriting process, Schendel and other agents of the Bonding Defendants toured OST's offices located at 2001 M Street, NW, Washington, D.C., for the purpose of ascertaining the organizational structure, history, and financial capacity of CSG. Schendel had an existing business relationship with Parekh and, upon information and belief, already had a deep understanding of the assets and capabilities CB possessed.

177. Because of the on-site tour of OST's offices, the Bonding Defendants necessarily understood that CSG was a shell company dependent on the resources and capabilities and capital of CB and OST and the experience and knowledge and financial backing of Parekh, Narula, and Madan.

178. The underwriting and due diligence engaged in by the Bonding Defendants would reasonably have revealed that CSG did not possess the necessary construction history or financial capabilities to carry out the scope of the contracting activity ultimately undertaken in the name of CSG.

179. The Bonding Defendants' due diligence and underwriting reasonably led to the conclusion that OST, CSG, and CB Construction shared common ownership.

180. The Bonding Defendants' due diligence and underwriting reasonably led to the conclusion that Parekh, Narula, and Madan exerted dominance and control over CSG.

181. The Bonding Defendants' due diligence and underwriting reasonably led to the conclusion that Gogia lacked the skill, knowledge, resources and past performance to engage in the scope of contracting activity undertaken by the CSG conspirators.

182. The Bonding Defendants' due diligence and underwriting reasonably led to the conclusion that CSG was not a service-disabled small business operating out of Harrisonburg, Virginia.

183. The Bonding Defendants would have reasonably concluded that Parekh, Narula, and Madan exercised domination and control and ownership over CSG are such conclusion was manifest in Bonding Defendants' insistence that OST and CB had to acknowledge common ownership of CSG and had to agree to indemnify the Bonding Defendants for any losses sustained on bonds issued against any contracts issued in the name of CSG.

184. The Bonding Defendants required Gogia to execute a notarized agreement on behalf of CSG confirming that OST, CB, and CSG were "materially interested through common ownership" and "authorizes, affirms, ratifies and approves the acts" OST and CB engaged in on its behalf.

185. The Bonding Defendants required Narula to execute on behalf of OST a notarized agreement confirming that OST, CB, and CSG were "materially interested through common ownership" and "authorizes, affirms, ratifies and approves the acts" of the other entities.

186. The Bonding Defendants forced Parekh to execute on behalf of CB a notarized agreement confirming that OST, CB, and CSG were "materially interested through common ownership" and "authorizes, affirms, ratifies and approves the acts" of the other entities.

187. The Bonding Defendants further required Narula and his wife to separately agree to personally indemnify the bonding defendants in the amount of $1,000,000 for any contracting activity engaged in by CSG.

188. The Bonding Defendants issued a single bonding agreement that extended to OST, CSG, and CB.

189. With the bonding agreement in place, the CSG conspirators commenced the process of bidding on SDVOSB set aside contracts without revealing to the government material facts related to the true control and ownership of CSG, or that OST, Narula, Parekh and Madan exercised control over CSG in violation of the government's contracting requirements for the contacts at issue herein.

190. The Bonding Defendants reviewed every SDVOSB contracting action pursued in the name of CSG and issued bonding against all of them.

191. Each and every time a bond was issued against a contract executed in the name of CSG the Bonding Defendants reasonably understood that CSG was nothing more than a shell company, that CSG did not operate out of Harrisonburg, VA, that the contract proposal originated out of OST's Washington, D.C. offices, that the execution of the contract would be carried out under the direction of Parekh, Narula, and Madan, that day-to-day management of that contracting action would be done by Parekh, that financing necessary to carry out the contract would be provided by OST, CB, Parekh, Narula and Madan, that Gogia did not have the knowledge, skill, background or financial resources to undertake the contracting actions CSG was submitting to the VA. In sum and substance, the Bonding Defendants would have known that the proposals submitted in the name of CSG in furtherance of the CSG conspiracy knowingly misled the government as to the true ownership and control over CSG and that CSG

did not qualify for SDVOSB status.

192. That the bonding extended to a hundred of bids submitted in the name of CSG and extended over a period of multiple years meant that the Bonding Defendants engaged in due diligence and underwriting activity and multiple occasions. An example of the multiple evaluations undertaken by the Insurance Defendants is contained in a January 13, 2012, email issued by Centennial to Madan, Narula, Parekh and Gogia reconfirming the Insurance Defendants' conclusion that CSG remained unable to "stand on their own merits for a bond" and that CSG's bonding was "based on OST's financial support" and remained dependent on "written indemnity" from OST. In other words, the Bonding Defendants knew that OST, in addition to the other Defendants involved in the CSG conspiracy, exercised financial control over CSG.

193. But for the actions of Bonding Defendants, CSG could not have bid on or been awarded the SDVOSB construction contracts because CSG would not have met the government's material conditions to award those contracts. Had the government known the material information about the financial ownership and control over CSG by the other CSG conspiracy defendants, including OST, the government would not have awarded the contracts to CSG and the government would not have paid any of the false claims made or caused to be made pursuant to the CSG contracts.

194. The Citibuilders conspiracy also could not have taken place without bonding. The underwriting and due diligence by the Bonding Defendants to provide bonding to Citibuilders would have revealed that Goodweather was not in control of that entity and that Citibuilders constitutes a separate shell company Parekh established for the purpose of obtaining SDVOSB contracts.

195. But for the actions of the Bonding Defendants, Citibuilders could not have bid on or been awarded its SDVOSB construction contracts because Citibuilders would not have met the government's material conditions to award those contracts. Had the government known the material information about the financial ownership and control over Citibuilders by the other Defendants, including OST, the government would not have awarded the contracts to Citibuilders and the government would not have paid any of the false claims made or caused to be made pursuant to the Citibuilders contracts.

196. The Bonding Defendants sought and obtained financial gain from the fraud CSG and Citibuilders carried out. Under the Miller Act, bonding submitted in connection with any of the CSG or Citibuilders contracts represented steady cash flow derived from the millions of dollars in bonds written against the millions of dollars in SDVOSB contracts awarded to CSG and Citibuilders. Furthermore, the Bonding Defendants utilized its underwriting capabilities to knowingly extracted indemnification agreements from CSG and Citibuilders conspirators.

197. The Bonding Defendants underwriting capacity led them to believe they were inoculated against any loss should the scheme unravel. The steady flow of income and the indemnification protections provide ample motivation to participate in the scheme that included supplying CSG and Citibuilders bonding for all their SDVOSB construction contracts.

198. Because of the foregoing factual allegations, the Bonding Defendants were willing participants in the CSG conspiracy and Citibuilders conspiracy to commit the fraud CSG and Citibuilders fraud schemes. In fact, the Bonding Defendants facilitated these fraud schemes by obtaining facts that the Bonding Defendants knew or should have known violated the government's contracting requirements, but the Bonding Defendants not only concealed those facts from the government, they also issued surety bonds to CSG and Citibuilders, which gave

the misleading appearance that CSG and Citibuilders were qualified to bid on these SDVOSB construction contracts. The Bonding Defendants also materially benefitted because of their participation in the scheme. Had the government known the facts known by the Bonding Defendants about the true ownership and control over CSG and Citibuilders, the government would not have awarded CSG and Citibuilders these contracts and the government would not have paid these claims. Accordingly, the Bonding Defendants knowingly participated in the schemes and they also knowingly caused CSG and Citibuilders to submit false bids and false claims to the government on the SDVOSB construction contracts.

The KCGI Fraud Scheme

199. In or about 2010, OST, Narula, Parekh, and Madan knowingly defrauded the government by seeking Small Business Administration ("SBA") Section 8(a) set aside contracts and/or service disabled contracts extending bonding access to a failing economically disadvantaged corporate entity known as KCGI.

200. To qualify a business must be owned by socially or economically disadvantaged individuals, in business for at least two years with the owners having a net worth of under $250,000.

201. The scheme to defraud the government was discussed in a "Teaming Arrangement" memo was prepared by Parekh and shared with Narula and Madan. The memo devised a plan for OST to gain a 60% stake in any SDVOSB contracts KVGI could obtain and a 40% share of the Section 8(a) contract profits.

202. On or about August 17, 2010, OST, through the hands of Narula, entered into an indemnification agreement with Merchants Bonding Company to bond the set aside contracts obtained by KGCI.

203. Parekh was involved with KCGI contracting activity. He possessed a copy of "Teaming Arrangement" document.

204. Parekh flew to Boston to assist with price out the KCGI contracts and, upon information and belief, helped oversee KCGI projects.

205. KCGI, Guatam Chitnis, Anita Chitnis, OST and Narula teamed together and conspired with one another to seek and obtain 8(a) set aside contracts by fraudulently concealing OST's and Narula's involvement.

206. Narula and OST provided indemnification on KCGI 8(a) contracts to gain a share of 8(a) contract profits that including but may not be limited to the following:

KGCI	**Contract Award Date**	**Original Price**	**Final Price**
Recipient: KGCI INC 999 BROADWAY STE 302, SAUGUS, Massachusetts Program Source: 14-1039 Department/Agency: Department of the Interior: National Park Service Product/Service: Z199: MAINT-REP-ALT/MISC BLDGS Description: BOST 16306 DRYDOCK AND REHABILITATE HISTORIC SHIP Boston MA- Drydock and Rehabilitate historic ship USS Cassin Young Boston National Historic Park-INPC2011100224 (Awarded 6/1/2010)	6/1/10	$3,406,186.00	$2,708,311.00

Recipient: KGCI INC 999 BROADWAY STE 302, SAUGUS, Massachusetts Program Source: 14-1036 Department/Agency: Department of the Interior: National Park Service Product/Service: C119: OTHER BUILDINGS Description: EAGLE CONDITION SURVEY, FORT JAY, GOVERNOR'S ISLAN Staton Island NY- Eagle Condition Survey- Governors National Monument- Construction of Scaffolding, Condition Survey and Masonry Probes- INPC1766100050 (Awarded 9/18/2010)	9/18/10	$187,250.00	$189,392.00
Boston MA- Improvements Building 5 and Quarters B, Boston National Historic Park, Boston MA- C1720100416 (Awarded 9/24/2010)	9/24/10	$591,603.00	$717,387.00
KGCI Total Revenue to Date			***$3,615,090.00***

207. Merchants Bonding Company, who provided bonding on the KCGI contracts, filed claim against OST as the indemnifier of those contracts.

208. A pattern of bonding manipulation on government set aside contracts through the use of indemnification agreements exists.

COUNT I

VIOLATIONS OF 31 U.S.C. § 3729(a)(1)(A)
(Submitting or Causing to Be Submitted False or Fraudulent Claims to the United States)

209. The allegations contained in the above paragraphs are hereby realleged as set forth fully above.

210. In violation of 31 U.S.C. § 3729(a)(1)(A), Defendants knowingly presented or caused to be presented false or fraudulent claims for payment or approval by the Government.

211. Defendants obtained service-disabled veteran-owned small business ("SDVOSB"), and/or Section 8(a) and/or HUBzone set-aside contracts through fraudulent means and false certifications.

212. The fraudulent contracting activity by Defendants was done in the name of CSG, Citibuilders, and KGCI and other unknown co-conspirators.

213. By virtue of the false statements, false certifications, and fraudulent conduct described herein, Defendants knowingly made, or caused to be made, false and fraudulent claims for federal funds. Defendants, and each of them, knowingly made or caused to be made false and fraudulent statements, and/or created false records, to obtain contracts through fraudulent means and to get a false and fraudulent claim against such contracts paid.

214. Unaware of the false and fraudulent nature of the bids and technical proposals, the United States – in reliance on the claims and certifications submitted therewith – awarded contracts to CSG, Citibuilders, and KGCI, respectively, and the government was damaged thereby. The amount of damages would include the total sum paid out or otherwise disbursed against each contract the Defendants obtained based on false claims of services-disabled, and/or veteran-owned small business and/or HUBZone and/or Section 8(a) status, as well as every contract and claim that included knowingly false and material statements.

215. Defendants' false statements and certifications, which included claims that CSG or Citibuilders was a services-disabled and/or veteran-owned small business and/or Hub-Zone entity diverted government funds intended to be provided and which by law could only be provided to small businesses and/or service-disabled veteran-owned and/or entities located in a Hub-Zone.

216. Defendants' false statements as to KCGI's Section 8(a) status diverted

government funds intended to be provided and which by law could only be provided to Section 8(a) qualified entities.

217. As a direct and proximate result of Defendants' fraudulent and/or illegal actions and pattern of fraudulent conduct, the United States has paid directly or indirectly numerous false claims that it would not otherwise have paid.

218. Defendants engaged in fraud in the inducement such that the United States was damaged in the entire amount of the contract funds awarded and paid to the Defendants.

219. Damages to the United States include, but are not limited to, three times the full value of all such fraudulent claims.

220. Each separate submission of a fraudulent bid proposal or contract claim are subject to a civil fine under the False Claims Act of five thousand five hundred to eleven thousand dollars ($5,500 – $11,000) per occurrence.

221. Defendants are jointly and severally liable for all damages.

222. Because of Defendants' violations of 31 U.S.C. § 3729, *et seq.,* the United States has suffered damages in an amount to be determined at trial.

COUNT II

VIOLATIONS OF 31 U.S.C. § 3729(a)(1)(B)

(Causing to Be Made or Used False Records to Submit False or Fraudulent Claims to the United States or to Avoid Obligations)

223. The allegations contained in the above paragraphs are hereby realleged as set forth fully above.

224. In violation of 31 U.S.C. § 3729(a)(1)(B), Defendants knowingly made or used false records to submit false or fraudulent claims for payment or approval by the Government, or to avoid obligations to the Government. In violation of 31 U.S.C. § 3729(a)(1)(B), Defendants

knowingly made, used or caused to be made or used, the false records and statements described above to obtain payments from federal government agencies under government contracts, with knowledge they were false and/or with deliberate ignorance of their truth or falsity, and/or with reckless disregard for their truth or falsity.

225. Defendants obtained service-disabled veteran-owned small business ("SDVOSB"), and/or 8(a) and/or HUBzone set-aside contracts through fraudulent means, false certifications and by making or using false records. By the false statements, false records, false certifications and fraudulent conduct described herein, Defendants knowingly made, or caused to be made, false and fraudulent claims for federal funds. Defendants, and each of them, knowingly made or caused to be made false and fraudulent statements, and/or created false records, to obtain contracts through fraudulent means and to get a false and fraudulent claim against such contracts paid.

226. Unaware of the false and fraudulent nature of the bids and technical proposals, the United States – in reliance on the claims and certifications submitted therewith – awarded contracts to Defendants and was damaged thereby. The amount of damages would include the total sum paid out and disbursed on every contract the Defendants submitted or caused to be submitted that were awarded on behalf of the United States based on false claims of services-disabled, and/or veteran-owned small business and/or HUBZone and/or Section 8(a) status, or because of including materially false statements including false statements as to past performance.

227. Defendants' false statements, false records and false certifications claiming CSG or Citibuilders was a services-disabled, and/or veteran-owned small business and/or Hub-Zone entity diverted government funds intended to be provided and which by law could only be

provided to small businesses and/or service-disabled veteran-owned and/or entities located in a Hub-Zone.

228. Defendants' false statements as to KCGI's Section 8(a) status diverted government funds intended to be provided and which by law could only be provided to Section 8(a) qualified entities.

229. As a direct and proximate result of Defendants' fraudulent and/or illegal actions and pattern of fraudulent conduct, the United States has paid directly or indirectly numerous false claims that it would not otherwise have paid.

230. Defendants engaged in fraud in the inducement such that the United States was damaged in the entire amount of the contract funds awarded and paid to the Defendants.

231. Damages to the United States include, but are not limited to, three times the full value of all such fraudulent claims.

232. Each such fraudulent claim is also subject to a civil fine under the False Claims Act of five thousand five hundred to eleven thousand dollars ($5,500 – $11,000).

233. Defendants are jointly and severally liable for all damages.

234. Because of Defendants' violations of 31 U.S.C. § 3729, *et seq.*, the United States has suffered damages in an amount to be determined at trial.

COUNT III

VIOLATIONS OF 31 U.S.C. § 3729(a)(1)(G)
(Avoiding an Obligation Owed to the United States)

235. The allegations contained in the above paragraphs are hereby realleged as set forth fully above.

236. The bonding agreements were separate instruments entered between the United States government and although submitted with the contract, did separately obligate the Bonding

Defendants to compensate the government for losses sustained if the specifications found in the contract, including the specification that the construction activity be paid a service-disabled, veteran-owned small business entity.

237. The Bonding Defendants knew each time a payment was transmitted to CSG or Citibuilders against a bonded contract that a violation of the SDVOSB specification did occur and that the government suffered a loss in that amount.

238. In violation of 31 U.S.C. § 3729(a)(1)(G), the Bonding Defendants knowingly concealed and avoided an obligation to pay against the bonding agreement each time funds under the contract were not transmitted to service-disabled, veteran-owned small business entity. The Bonding Defendants thereby purposely of improperly avoided an obligation it owed to the United States of America. In carrying out these wrongful acts, Bonding Defendants have engaged in a protracted and continuing course and pattern of fraudulent conduct that deceived the United States into believing it was not owed this money.

COUNT IV

(Conspiracy to Violate the False Claims Act, 31 U.S.C. §3729(a)(1)(C))

239. The allegations contained in the above paragraphs are hereby realleged as set forth fully above.

240. Defendants conspired with each other to commit the violations of 31 U.S.C. § 3729(a)(1) (A), (B), and (G) described above.

241. As described throughout this Complaint, all Defendants knew about the scheme to defraud the United States by making false records, statements and certifications in violation of 31 U.S.C. § 3729(a)(1)(A), (B), and (G). By participating in this scheme, Defendants implicitly agreed to form a conspiracy to violate 31 U.S.C. § 3729(a)(1)(A), (B), (D) and (G).

242. Each of the Defendants committed one or more overt acts in furtherance of the conspiracy to violate 31 U.S.C. §§3729(a)(1)(A), (B), and (G), including but not limited to each time they made false records, false statements, and/or false certifications to conceal from the United States the Defendants' fraudulent scheme and false claims, and each time false claims were submitted or caused to be submitted to the United States.

243. Defendants conspired with each other to and did obtain service-disabled veteran-owned small business ("SDVOSB"), and/or 8(a) and/or HUBzone set-aside contracts through fraudulent means in violation of the False Claims Act, 31 U.S.C. §3729(a)(1)(C).

244. The fraudulent contracting activity was done in the name of CSG and Citibuilders and KGCI and other unknown co-conspirators.

245. Defendants knowingly conspired with each other to make, or caused to be made, false and fraudulent claims for federal funds. Defendants, and each of them, knowingly conspired to make or caused to be made false and fraudulent statements, and/or created false records, to obtain contracts through fraudulent means and to get a false and fraudulent claim against such contracts paid.

246. Unaware of the Defendants' conspiracy or the false and fraudulent nature of the bids and technical proposals, the United States – in reliance on the claims and certifications submitted therewith – awarded contracts to Defendants and was damaged thereby. The amount of damages would include the total sum paid out and disbursed on each contract in which the Defendants submitted or caused to be submitted bid proposals that were awarded on behalf of the United States based on false claims of services-disabled, and/or veteran-owned small business and/or HUBZone and/or Section 8(a) status.

247. Defendants' false statements and certifications claiming CSG or Citibuilders was

a services-disabled, and/or veteran-owned small business and/or Hub-Zone entity, and all the other above-identified material false statements, including false statements as to past performance, diverted government funds intended to be provided and which by law could only be provided to small businesses and/or service-disabled veteran-owned and/or entities located in a Hub-Zone.

248. Defendants' false statements as to KCGI's 8(a) status diverted government funds intended to be provided and which by law could only be provided to 8(a) qualified entities.

249. As a direct and proximate result of Defendants' conspiracy resulting in fraudulent and/or illegal actions and pattern of fraudulent conduct, the United States has paid directly or indirectly numerous false claims that it would not otherwise have paid.

250. Defendants engaged in fraud in the inducement such that the United States was damaged in the entire amount of the contract funds awarded and paid to the Defendants.

251. Damages to the United States include, but are not limited to, three times the full value of all such fraudulent claims.

252. Each such fraudulent claim is also subject to a civil fine under the False Claims Act of five thousand five hundred to eleven thousand dollars ($5,500 – $11,000).

253. Defendants are jointly and severally liable for all damages.

254. Because of Defendants' violations of 31 U.S.C. § 3729, *et seq.,* the United States has suffered damages in an amount to be determined at trial.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff-Relator, on behalf of himself and the United States, requests:

a. That the Court enter judgment against Defendants in an amount equal to three times the amount of damages the United States has sustained because of Defendants' actions, including but not limited to the full value of all economic benefits obtained by Defendants through their illegal conduct, plus a civil penalty of between \$5,500 and \$11,000, as adjusted by the Federal Civil Penalties Inflation Adjustment Act of 1990, for each violation of 31 U.S.C. § 3729;

b. That Plaintiff-Relator be awarded an amount that the Court decides is reasonable for collecting the civil penalty and damages, which shall be at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim if the United States intervenes, and not less than 25 percent nor more than 30 percent of the proceeds of the action or settlement of the claim if the United States does not intervene;

c. That Plaintiff-Relator be awarded all costs and expenses incurred, including reasonable attorneys' fees, with interest, including expert witness fees;

d. That Plaintiff-Relator and the United States be awarded pre-judgment interest on all monies awarded;

e. That Plaintiff-Relator be awarded an amount that the Court decides is reasonable, which shall be not less than 15% nor more than 30% of the proceeds awarded to the United States from any alternate remedies under the False Claims Act, 31 U.S.C. §§ 3729(a)(1), 3730(c)(5), (d), including but not limited to proceeds from any related administrative, criminal, or civil actions, and the monetary value of any equitable relief, fines, restitution, or disgorgement to the United States and/or third parties;

f. That Plaintiff-Relator be granted all other relief provided for in the False Claims Act not specifically referenced above; and

g. That all appropriate equitable be awarded.

JURY TRIAL DEMANDED

Pursuant to Rule 38 of the Federal Rules of Civil Procedure, Plaintiff-Relator hereby demands a jury trial.

Respectfully submitted,

/s/ Michael D. Kohn
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Attorneys for Plaintiff-Relator

January 30, 2017

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *ex. rel.* ANDREW SCOLLICK Plaintiff-Relator, v. VIJAY NARULA, *et al.* Defendants.	Civil Action No. 1:14-cv-01339 Assigned to: The Honorable Royce C. Lamberth **HEARING REQUESTED**

DEFENDANT THE HANOVER INSURANCE COMPANY'S
MOTION TO DISMISS AMENDED COMPLAINT

Defendant The Hanover Insurance Company ("Hanover"), by counsel, and pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b), files this motion to dismiss the in the Amended Complaint against Hanover. As set forth more fully in Hanover's Memorandum in Support of its Motion to Dismiss, the Amended Complaint against Hanover must be dismissed for failure to state a claim and for failure to plead with sufficient particularity.

Defendant Hanover respectfully requests that this Court dismiss Plaintiff's Amended Complaint against Hanover with prejudice, and grant Hanover its costs, attorneys' fees, and such other relief as this Court deems just and proper.

Dated: October 6, 2017.

Respectfully Submitted,

/s/

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Counsel for Defendant The Hanover Insurance Company

CERTIFICATE OF SERVICE

I Hereby Certify that on October 6, 2017, a copy of the foregoing Motion to Dismiss Amended Complaint was served by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt.

Counsel for Defendant The Hanover Insurance Company

/s/
Mitchell A. Bashur

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *ex. rel.* ANDREW SCOLLICK Plaintiff-Relator, v. VIJAY NARULA, *et al.* Defendants.	Civil Action No. 1:14-cv-01339 Assigned to: The Honorable Royce C. Lamberth **HEARING REQUESTED**

MEMORANDUM IN SUPPORT OF
DEFENDANT THE HANOVER INSURANCE COMPANY'S
MOTION TO DISMISS AMENDED COMPLAINT

Defendant The Hanover Insurance Company ("Hanover"), by counsel, and pursuant to Federal Rules of Civil Procedure 12(b)(6) and 9(b), respectfully submits this Memorandum in Support of its Motion to Dismiss Amended Complaint against Hanover.

INTRODUCTION

Plaintiff, a *qui tam* relator, brings this action against Hanover asserting violations of the False Claims Act ("FCA"). Though lacking the specificity required for the assertion of claims involving fraud, Plaintiff's Amended Complaint alleges essentially that Hanover was among a group of defendants that knew or should have known that other defendants were fraudulently claiming service-disabled veteran-owned small business (SDVOSB) status to bid on and obtain set-aside contracts from the Veterans Administration. The Amended Complaint further alleges that, despite this knowledge, Hanover continued to do business with those involved in the fraudulent scheme by issuing construction bonds in furtherance of the fraud alleged.

At the heart of Plaintiff's theory that Hanover knew or should have known about the scheme to defraud the government are allegations regarding an on-site tour of the offices of a contractor involved in the fraud – a tour Hanover is *not* alleged to have attended. Instead, the Amended Complaint alleges that Hanover's broker (and other unnamed individuals) toured the offices and seeks to impute knowledge gained from the tour to Hanover by describing the broker as Hanover's "lawful agent and attorney-in-fact." A broker, however, is just a broker and, as a matter of law, any knowledge held by Hanover's broker, no matter the substance, cannot be imputed to Hanover. Without the imputed knowledge of the office tour, what remains in the Amended Complaint are threadbare allegations regarding Hanover's knowledge and bald conclusions regarding what Hanover "necessarily understood" and "reasonably should have concluded" as a result of its underwriting process. At bottom, the Amended Complaint fails sufficiently to plead that Hanover knew that any claim or statement submitted to the government was false, and all of Plaintiff's claims asserting violations of the FCA must be dismissed.

The FCA claims set forth in the Amended Complaint are susceptible to dismissal for other reasons as well. The allegations in the Amended Complaint fail to meet the standards for pleading fraud because they lack sufficient particularity with regard to when Hanover submitted bonds (the act Hanover allegedly took in furtherance of the scheme to defraud the government) and when Hanover had knowledge of the fraud. As a result, no reasonable inference can be drawn that Hanover acted knowingly – a material requirement for pleading FCA claims. The Amended Complaint also fails sufficiently to plead (with regard to the reverse false claim in particular) that Hanover had an established duty to pay the government, and also fails sufficiently to plead that the misrepresentations at the heart of the fraudulent scheme it alleges were material to the government's decision to make payments. This latter pleading failure necessitates dismissal of the entire Amended Complaint against Hanover.

Mindful that the Court's review of the futility arguments raised by the Defendants in opposition to Plaintiffs' Motion for Leave to File an Amend Complaint tracked the review of a Rule 12(b)(6) dismissal, this Motion places before the Court grounds for dismissal that were either not presented in Hanover's Opposition to Plaintiff's Motion for Leave to Amend or on which the Court offered no opinion its July 31, 2017 Memorandum Opinion.

I. FACTUAL BACKGROUND

A. Procedural History

On October 29, 2015, Hanover filed a Motion to Dismiss Plaintiff's Complaint. [ECF No. 85]. Following briefing by the parties on the sufficiency of the allegations in Plaintiff's Complaint, the Court granted Hanover's Motion to Dismiss on October 17, 2016. [ECF No. 123] ("October 17, 2016 Opinion"). On January 30, 2017, Plaintiff submitted a Motion for Leave to File an Amended Complaint seeking to reinstate Hanover as a defendant. [ECF No. 131]. Hanover opposed the motion, arguing that the proposed Amended Complaint failed to cure the deficiencies previously identified in Plaintiff's pleading. [ECF No. 146]. Following briefing by the parties, the Court granted Plaintiff's Motion for Leave to File an Amended Complaint on July 31, 2017. [ECF Nos. 160 & 161].

In its July 31, 2017 Memorandum Opinion, and in connection with Plaintiff's indirect presentment claim, the Court found that Plaintiff's proposed Amended Complaint sufficiently alleges that Hanover "should have known that CSG and Citibuilders were violating the government's contracting requirements by alleging that the insurance defendants engaged in an underwriting process during which they conducted an on-site inspection of OST's offices." Mem. Op. at 26-27. In so finding, the Court clearly linked the sufficiency of Plaintiff's allegations regarding Hanover's and the other insurance defendants' knowledge of CSG's and Citibuilder's violations to the onsite inspection of OST's offices. The Court went on to summarize the allegations in the Amended Complaint that it found sufficient to allege knowledge of the fraud, noting that Hanover's and other defendants' understanding of the fraud existed "[a]fter this tour." *Id.* at 27.

The Court also found in its July 31, 2017 Memorandum Opinion that the Amended Complaint sufficiently alleges a reverse false claim cause of action against Hanover and the other surety defendant, Hudson, because it alleges that the surety bonds were separate agreements with the government that created an obligation on the part of the surety to pay the government. *Id.* at 29-30. The Court found that the reverse false claim cause of action was not sufficiently pled, however, as to defendants Centennial Surety Associate, Inc. ("Centennial") and Michael E. Schendel ("Schendel") on the basis that they "were simply brokers." *Id.* at 32.

B. <u>The Allegations Set Forth in Plaintiff's Amended Complaint</u>

1. The Core Defendants

The Amended Complaint alleges that defendants Neil Parekh, Ajay K. Madan, Vijay Narula, and Amar Gogia (collectively the "Core Defendants") conspired to use defendant CSG to obtain SDVOSB set-aside contracts through the submission of false certifications.[1] Am. Compl. ¶ 36.

With regard to certifications, the Amended Complaint alleges that a prospective SDVOSB contractor "must complete an application package consisting of representations, certifications, and personal documents as required by the Department of Veterans Affairs ("VA")." Am. Compl. ¶ 28. "The VA reviews the application and determine[s] whether the

[1] The Amended Complaint also alleges a conspiracy related to KCGI, but alleges that Merchants Bonding Company, not Hanover, provided the bonds for KCGI. Am. Compl. ¶¶ 202, 207. Plaintiff has not brought any action against Merchants Bonding Company. There is also an allegation of a conspiracy related to Citibuilders, but the Amended Complaint fails to plead with particularity any Citibuilders contract award that Hanover bonded. The reason for this failure is simple – Hanover never bonded Citibuilders. As noted in Hudson's Answer, after Hanover stopped bonding CSG, the Core Defendants engaged Hudson in the first half of 2011 because they needed to find a new surety to issue bonds. ECF No. 187, Cross-Claims ¶ 16.

prospective contractor qualifies for SDVOSBC status." *Id.* Only "[a]fter the VA determines that a contractor meets SDVOSBC qualifications," is the contractor required to register as a SDVOSB company. Am. Compl. ¶ 29. "Thereafter, the participant must submit a new application each year certifying its accuracy to remain eligible." *Id.*

2. Defendants Hanover, Hudson, Centennial and Schendel

Plaintiff alleges that defendant Hanover is located at 440 Lincoln Street, Worcester, MA 01653. Am. Compl. ¶ 22. Plaintiff alleges that defendant Hudson, a separate corporate entity, is located at 17 State Street, 29th Floor, New York, NY 10004. Am. Compl.¶ 21. The Amended Complaint fails to allege that these two, separate entities ever worked in concert or that any of the bonds issued on CSG or Citibuilders SDVOSB construction contracts were issued by Hanover and Hudson as co-sureties.[2] Neither is there any allegation in the Amended Complaint that Hanover knew about, or was even aware of, bonds that were issued by defendant Hudson. Despite this, Hanover is generally lumped into a group of defendants identified as "the Bonding Defendants," which group includes Hanover and Hudson, and insurance brokers Centennial and Schendel. Am. Compl. ¶ 164. Almost without exception, the allegations in the Amended Complaint that address Hanover's participation in the scheme to obtain set-aside government contracts through fraudulent means address the "Bonding Defendants" and fail to identify

[2] Given the Amended Complaint does not allege that Hanover and Hudson ever issued bonds as co-sureties, the only reasonable inference that can be drawn is that each of the bonds identified in the Amended Complaint was written by either Hanover or Hudson, to the exclusion of the other. Thus, the allegation in ¶190 of the Amended Complaint that "[t]he Bonding Defendants reviewed every SDVOSB contracting action pursued in the name of CSG and issued bonding against all of them" must reasonably be read to allege that the Bonding Defendants, including either Hanover or Hudson, but not both, reviewed every SDVOSB contracting action pursued in the name of CSG and either Hanover or Hudson, but not both, issued bonding against each one of them. The Amended Complaint fails to allege with particularity which bonds were issued by Hanover and which were issued by Hudson and, as such, clearly fails to meet the requirement under FRCP 9(b) that "[A]n FCA plaintiff must identify the 'who, what, when, where, and how of the alleged fraud.'" *United States v. Kellogg Brown & Root Servs., Inc.* 800 F.Supp.2d 143, 153 (D.D.C. 2011).

specifically what knowledge was possessed by and what actions were taken by Hanover, as opposed to the other grouped defendants.

With regard to the non-surety defendants lumped into the "Bonding Defendants" – Centennial and Schendel – the Amended Complaint alleges that Centennial is an insurance broker and the agent and attorneys-in-fact for both Hudson and Hanover.[3] Am. Compl. ¶ 19. The Amended Complaint alleges that Schendel is the president of Centennial.

With regard to Hanover's participation in the scheme to obtain set-aside government contracts through fraudulent means, and specifically Hanover's knowledge that the proposals submitted to the government in the name of CSG misled the government, the allegations in the Amended Complaint focus exclusively on Hanover's underwriting process and a tour of defendant Optimal Solutions Technologies, Inc.'s ("OST's") offices in NW, Washington, D.C., which Plaintiff alleges were "part of the underwriting process." Am. Compl. ¶ 176. The Amended Complaint does not allege, however, that Hanover or any individual whose knowledge could be attributed to Hanover actually took part in or even attended the tour of OST's offices. Instead, the Amended Complaint alleges that "Schendel and other agents of the Bonding Defendants toured OST's offices . . . for the purposes of ascertaining the organizational structure, history, and financial capacity of CSG." Am. Compl. ¶ 176. The Amended Complaint also alleges that "Schendel had an existing business relationship with Parekh and, upon information and belief, already had a deep understanding of the assets and capabilities CB possessed." *Id.*

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[3] Pursuant to the government regulations applicable to the Miller Act bonds and government contracts identified in the Amended Complaint, the term "attorney-in-fact" can refer to either an agent or an independent agent. *See* FAR 28.001 ("Attorney-in-fact means an agent, independent agent, underwriter, or any other company or individual holding a power of attorney granted by the surety."). Given the Amended Complaint: i) identifies Centennial as "an insurance broker;" and ii) alleges that Centennial is the agent of two, separate entities (Hanover and Hudson), no reasonable inference can be drawn other than that Centennial is an independent agent. This is consistent with the Court's determination, reflected in its July 31, 2017 Memorandum Opinion, that "Centennial and Schendel were simply brokers." Mem. Op. at 32.

Though none mentions Hanover by name or describes any knowledge held uniquely by Hanover, Paragraphs 177-183, 191 and 194 of the Amended Complaint set forth the entirety of Plaintiff's allegations regarding Hanover's knowledge that CSG was violating the government's contracting requirements. Each of these paragraphs identifies generally some fact that Hanover would have "necessarily understood" (Am. Compl. ¶¶ 177, 191) or which would have been "reasonably revealed" to Hanover (Am. Compl. ¶¶ 178, 194), or sets forth a conclusion to which Hanover was "reasonably led." Am. Compl. ¶¶ 179 -183. All of this knowledge, however, is attributed to Hanover "because of the on-site tour of OST's offices," Am. Compl. ¶177 or as a result of the underwriting process – which Plaintiff alleges included the tour of OST's offices. (Am. Compl. ¶176). In short, without reference to the tour of OST's offices, the Amended Complaint fails to allege that Hanover had any knowledge, let alone any specific knowledge, that CSG was violating the government's contracting requirements.[4]

Though all of the allegations regarding Hanover's knowledge of the alleged fraud tie back to the tour of OST's offices, the Amended Complaint fails to allege when that tour took place.

3. The Bonds

At the heart of the allegations in the Amended Complaint, as they relate to Hanover, is the allegation that Hanover continued to issue bonds after it knew or should have known that CSG was fraudulently violating the government's contracting requirements. The Amended Complaint, however, fails to plead with the required particularity which bond or bonds were issued by Hanover or when Hanover acquired knowledge that CSG was violating the

[4] Consistent with this, the Court's July 31, 2017 Memorandum Opinion found that the Amended Complaint met the pleading requirements with regard to what Hanover and the other Bonding Defendants knew or should have known "by alleging that the insurance defendants engaged in an underwriting process *during which they conducted an on-site inspection of OST's offices*," Mem. Op. at 26-27 (italics added), and noting that all of the allegations in the Amended Complaint impute knowledge to Hanover and the other Bonding Defendants *"[a]fter this tour."* Mem. Op. at 27 (italics added).

government's contracting requirements. Instead, the Amended Complaint (without mentioning Hanover by name) vaguely alleges that "[e]ach and every time a bond was issued against a contract executed in the name of CSG the Bonding Defendants reasonably understood that CSG was nothing more than a shell company . . . . In sum and substance, the Bonding Defendants would have known that the proposals submitted in the name of CSG in furtherance of the CSG conspiracy knowingly misled the government as to the true ownership and control over CSG and that CSG did not qualify for SDVOSB status." Am. Compl. ¶ 191.

4. The Government's Response to Plaintiff's Allegations

Plaintiff's sealed Complaint was filed in this action on August 6, 2014 [ECF No. 1]. The Department of Justice declined to intervene in the relator's Complaint on February 9, 2015 [ECF No. 6]. Five months later, on July 9, 2015 the case was unsealed, and Plaintiff's allegations and the details of the alleged fraud were made public. [ECF No. 8].

The Amended Complaint alleges that CSG was required to submit a new application for SDVOSB status each year, certifying its accuracy to remain eligible. Am. Compl. ¶ 29. On July 24, 2015, fifteen days after the case was unsealed and Plaintiff's allegations were made public the Veterans Administration ("VA") reviewed CSG's new application and recertified CSG as an SDVOSB.[5] This recertification is active through July 24, 2018.

The Amended Complaint alleges that, despite the public nature of the allegations in the Complaint, "CSG continued to seek and obtain SDVOSBC contract funds through at least 2016." Am. Compl. ¶ 87. Thus, the government continued to pay CSG for at least a year and a half after the allegations of CSG's fraudulent scheme were known to the government and the public.

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[5] *See* https://www.vip.vetbiz.gov/Public/Business/View*Business.aspx?Duns=833261162*.

II. ARGUMENT

Plaintiff's Amended Complaint is susceptible to dismissal under both Fed.R.Civ.P. 12(b)(6) for failure to state a claim upon which relief can be granted and Fed.R.Civ.P. 9(b) for failure to plead the fraud aspects of the claims with sufficient particularity. First, the Amended Complaint fails adequately to allege Hanover's knowledge of the CSG's fraud and violation of government regulations. As alleged in the Amended Complaint, Hanover's knowledge is premised entirely upon a site tour of defendant OST's offices; however, Hanover is not alleged to have attended or been part of that tour. Neither is Plaintiff entitled to an inference that Centennial's and Schendel's knowledge should somehow be imputed to Hanover. It is a fundamental principle of suretyship that the knowledge of an insurance broker cannot be imputed to a surety. When the insufficient allegations regarding knowledge gained from the on-site tour of OST's offices are stripped away, the only allegations remaining with regard to Hanover's knowledge of CSG's violation of government regulations are bald, conclusory allegations regarding Hanover's underwriting program. The Amended Complaint's allegations that Hanover "reasonably should have known" about CSG's fraud because of its underwriting process, without any particularity, are insufficient to meet the FCA's heightened pleading requirements, requiring dismissal of Plaintiff's FCA claims.

Second, the Amended Complaint fails to allege the date or dates on which Hanover obtained its knowledge of CSG's violations of government regulations and fraud. Without such an allegation or any allegation identifying which contracts Hanover allegedly bonded, the Amended Complaint fails sufficiently to plead a critical element of the FCA claims as it relates to Hanover's knowledge – that the knowledge was held at the time the false claim or statement was submitted. This pleading failure also requires dismissal of Plaintiff's FCA claims.

Third, with regard to Plaintiff's reverse false claim cause of action, the Amended Complaint fails to allege that Hanover had an established duty or obligation to pay the government. Instead, Plaintiff alleges that the bonding agreements (*i.e.*, the unspecified bonds Hanover allegedly issued) separately obligate Hanover to compensate the government for losses sustained. The Amended Complaint reflects a misunderstanding of suretyship, which requires that a bond obligee declare a default and make a demand upon the surety before *any* obligation on the part of the surety arises. As the Amended Complaint fails to allege a set of facts that could give rise to a duty on Hanover's part to pay the government, Plaintiff's reverse false claim count must be dismissed.

Fourth, the Amended Complaint fails sufficiently to allege the materiality of CSG's alleged fraud – a required element of any FCA claim. As reflected on the face of the Amended Complaint, after the original Complaint was unsealed and after all the allegations in it were known to the government and made public, the government continued to award contracts to CSG and proceeded with performance on the existing contracts, including making payments to CSG. Moreover, since Plaintiff's allegations were made public, the VA has recertified CSG's SDVOSB status, and the government, acting through the Department of Justice, declined to intervene in Plaintiff's complaint. The government's actual reaction to Plaintiff's allegations demonstrates that the "falsities" upon which the Amended Complaint rests were not material to the government's decision to make payments to CSG. On that separate basis, the FCA claims set forth in the Amended Complaint must be dismissed.

Finally, the Amended Complaint fails sufficiently to plead Hanover's participation in a conspiracy, as the Amended Complaint otherwise fails to allege that Hanover knew of or participated in the alleged fraud. This mandates dismissal of Plaintiff's conspiracy claim against Hanover.

A. Legal Standard

"To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face." *Harris v. D.C. Water & Sewer Auth.*, 791 F.3d 65, 68 (D.C. Cir. 2015) (internal quotation marks and citation omitted). "'A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *Id.* (citation omitted). "But 'the tenet that a court must accept as true all of the allegations contained in a complaint is inapplicable to legal conclusions.'" *Id.* (citation omitted). "Accordingly, '[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements, do not suffice.'" *Id.* (citation omitted).

"A False Claims Act violation includes four elements: falsity, causation, knowledge, and materiality." *United States ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481, 487 (3d Cir. 2017). "Every circuit to consider the issue has held that, because the False Claims Act is self-evidently an anti-fraud statute, complaints brought under it must comply with Rule 9(b)." *United States ex rel. Totten v. Bombardier Corp.*, 286 F.3d 542, 551-52 (D.C. Cir. 2002). "Rule 9(b)'s particularity requirement serves several purposes. It 'discourage[s] the initiation of suits brought solely for their nuisance value, and safeguards potential defendants from frivolous accusations of moral turpitude. . . . And because 'fraud' encompasses a wide variety of activities, the requirements of Rule 9(b) guarantee all defendants sufficient information to allow for preparation of a response." *United States ex rel. Williams v. Martin-Baker Aircraft Co.*, 389 F.3d 1251, 1256 (D.C. Cir. 2004) (citation omitted). "Accordingly, to survive a motion to dismiss [under Rule 9(b)], a complaint pleading fraud must 'state the time, place and content of the false misrepresentations, the fact misrepresented and what was retained or given up as a consequence of the fraud . . . [and must] identify individuals allegedly involved in the fraud." *See United States ex rel. Folliard v. Hewlett-Packard Co.*, 272 F.R.D. 31, 33 (D.D.C. 2011).

B. The Amended Complaint Fails Sufficiently to Plead that Hanover Had Knowledge of the Alleged Fraud

The Amended Complaint fails sufficiently to plead Hanover's knowledge of CSG's scheme to defraud the government because it: i) fails to allege that Hanover had any actual knowledge of the fraud, but instead seeks to impute a broker's knowledge of an on-site tour of OST's offices to Hanover; and ii) fails to allege with particularity when Hanover issued any bond and when Hanover had knowledge of the fraud. As such, it would be pure speculation to assume that Hanover acted *knowingly*.

1. The Amended Complaint Wrongly Seeks to Impute Centennial's and Schendel's Alleged Knowledge of Fraud to Hanover

The scienter element of FCA claims requires "that a defendant present a false claim knowingly, which entails having actual knowledge of the information[,] acting in deliberate ignorance of the truth or falsity of the information[,] or acting in reckless disregard of the truth or falsity of the information." *United States v. DRC, Inc.*, 856 F. Supp. 2d 159, 168 (D.D.C. 2012); *see also United States ex rel. K&R Ltd. P'Ship v. Massachusetts Hous. Fin. Agency,* 530 F.3d 980, 983 (D.C. Cir. 2008). Thus, to allege either a presentment claim or a false statement claim, a plaintiff must plead factual content that would allow the court to draw a reasonable inference that the defendant made the false claim or statement *knowingly.*

Plaintiff attempts to satisfy the scienter pleading requirement by alleging in the Amended Complaint that: i) defendants Centennial and Schendel were "the lawful agents and the attorney-in-fact" for Hanover, such that their knowledge of CSG's fraud gleaned from an on-site tour of OST's offices is somehow imputed to Hanover; and ii) Hanover's underwriting process, which included the tour of OST's offices, should have reasonably lead Hanover to understand and appreciate CSG's fraud. Am. Compl. ¶¶ 19-20, 174-83. The Amended Complaint alleges that "because of the on-site tour of OST's offices," the Bonding Defendants, including Hanover, should have known that CSG was a shell company that failed the ownership and control prongs of the VA's SDVOSB regulations. Am. Compl. ¶¶ 176-192. The Amended Complaint is a bridge too far, and relies on an inference of imputed knowledge that is neither reasonable nor consistent with the remaining allegations in the Amended Complaint.

Plaintiff's pled theory of Hanover's knowledge rests on a fundamental misapplication of "agency" principles not applicable to the facts as alleged. An insurance broker is not an "agent" whose knowledge is legally imputed to the insurance company or whose actions can be attributed to the insurance company's "underwriting process." Instead, an insurance broker (such as Centennial or Schendel) is an independent entity whose fiduciary duties run to its principal – the contractor bidding on the contract. *See Chao v. Day*, 436 F.3d 234 (D.C. Cir. 2006) ("Under the common law, insurance brokers . . . are the agents of the insureds . . . not the companies."); *Travelers Indem. Co. v. Bookers*, 657 F. Supp. 280, 286 (D.D.C. 1987) (holding that where brokers "are employed to procure insurance, they are the agents of the insured"); *Sylvan Learning Sys., Inc. v. Gordon,* 135 F. Supp. 2d 529, 540 (D.N.J. 2000) ("As a general rule, a broker acts as the agent of the insured, not as the agent of the insurer.").

As insurance brokers, Centennial's and Schendel's knowledge (including knowledge of the tour of OST's offices) *cannot* be imputed to Hanover because their agency relationship was with CSG. *See Economy Fire & Cas. Co. v. Bassett*, 525 N.E.2d 539, 54 (Ill. App. Ct. 1988) ("[The insurance brokers] were 'insurance brokers' not 'insurance agents,' and their agency relationship was with the [insured], not [insurer]. Because the [insurance brokers] were not agents for [insurer], nothing that they knew or should have known and no negligent act on their part can be imputed to [insurer]."); *Essex Ins. Co. v. Zota*, 985 So.2d 1036, 1046 (Fla. 2008) ("The distinction between an agent and a broker is important because acts of an agent are imputable to the insurer, and *acts of a broker are imputable to the insured*." (emphasis in original) (quoting 3 Lee R. Russ & Thomas F. Segalla, *Couch on Insurance* § 45:1 (3d ed.2007))). Once Centennial's and Schendel's imputed knowledge regarding Schendel's tour of OST's offices and Schendel's "deep understanding" of CB's assets and capabilities is untangled and discarded, the only remaining allegations in the Amended Complaint relating to Hanover's knowledge of any fraud are grounded solely on the alleged fact that Hanover had an underwriting process.

The Court should not allow Plaintiff's FCA claims against Hanover to move past the pleading stage based solely on the allegations in the Amended Complaint that: i) Hanover issued unspecified bond(s) on unspecified date(s) in connection with unspecified CSG contracts; and ii) Hanover had an underwriting process through which it "necessarily understood," was "reasonably led to believe" or "reasonably should have concluded" that CSG was violating government contracting regulations. No reasonable inference can be drawn by the Court that the mere existence of an underwriting process (without allegations in the Amended Complaint describing how any specific facts were learned through that underwriting process), gave Hanover knowledge of CSG's fraud.[6] Were the Court to draw such an inference, it would put in jeopardy

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[6] The absurdity of such an inference is highlighted by Plaintiff's attempt to plead the Bonding Defendants' knowledge of Citibuilders' fraud. The Amended Complaint does not allege that anyone toured Citibuilders' offices or that any underwriting process included a tour of Citibuilders' offices, yet the Amended Complaint alleges that "[t]he underwriting and due diligence by the Bonding Defendants to provide bonding to Citibuilders would have revealed that Goodweather was not in control of that entity and that Citibuilders constitutes a separate shell company Parekh established for the purpose of obtaining SDVOSB contracts. Am. Compl. ¶ 194. Clearly, standing alone as it does, this conclusory allegation is insufficient to establish that Hanover knew or should have known that Citibuilders was violating the government's contracting requirements. Stripped of the knowledge held by others (but not Hanover) regarding the tour of OST's offices, the Amended Complaint's allegations regarding Hanover's

every surety that underwrites construction bonds for small, disadvantaged or set-aside contractors.

Such an inference would also be in conflict with Hanover's established right to rely in its underwriting process on the VA's certification of CSG as an SDVOSB contractor. *See Burlington Ins. Co. v. Okie Dokie, Inc.*, 368 F. Supp. 2d 83 (D.D.C. 2005) ("Courts generally recognize an insurer's right to rely on statements made in an insurance application—the insurer need not conduct an independent investigation unless it has reason to doubt the statements."). Other than the tour of OST's offices "for the purpose of ascertaining the organizational structure, history, and financial capacity of CSG" and Schendel's "deep understanding" of CB's assets and capabilities (Am. Compl. ¶ 176), knowledge of which cannot imputed to Hanover, the Amended Complaint sets forth no allegations (other than bald conclusions) that would cause Hanover to independently investigate CSG's SDVOSB status in light of the VA's certification of CSG as an SDVOSB contractor.

Plaintiff's failure sufficiently to plead Hanover's knowledge of CSG's fraud warrants dismissal of Plaintiff's FCA claims pursuant to Fed. R. Civ. P. 12(b)(6).

2. The Amended Complaint Fails Sufficiently to Allege that Hanover's Knowledge was Obtained Before Its False Claims or Statements Were Submitted

The knowledge element of FCA claims has a chronological component. A plaintiff is required to allege that the defendant in an FCA case gained its knowledge of fraud *before* the presentment of a false claim or false statement. *See United States ex rel. Wilkins v. United Health Grp., Inc.*, 659 F.3d 295, 313 (3d Cir. 2011) ("[A]ppellants were required to allege, as they did, that appellees *submitted claims for payment to the Government at a time that they*

knowledge of CSG's fraud fare no better, and fail to raise Plaintiff's right to relief "above the speculative level." *See Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007).

knowingly violated a law, rule, or regulation which was a condition for receiving payment from the Government." (emphasis added)); *United States ex rel. Hefner v. Hackensack Univ. Med. Ctr.*, 495 F.3d 103, 109 (3d Cir. 2007) (holding that a FCA claim failed the scienter element because an employee's "after-the-fact interpretation of the situation [that double billing both Medicare and a federal grant may be fraud] does not establish that the individuals submitting the claims knew that they were submitting false claims"). Plaintiff's Amended Complaint skirts this pleading requirement by alleging, devoid of any specificity, that "[e]ach and every time a bond was issued against a contract executed in the name of CSG the Bonding Defendants reasonably understood that CSG was nothing more than a shell . . . ." Am. Compl. ¶ 191.

As this Court has previously explained, "Federal Rule of Civil Procedure 9(b) applies to FCA actions. Mem. Op. at 6. As such, the time, place and contents of the false representations must be pleaded with specificity, as these are the elements of fraud about which the rule is chiefly concerned. *Id.* (quoting *United States ex rel. Totten v. Bombardier Corp.*, 286 F.3d 542, 544 (D.C. Cir. 2002) (internal quotations omitted). It is not sufficient that Plaintiff pleads with particularity the circumstances surrounding the Core Defendants' fraud. Plaintiff must plead, with particularity, the circumstances surrounding Hanover's fraud. The Amended Complaint fails sufficiently to plead Hanover's involvement in the alleged fraud in two significant ways: i) it lumps the alleged fraudulent actions of Hanover and Hudson together and fails to allege that any particular bond was issued by Hanover on a particular date; and ii) it fails to allege when in time Hanover knew or should have known about CSG's violation of government contracting regulations, including failing to identify when the alleged on-site tour of OST's offices by Schendel occurred. Without these two critical allegations, it is impossible for the Court reasonably to infer that Hanover knew or should have known about CSG's fraud at the time it actually wrote a bond for a CSG contract, *i.e.* that Hanover acted *knowingly*.[7] Put differently, the Amended Complaint fails to allege facts that would allow the inference that Hanover, separate from the other Bonding Defendants, agreed to bonding in furtherance of *a known* fraud.

This pleading failure warrants the dismissal of all the FCA claims asserted by Plaintiff against Hanover pursuant to Fed. R. Civ. P. 12(b)(6) and Fed. R. Civ. P 9(b).

C. The Amended Complaint Fails to Allege that Hanover Actually Owed A Payment to the Government Sufficient to Sustain a Reverse False Claim

The Amended Complaint fails on its face to assert a plausible reverse false claim cause of action against Hanover. A reverse false claim requires that the defendant take some false action to avoid or decrease an obligation to pay to the Government. *See* 31 U.S.C. § 3729(a)(1)(G). As a result, "[a] prerequisite for liability under [a reverse false claim] theory is a legal obligation" to pay or credit the Government. *United States ex rel. Quinn v. Omnicare Inc.*, 382 F.3d 432, 444 (3d Cir. 2004). Under the FCA, the term "obligation" is defined as "*an established duty*, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, or from the retention of any overpayment." 31 U.S.C. § 3729(b)(3) (emphasis added).

In 2009, Congress amended the FCA through the Fraud Enforcement and Recovery Act ("FERA"), including adding the definition of the term "obligation. FERA, Pub. L. 111-21, § 4(f), 123 Stat. 1617, 1625 (2009). In debating FERA, Congress initially proposed defining

[7] In its July 31, 2017 Memorandum Opinion, the Court noted that Plaintiff's Amended Complaint sufficiently alleges that the Bonding Defendants knew or should have known that CSG and Citibuilders were violating government regulations "by alleging that the insurance defendants engaged in an underwriting process during which they conducted an on-site inspection of OST's offices." Mem. Op. at 26-27. The Court went on to note that it was only "[a]fter this tour" that the Bonding Defendants knew or should have known about the fraud. *Id.* at 27. The Court's analysis did not address whether the allegations in the Amended Complaint are sufficient to plead that Hanover individually had knowledge of any fraud in light of the facts that: i) the Amended Complaint fails to plead the date on which the on-site inspection of OST's offices took place; ii) the only reasonable inference that can be drawn from the allegations in the Amended Complaint is that each of the bonds identified was issued by either Hanover or Hudson, but never by both; and iii) the Amended Complaint fails to plead with specificity which bonds were issued by Hanover and which were issued by Hudson and when any bond issued by Hanover was issued.

"obligation" to include "contingent" obligations, but struck "contingent" duties from the definition included in FERA to avoid the exact situation presented here—private litigants seeking remedies that the Government could not pursue. As articulated by Senator Kyl in the legislative history for FERA:

> The bill's new definition of the word "obligation," in particular, posed several problems. The original language spoke of "contingent" obligations. Such contingent or potential duties could include duties to pay penalties or fines, which could arise--and at least become "contingent" obligations--as soon as the conduct that is the basis for the fine has occurred.
>
> Obviously, we don't want the Government or anyone else suing under the False Claims Act to treble and enforce a fine before the duty to pay that fine has been formally established. It is unlikely that Justice would ever have brought suit to enforce a claim of this nature, but the FCA can also be enforced by private realtors [sic] who often may be motivated by personal gain and not always exercise the same good judgment that the Government usually does.
>
> To preclude such a reading of the act, my amendment strikes contingent obligations from the FCA's new definition of "obligation."

155 Cong. Rec. S. 4539 (daily ed. Apr. 22, 2009) (statement of Sen. Jon Kyl).[8] Reflecting Congress's agreement with this analysis, the final version of the amendment excluded "contingent obligations" from the definition of obligations. *See* 31 U.S.C. § 3729(b)(3). Thus, to sufficiently allege a reverse false claim against Hanover, the Amended Complaint must allege that Hanover had an established, non-contingent obligation to pay the government. The Amended Complaint fails to do so.

As the Court noted in its July 31, 2017 Memorandum Opinion, the allegation in the Amended Complaint upon which Plaintiff relies for its reverse false claim is Paragraph 236, which alleges that "[t]he bonding agreements were separate instruments entered between the

[8] Available at https://www.congress.gov/congressional-record/2009/04/22/senate-section/article/S4531-1.

United States Government and although submitted with the contract, did separately obligate the Bonding Defendants to compensate the government for losses sustained … ." Mem. Op. at 30. The Court did not address, however, whether these allegations sufficiently allege an established, non-contingent obligation. They do not. In that regard, it is widely acknowledged that a surety's obligations under a performance bond are inchoate (contingent) and do not require or obligate the surety to make any payment unless and until its principal is defaulted by the bond obligee (here the government) and a demand is made for the surety's performance. *See Hunt Const. Grp., Inc. v. Nat'l Wrecking Corp.*, 587 F.3d 1119, 1121 (D.C. Cir. 2009) (requiring default of the principal to trigger the surety's performance bond liability). Thus, Hanover had no obligation whatsoever to make a payment to the government unless the government declared CSG to be in default and the government made a demand on Hanover for performance.

On its face, the Amended Complaint fails to allege a set of facts that would give rise to Hanover's otherwise contingent obligations to the government. The Amended Complaint fails to allege that the government ever declared CSG to be in default under any contract bonded by Hanover or that the government ever made a demand on Hanover for payment. As a result, the Amended Complaint fails to allege that Hanover took some action to avoid an "established duty" to pay the Government "when payment is otherwise due." As such, the allegations in the Amended Complaint are insufficient, and Plaintiff's reverse false claim count must be dismissed as against Hanover pursuant to Fed. R. Civ. P. 12(b)(6).

D. The Amended Complaint Fails Sufficiently to Plead that the Alleged Misrepresentations Were Material to the Government's Payment Decisions

1. The Materiality Standard Required for FCA Claims

"When a defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant's representations misleading with respect to the goods or services provided." *United States ex rel. McBride v. Halliburton Co.*, 848 F.3d 1027, 1031 (D.C. Cir. 2017) (quoting *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016)) (internal alterations omitted). "The [Supreme] Court [of the United States] made clear that courts should continue to police expansive implied certification theories 'through strict enforcement of the Act's materiality and scienter requirements.'" *Id.* (citing *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016)) (internal alterations omitted).

"In particular, 'a misrepresentation about compliance with a statutory, regulatory, or contractual requirement must be material to the Government's payment decision in order to be actionable under the False Claims Act.'" *Id.* (quoting *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016)) (internal alterations omitted). "[C]ourts need not opine in the abstract when the record offers insight into the Government's actual payment decisions." *Id.* at 1032 (quoting *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016) ("Under any understanding of the concept, materiality 'look[s] to the effect on the likely or *actual* behavior of the recipient of the alleged misrepresentation.'")).

"The materiality standard is demanding." *Universal Health Servs., Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2003 (2016). "The False Claims Act is not 'an all-purpose antifraud statute' or a vehicle for punishing garden-variety breaches of contract or regulatory violations." *Id.* (internal citation omitted). "A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment." *Id.* "Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance." *Id.*

"In sum, when evaluating materiality under the False Claims Act, the Government's decision to expressly identify a provision as a condition of payment is relevant, but not automatically dispositive." *Id.* "If the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material." *Id.*

2. Defendants' Misrepresentations, If Any, Made In Obtaining SDVOSB Certification Were Immaterial to the Government and Cannot Form the Basis for an FCA Claim

Federal courts have consistently reaffirmed the demanding nature of the materiality standard and the importance of the government agency's reactions since the Supreme Court of the United States' seminal decision in *Universal Health Services v. United States ex rel. Escobar*, 136 S. Ct. 1989, 2003 (2016). For example, the United States Court of Appeals for the Third Circuit recently issued a decision in *United States ex rel. Petratos v. Genentech Inc.*, 855 F.3d 481, 485 (3d Cir. 2017) that affirmed a dismissal of a relator's complaint for failure to satisfy the False Claims Act's demanding materiality requirement.

In *Petratos*, the relator alleged that a defendant concealed health risks from the FDA to obtain approval of a widely-prescribed cancer drug that received substantial Medicare reimbursements. *Id.* The relator disclosed the alleged material, non-public information to the FDA and the FBI, but instead of discontinuing use, the FDA continued in its approval of the cancer drug, and, in fact, added additional uses of it. *Id.* at 490. The FDA did not initiate any adverse proceedings against the defendant, the FBI took no action against the defendant, and the DOJ declined to intervene in the relator's complaint. *Id.* The Third Circuit concluded that since "the expert agencies and government regulators have deemed these violations insubstantial (or at least would do so if made aware), we do not think it appropriate for a private citizen to enforce these regulations through the False Claims Act." *Id.*

The *Petratos* relator argued that his complaint sufficiently pleaded an FCA claim against the named defendants because "materiality can be established by proving that the alleged fraud was the 'but for' cause of the submitted claim." *Id.* at 491. The Third Circuit rejected this argument, finding that the "argument conflates materiality with causation, a separate element of a False Claims Act cause of action. Collapsing the materiality analysis into a causation inquiry would render the materiality element surplusage and fail to give effect to every clause and word of the statute, which we are loath to do." *Id.* (internal alterations and citations omitted). "And even the causation element cannot be met merely by showing 'but for' causation." *Id.* (citing *United States ex rel. Hendow v. Univ. of Phoenix*, 461 F.3d 1166, 1174 (9th Cir. 2006) (explaining that the false claim must be "integral to a causal chain leading to payment" (citations omitted)). "If a 'but for' causation theory is insufficient to meet the causation element—where that type of proof is more properly directed—it follows that it should be insufficient to demonstrate materiality." *Id.*

Here, Plaintiff's Amended Complaint fails sufficiently to plead that CSG's alleged violations of government contracting regulations were material to the government's decisions to pay CSG under any contract bonded by Hanover. To the contrary, the Amended Complaint makes it clear that those alleged violations were immaterial to the government's payment decisions. Fatal to Plaintiff's ability to demonstrate materiality here, the Amended Complaint actually alleges that "CSG continued to seek and obtain SDVOSBC contract funds through at least 2016." Am.Compl. ¶ 87. Thus, as alleged in the Amended Complaint, the government decided to continue making payments to CSG for more than 2 years after the filing of the original sealed complaint (see Complaint [ECF No. 1] (Aug. 6, 2014)) and for more than a year and a half after the Department of Justice declined to intervene in the relator's Complaint, the case was unsealed, and Plaintiff's allegations and the details of the alleged fraud were made public (see Order [ECF No. 8] (July 9, 2015). Worse for Plaintiff, fifteen days after this case was unsealed, on July 24, 2015, the VA reviewed CSG's new application and recertified CSG as an SDVOSB. This recertification is active through July 24, 2018. Patently, the many allegations of CSG's misrepresentations and violations of government contracting regulations alleged by Plaintiff are not material to the VA's payment decisions, because with full knowledge of those allegations, the VA continued to make payments to CSG and recertified CSG as an SDVOSB.

As in the *Petratos* case, the "expert agencies and government regulators" in this case have deemed the violations alleged in Plaintiff's Amended Complaint insubstantial, and it would be inappropriate for a private citizen, relator Andrew Scollick, to enforce the VA's SDVOSB regulations in this proceeding through the FCA. As such, Plaintiff's FCA claims should be dismissed pursuant to Fed.R.Civ.P. 12(b)(6).

E. The Amended Complaint Fails to State a Claim for Conspiracy Because It Does Not Sufficiently Plead Hanover's Knowledge of the False Claims

Count IV of the Amended Complaint against Hanover asserts a claim of conspiracy. The FCA subjects "any person who conspires" to violate the FCA to liability to the Government. 31 U.S.C. § 3729(a)(1)(c). The FCA does not further define conspiracy, but Courts have applied general conspiracy principles to FCA conspiracy claims. *United States v. Toyobo Co.*, 811 F. Supp. 2d 37, 50 (D.D.C. 2011). Doing so, the *Toyobo* court held that "[t]o state a claim under the FCA for conspiracy, a plaintiff must plead that the alleged conspirators agreed to make use of a false record or statement to achieve the end of getting the government to pay a claim." *Id.*

As discussed above, the Amended Complaint fails sufficiently to plead that Hanover knew of or should have known of the alleged fraud. The Amended Complaint, therefore, also fails sufficiently to plead that Hanover agreed to make use of a false record or statement in order to get the government to pay or avoid paying a claim or otherwise intended to defraud the government. As a result, Count IV of the Amended Complaint must be dismissed as against Hanover pursuant to Fed.R.Civ.P. 12(b)(6).

CONCLUSION

Hanover respectfully requests that the Court issue an Order dismissing, with prejudice, Counts I-IV of Plaintiff's Amended Complaint against Hanover and granting Hanover its costs, attorneys' fees, and such further relief as this Court deems just and proper.

Dated: October 6, 2017

Respectfully Submitted,

/s/

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Counsel for Defendant The Hanover Insurance Company

CERTIFICATE OF SERVICE

I hereby certify that on October 6, 2017, a copy of the foregoing Motion to Dismiss was served by operation of the Court's electronic filing system to all parties indicated on the electronic filing receipt.

Counsel for Defendant The Hanover Insurance Company

/s/

Mitchell A. Bashur

THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, *ex. rel.* ANDREW SCOLLICK Plaintiff-Relator, v. VIJAY NARULA, *et al.* Defendants.	Civil Action No. 1:14-cv-01339 Assigned to: The Honorable Royce C. Lamberth **HEARING REQUESTED**

ORDER

UPON CONSIDERATION of Defendant The Hanover Insurance Company's Motion to Dismiss Amended Complaint and supporting Memorandum, Plaintiff's Opposition, Defendant The Hanover Insurance Company's Reply, and the oral arguments of parties, it is this ____ day of ________, 2017:

ORDERED, that Defendant The Hanover Insurance Company's Motion to Dismiss Plaintiff's Amended Complaint is GRANTED; it is

FURTHER ORDERED, that Counts I, II, III, and IV of the Amended Complaint are dismissed as to Defendant Hanover Insurance Company WITH PREJUDICE; and it is

FURTHER ORDERED that Defendant The Hanover Insurance Company is dismissed as a Defendant to the Amended Complaint.

____
The Honorable Royce C. Lamberth

SESSION 2

HIDDEN RISKS IN SPECIFICATIONS, LEED, DESIGN, AND OTHER PITFALLS

Michael Spinelli | Cashin, Spinelli & Ferretti, LLC | Hauppauge, NY

Ellen Cavallero | Berkley Surety Group | Morristown, NJ

Kurt Faux | The Faux Law Group | Henderson, NV

PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

Unwittingly Bonding Design Responsibility

Ellen M. Cavallaro, Esq.
Kurt C. Faux, Esq.
Michael W. Spinelli, Esq., AIA

A DISCUSSION ON PRESCRIPTIVE AND PERFORMANCE SPECIFICATIONS

What are the different methods of specifying materials and products?

- Design (Prescriptive) Specifications
- Performance Specifications
- Proprietary Specifications
  - Restrictive Specifications

What are the different methods of specifying materials and products?

- Design (Prescriptive) Specifications
  - Describe the exact characteristics of materials and products without listing proprietary names
    - *The Contractor has no discretion to deviate from the specifications*
    - *The Owner and its Design Professionals are responsible for the design*
    - *The Owner provides the Contractor with an implied warranty as to the adequacy of the design documents*

Berkley Surety a Berkley Company

CSF CASHIN SPINELLI FERRETTI

FAUX LAW GROUP

What are the different methods of specifying materials and products?

- Design (Prescriptive) Specifications

Owner (through its design professional) provides the specific design to be followed and the materials to be used. The contractor is obligated to follow the stated design without deviation.

The *HOW* a project gets done.

The Implied Warranty of a Design Specification

"the insertion of the articles prescribing the character, dimensions and location of the sewer imported a warranty that if the specifications were complied with, the sewer would be adequate."

United States v. Spearin, 248 U.S. 132, 137 (1918)

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The Implied Warranty of a Design Specification

"But 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."

United States v. Spearin, 248 U.S. 132, 136, (1918)

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What are the different methods of specifying materials and products?

- Performance Specifications
  - Specify the end result or objective criteria required
  - Specify the performance and design criteria (loads, profiles, component materials, and finishes, etc)
  - Allows contractors, manufactures and fabricators the flexibility and creativity to meet those requirements

What are the different methods of specifying materials and products?

- Performance Specifications
  - *The Contractor is responsible for accomplishing the <u>intended results</u>*
  - *The Contractor is responsible for means and methods*
  - *The Contractor <u>does not have an implied warranty</u>*
  - *The criteria cannot be impossible or commercially impractical (unreasonable or excessive cost)*
  - *The Contractor <u>IS NOT</u> responsible for the adequacy of the performance or design criteria contained in the Contract Documents*

What are the different methods of specifying materials and products?

- Performance Specifications

Requires a contractor to produce a specific result without specifying the particular means or methods for achieving that result.

The *WHAT* that is to be done.

SECTION 08911 - GLAZED ALUMINUM CURTAIN WALLS

PART 1 - GENERAL

1.1 RELATED DOCUMENTS

A. Drawings and general provisions of the Contract, including General and Supplementary Conditions and Division 1 Specification Sections, apply to this Section.

1.2 SUMMARY

A. This Section includes conventionally glazed aluminum curtain walls installed as stick systems.

B. Related Sections include the following:

1. Division 7 Section "Building Insulation" for insulation materials field installed with glazed aluminum curtain-wall systems.
2. Division 7 Section " Building Insulation" for perimeter fire-containment systems (safing insulation) field installed with glazed aluminum curtain-wall systems.
3. Division 7 Section "Joint Sealants" for installation of joint sealants installed with glazed aluminum curtain-wall systems and for sealants to the extent not specified in this Section.
4. Division 8 Section "Aluminum Entrances and Storefronts" windows for entrance and storefront systems installed with glazed aluminum curtain-wall systems.
5. Division 8 Section "Glazing" for insulating glass requirements.
6. Division 10 Section "Louvers and Vents" for units installed with glazed aluminum curtain-wall systems.

1.3 PERFORMANCE REQUIREMENTS

A. General: Provide glazed aluminum curtain wall systems, including anchorage, capable of withstanding, without failure, the effects of the following:

1. Structural loads.
2. Movements of supporting structure indicated on Drawings including, but not limited to, story drift, twist, column shortening, long-term creep, and deflection from uniformly distributed and concentrated live loads.
3. Dimensional tolerances of building frame and other adjacent construction.
4. Failure includes the following:

1.3 PERFORMANCE REQUIREMENTS

A. General: Provide glazed aluminum curtain-wall systems, including anchorage, capable of withstanding, without failure, the effects of the following:

1. Structural loads.
2. Movements of supporting structure indicated on Drawings including, but not limited to, story drift, twist, column shortening, long-term creep, and deflection from uniformly distributed and concentrated live loads.
3. Dimensional tolerances of building frame and other adjacent construction.
4. Failure includes the following:

    a. Deflection exceeding specified limits.
    b. Thermal stresses transferred to building structure.
    c. Framing members transferring stresses, including those caused by thermal and structural movements, to glazing.
    d. Noise or vibration created by wind and thermal and structural movements.
    e. Loosening or weakening of fasteners, attachments, and other components.
    f. Sealant failure.

B. Structural Loads:

1. Wind Loads: 30 psf.

C. Structural-Test Performance: Provide glazed aluminum curtain-wall systems, including anchorage, capable of withstanding test pressure indicated without material and deflection failures and permanent deformation of structural members exceeding 0.2 percent of span when tested according to ASTM E 330.

1. Test Pressure: 150 percent of positive and negative wind-load design pressures.
2. Test Duration: As required by design wind velocity but not less than 10 seconds.

D. Deflection of Framing Members:

1. Deflection Normal to Wall Plane: Limited to 1/175 of clear span or 3/4 inch (19 mm), whichever is smaller.
2. Deflection Parallel to Glazing Plane: Limited to 1/360 of clear span or 1/8 inch (3.2 mm), whichever is smaller.

3. Cantilever Deflection: Where framing members overhang an anchor point, limited to 2 times the length of cantilevered member, divided by 175.

E. Story Drift: Provide glazed aluminum curtain-wall systems that accommodate design displacement of adjacent stories indicated.

1. Design Displacement: ½ inch.
2. Test Performance: No glass breakage, anchor failures, or structural damage when tested according to AAMA 501.4.

Blake Construction Company, Inc. v. U.S. 987 F. 2d 743 (Fed.Cir. 1993)

- Contracts may have both design and performance charactoritics
- The mere fact a specification cannot be followed precisely does not in and of itself indicate that it is a “performance” specification.

The ISSUE is: How much discretion does the specification give the contractor?

What are the different methods of specifying materials and products?

- The water can be muddy!
  - In practice, several specifying techniques are often rolled up into various specification sections contained within the Contract Documents
    - *<u>How much discretion</u> did the specifications give the Contractor?*

What are the different methods of specifying materials and products?

- The water can be muddy!
  - *Owner changes or directives can transform a Performance Specification to a Design Specification*
  - *Substitutions and "or equal" submissions can transform a Design Specification to a Performance Specification*

Contractors Professional Liability Chart

AIA Document A201-1997

3.12.10: The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless :

- Means and Methods
- Systems

AIA Document A201-1997

3.12.10 Continued

The Contractor shall cause such services or certifications to be provided by a properly licensed design professional, whose *signature and seal* shall appear on all drawing, calculations, specifications, certifications, Shop Drawings and other submittals . . .

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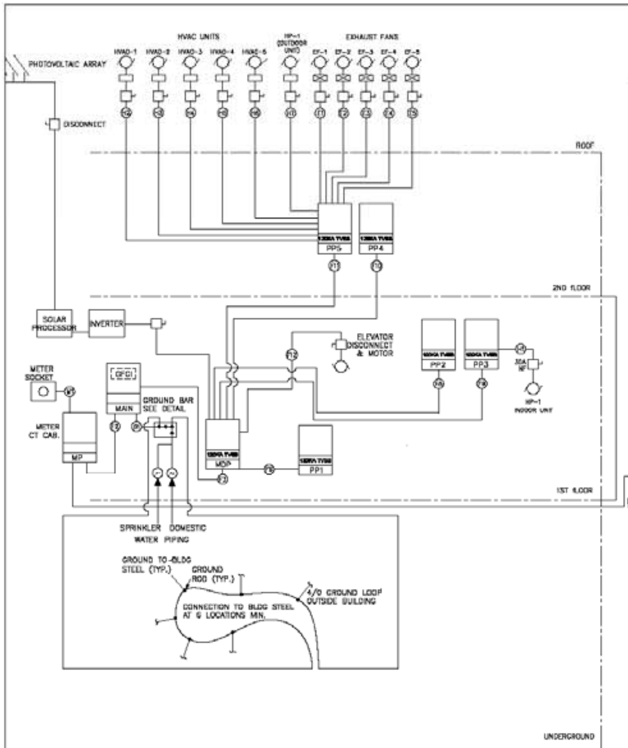
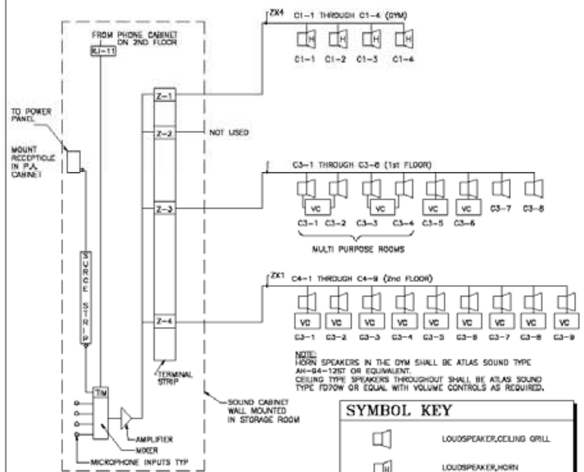


WIRE AND CONDUIT SCHEDULE					
FDR ID	OCPD	PHASE WIRES (AWG)	NEUTRAL WIRES (AWG)	EQUIP. GND (AWG)	MIN. CONDUIT SIZE
P1	–	SEE NOTE ON E-2			
F1	–	3X500KCMIL	3X500KCMIL	–	3 X 4"
F2	–	3X500KCMIL	3X500KCMIL	–	3 X 4"
F3	1200	3X500KCMIL	3X500KCMIL	3 X 1/0	3 X 4"
F4		NOT USED			
F5		NOT USED			
F6	225	4/0	4/0	1/0	2-1/2"
F7		NOT USED			
F8	225	4/0	4/0	1/0	2-1/2"
F9	225	4/0	4/0	1/0	2-1/2"
F10	225	4/0	4/0	1/0	2-1/2"
F11	800	2X500KCMIL	2X500KCMIL	1/0	2 X 4"
F12	100	2	2	8	1-1/2"
H1	30	10	10	10	1"
H2	200	3/0	3/0	4	2-1/2"
H3	200	3/0	3/0	4	2-1/2"
H4	100	2	2	8	1-1/2"
H5	70	4	4	15	1-1/2"
H6	60	4	4	8	1-1/2"
H7	40	8	8	10	1"
E1	15	12	–	12	3/4"
E2	15	12	–	12	3/4"
E3	10	12	–	12	3/4"
E4	15	12	–	12	3/4"
E5	15	12	12	12	3/4"
G1	–	–	–	2 X 4/0	3" PVC
M1	–	LIPA CONTROL CABLE	–	#8	1-1/4"

NOTES:

1. ADD ALTERNATE NO.1 ADDS A PHOTOVOLTAIC CELL ARRAY, INVERTER, DISCONNECTS, CONDUIT AND WIRING.
2. ALL WIRE IS COPPER TYPE XHHW UNLESS OTHERWISE NOTED.
3. EF-1 THROUGH EF-5 TO BE WIRED THROUGH MAGNETIC STARTERS, FURNISHED BY THE H.V.A.C. CONTRACTOR AND INSTALLED BY THE ELECTRICAL CONTRACTOR.

1 E-10 **POWER RISER DIAGRAM**
SCALE: NO SCALE

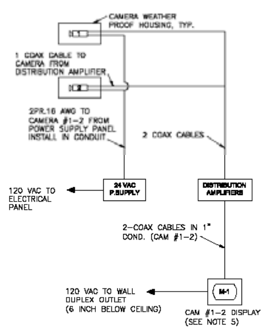


NOTE:
HORN SPEAKERS IN THE GYM SHALL BE ATLAS SOUND TYPE AH-64-12ST OR EQUIVALENT.
CEILING TYPE SPEAKERS THROUGHOUT SHALL BE ATLAS SOUND TYPE FD70W OR EQUAL WITH VOLUME CONTROLS AS REQUIRED.

WIRING KEY (ALL WIRES FOR 70 VOLT SYSTEM)	
TAG	GAUGE
2 x 1	2 #16 AWG SHIELDED
2 x 4	4 SETS 2 #16 AWG SHIELDED

SYMBOL KEY	
	LOUDSPEAKER,CEILING GRILL
	LOUDSPEAKER,HORN
	PAGING AMPLIFIER
VC	SPEAKER VOLUME CONTROL
TIM	TELEPHONE INTERFACE MODULE
SURGE STRIP	POWER OUTLET STRIP

2 E-10 **PUBLIC ADDRESS SYSTEM RISER DIAGRAM**
SCALE: NO SCALE

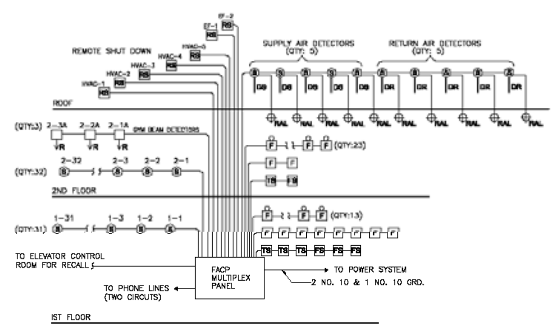


CCTV CAMERA SCHEDULE				
CAM NO.	LOCATION OF CAMERA PLACEMENT	SURVEILLANCE AREAS	CAMERA ENCLOSURE LENS TYPE	CAMERA MOUNT & HEIGHT (AFF)
1	ENTRANCE	VICINITY OF BLDG DOOR	OUTDOOR/ FIXED FOCAL	ON WALL APP. 10 FT
2	ENTRANCE	VICINITY OF BLDG DOOR	OUTDOOR/ FIXED FOCAL	ON WALL APP. 10 FT

NOTES:

1. FOR EQUIPMENT LAYOUT, SEE DWGS. NOS. E-5 THRU. E-7.
2. ALL COAXIAL CABLES SHALL BE RG-6 RATED AT 75 OHM OF IMPEDANCE AND MUST BE TERMINATED WITH 75 OHM RATED CONNECTORS.
3. THE CCTV/SECURITY MONITOR CONSOLE CONFIGURATIONS AND DIMENSIONS ARE APPROXIMATE.
4. THE MONITOR INSTALLED SHALL HAVE BUILT-IN MULTIPLEXER. THE MONITOR SHALL BE MOUNTED WITH PELCO MODEL MR3050 MOUNT OR APPROVED EQUAL, AND ITS MOUNTING DETAILS AND REQUIRED HARDWARE SHALL BE SUBMITTED FOR THE ENGINEER'S APPROVAL.
5. ALL CAMERA CONTROL DATA SIGNALS, VIDEO SIGNAL, TIMING PULSE, AND BUILT-IN DIGITAL MOTION ALARM SIGNAL SHALL BE INTEGRATED AND TRANSMITTED OVER A SINGLE COAXIAL CABLE BETWEEN RECEIVER AND MULTIPLEXER.
6. ALL CCTV WIRING SHALL BE IN CONDUIT.

3 E-10 **CCTV RISER DIAGRAM**
SCALE: 1/8"=1'-0"



NOTES:
1. CONTRACTOR TO INSTALL RAL IN CEILING BELOW ASSOCIATED H.V.A.C. UNIT OR EXHAUST FAN.
2. IF FIRE SERVICE HAS A CURB VALVE, A TAMPER SWITCH SHALL BE INSTALLED ON IT AND WIRED TO FACP.

4 E-10 **FIRE ALARM RISER DIAGRAM**
SCALE: NO SCALE

CASHIN, SPINELLI, FERRETTI

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www.nassausuffolkea.com

DATE	REV NO	REVISION
8/10/07		FINAL RE-BID

ARCHITECT SEAL
ENGINEER SEAL

PROJECT: TOWN OF OYSTER BAY
HICKSVILLE ATHLETIC BUILDING
ADDRESS: BROADWAY & CARLE STREET
HICKSVILLE, NY

DRAWING TITLE: RISER DIAGRAMS

DATE: 8/10/07
SCALE: AS NOTED
CSF PROJECT NO.: 40710
DRAWN BY: LJ
CHECKED BY: RLR

DRAWING NO.: E-10
10 OF 14

Blake Construction Company, Inc. v. United States 987 F. 2d 743 (1993)

- "Because we conclude the contract did not permit Blake to install the electrical conduits underground,
- whether or not this method would have been 'better' is irrelevant.
- Finally, whether local trade custom was to install electrical conduits underground is also irrelevant here"

Why does any of this matter?

NYS clarified that a design professional may delegate certain responsibilities to others without breaching the rules of unprofessional conduct.

Delegation of Design

The Guideline recognizes that

"In essence, the design professional has left the detail up to the successful low bidder".

(NYS Office of the Professions – Practice Guidelines)

Berkley Surety | a Berkley Company

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FAUX LAW GROUP

Delegation of Design

The Guideline goes on to state:

"The successful low bidder must use a New York licensee to prepare, sign and <u>certify</u> the shop drawings."

(NYS Office of the Professions – Practice Guidelines)

SECTION 08911 - GLAZED ALUMINUM CURTAIN WALLS

1.4 SUBMITTALS

A. Product Data: Include construction details, material descriptions, dimensions of individual components and profiles, and finishes for each type of product indicated.

B. Shop Drawings: Prepared by or under the supervision of a qualified professional engineer detailing fabrication and assembly of glazed aluminum curtain-wall systems.

What does the AIA say about Delegation of Design?

§ 3.12.10 The Contractor shall not be required to provide professional services which constitute the practice of architecture or engineering unless such services are specifically required by the Contract Documents for a portion of the Work or unless the Contractor needs to provide such services in order to carry out the Contractor's responsibilities for construction means, methods, techniques, sequences and procedures…

- *The Contractor shall not be responsible for the adequacy of the performance or design criteria required by the Contract Documents.* (Emphasis Added)

SECTION 08911 - GLAZED ALUMINUM CURTAIN WALLS

1.3 PERFORMANCE REQUIREMENTS

B. Structural Loads:

1. Wind Loads: 30 psf.

C. Structural-Test Performance: Provide glazed aluminum curtain-wall systems, including anchorage, capable of withstanding test pressure indicated without material and deflection failures and permanent deformation of structural members exceeding 0.2 percent of span when tested according to ASTM E 330.

1. Test Pressure: 150 percent of positive and negative wind-load design pressures.
2. Test Duration: As required by design wind velocity but not less than 10 seconds.

How does this relate to the Administration of the Construction Contract?

The Design Professional responsible for the construction administration must review all shop drawings and submittals for their compliance with the Contract Documents.

Some submissions will also require the signature and certification of the licensed New York design professional who prepared that submission.

How does this relate to the Administration of the Construction Contract?

NYS has identified the types of non-standardized products or systems where the Architect may delegate design.

Non-standardized products or systems

- Geotechnical Reports
- Pre-fabricated Bridges
- Structural Metal Framing and/or Systems
- Joists/Trusses
- Glue Laminated Timber
- Curtain Wall Systems
- Cable Supported and Fabric Systems
- Pre-Engineered Structures

Non-standardized products or systems

- Elevators, Escalators and Moving Sidewalks
- Turntables
- Bleachers and Grandstands
- Fire Protection Systems
- Temporary Shoring or Scaffolding

(NYS Office of the Professions – Practice Guidelines)

Unwittingly Bonding Design Responsibility

Ellen M. Cavallaro, Esq.
Kurt C. Faux, Esq.
Michael W. Spinelli, Esq., AIA

A DISCUSSION ON PRESCRIPTIVE AND PERFORMANCE SPECIFICATIONS

SESSION 3

SUBCONTRACTOR DEFAULT INSURANCE AND EXPEDITED RESOLUTION BONDS

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

Bryce Holzer | Travelers | Federal Way, WA

Chris Morkan | Hudson Insurance Group | Avon, CT

PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

SUBCONTRACTOR DEFAULT INSURANCE: PROS & CONS AND PRACTICAL TIPS

JONATHAN BONDY, ESQ.
CHIESA SHAHINIAN & GIANTOMASI, PC

BRYCE HOLZER, ESQ.
CLAIM COUNSEL - BOND & SPECIALTY INSURANCE
TRAVELERS

CHRIS MORKAN, ESQ.
SENIOR VICE PRESIDENT & DIRECTOR OF CLAIMS
HUDSON INSURANCE GROUP

With increasing frequency, particularly for large general contractors undertaking large private projects, subcontractor default insurance ("SDI") is becoming an increasingly attractive alternative to traditional performance and payment bonds issued by commercial sureties. Since Zurich introduced its Subguard® product in the mid-1990's, many general contractors, when freed from the statutory requirements for surety bonds on public improvement projects, are choosing SDI to address subcontractor default situations. SDI is a first-party insurance contract between the insurer and the insured, usually the general contractor. SDI comes with a high deductible and serves more as a catastrophic or "umbrella" type policy and, unless excluded, usually covers all commercial risks resulting from a subcontractor's default, subject to certain policy terms and limits. The challenge to the surety industry from the SDI product is evolving and still unclear, but it is important for insurance companies, whether acting as sureties or as issuers of SDI, to understand the risks and benefit that come with SDI and how their customers, whether purchasing surety bonds or SDI, perceive the benefits of each product.

There is no boiler-plate form used for an SDI policy. Various riders, endorsements and exclusions are available and can be negotiated; the appetite for risk for both the insurer and insured plays a part. The size of the contractors purchasing SDI, many of which are significant customers for the insurer in other lines of business, may give the insured certain bargaining leverage not ordinarily available when surety bonds are issued. Insurers may prefer the certainty that comes with a surety bond, such as the AIA A-312 bond, the terms of which have been discussed repeatedly by courts and which can therefore give insurers a measure of reliability as to how a performance bond's terms will be enforced. There is still very little case law interpreting the rights and responsibilities of the parties to an SDI contract, so only experience and an interpretation of existing contract law and insurance policy construction will provide guidance in the event of an SDI claim.

Characteristics and conditions of an SDI policy often, but not always, include the following:

- The SDI policy is a two-party insurance contract;
- The SDI policy has a large deductible, often in the seven-figure range;
- There may be ongoing co-payment requirements for the insured for covered losses in excess of the deductible. This can be negotiable, and an insured general contractor may accept a higher deductible in lieu of a lower co-payment arrangement, or vice versa;
- There are often warranties expressly required from the insured that become conditions to the policy, including among them a subcontractor pre-qualification procedure. Other warranties may include the insured's representation that it will confirm the validity of the debt owed by the defaulting subcontractor and that the insured will take reasonable steps to mitigate its loss;
- The SDI product calls for reimbursement to the insured, rather than as with a surety bond, the surety laying out its own money upfront;
- The SDI policy requires that the insured furnish a proof of loss that a default in performance caused a quantifiable loss;
- Where the loss has not been judicially determined (i.e., the "at-fault subcontractor" disputes that it is in default), provisions may provide for the insured to pay a pre-determined percentage of the claim until a judicial determination of the validity of the default is established;
- The SDI policy usually contains a per-occurrence and aggregate limit;

- Where the insured has obtained a performance bond from a subcontractor, the SDI policy is an excess one, over and above the penal sum protection afforded the insured under the subcontractor's bond;
- The policy can be declared void if the insured makes a claim that is false or fraudulent or knowingly conceals a material fact prior to the issuance of the policy.[1]

So why are general contractors, when not otherwise required by a statute or a developer's lending bank (s is sometimes the case on private projects) choosing SDI? Much has been written in trade publications on this issue. One main selling point cited by purchasers of SDI is that it "is a faster and more reliable alternative to surety bonds…"[2]

Many general contractors have voiced complaints concerning the speed with which sureties respond (or, in their opinion, fail to respond), when claims are made under performance bonds. There is also the perception of additional procedural hurdles under standard performance bonds, whereas an SDI policy is potentially more "friendly" to the SDI-insured general contractor. Most of the purchasers of SDI, being larger general contractors, have the financial strength to overcome the minor monetary "bumps" that are attendant to many projects. If a subcontractor is struggling and needs to be assisted by the general contractor, at an economically reasonable cost to the general contractor, it may well be in the general contractor's self-interest to bypass the surety bond claims process, in its possibly self-perceived self-interest, to avoid project delay, even if it entails the general contractor incurring certain additional costs as a

[1] Stephen J. Trecker, *Anticipating the Preventable: Identifying and Managing Project Risk*, 1999 American Bar Association, presented at the 1999 TIPS Fidelity & Surety Law Committee Meeting, pages 65-68.

[2] *Engineering News-Record*, April 14, 2003.

result. And in those instances where a general contractor feels the need, whether warranted or (sometimes) not, to replace the subcontractor and promptly oversee itself the completion of the subcontractor's work, the general contractor needs only to declare a default, advise the SDI carrier of the claim, and then provide the supporting documentation for its claim it. This, of course, does mean that the general contractor will, at least initially, have to utilize its own funds to remedy the subcontractor's default; but since most of the SDI purchasers are large contractors, they usually have the financial strength and flexibility to incur these costs and seek reimbursement later, while ensuring that their projects move forward with, presumably, minimized disruption and delay.

Another benefit cited by general contractors is that it frees them from a "bidding" process and allows them to use a regular stable of subcontractors with which the general contractor has familiarity and some comfort level. Some general contractors also feel that they do a better job of prequalifying subcontractors than do sureties. In the surety underwriting process, a trained underwriter analyzes the bond principal's financial strength, experience, management, and its overall ability to perform the work for which a bond is requested. Under an SDI policy, however, it is the general contractor that prequalifies the subcontractor. Given the hefty deductibles that apply to an SDI policy, it is the general contractor which will have to absorb the initial layer of financial risk if it mistakenly placed its faith in one of its subcontractors. And another issue cited by general contractors in choosing SDI policies is their ability to avoid what some perceive as the onerous terms of a surety's general agreement of indemnity, even where personal indemnity has been eliminated, as is the case for many large general contractors.

So, what does the SDI policy cover? A typical policy covers “loss” (as defined by the policy) over and above the insured’s payment of the deductible and any applicable co-payment required of the insured. The insured receives payment when a loss is caused by a “performance default” by the insured’s subcontractor for a “covered” subcontract or purchase order, and provided that the insured provided the insurer with formal notice of the default and reported same to the insurer before the expiration of the post-completion coverage period. An SDI policy does not obligate the insurer to provide the insured with a defense with respect to any legal proceeding, but the policy may provide that the insured will be reimbursed for legal and loss adjustment expenses if the insured had no other insurance covering its defense against such a claim. Coverage is available to the amount equal to the per loss limits and aggregate limits set forth in the policy. There is usually a separate limit under the policy for “indirect costs” suffered by the insured due a subcontractor’s performance default.

An SDI policy may also provide that the insured has the burden of establishing its compliance with the policy’s terms, as well as the insured’s expenditure of its deductible and required co-payments. The time within which a “notice of loss” must be submitted to the carrier is set forth in the policy, and the policy may provide that failure to submit timely notice voids coverage for the loss complained of. The insured must submit a satisfactory proof of loss. Examples of when the proof of loss must be submitted may include that it be provided no later than the earlier of: (a) the expiration of a completed coverage duration, which exists after the date of substantial completion of the covered subcontract; (b) the expiration of the right to seek recovery against the defaulted subcontractor; (c) at least 45 days prior to the expiration of a statute of limitations with respect to a claim against the defaulted subcontractor; or (d) the date on which the project is converted to a "for sale residential structure."[3]

As with any insurance policy, there are, of course, exclusions to coverage. Typical exclusions may include the following: (a) a loss caused by a subcontractor previously declared in default, which default has not been cured as of the commencement of the policy, unless that default is disclosed to the insurer prior to the issuance of the policy and the insurer agreed to provide coverage; (b) where the subcontractor has provided surety bonds in favor of the insured general contractor as obligee; (c) a loss caused by dishonest or fraudulent acts or omissions or intentional misrepresentations committed by the insured; (d) *force majeure* events; (e) claims relating to bodily injury; (f) claims arising out of a subcontractor's failure to render professional services, although the exclusion may not apply to normal supervisory duties or a subcontractor providing incidental professional services; and (g) claims for punitive or similar type damages.

An SDI policy usually calls for fairly prompt payment or a response from the insurer. One policy provides for payment within 30 days of receipt of a satisfactory proof of loss. If, in the insurer's view, the proof of loss is deficient, the insurer will notify the insured within 30 days, and then the insurer will make payment for the loss within 30 days of receipt of information curing those deficiencies; or, at least, those amounts for which the proof of loss was not deficient. If, however, it is ultimately determined by a

[3] Due to the proprietary nature of SDI policies, the identity of the insurer whose policy conditions are cited above is not identified here.

court or arbitrator that the “offending” subcontractor was *not* in fact in default of performance, the insured is required to return to the insurer any payments made by the insurer under the policy.

The SDI insurer may have the right, at its option, to pursue all recovery and subrogation actions for losses it has paid, and the insured has the obligation to not impair the insurer’s right of recovery and must also cooperate with the insurer’s prosecution of its claims seeking recovery. The proceeds of any recovery go first to the insurer for the cost of its pursuit of the recovery, then to the company for the loss it paid to the insured; if there is any net recovery still to be dealt with, and the insured paid something as a co-payment, the insurer and insured share in accordance with the co-payment ratio. Finally, if any recovery still remains, at which point the insurer has been made whole, such proceeds are paid to the insured.

Endorsements to the SDI policy may change the percentage or amount of the co-payments required of the insured. For example, one endorsement provides that if the insured notifies the insurer within five days of the issuance of a notice of default of performance to a subcontractor, or the insured’s becoming aware that the subcontractor is insolvent, the insurer will reduce the co-payment percentage by 50 percent. The faster notification required of the insured to take advantage of this reduction reduces the amount of the insured’s co-payments (assuming the deductible is completely exhausted by the insured) and brings the insured closer in time to receiving reimbursement for the expenditures it has laid out.

With the SDI product now having been on the market for 20 years, there is still a division of opinion as to SDI’s viability and profitability, even as additional insurance companies are coming into the SDI market. More than any other factor, however, it appears that the desire of large general contractors on large private projects to (a) control the completion process while (b) having financial protection for large losses caused by a subcontractor’s default will be what drives the continued demand for SDI.

SESSION 4

THE PEARLMAN CASE

Gregory Smith | Booth, Mitchel & Strange LLP | Orange, CA

PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

Pearlman v. Reliance Ins. Co., 371 U.S. 132 (1962)

By: Gregory H. Smith of Booth, Mitchel & Strange LLP

Pearlman is the flagship case related to the surety's right to contract balances under the doctrine of equitable subrogation. Accordingly, it only makes sense that on the 25th anniversary of the conference that takes its name that we revisit what is one of the most cited federal cases in surety law, and which is followed by many states. The application of equitable subrogation allows sureties to seek reimbursement for payments made independent of contract rights and is enforced solely to accomplish the ends of substantial justice.[1] Although *Pearlman* has been distinguished in some instances in the 56 years since its decision, for the surety practitioner, the principals discussed in *Pearlman* continue to find application.

In *Pearlman*, Dutcher Construction Corporation ("Dutcher") contracted with the United States to do work on the Government's St. Lawrence Seaway project. Reliance Ins. Co. ("Reliance") issued payment and performance bonds on behalf of Dutcher.

Dutcher suffered financial trouble, and the U.S. terminated its contract and another contractor completed the job. Reliance paid $350,000 for labor and materials pursuant to its payment bond obligations; however, at the time of completion, the U.S. was holding retention of $87,737.35, which would have been paid to Dutcher had it completed the project.

Dutcher filed bankruptcy, and Pearlman was appointed as the bankruptcy trustee. The retention was turned over to Pearlman as property of the bankruptcy estate. Reliance filed a petition in District Court denying that the retention had vested in the trustee and arguing that it was the owner of the fund.

The bankruptcy referee, relying on *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947), held that the surety had no superior rights to the fund other than that of a general creditor. The District Court vacated the referee's order and held that cases prior to *Munsey* had established the right of a surety under circumstances like this to be accorded priority over general creditors, and that *Munsey* had not changed that rule. The Second Circuit affirmed. The Supreme Court granted certiorari.

As a preliminary issue, the Court addresses who had property interests in the retention and at what point, finding that "[p]roperty interests in a fund not owned by a bankrupt at the time of adjudication, whether complete or partial, legal or equitable, mortgages, liens, or simple priority of rights, are of course not a part of the bankruptcy's property and do not vest in the trustee." Accordingly, if the surety at the time of adjudication was either the outright legal or equitable owner of this fund, or had an equitable lien or prior right to it, then it was never part of the bankruptcy estate and priority under the Bankruptcy Act was irrelevant.

The Court explored what rights Reliance had in the retention by first acknowledging two fundamental surety concepts (1) reimbursement ("[t]raditionally sureties compelled to pay debts

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[1] Id. at 138.

for their principal have been deemed entitled to reimbursement, even without contractual promise such as the surety had here") and (2) subrogation ("there are few doctrines better established then that a surety who pays the debt of another is entitled to all the rights of the person he paid to enforce his right to be reimbursed"). The Court then addressed two cases that previously held that there is a security interest in a withheld fund, *Prairie State Bank v. United States*, 164 U.S. 227 (1896) and *Henningsen v. United States Fid. & Guar. Co.*, 208 U.S. 404 (1908).

In *Prairie Bank*, the surety had completed a project pursuant to its performance bond obligations and was seeking retention. Prairie Bank contested the surety's claim, asserting that it had a superior equitable lien arising from moneys advanced by the bank prior to the surety's completion efforts. The *Prairie Bank* Court held that the retention materially tended to protect the surety; the creation of retention raised an equity in the surety's favor; the U.S. was entitled to protect itself out of the fund, and the surety, through subrogation, could protect itself by resort to the same securities and remedies available to the U.S. against the contractor. Accordingly, *Prairie Bank* follows the already established doctrine: a surety who completes a contract has an "equitable right" to indemnification out of a retained fund.

In *Henningsen*, Henningsen contracted with the U.S. to build public buildings. The buildings were completed, but Henningsen failed to pay laborers and materialmen, which the surety paid pursuant to its payment bond obligations. The *Henningsen* Court applied the same equitable principals in *Prairie Bank*, which entitled the surety to the same equitable claim to the retained fund that the surety in *Prairie Bank* case was held to have.

Finding that *Prairie Bank* and *Henningsen* held there is a security interest in a withheld fund pursuant to equitable subrogation, the *Pearlman* Court next explored whether the Miller Act or *Munsey* changed this rule.

The Court quickly dismissed the argument that the Miller Act changed the law, finding that it didn't matter that two bonds are now required because the single bond format covered the same things (i.e. performance and payment of labor/materials). Further, to hold otherwise would result in the "unsettling of the usual view, grounded in commercial practice, that suretyship is not insurance."

The Court then concluded that *Prairie Bank* and *Henningsen* were not overruled by *Munsey*, explaining that Munsey <u>only</u> states that the Government could exercise the well-established common-law right of debtors to offset claims of their own against their creditors. The *Pearlman* Court acknowledges that the *Munsey* decision contained statements which some have misinterpreted; however, the equitable rights of a surety (from *Prairie*) who completes performance were approved in *Munsey*. Accordingly, "*Munsey* left the rule in Prairie Bank and *Henningsen* undisturbed."

The Court summarized its holding has follows:

- The Government had a right to use the retained fund to pay laborers and materialmen;
- that the laborers and materialmen had a right to be paid out of the fund;

- that the contractor, had he completed his job and paid his laborers and materialmen, would have become entitled to the fund; and
- that the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it.

Since the surety paid more than the fund, it was entitled to the entire amount of the fund.

Justices Clark, Douglas and Brennan concurred in the result on the ground that the surety, standing in the shoes of the U.S., not the laborers and materialmen, was entitled to retention and that the equities in favor of the surety grow out of the contract between it and the contractor (i.e., the indemnity agreement) which assigned all sums being due to the surety.

Justice White dissented.

Opinion

[*133] [***191] [**233] MR. JUSTICE BLACK delivered the opinion of the Court.

This is a dispute between the trustee in bankruptcy of a government contractor and the contractor's payment bond surety over which has the superior right and title to a fund withheld by the Government out of earnings due the contractor.

The petitioner, Pearlman, is trustee of the bankrupt estate of the Dutcher Construction Corporation, which in April 1955 entered into a [****3] contract with the United States to do work on the Government's St. Lawrence Seaway project. At the same time the respondent, Reliance Insurance Company, 1 executed two surety bonds required of the contractor by the Miller Act, one to guarantee performance of the contract, the other to guarantee payment to all persons supplying labor [***192] and material for the project. 2 [****6] Under the terms of the contract, which was attached to and made a part of the payment bond, the United States **[*134]** was authorized to retain and hold a percentage of estimated amounts due monthly until final completion and acceptance of all work covered by the contract. Before completion Dutcher had financial trouble and the United States terminated its contract by agreement. Another contractor completed the job, which was finally accepted by the Government. At this time there was left in the Government's withheld fund $ 87,737.35, which would have been due to be paid to Dutcher had it carried out its obligation to pay its laborers and materialmen. Since it had not met this obligation, its surety had been compelled to pay about $ 350,000 to discharge debts of the contractor for labor and materials. [****4] In this situation the Government was holding over $ 87,000 which plainly belonged to someone else, and the fund was turned over to the bankrupt's trustee, who held it on the assumption that it had been property of the bankrupt at the time of adjudication and therefore had vested in the trustee "by operation of law" under § 70 of the Bankruptcy Act. 3 The surety then filed a petition in the District Court denying that the fund had vested in the trustee, alleging that it, the surety, [**234] was "the owner of said sum" of $ 87,737.35 "free and clear of the claims of the Trustee in Bankruptcy or any other person, firm or corporation," and seeking an order directing the trustee to pay over the fund to the surety forthwith. 4 The referee in bankruptcy, relying chiefly on this Court's opinion in *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947), held that the surety had no superior rights in the fund, refused to direct payment to the surety, and **[*135]** accordingly ordered the surety's claim to be allowed as that of a general creditor only to share on an equality with the general run of unsecured creditors. 5 The District Court vacated the referee's [****5] order and held that cases decided prior to *Munsey* had established the right of a surety under circumstances like this to be accorded priority over general creditors and that *Munsey* had not changed that rule. 6 The Second Circuit affirmed. 7 Other federal courts have reached a contrary result, 8 and as the question is an [***193] important and recurring one, we granted certiorari to decide it. 9

LEdHN[1] [1] One argument against the surety's claim is that this controversy is governed entirely by the Bankruptcy Act and that § 64, [****7] 11 U. S. C. § 104, which prescribes priorities for different classes of creditors, gives no priority to a surety's claim for reimbursement. But the present dispute -- who has the property interests in the fund, and how much -- is not so simply solved. Ownership of property rights before bankruptcy is one thing; priority of distribution in bankruptcy of property that has passed unencumbered into a bankrupt's estate is quite another. ***HN1*** Property interests in a fund not owned by a bankrupt at the time of adjudication, whether complete or partial, legal or equitable, mortgages, liens, or simple priority of rights, are of course not a part of the bankrupt's property and do not vest in the trustee. The Bankruptcy Act simply does not authorize a trustee to distribute other people's **[*136]** property among a bankrupt's creditors. **10** So here if the surety at the time of adjudication was, as it claimed, either the outright legal or equitable owner of this fund, or had an equitable lien or prior right to it, this property interest of the surety never became a part of the bankruptcy [****8] estate to be administered, liquidated, and distributed to general creditors of the bankrupt. This Court has recently reaffirmed that such property rights existing before bankruptcy in persons other than the bankrupt must be recognized and respected in bankruptcy. **11** Consequently our question is not who was entitled [**235] to priority in distributions under § 64, but whether the surety had, as it claimed, ownership of, an equitable lien on, or a prior right to this fund before bankruptcy adjudication.

[****9] ***LEdHN[2]*** [2]***LEdHN[4]*** [4] Since there is no statute which expressly declares that a surety does acquire a property interest in a fund like this under the circumstances here, we must seek an answer in prior judicial decisions. Some of the relevant factors in determining the question are beyond dispute. Traditionally sureties compelled to pay debts for their principal have been deemed entitled to reimbursement, even without a contractual promise such as the surety here had. **12** And probably there are few doctrines better established **[*137]** than that ***HN2*** a surety who pays the debt of another is entitled to all the rights of the person he paid [***194] to enforce his right to be reimbursed. **13** [****11] This rule, widely applied in this country **14** and generally known as the right of subrogation, was relied on by the Court of Appeals in this case. It seems rather plain that at least two prior decisions of this Court have held that there is a security interest in a withheld [****10] fund like this to which the surety is subrogated, unless, as is argued, the rule laid down in those cases has been changed by passage of the Miller Act or by our holding in the *Munsey* case. Those two cases are *Prairie State Bank* v. *United States*, 164 U.S. 227 (1896), and *Henningsen* v. *United States Fid. & Guar. Co.*, 208 U.S. 404 (1908).

In the *Prairie Bank* case a surety who had been compelled to complete a government contract upon the contractor's default in performance claimed that he was entitled to be reimbursed for his expenditure out of a fund that arose from the Government's retention of 10% of the estimated value of the work done under the terms of the contract between the original contractor and the Government. That contract contained almost the same provisions for retention of the fund as the contract presently before us. The Prairie Bank, contesting the surety's claim, asserted that it had a superior equitable lien arising from moneys advanced by the bank to the contractor before the surety began to complete the work. The Court, in a well-reasoned opinion by Mr. Justice White, held that this fund materially tended to protect the surety, **[*138]** that its creation raised an equity in the surety's favor, that the United States was entitled to protect itself out of the fund, and that the surety, by asserting the right of subrogation, could protect [****12] itself by resort to the same securities and same remedies which had been available to the United States for its protection against the contractor. The Court then went on to quote with obvious approval this statement from a state case:

"The law upon this subject seems to be, the reserved per cent to be withheld until the completion of the work to be done is as much for the indemnity of him who may be a guarantor of the performance of the contract as for him for whom it is to be performed. And there is great justness in the rule adopted. Equitably, therefore, the sureties in such cases are entitled to have the sum [**236] agreed upon held as a fund out of which they may be indemnified, and if the principal releases it without their consent it discharges them from their undertaking." 164 U.S., at 239, quoting from *Finney* v. *Condon*, 86 Ill. 78, 81 (1877).

The *Prairie Bank* case thus followed an already established doctrine that ***HN3*** a surety who completes a contract has an "equitable right" to indemnification out of a retained fund such as the [****13] one claimed by the surety in the present case. The only difference in the two cases is that here the surety incurred his losses by paying debts for the contractor rather than by finishing the contract.

[***195] ***LEdHN[5]*** [5] The *Henningsen* case, decided 12 years later in 1908, carried the *Prairie Bank* case still closer to ours. Henningsen had contracts with the United States to construct public buildings. His surety stipulated not only that the contractor would perform and construct the buildings, but also, as stated by the Court, that he would "pay promptly **[*139]** and in full all persons supplying labor and material in the prosecution of the work contracted for." **15** Henningsen completed the buildings according to contract but failed to pay his laborers and materialmen. The surety paid. This Court applied the equitable principles declared in the *Prairie Bank* case so as to entitle the surety to the same equitable claim to the retained fund that the surety in the *Prairie Bank* case was held to have. Thus the same equitable rules as to subrogation and property interests in a retained fund [****14] were held to exist whether a surety completes a contract or whether, though not called upon to complete the contract, it pays the laborers and materialmen. These two cases therefore, together with other cases that have followed them, **16** establish the surety's right to subrogation in such a fund whether its bond be for performance or payment. Unless this rule has been changed, the surety here has a right to this retained fund.

It is argued that the Miller Act **17** changed the law as declared in the *Prairie Bank* and *Henningsen* cases. We think not. Certainly no [****15] language of the Act does, and we have been pointed to no legislative history that indicates such a purpose. The suggestion is, however, that a congressional purpose to repudiate the equitable doctrine of the two cases should be implied from the fact that the Miller Act required a public contract surety to execute two bonds instead of the one formerly required. It is true that the Miller Act did require both a performance **[*140]** bond and an additional payment bond, that is, one to assure completion of the contract and one to assure payments by the contractor for materials and labor. But the prior Acts on this subject, while requiring only one bond, made it cover both performance and payment. **18** [****16] Neither this slight difference in the new and the old Acts nor any other argument presented persuades us that Congress in passing the Miller Act intended to repudiate equitable principles so deeply imbedded in our commercial practices, our economy, and our law as those spelled out in the *Prairie Bank* and *Henningsen* cases. **19**

The [**237] final argument is that the *Prairie Bank* and *Henningsen* cases were in effect overruled by our holding and opinion in *United States* v. *Munsey Trust Co., supra.* The point at issue in that case was whether the United States while holding a fund like the one in this case could offset against the contractor a claim bearing no relationship [***196] to the contractor's claim there at issue. We held that the Government could exercise the well-established common-law right of debtors to offset claims of their own against their creditors. This was all we held. The opinion contained statements which some have interpreted 20 as meaning that we were abandoning the established legal and equitable principles of the *Prairie Bank* and [****17] *Henningsen* cases under which sureties can indemnify themselves against losses. But the equitable rights of a surety declared in the *Prairie Bank* case as to sureties who complete **[*141]** the performance of a contract were expressly recognized and approved in *Munsey*, 21 and the *Henningsen* rule as to sureties who had not completed the contract but had paid laborers was not mentioned. *Henningsen* was not even cited in the *Munsey* opinion. We hold that *Munsey* left the rule in *Prairie Bank* and *Henningsen* undisturbed. We cannot say that such a firmly established rule was so casually overruled. 22

LEdHN[6] [6] We therefore hold in accord with [****18] the established legal principles stated above that the Government had a right to use the retained fund to pay laborers and materialmen; that the laborers and materialmen had a right to be paid out of the fund; that the contractor, had he completed his job and paid his laborers and materialmen, would have become entitled to the fund; and that the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it. 23 Consequently, since the surety in this case has paid **[*142]** out more than the amount of the existing fund, it has a right to all of it. On this basis the judgment of the Court of Appeals is

Affirmed.

[****19] MR. JUSTICE WHITE dissents.

Concur by: CLARK

Concur

MR. JUSTICE CLARK, with whom MR. JUSTICE DOUGLAS and MR. JUSTICE BRENNAN join, concurring in the result.

The Court holds that the surety company here is entitled to the funds the Government has paid into court on the theory that the surety is subrogated to the claims of the laborers and materialmen which it has paid. I cannot agree. None of the cases in this Court so hold. Indeed, in *United States* v. *Munsey Trust Co*., 332 U.S. 234 [***197] (1947), this Court said:

"But nothing is more clear than that laborers and materialmen do not [**238] have enforceable rights against the United States for their compensation. . . . They cannot acquire a lien on public buildings . . . and as a substitute for that more customary protection, the various statutes were passed which require that a surety guarantee their payment. Of these, the last and the one now in force is the Miller Act under which the bonds here were drawn." *Id*., at p. 241.

"It is elementary that one cannot acquire by subrogation what another whose rights he claims did not have. . . ." *Id*., at p. 242.

Since [****20] the laborers and materialmen have no right against the funds, it follows as clear as rain that the surety could have none. It appears to me that today's holding that laborers and materialmen had "rights" to funds in the Government's hands might jeopardize the rights of the United States and have serious consequences for its building operations. The Congress has not so provided and I would not so hold.

[*143] However, this Court has held in two cases not necessary to the decision in *Munsey* that the surety who pays laborers' and materialmen's claims stands in the shoes of the United States and is entitled to surplus funds remaining in its hands after the contract is completed. The first is *Prairie State Bank* v. *United States*, 164 U.S. 227 (1896), and the other *Henningsen* v. *U. S. Fid. & Guar. Co*., 208 U.S. 404 (1908). In neither of those cases, however, did the Court find that laborers and materialmen had any right against the United States but only that the "Guaranty Company [was] entitled to subrogation to any right of the United States Government arising through the building contract." *Henningsen, supra*, at p. 410. [****21]

Since the funds here have been paid into court by the Government, there is some question whether the doctrine of those cases would apply. In each of them the money was in the hands of the United States at the time the suit was commenced and was clearly applicable to payment of any debt under the contract. It would, therefore, be my view that the equities existing here in favor of the surety grow out of the contract between it and the contractor (in whose shoes the trustee now stands), which was made in consideration of the execution of the bond. Under that agreement in the event of any breach or default in the construction contract all sums becoming due thereunder were assigned to the surety to be credited against any loss or damage it might suffer thereby. In*Martin* v. *National Surety Co*., 300 U.S. 588 (1937), this Court in an identical situation awarded such a fund to **[*144]** the surety. Mr. Justice Cardozo, for a unanimous Court, said: "In our view of the law, the equities in favor of materialmen [***198] growing out of that agreement [between the surety and the contractor] were impressed upon the fund in the possession of the court." *Id*., at pp. 593-594. [****22] It is well to note also that the Court of Appeals in *Martin* had based its decision on the theory announced by the Court today, but Mr. Justice Cardozo for a unanimous Court chose the "narrower" [**239] ground of the assignment in affirming the judgment for the surety. I agree with *Martin* as to the "narrower" ground and believe the Court should keep the opinion today "within the necessities of the specific controversy" rather than enlarging upon the rules of *Henningsen* and *Prairie State Bank*. In so doing the Court would but fulfill the prophecy made in *Martin* that "the grounds chosen . . . may be expected to be helpful as a guide in other cases." *Id*., at p. 593.

[****23] I would affirm the judgment on this basis.

References

Annotation References:

Relative rights, as between surety on public work contractor's bond and unpaid laborers or materialmen, in percentage retained by obligee. 61 ALR2d 899.

Footnotes

- **1**

  The company was then known as Fire Association of Philadelphia.

- **2**

  40 U. S. C. § 270a provides in part as follows:

  "(a) Before any contract, exceeding $ 2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as 'contractor':

  "(1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.

  "(2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person."

- **3**

  30 Stat. 565 (1898), 11 U. S. C. § 110.

- **4**

  The surety appears also to have claimed some general priority over all creditors for the entire $ 350,000 it had paid out for the contractor, based on "liens, subrogation and assignment," but here its petition for certiorari and briefs seem to limit its claim to the net amount of the retained fund turned over to the trustee by the Government.

- **5**

  35 J. N. A. Ref. Bankr. 81 (1961).

- **6**

  In re Dutcher Constr. Corp., 197 F.Supp. 441 (D. C. W. D. N. Y. 1961).

- 7
  298 F.2d 655 (C. A. 2d Cir. 1962).
- 8
  See, *e. g.*, *American Sur. Co.* v. *Hinds*, 260 F.2d 366 (C. A. 10th Cir. 1958); *Phoenix Indem. Co.* v. *Earle*, 218 F.2d 645 (C. A. 9th Cir. 1955).
- 9
  369 U.S. 847 (1962).
- 10
  See Justice Holmes' discussion in *Sexton* v. *Kessler & Co.*, 225 U.S. 90, 98-99 (1912). As to the difficulties inherent in phrases like "equitable lien," see Glenn, The "Equitable Pledge", Creditors' Rights, and the Chandler Act, 25 Va. L. Rev. 422, 423 (1939).
- 11
  United States v. *Durham Lumber Co.*, 363 U.S. 522 (1960). See also *Security Mortgage Co.* v. *Powers*, 278 U.S. 149 (1928), and cases collected in 6 Am. Jur., Bankruptcy, § 949 (rev. ed. 1950). Cf. *Aquilino* v. *United States*, 363 U.S. 509 (1960).
- 12
  LEdHN[3] [3]
  "The right of subrogation is not founded on contract. It is a creature of equity; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties." *Memphis & L. R. R. Co.* v. *Dow*, 120 U.S. 287, 301-302 (1887).
- 13
  See, *e. g.*, *Hampton* v. *Phipps*, 108 U.S. 260, 263 (1883); *Lidderdale's Executors* v. *Robinson's Executor*, 12 Wheat. 594 (1827); *Duncan, Fox, & Co.* v. *North and South Wales Bank*, 6 App. Cas. 1 (H. L. 1880). See generally Sheldon, Subrogation, § 11 (1882).
- 14

  See cases collected in 50 Am. Jur., Subrogation, § 49 (1944).

- 15
  208 U.S., at 410.
- 16
  See, *e. g.*, *Martin* v. *National Sur. Co.*, 85 F.2d 135 (C. A. 8th Cir. 1936), aff'd, 300 U.S. 588 (1937); *In re Scofield Co.*, 215 F. 45 (C. A. 2d Cir. 1914); *National Sur. Corp.* v. *United States*, 132 Ct. Cl. 724, 133 F.Supp. 381, cert. denied *sub nom.* *First Nat. Bank* v. *United States*, 350 U.S. 902 (1955).
- 17
  See note 2, *supra*.
- 18

  28 Stat. 278 (1894), amended, 33 Stat. 811 (1905).

- 19

  Among the problems which would be raised by a contrary result would be the unsettling of the usual view, grounded in commercial practice, that suretyship is not insurance. This distinction is discussed in Cushman, Surety Bonds on Public and Private Construction Projects, 46 A. B. A. J. 649, 652-653 (1960).

- 20

  See note 8, *supra*.
- 21

  332 U.S., at 240.
- 22

  State courts likewise apply the rule that sureties on public contracts are entitled to the benefits of subrogation. See cases collected in 43 Am. Jur., Public Works and Contracts, § 197 (1942).

- 23

  See the somewhat different but closely related discussion by which Mr. Justice Cardozo, speaking for this Court, reached a similar result in *Martin* v. *National Sur. Co.*, 300 U.S. 588, 597-598 (1937).

  Our result has also been reached by the Court of Claims in cases substantially like ours. *Continental Cas. Co.* v. *United States*, 145 Ct. Cl. 99, 169 F.Supp. 945 (1959); *National Sur. Corp.* v. *United States*, 132 Ct. Cl. 724, 133 F.Supp. 381, cert. denied *sub nom. First Nat. Bank* v. *United States*, 350 U.S. 902 (1955); *Royal Indem. Co.* v. *United States*, 117 Ct. Cl. 736, 93 F.Supp. 891 (1950). See generally Speidel, "Stakeholder" Payments Under Federal Construction Contracts: Payment Bond Surety vs. Assignee, 47 Va. L. Rev. 640, 646-648 (1961); note, Reconsideration of Subrogative Rights of the Miller Act Payment Bond Surety, 71 Yale L. J. 1274 (1962); comment, 33 Cornell L. Q. 443 (1948).
- *

  In *Martin* the contractor assigned to the surety "all the deferred payments and retained percentages, and any and all moneys and properties that may be due and payable to the undersigned at the time of any breach or default in said contract, or . . . thereafter . . . ." *Id.*, at pp. 590-591. Here the assignment was of, *inter alia*, "Any and all percentages of the contract price retained on account of said contract, and any and all sums that may be due under said contract at the time of such . . . forfeiture or breach, or that thereafter may become due . . . ."

SESSION 5

UNDERWRITING 101

Keith Langley | Langley LLP | Westlake, TX

Bryan Bullinger | Travelers | Seattle, WA

George Crittenden | Liberty Mutual Surety | Seattle, WA

PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

Underwriting 101: How did we get here?

- The role, job responsibilities, training of underwriters.
- Discussion of what underwriters do, how underwriting is done, and what is changing and how.
- How underwriting relates to agents.
- Information and contacts received and processed.
- How do lines of authority work?
- What tools are used by underwriters to evaluate risk?
- The three C's - character, capacity, capital.
- Trend lines for the future.

SESSION 6

INTERNATIONAL BONDS AND FOREIGN CONTRACTORS COMING TO THE U.S.

Richard Tasker | Sage Associates, Inc. | Irvine, CA

Luis Aragon | Liberty Mutual Surety | Seattle, WA

John McDevitt | Liberty Mutual Surety | Weston, MA

Gina Shearer | Clark Hill | Strasburger | Frisco, TX

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Bonds without Borders: Challenges and Opportunities for Sureties Issuing Bonds in Foreign Markets and Working with International Contractors Entering the U.S. Bond Market

By John McDevitt, Luis Aragon, Richard Tasker, and Gina Shearer

The world of construction, surety, and insurance is getting flatter. Markets, economies, and companies are increasingly interconnected. The relative peace and stability enjoyed by many countries, including the United States, over the last several decades has resulted in long term economic expansion which, coupled with rapid advancements in communications, finance, commerce, travel, and especially technology, have facilitated increased global interconnectedness and interdependence.

Although the impacts of globalization may not be evident as we go about our daily lives in our offices, cubicles, and conference rooms, the construction and surety industries are evolving and broadening in response. For instance, several of the larger U.S. surety companies have moved into international bond markets in recent years. Some have entered on a limited basis in limited markets with limited products, others more broadly. Given the opportunities created by this large and expansive pool of business, the scope and volume of international bond products are likely to continue to increase in the coming years.

Exposure to new foreign markets also has domestic impacts. While participation of foreign contractors in the U.S. construction market is not a new trend, in recent years many new foreign contractors, particularly those from Western Europe, have moved into the U.S. market. Many other new foreign contractors, particularly from the massive Asian market, also appear poised to enter the U.S. market. The integration of foreign contractors, many of whom come from countries with very different cultures, business practices, and economies, creates challenges for sureties writing bonds for these foreign entities working in the United States.

This paper provides an overview discussion of the factors driving international bond market trends, the business opportunities and challenges presented by a global construction market and implications for the surety claims business.

America: The Land of Opportunity for Foreign Contractors

The authors of this paper recognize the irony of use of the term "foreign contractors" to describe contractors in a nation of immigrants. However, in this paper, the term refers to construction contractors with a home office domiciled in countries other than the United States (or Canada) with senior management, financial and insurance arrangements and structures outside of the United States. Typically, these are larger work volume contractors who are attracted to significant opportunities in the U.S. market. Much of the work attracting these contractors is very large public work, including, but not limited to, P3 opportunities. Other market attractions include very large industrial, manufacturing, technology, private energy and transportation, and major distribution projects.

By virtue of either statutory requirements or owner/lender conditions, many of the projects targeted by these foreign contractors require surety bonds. To satisfy the bonding requirements, foreign contractors have several options, including:

- Pay. A foreign contractor can pay to enter the U.S. market by purchasing a U.S. contractor to manage as a wholly-owned affiliate. This approach is common and remains an attractive option for the foreign contractor purchaser so long as favorable financing is available, as it allows the foreign contractor to rely on the capital, capacity, and character of the U.S. entity and hit the ground running upon entry to the U.S. market. For closely held U.S. contractors who may be acquisition targets, benefits include opportunities for owners to monetize their assets and eliminate the need for succession planning.

- Play. A foreign contractor can also choose to enter the U.S. market directly. To do so, the foreign contractor must take certain administrative actions, such as qualifying individuals for the requisite licenses needed to conduct business in the selected market, establishing a surety bond program, obtaining audited financial statements and satisfying other financial prequalification requirements, and staffing both home office and field office operations. Foreign contractors frequently staff the field office with a combination of transplants from abroad and local hires, most often "importing" proven talent for key roles and managerial positions and "purchasing" the labor force. The risk in this approach is that the individuals coming from abroad will not be familiar with the locals, i.e. the clients, trade contractor partners, and suppliers, and may have difficulty establishing relationships or determining credibility. Differences in customs and cultures may also present challenges to the foreign contractor in establishing a unified team of project personnel.

- Join Forces. Another option for a foreign contractor looking to enter the U.S. market is to join forces with an established U.S. contractor. The joint venture approach has several advantages, including that the foreign contractor's initial investment is limited, its risk is limited to project risk only, and the JV partners already have the local contacts and connections. However, allocation of control between the partners and management of the relationship may present challenges. To succeed, it is critical that the foreign contractor choose the correct joint venture partner.

Each of these approaches can and does work. However, as the surety industry can attest, failures and losses occur under all three approaches. Recently, the surety industry has experienced a series of significant defaults and losses. In these instances, where seemingly large, well-financed foreign owned contractors have defaulted on U.S. surety bonds, indemnity has become a significant problem and the sureties have had difficulty with collateral and enforcement of indemnity rights.

"That's Not How We Do It Here in America": Challenges for the Foreign Contractor Entering the U.S. Market and Its Surety

From the surety's perspective, diligent underwriting is often the best way for the surety to mitigate risk when writing bonds for foreign contractors doing business in the United States. An issue that frequently arises is the legal and financial relationship between the foreign entity and the U.S. entity that actually holds the construction contract. The U.S. entity holding the contract may be nothing more than an LLC conduit with no net worth while the foreign entity may have significant assets. It is important to have an accurate understanding of the relationship between the principal and any potential guarantors or indemnitors, as well as the respective value of each, so that the surety can ensure appropriate agreements are in place to protect itself in the event of a default.

Even the process of defining conditions of default, whether in an indemnity agreement, construction contract, or other agreement, can be a challenging process because foreign accounting, financial reporting and bankruptcy laws vary significantly in foreign jurisdictions. There is also the risk that the foreign contractor is largely unfamiliar with the nature of its contractual risks and obligations with U.S.

performance and payment bonds. As will be discussed in detail further herein, surety bonds in use in other countries are very different than their U.S. counterparts and the foreign contractor is likely unfamiliar with the statutory authority and robust body of U.S. case law related to surety bonds and the surety's indemnity and recourse rights.

Foreign contractors very often have difference experience and perception of their relationships with owners, trade contractors and the role of the legal system. These cultural differences can lead to misunderstandings or unrealistic expectations between the parties to a construction project. For instance, in some countries, the project is not necessarily awarded to the "low bidder." In other countries, trade unions and even governments can be financial participants in the construction process and lenders, who are often creditors to both the general contractor and trade contractors, may act as informal mediators in payment disputes. Policies and laws against false claims, collusion, bribery, which are strictly enforced in the United States, coupled with generally high levels of litigation, may also be unfamiliar territory for foreign contractors and serve as potential disincentives to those looking to enter the U.S. market. Despite cultural differences in doing business and other barriers to entry, the United States remains a beacon for foreign contractors, due in part to the large size of the U.S. market, the country's massive infrastructure replacement needs, security of its financial markets, the strong and stable U.S. dollar, the general universality of the English language in the business world, a low risk of government debt default, a reasonably high standard of living, and a solid rule of law.

Sureties, and consequently surety claims professionals, are likely to see continued increases in foreign contractors as their principals on bonded projects in the domestic market.

A New Frontier: Opportunities for the Surety in Foreign Markets

Foreign contractors are being drawn to doing business in the United States in ever increasing numbers; yet, increased competition in the U.S. private sector insurance market is drawing large insurers, and their surety divisions, oversees to do business in foreign markets. Name recognition of U.S. insurers oversees is high, as foreign business communities and regulators recognize the high quality and strength of the U.S. insurers' balance sheets.

U.S. banks and financial institutions are well respected abroad. As a result, their capital requirements, transparency, and investments are often better than that of the local banks. Some U.S. insurers in the life, property and casualty, and specialty markets have operated abroad for many years. A well known example is the role that AIG and its legendary leader, Hank Greenberg, played in working with Kissinger and Nixon in China.

Traditionally, surety bonds were not frequently used as a construction risk management tool in much of the world. The statutory authority for bonds was non-existent and nature of the construction market and its participants were very different. As the world, and the business sector in particular, has become flatter, cross-fertilization of ideas, financial products, and risk management options has increased and American business practices have seen increased exposure and influence.

The dominant risk mitigation tool for much of the world other than U.S. and Canada has traditionally been the letter of credit. This remains the case today. The advantages of letters of credit ("LOCs") are that they are well understood and simple and usually offer immediate liquidity. As will be discussed in greater detail during the authors' panel discussion at the Pearlman conference, a LOC also comes with risks and downsides, both for the contractor and the owner (as well as the sponsor who is often a bank). Some of those risks and downsides relate to price volatility, renewability, and proportionality.

While the LOC still dominants the "rest of world" as the preferred construction risk mitigation tool, use of surety bonds has become common in some foreign countries, such as Italy, Germany, and South Korea, and is becoming common in others, such as Australia, Mexico, Brazil, and Columbia. The attraction for U.S. sureties to enter foreign markets is the potential upside. The U.S. surety market fully matured decades ago and is largely a market share/ "slice of the pie" business environment. In contrast, the market for surety products in the rest of the world is larger than the entire U.S. market and is in relative infancy. Although the authors of this paper have unsuccessfully attempted to quantify the potential market size, it is safe to say that the upside potential is enormous.

<u>A Horse of a Different Color: Understanding the Difference between Foreign Surety Bonds and U.S. Bonds</u>

At present, a limited number of U.S. based surety claims handlers have experience with international bonds. This is changing and will continue to change as more insurance companies expand their surety divisions overseas and broaden the scope of surety products offered in foreign markets. Likewise, as more foreign contractors move into the U.S. bond market and establish long-term surety relationships, these accounts may incentivize sureties to venture into their principals' home markets overseas. Some may call the authors of this paper "surety nerds," but the exciting opportunities that exist for current claims professionals to shape and nurture this fledgling market are what inspired this topic and its presenters.

The balance of this paper will provide only the most cursory overview of foreign surety bonds. If you take but one thing from this paper, remember that foreign surety bonds are VERY DIFFERENT in almost all respects from traditional U.S. performance and payment bonds. The group will discuss these differences in depth during their presentation, but for illustrative purposes, the major differences between foreign bonds and U.S. bonds can be summarized as follows:

- <u>Low Penalty.</u> Penal sums on bonds issued in foreign markets are typically only a small fraction of the contract value (generally around 10 percent).
- <u>Lack of Statutory Mandates.</u> Bonds are generally not mandated by statute and there are usually no equivalents to Miller Act or Little Miller Act requirements.
- <u>Lack of Established Relationships.</u> The long-term relationship between principal and surety that is common in the United States is very uncommon abroad, where principal/surety relationships are more transaction driven on project-by-project basis.
- <u>Cancellable.</u> Much like LOCs, bonds issued in foreign markets often have terms and may be cancelable.
- <u>On Demand Bonds.</u> On demand bonds are common in foreign markets and, unlike traditional performance bonds that give the surety an option to pay or perform, under most foreign bonds payment is the surety's only option.
- <u>Narrow Indemnity Rights.</u> In foreign markets, the surety typically receives corporate, but not personal, indemnity and its rights are less well-defined than in the United States. The provision of collateral is more common overseas, but the surety's rights with respect to collateral are often narrower. Often collateral held by the surety will be subject release upon occurrence of certain triggers.

- Expanded Use as a Risk Mitigation Tool. In some countries, bonds are used as forms of financial guarantee to manage risk with respect to a far broader range of goods and services than are traditionally bonded in the United States.

The infancy of the international market means that as globalization and the use of surety bond products overseas increase, opportunities will arise to reshape the landscape of the foreign bond market to be more consistent with that of the existing U.S. market. However, obstacles exist to rapid expansion of the international bond market, including:

- Lack of Long Term Confidence, Strength, and Transparency. Referring again to the Tom Friedman analogy, you won't find surety bonds in countries that don't have McDonald franchises. Long term stability and public confidence in the legal, financial, and political systems of foreign countries are threshold issues to expansion of the foreign bond market. This explains why surety bonds are not presently in use in most of Asia, Africa, and the Middle East, but can be found in many South and Central American countries.

- Inertia and Familiarity. LOCs dominate foreign markets and there is comfort in familiarity. Once difficulty in entering emerging markets is convincing industry professionals to use and rely on products that differ from local custom and practice. Those selling competing risk management tools are as eager to protect their turf as U.S. sureties are to protect the market advantages afforded to them by the Miller and Little Miller Acts.

- Knowledge and Perceived Benefit. In the land of the blind, the one eyed man truly is king. Market education as to the application and advantages of surety bonds over other risk management tools can assist in facilitating increased demand for surety bond products.

Both beneficiary (owner) and account party (contractor) of an LOC must perceive a benefit to use of the product to justify ignoring alternative risk management products available. As the international construction community becomes more diversified and financial structures become more tailored to optimize performance, the LOC has one significant patent downside for the contractor. It either immediately encumbers capital in terms of upfront collateral requirements or exposes the contractor to the risk of cancellation due to breach resulting from deterioration in the contractor's financial condition. Bonds are an attractive alternative to avoid these problems and it is for these reasons, more than any others, that the international bond market will likely continue to expand, and with it the participation of U.S. sureties.

Like the foreign contractor coming to the U.S. bond market, there are several options for sureties entering a foreign market. To the authors' knowledge, no U.S. surety has sought to open a foreign bond operation on its own. The efforts required to meet the stringent qualifications and standards of the target country (the established local bond providers are never happy to see U.S. companies in their backyard) are substantial and learning curve challenges are high. Accordingly, U.S. sureties have opted either to utilize forms of joint venture or fronting agreements, or acquire an established local company (the most common approach to date).

These approaches to business acquisition have also carried over to claims handling. U.S. sureties that have acquired foreign "in-country" companies continue to address claims locally using "in-country" staff. Sureties in joint venture or fronting agreements also continue to rely upon the foreign partner for claims handling. However, as would be expected, as premium volume and corresponding risk have increased for those U.S. sureties expanding their overseas operations, training and involvement of U.S. based staff in more hands-on overseas claims issues has also expanded.

These are exciting times and we are happy to talk further with you about them.

SESSION 7

DEALING WITH BAD CASES

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Bad Surety Cases, Dealing with Them, and Lessons Learned

by

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It is basic surety law that every surety's liability is contained within the letter of the surety bond, and a surety is bound by the express terms of the bond. The courts, however, sometimes have other ideas about a surety's obligations, and sometimes a court does not agree with a surety's interpretation of a bond, the statutes pursuant to which it was written, and the surety's bonded obligations. A Bad Surety Case is born.

A Bad Surety Case is just the beginning. Surety adversaries rarely keep their arguments within the confines of a Bad Surety Case. Instead, surety adversaries have been known to use Bad Surety Cases to argue for ever-broadening surety obligations and against traditional surety defenses.

Our panel will discuss a selection of Bad Surety Cases that expand a surety's liability in various contexts, how surety adversaries are using those cases to support novel arguments against sureties, and how surety representatives can respond to them. We will also discuss the valuable lessons that can be learned from Bad Surety Cases. The following is a summary of the cases we will present.

1. The Not Good, the Bad, and the Truly Awful

***National Technical Sys. v. Superior Court*, 97 Cal. App. 4th 415 (2002)**

Facts: Commercial Contractors was the direct contractor to the City of Long Beach to perform remediation work at the Port of Long Beach. Commercial subcontracted with National

Technical Systems.

NTS claimed that it was only partially paid for its services and filed a stop notice with the City in the amount of $345,905.00. On April 8, 1997, Commercial obtained a stop notice release bond from United Pacific Insurance Company in the amount of $429,881.00.

On April 30, 1997, UPIC notified NTS of its stop notice release bond. Thus aware of the bond, NTS thereafter filed suit against Commercial, only. On the eve of trial, NTS moved to file an amended complaint to add UPIC as a party in order to avail itself of the summary proceeding provided by section 996.440 of the Code of Civil Procedure §996.440. The motion was denied.

NTS prevailed against Commercial and then made demand on UPIC for $466,552.00, which included damages of $178,631.00, pre-judgment interest, $204,468.00 in attorney's fees and statutory penalties of 2% per month pursuant to Business & Professions Code §7108.5.

NTS then filed a motion for summary judgment against UPIC in the original action it had filed against Commercial claiming it was entitled to judgment under C.C.P. §996.440. The trial court denied NTS's motion for summary enforcement against UPIC of the judgment it had previously obtained against Commercial.

In a separate published opinion, *National Technical Systems v. Commercial Contractors, Inc.*, 89 Cal.App.4th 1000 (2001), the Court of Appeal affirmed the order denying NTS's motion for summary judgment, finding that the stop notice release bond was issued prior to the filing of NTS's lawsuit against Commercial and therefore not "given in action or proceeding" as required by section 996.440.

While NTS's action against Commercial was pending, it filed a separate action against UPIC from which this case arises. UPIC filed two motions in limine: (1) to preclude evidence of the previous trial and judgment against Commercial on the ground that UPIC was not named as a party in the prior action and therefore not bound by NTS's judgment against Commercial; (2) to preclude evidence of non-recoverable damages contending, specifically, that attorney's fees, statutory penalties, delay and other damages were not recoverable against a stop notice release bond and that UPIC's liability was limited to the value of the labor, services, equipment and materials actually furnished by NTS on the project.

The trial court granted both motions in limine. NTS filed a petition for writ of mandate. Writ issued.

With respect to the first motion in limine, the Court held: (1) UPIC is not bound by NTS's judgment against Commercial because "it is well established that a judgment against a principal is not binding in a separate action against a surety." (Citing, most recently, *All Bay Mill & Lumber Co. v. Surety Co.*, 208 Cal.App.3d 11 (1989).)

In addition, the Court distinguished between a bond given before an action is commenced with one given afterwards based on the Surety's right to notice. Where a stop notice release bond is issued after the filing of a lawsuit, it is "given in an action or proceeding" in which the Surety is deemed to have notice and thus subject to summary enforcement procedure under section 996.440. However, where the stop notice release bond is issued before the lawsuit is filed, the bond is not "given in an action or proceeding." Consequently, the claimant would be required to join both principal and surety pursuant to section 996.430, thereby giving the surety notice of the action so as to enable the surety to protect its rights.

Nevertheless, the Court permitted testimony from the prior trial to be admissible for impeachment purposes, and thus only evidence of the verdict and judgment against Commercial would be precluded, not the entirety of the first trial.

As to the second motion in limine, the Court held that UPIC would be liable for attorney's fees and statutory penalties. UPIC argued that under former Civil Code § 3103 (now found in parts of Civil Code §§ 8044, 8502, 8506, 9352 and 9354) the stop notice release bond was limited to labor, services, equipment or materials but not for attorney's fees or other types of damage.

The Court disagreed. The subcontract between Commercial and NTS included a reasonable attorney's fees provision and, therefore, "It reasonably follows that UPIC's liability on the stop notice release bond extends to the attorney fees in which NTS is entitled under the subcontract." (Citing *Boliver v. Surety Co.* 72 Cal. App. Supp. 22 (1977), and *T&R Painting Construction, Inc. v. St. Paul Fire & Marine Ins. Co.*, 23 Cal. App. 4th 738 (1994).) Thus, "so long as the total recovery against the surety, including attorney's fees, does not exceed the penal sum of the bond," the subcontractor can recover its attorney's fees as provided in the subcontract.

Prompt payment statutes are common under California law. Section 7108.5 of the Business & Professions Code provides for a "penalty payable to the subcontractor of 2% of the amount due per month for every month that payment is not made." Section 10262.5 of the Public Contract Code provides for the same on a public works payment bond. *Washington Int'l Ins. Co. v. Superior Court*, 62 Cal. App. 4th 981, 985 (1998).

Thus, under *Washington International*, the court held that UPIC was liable under its stop notice release bond for statutory penalties under section 7108.5 of the Business and Professions Code, provided the total recovery does not exceed the amount of the bond.

2. Double Indemnity; Double Jeopardy

***First Nat'l Ins. Co. v. Cam Painting, Inc.*, 173 Cal. App. 4th 1355 (2009)**

Facts: Cam Painting, Inc. was the direct contractor on a construction project for the Los Angeles Unified School District. Cam subcontracted with Sabco Electrique, Inc. FNIC bonded both the Cam/LAUSD direct contract and the Cam/Sabco subcontract. FNIC had indemnity agreements with both CAM (and associated individuals) and Sabco (and associated individuals).

The Cam/LAUSD bond was a $2.29 million payment and performance bond. The Sabco/Cam bond was a $400,000.00 payment and performance bond.

Sabco failed to pay its supplier, Allsale Electric. FNIC paid Allsale $47,000.00, allocating half the payment to each bond, and sought indemnity from both Cam and Sabco (and their respective individual indemnitors).

The trial court agreed that FNIC could allocate the loss between the Cam and Sabco bonds. However, the Court of Appeal did not.

Further, Cam sued Sabco for breach of contract, alleging that Sabco drilled through asbestos, contrary to contract specifications. Cam prevailed against Sabco, and the trial court ordered it to pay damages and attorney's fees to Cam. FNIC, as Sabco's surety, was found jointly and severally liable for Cam's damages but not its attorney's fees. On appeal, Cam once again prevailed. FNIC should have been jointly and severally liable for the fees award as well.

Holdings:

(1) "Surety bonds such as the one here 'will be construed most strongly against the surety and in favor of all persons for whose benefit such bond is given . . .'" [Cal. Civ. Code § 8154].

(2) FNIC was required to allocate the entire Allsale payment to the subcontractor's bond and could not attempt to maximize recovery on the indemnity agreements by attributing some of the loss to the Cam bond.

(3) Had FNIC been Sabco's surety only, and not Cam's, it would have had no reason to turn to Cam. Therefore, FNIC was not entitled to attribute any of the Allsale loss to the Cam

bond, nor was it entitled to indemnity from Cam for either the sum paid to Allsale or for its attorney's fees incurred in the litigation. Consequently, FNIC was not entitled to attorney's fees as prevailing party.

(4) Civil Code § 2808 (unchanged) states, "Where one assumes liability as surety upon a conditional obligation, his liability is commensurate with that of the principal." Thus, bond claimants are entitled to recover from a surety the attorney's fees they expend to enforce their contract with the principal if the contract between principal and claimant expressly calls for the payment of attorney's fees. *T&R Painting Construction, Inc. v. St. Paul Fire & Marine Ins. Co.*, 23 Cal. App. 4th 738, 744-45 (1994). Under these principles, the trial court should have found FNIC liable for the fees awarded to Cam against Sabco.

(5) FNIC had argued that the above rules apply only when the underlying contract is incorporated into the performance bond and that the Cam/Sabco subcontract was not incorporated into the Sabco bond. The Court of Appeal disagreed. "[A] performance bond and the underlying contract must be read together, as 'parts of . . . substantially one transaction.'" [Civil Code §1642; *Boys Club of San Fernando Valley, Inc. v. Fidelity & Deposit Co.,* 6 Cal. App. 4th 1266, 1271-72 (1992).]

The Sabco performance bond specifically referenced the Cam/Sabco subcontract and provided that that contract is a condition of FNIC's obligation on the bond.

3. When Can the Surety Forfeit Its Right to Earned Contract Funds?

***East Quincy Serv. Dist. v. General Acc. Ins. Co. of Am.*, 88 Cal. App. 4th 239 (2001)**

Facts: In 1996, the East Quincy Services District entered into a contract with P&M Pipelines for a sewer project, which as a public project required the payment of prevailing wages. General Accident issued the payment and performance bonds for the approximately $2.2

million project. The performance bond expressly incorporated the contract by reference: "cause the obligations and duties of the PRINCIPAL, as set forth in the CONTRACT referred to herein, to be carried out in full."

The contractor defaulted in October 1996, with the District having paid it $1,346,000 for $1,854,000 in completed work. The surety paid $1,059,000 to "unpaid creditors" and "engaged" a contractor to complete the contract. The surety recovered $492,000 of the contract balance of from the District. The notice of completion was recorded in September 1997.

In November 1997, after the District had paid the earned contract balance to the surety, the California Division of Labor Standards Enforcement (DLSE) issued a notice of withholding under the Labor Code provisions then in effect (which were substantially revised in 2001). The notice of withholding required the District to withhold forfeited "payments which are or hereafter may become due to the contractor" of $97,000 for wages and $80,000 for penalties. Neither the contractor nor surety filed the required lawsuit to dispute the notice of withholding. In June 1998, the surety paid the wages to DLSE, but not the penalties.

DLSE then filed suit to recover the $80,000 for penalties. The District intervened and interpled the $80,000 with the court, naming DLSE and the surety as the two claimants. After that, the reasoning of the opinion becomes murky.

Holdings:

(1) Although the trial court relied on *Harsco Corp. v. Department of Public Works*, 21 Cal. App. 3d 272, 277(1971), in ruling that the DLSE notice of withholding did not reach contract retention when completion costs exceed the amount retained, the Court of Appeal disagreed, holding that the contractor had forfeited its right to the contract funds by operation of law when it failed to pay proper wages, months before DLSE issued the notice of withholding.

[Citing Cal. Lab. Code § 1727; *J&K Painting Co. v. Bradshaw*, 45 Cal. App. 4th 1394 (1996).]

(2) The surety's argument that once it assumed the principal's duties under the contract, its "entitlement to all funds arose ab initio," based on *Prairie State Nat'l Bank v. United States*, 164 U.S. 227 (1896), was rejected by the Court of Appeal both because it declined to follow federal case law on a state law issue, and also because it was holding the contractor had no entitlement to the contract funds once it violated wage laws.

4. California Labor Law: How Can a Surety Request Review?

***First Sealord Surety, Inc.*, DIR Case No. 10-0301-PWH**

Facts: First Sealord Surety issued payment and performance bonds on behalf of UST Development, Inc. UST filed a Chapter 11 bankruptcy petition on March 5, 2010. On September 15, 2010, DLSE served a Civil Wage and Penalty Assessment for the project, asserting that UST had failed to pay wages and assessing penalties, together totaling $35,823.91.

First Sealord submitted a timely request for review of the CWPA on its own behalf. The matter went to hearing, and the Hearing on the Merits (trial) was conducted on August 15, 2011. After the Hearing was concluded, the surety submitted UST's Chapter 11 petition.

Holdings:

(1) In his decision, the Director of Industrial Relations held that its procedures are exempt from the automatic stay because the CWPA "is an exercise of DLSE's police powers to enforce California's prevailing wage statute," and is, therefore, exempt under section 362(b)(4) of 11 USC. The Director declined to address whether DLSE could actually collect from UST or the surety.

(2) The Director further held that a surety does not have independent standing to request review of the CWPA because it is not one of the listed parties in section 1742 of the

Labor Code; the only parties listed are "the affected contractor or subcontract." The Director rejected the surety's fifth amendment due process arguments, but confirmed that the ability to challenge a prevailing wage withholding through assignment or by other contractual means is sufficient due process protection, citing *Lujan v. G&G Fire Sprinkler*, 532 U.S. 189 (2001).

(3) The Director's decision also states that while the surety can "step into the shoes of the contractor" to challenge the CWPA, citing *East Quincy*, above, the surety then becomes liable for statutory penalties. This is not the holding of *East Quincy*.

5. A Triple Threat to Motor Vehicle Dealer Bond Liability in Alaska

***Kenai Chrysler Center, Inc. v. Denison*, 167 P.3d 1240 (2007)**

Facts: David Denison, a mentally disabled young man, of the age of 21 years old, found himself in desperate need of a new car. David dreamed of trading in his old Pontiac and driving off in something more fun and flashier. In search of his new car dreams David found himself at the local auto dealership. While on site David called his Dad and asked him to cosign for a car loan. David's dad refused and his parents thought the matter had been resolved. David was developmentally disabled and was under the legal guardianship of his parents. Intent on securing new wheels David returned to the auto dealership the very next day. This time David called his mother and asked her to give him money for a down payment on a brand-new Dodge Neon. David's mother refused and assumed her word on the issue was final because she didn't realize David could obtain a significant amount of money from his debit card. Unhappy with his parent's refusal to buy him a new car David decided to take matters into his own hands. David withdrew a down payment from his debit card, traded in his used Pontiac and signed loan papers to purchase a brand-new Dodge Neon for a total price of $17,802.

Two days later David and his mother returned to the dealership. David's mom provided the dealership with guardianship papers showing that David was under the legal guardianship of his parents and she explained that she would not agree to buy the car and that the contract was void. The manger for dealership told David's mom that he would not take the car back and stated that he sold a lot of cars to people that were not that smart. He handed the keys to the brand-new Dodge to David over his mother's objections and David sped off.

David's new car dreams came crashing down when a few days later David wrecked his new car. David's parents managed to get the car away from David and once again returned the car to dealership. A few days later David called the dealership and asked to pick up his old Pontiac. The dealership told David that he couldn't have the Pontiac back but that he could come back and pick up the new Dodge he had purchased. David went straight down to the dealership and drove away once more in the new Dodge. The next day David's parents again returned the Dodge to the dealership. During this time even though David's parents disputed the contract the dealership sold David's old Pontiac.

Over the next month, David's parents tried to reason with the dealership. The Denisons contacted the Alaska State Association for Guardianship and Advocacy, The Disability Law Center and the court-appointed investigator for David's guardianship case. These parties reached out to the dealership to explain how guardianship law worked. The dealership refused to back down or consult legal counsel. Instead the dealership continued its attempt to enforce the contract and demanded the Denisons pay additional fees for the storage of the Dodge on its lot. The dealership went so far as to attempt to modify the guardianship over David claiming that it had standing to file the probate proceeding because it was a person interested in David's welfare. The probate court denied the petition to modify and awarded the Denisons their attorney's fees and costs "expressly finding the petition to be frivolous and without good cause."

Thereafter David's parents sued the dealership: (1) to void the contract; (2) for damages under the Unfair Trade Practices Act ("UTPA"); and for punitive damages. The Denisons prevailed and were awarded treble damages under the UTPA. Kenai Chrysler appealed, arguing the superior court erred in awarding treble damages because the Denisons withdrew their claim for punitive damages during the trial. Kenai Chrysler argued that because treble damages are punitive in nature, and because Denison dismissed his claim for punitive damages, then the claim for treble damages was also dismissed. The Alaska Supreme Court disagreed, stating "this reasoning conflicts with the language and purposes of Alaska's treble damages provision." In refusing to find that treble damages are punitive, the Alaska Supreme Court made much ado about the fact that treble damages are awarded automatically, "solely on an allegation and finding the UTPA has been violated."

Kenai Chrysler also argued that "treble damages should be equated to punitive damages because they serve a punitive role." Again, the Alaska Supreme Court disagreed. "The legislative history of Alaska's provision establishes that treble damages were adopted not just to deter fraud, but also to encourage injured parties to file suits under the UTPA and to ensure that they would be adequately compensated for their efforts." Thus, the Supreme Court upheld the treble damages awards to the Denisons finding that the award was not punitive in nature.

To learn more about how this case could impact a surety issued motor vehicle bonds in Alaska be sure to attend our presentation.

6. Ending on a Positive Note - an Alaskan Court Draws Some Bright Lines and Its Narrow Interpretation Results In a Failure to the Pick the Deep Pocket…

***Alaska Nat'l Ins. Co. v. Northwest Cedar Structures, Inc.*, 153 P.3d 336 (2007)**

Facts: As part of a construction project, Northwest Cedar Structures, a construction contractor, secured a statutory bond from Traveler's Casualty and Insurance Co. In pursuit of its construction masterpiece Northwest Cedar entered into a number of contracts including a contract to obtain worker's compensation coverage with Alaska National Insurance Company. However, after Alaska National Insurance provided worker's compensation insurance the contractor failed to pay. After the debt ballooned to $80,000, Alaska National Insurance filed suit against the contractor for breach of contract and simultaneously attempted to collect its past due worker compensation premiums directly from the surety under the contractor's statutory bond. The surety took the position that for purposes of the contractor's statutory bond it was irrelevant whether Northwest Cedar breached the contract it entered with Alaska National Insurance. Since the contract between Alaska National Insurance and Northwest Cedar did not concern a "breach of contract in the conduct of the contracting business" and accordingly the surety was not responsible for the breach as this type of breach was not covered by the bond. The surety filed for summary judgment arguing that the surety was not liable for Northwest Cedar's breach of contract because the contract did not concern the "sort of activities the licensing statute" addresses.

The superior court ruled that Northwest Cedar breached its contract with Alaska National Insurance and was therefore liable for damages under the contract. However, the court ruled in favor of the surety reasoning that workers compensation insurance was more of a general expense unrelated to the conduct of the contracting business. Alaska National Insurance appealed the superior court's ruling. The Supreme Court affirmed the holding of the superior court dealing a big win to Alaska surety companies.

Holdings: The issue examined on appeal by the Supreme Court was narrow. Essentially the court reviewed what qualified as a compensable "breach of contract" subjecting a surety to liability under the bond for purposes of Alaska Statute § 08.18. Even though the issue raised on appeal was narrow the court handed sureties everywhere a big win with its thorough analysis. As a result, the court eliminated a surety's exposure for a contractor's breach of all general contracts that were not in the "conduct of the contracting business." Accordingly, a contract, such as one pertaining to workers compensation insurance or those pertaining to more general expenses, arising in connection with a construction project are not covered by the bond.

The court reasoned that the term "breach of contract in the conduct of the contracting business" in the applicable statute was a narrow term that was not unlimited allowing any and every breached party to go looking for the nearest deep pocket to pick when a contractor defaulted on its obligations. Since the statute requires a contractor to secure a bond covering amounts that could arise in the contracting arena by reason of breach of contract the protections created in these statutes were limited and only extended to those contracting parties the statutes intended to protect. The court explained that the statute "intended to protect contracting parties for whom the danger of breach is central to the activity of contracting—especially parties whose ability or incentive to investigate contractors is limited" the parties that could recover under the statutory bond was also limited. See Alaska Statute § 08.18.071(a)(3).

The courts explained: "The statutory requirement of a surety bond to cover contractor's breach of contract in the conduct of the contracting business was not intended to cover such general expenses as rent, telephone, electricity, car leases, or workers' compensation insurance that are not subject to the unique risks and uncertainties of the contracting business."

In short, the Supreme Court's detailed analysis of the "conduct of the contracting business" created clearly delineated contracting activities that would be covered under the statutorily required contractor's bond. Importantly, the Court's identification of "general expenses" limited a surety's obligation for a contractor's failure to follow through on its obligations to those activities that are central to the activity of contracting. The bright lines created by this court resulted in clear identification of those "general expenses" that are excluded from recovery under the contractors statutorily required contractors' bond.

SESSION 8

EXPERIENCES AT NATIONAL INSURANCE CRIME BUREAU

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PEARLMAN CONFERENCE
September 2018

"Fraud and the Surety: An Introduction to the National Insurance Crimes Bureau"

I. INTRODUCTION

In an era of fake news, identity and data theft, and hacking, with vast numbers of virtually anonymous personal and commercial internet transactions occurring daily, the potential for fraud seems to be increasing all around us. Not only do individuals face these seemingly increasing perils, but of course businesses do as well. Perhaps particularly exposed in this regard are businesses, like sureties, which extend credit and/or are called upon to evaluate and pay large numbers of claims.

This paper, and the session at the Pearlman Conference which will accompany it, will take a look at potential fraud as it may be presented to and affect sureties. It will also introduce them to an entity, the National Insurance Crime Bureau ("NICB"), which is already formed to assist insurance companies with issues related to fraudulent underwriting or claims. Perhaps, in certain situations, the NICB could be of assistance to sureties in investigating what they suspect may have been fraud in the underwriting of bonds, or in the presentation of a claim. What NICB can definitely help with is in situations familiar to most surety practitioners where, even after resolution of issues involving the surety, there is a lingering sense that something more should be done with regard to what appears to be fraud or criminal conduct. These are situations where the NICB may be able to help, as it has experience in investigating and preparing for presentation of evidence to administrative or criminal authorities.

II. THE NATIONAL INSURANCE CRIME BUREAU

The NICB is a not-for-profit entity exclusively dedicated to fighting insurance fraud and crime. The NICB was created through a merger of the former National Automobile Theft Bureau and the Insurance Crime Prevention Institute, which were also industry-formed and funded not-for-profits. NICB's membership includes over 1100 property-casualty insurance companies. Surety representatives would do well to scan the NICB's membership list in the likely event their company is already a member. NICB's membership also includes vehicle rental and finance companies, auto auctions, and self-insured organizations. NICB works with law enforcement agencies, technology experts, government officials, international crime-fighting organizations, and the public to prevent and combat insurance fraud and crime.[1]

NICB operates by using data analytics and performs investigations of major criminal activity. One example is NICB's "Hot Wheels: America's 10 Most Stolen Vehicles" where they reveal, for example, that two Honda models contribute 42 percent of all "top 10" thefts. https://www.nicb.org/sites/files/2017-11/2016-Hot-Wheels-Report.pdf

NICB provides training to companies and their personnel to stay current on the latest insurance crime issues and trends, red flag indicators, and fraud-fighting technologies. NICB has a legislative advocacy team that promotes statutes, regulations, and policies at all levels of government to help members detect, prevent, and defeat insurance-related crimes.

You may see NICB in the media. You can report fraud anonymously to them by various methods, including their website, phone and, of course, via an app. NICB also provides a service

[1] Per the NICB's website (https://www.nicb.org/) and literature.

called VINCheck which helps determine if a vehicle has been reported stolen, but not recovered, or as a salvage vehicle.[2]

III. APPLICATION FRAUD – "UNDERWRITING FRAUD" TO A CONTRACT SURETY

Many types of surety bonds, like most forms of widely issued property and casualty insurance policies, are issued based on an application. In other words, the person or entity seeking the bond (contractor's license bond, notary bond, motor vehicle dealer's bond, etc.) fills out a relatively straightforward and short document with summary information, often over the internet. Where an application is filled out and submitted by the applicant, it would be rare for there to be fraud in the application by anyone other than the applicant. In turn, the information provided is usually quite generic and, if desired, easily checked.

Contract surety performance and payment bonds issued to contractors, on the other hand, are underwritten much differently. An often lengthy process of introduction, examination, development of a relationship and track record, involving not just the contractor but its accounting and broker/agent representatives, precedes the issuance of an initial bond to any principal. Significant and often complex financial information is involved. Often the prospective obligee is known prior to the issuance of any bonds, and each set of bonds and the issuance thereof is particular to a project and owner or general contractor obligee.

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[2] The flip side of technology is, of course, its potential to prevent or avoid fraud. "The recovery of stolen Tesla's is notable in an industry where the overall recovery rate for stolen vehicles was just 58.4% in 2016. Tesla had a 100% recovery rate that year, thanks in part to its GPS tracking technology. "That's about as good as it gets," said Frank Scafidi, director of public affairs at the National Insurance Crime Bureau, which crunched the Federal Bureau of Investigation's National Crime Information Center data. "I'm wondering if the thieves' intellect might have been overwhelmed just sitting in a Tesla, much less figuring out how to operate it for any length of time.'"http://news.morningstar.com/all/marketwatch/TDJNMW2018081051/ update-nearly-100-of-teslas-stolen-in-the-us-since-2011-have-been-recovered.aspx

Further, once commenced, the surety/principal/indemnitor underwriting relationship is a continuous one, in which new and updated data and information is being relayed to the surety underwriting team concerning the principal and/or indemnitors and their financial status. This brings up the challenging scenario where a current, ongoing principal seeks, typically via a joint venture or "sponsoring" relationship, to introduce a new party to the surety for underwriting, necessitating quick and as thorough as possible examination of the new prospective principal or co-principal and its owners.

In the surety underwriting context, underwriting misrepresentations and/or fraud can come in at least two basic scenarios. First, and the most common scenario and focus of the NICB's potential role in assisting sureties, would be misrepresentations by the principal, indemnitors, or their agents to the surety. These misrepresentations would typically concern their corporate or personal financial status, and perhaps facts concerning the potential project or contract, and would be made in order to induce the surety to issue bonds that would not be underwritten otherwise. Like fraud or misrepresentation on applications, furthermore, they would be known only to the applicant or its agents, and would not present any defense against an otherwise valid claim on the bonds.[3]

The second scenario would involve a prospective obligee who is either aware of, or participating directly in, misrepresentations to the surety. In this much more unusual scenario, a surety is presented with potential defenses which will be briefly discussed below.

Turning back to misrepresentations or fraud solely involving facts or documents presented or prepared by the principal or its agents, a surety underwriter has, of course, as his or her central task the detection of any erroneous or unsupported, let alone false or fraudulent,

[3] Restatement of the Law Third, Suretyship and Guaranty, section 12 ("Restatement 3d").

information or documents presented by the principal or indemnitors. To uncover fraudulent information presented by the principal or its agents, the surety underwriter will attempt to conduct an extensive background check before any surety credit is extended. This check is done by reviewing corporate and personal credit reports using internet search engines to explore the public record, and conducting reference checks with owners, architects, other contractors and suppliers. While NICB is not really set up to assist with due diligence investigations of this nature, if any suspected fraud or misrepresentation is observed NICB can be of use in further investigating same.

Where misrepresentations or fraud in the surety underwriting process is perpetrated by, or even known to, the bond obligee, in addition to the principal or indemnitors, this may pose a defense for the surety. The Restatement 3d provides: "If the [the surety's] assent to [the bond] is induced by a fraudulent or material misrepresentation by the obligee upon which the [surety] is justified in relying, the [bond] is voidable by the surety." Many courts refer to the Restatement 3d or have developed similar requirements to support a surety's fraud defense. [See, e.g., *Banque Franco-Hellenique de Commerce International Et Maritime S.A. v Orestes Christophides*, 1997 U.S. Dist. LEXIS 8189, 1997 WL 317398 (S.D.N.Y. 1997).]

Focusing on the Restatement 3d, there are a number of specific requirements. First, the misrepresentation must either be fraudulent or material. Fraud is an intentional perversion of truth for the purpose of inducing another to act in reliance on it. A material misrepresentation, in contrast, may occur either where the obligee deliberately represents or suppresses a material fact (a fact which the surety relies on in deciding to issue a bond) or where the obligee innocently omits to disclose a material fact. Notwithstanding the innocent mistake, if the fact represented or omitted is material, the surety may raise the exoneration defense. Conversely, if the information is unimportant in the surety's decision to issue the bond, then the surety cannot void the bond. [*See*, Comment (b) to Restatement 3d.]

Second, the misrepresentation must have induced the surety to issue the bond. In other words, had the surety known the information was false or had it known the undisclosed facts, it would not have issued the bond. For example, in *Ground Improvement Techniques, Inc. v R.N. Robinson & Son, Inc. et al.*, 63 F Supp 2d 1272 (D Colo 1999), the principal applied for performance and payment bonds for excavation work already underway. When questioned as to the principal's bid and competency to perform the work, the obligee failed to disclose to the surety the existence of a dispute concerning the excavation work. The court held that a reasonable juror could find that had the surety known of the dispute, the surety may not have issued the bonds.

The final element in the fraud/misrepresentation defense is the surety's *justifiable* reliance. If a surety fails to seek important information that is available to it, it cannot, in the absence of fraud, assert as a defense ignorance of facts which it should have known and considered prior to the execution of the contract. The law does not favor the indifferent, unseeing surety who fails to help itself. [*St. Paul Fire & Marine Ins. Co. v Commodity Credit Corp.*, 646 F2d 1064, 1072 (5th Cir 1981); see also *Iowa Concrete Breaking Corp. v Jewat Trucking, Inc.*, 444 NW2d 865, 868 (1989).]

A surety is expected to make reasonable inquiries before issuing a bond. If the surety fails in this respect, it will not prevail on the fraud/material misrepresentation defense. In *Ground Improvement Techniques*, supra, the surety did inquire about the subcontractor's bid and its competency. However, the surety could not have reasonably been expected to inquire about some unknown dispute.

In most instances, the obligee is not involved in the bond transaction. Although the obligee may require a bond, obtaining it is left to the principal. An obligee's duty to disclose information is quite limited in this scenario as obligees are often wholly unaware of the facts that the principal presents to the surety. Accordingly, an obligee, acting in good faith and without knowledge of any misrepresentation, is entitled to enforce the bond. [*See* Restatement 3d, § 12(2).] However, if the obligee, before the bond becomes binding: (1) knows facts unknown to the surety, that materially increase the risk beyond that which the obligee has reason to believe the surety intends to assume; and (2) has reason to believe that these facts are unknown to the secondary obligor; and (3) has a reasonable opportunity to communicate them to the secondary obligor; then the obligee's nondisclosure of these facts to a surety constitutes a material misrepresentation. *Id*.

The *Ground Improvement Techniques* court stated that the obligee had no obligation to inform the surety *until* the surety inquired. Indeed, some courts do give a certain degree of grace to the silent obligee resting the initial burden of inquiry on the surety. However, other courts and arguably the Restatement 3d hold that voluntary disclosure is required without requiring that the surety contact the obligee.

For example, in *Sumitomo Bank of California v Iwasaki*, 70 Cal 2d 81, 88-90, 447 P2d 956, 961-962 (1968), the California Supreme Court recognized the obligee's duty to disclose information to the surety at least in situations when it is patently clear to the obligee that the principal misrepresented facts affecting the risk and that the surety did not know the true facts. [*See also Rachman Bag Co. v Liberty Mutual Insurance Company*, 46 F3d 230 (2nd Cir 1995) (holding that a requisite element of a fraudulent concealment claim is that the obligee had a duty to disclose the material fact, but not stating what creates that duty.)]

An obligee has no burden to investigate facts for the surety's benefit and is not required to confirm that the surety knows facts which the obligee reasonably believes are known to the surety. [*See* Restatement 3d, § 12, Comment on Subsection (3).] In that regard, the Restatement 3d, section 12(4), provides guidelines regarding the obligee's reasonable beliefs, including: (a) The nature of the surety's relationship to the principal, (b) The nature of the surety's business, and (c) The surety's ability to obtain independent factual knowledge using ordinary care.

Exoneration based on fraud or material misrepresentation can be a viable surety defense. Restatement 3d reveals the delicacy of prevailing on such a defense, however.

IV. FRAUDULENTLY CREATED BONDS

Commercial bonds are often purchased online from independent brokers who provide a very simplified bond application that includes a general indemnity agreement. For example, most states require a motor vehicle dealer bond as a condition for obtaining a license. Most sureties inquire as to whether the dealer has ever had a prior surety, claims history, etc. In California, it is very easy for an applicant/dealer to simply deny any past problems or issues with their surety as the bond history is not available online. Therefore, a surety will issue a new surety bond for an applicant being totally unaware the prior bond was cancelled because of claims paid.

One surety actually issued a new bond for an applicant/dealer even though the prior one had been cancelled due to claims activity because the application was submitted by a different broker and underwriting simply did not match up the personal indemnitor/applicant with the prior loss. These bonds would have never been issued but for the fraudulent applications.

Unscrupulous dealers also use multiple licenses and numerous fictitious business names to obtain bonds that would otherwise not be issued. For example, in Rahbarian v. Cawley (2010)

U.S. District Court – E.D. of California Case #: 2:10-CV-00767-TLN-KJN, the Honorable Troy L. Nunley recounted the history of the Rahbarian family owning and operating several auto dealerships with different family members being involved in different aspects of their operations. The Rahbarians caused the eventual bankruptcy of the dealerships due to the alleged embezzlement of over $4,000,000.00. The surety who filed the motor vehicle bonds for the family eventually paid out the penal sum on three (3) separate bonds for three (3) separate licenses, one after another, for a total loss of $150,000.00.

An example of fraud in the contract surety context involved a financially troubled principal has one last, very large, project, which has been awarded but has not yet commenced. The surety which issued performance and payment bonds will not finance. In order to "regain control," the principal procures replacement bonds, and under applicable Federal Acquisition Regulation ("FAR") provisions, presents same. The federal contracting agency accepts the new bonds and releases the original surety. It turns out the replacement bonds are fraudulent, issued as part of an elaborate scheme involving forged powers of attorney and bonds. Fortunately for the original surety, the government decides that its release of the original bonds must stand, notwithstanding the fraudulent nature of the new replacement bonds. But the principal is left with a substantial premium stolen and its attempt to regain control of what it considered a lucrative project is in shambles.

This frightening story is not as unusual as it sounds. The National Association of Surety Bond Producers, for example, has several articles devoted to how to verify the authenticity of bonds, awareness and detection strategies, and how sureties can battle surety bond fraud. See https://www.nasbp.org/informed/topics/topics-sbfraud.

In NICB's experience, fraudulently created insurance policies is not a frequent issue. Our speaker did have one case, however, where an individual set up a shell company and started selling motor vehicle insurance. NICB worked with the Washington Office of Insurance which brought legal action and shut down the company.

V. CLAIM FRAUD

Perhaps the most common sort of fraud confronted by any insurance carrier or surety is inflated or fraudulent claims. Again, much like an underwriter's job, investigating and verifying claims made against bonds, and hence detecting and defending against inflated or even fraudulent claims, is precisely what a surety claim representative's job entails.

Some of the most heated claim disputes are between homeowners and contractors. While there are certainly questionable contractors overcharging homeowners for poor work, there are homeowners that are sophisticated and set up a contractor for a claim/lawsuit. For example, there is a lawsuit pending in Los Angeles Superior Court in which the plaintiff/homeowner named as defendants an unlicensed individual, a licensed contractor, and his surety on the license bond for the failure to properly construct a swimming pool and abandoning the project. The plaintiff is a contractor himself and signed a one-page contract for the construction of the pool with an individual he knew was unlicensed but claimed was an "agent" of the licensed contractor. The licensed contractor admitted he had worked with this individual before, but was certainly not an agent or employee of his corporation. The contract itself does not come close to complying with California Business and Professions Code Section 7159, and the contractor has sworn under oath he has a standard, multipage form he uses for his home improvement work. It would appear at the very least the homeowner had to know he was signing a contract that is voidable because it is not legal, and could then try to avoid paying the contractor anything more than the bare minimum for the work performed. "Generally a contract made in violation of a regulatory statute is void." Asdourian v. Araj (1985) 38 Cal.3d 280.

Where a surety thinks it has been the subject of claim fraud, the NICB can be of assistance in investigating, uncovering and documenting same.

VI. POTENTIAL OBLIGATIONS FOR SURETIES TO REPORT FRAUD

Hypothetically, what if a surety were to be told by a subcontractor claimant that the surety's principal, a prime contractor deeply involved in completing previously defaulted and disputed projects, has directed the subcontractor to inflate current invoices to be submitted to a public entity owner and the payment bond surety by including amounts for quantities of materials not actually covered by the invoice or supplied to that project? Is the surety obligated to report the suspected fraud to its state insurance regulators or commissioner? If so, and the principal's operations were impacted or shut down, increased costs of completion were very likely.

Similarly, in many of the situations described above, a surety may become aware of fraud. At least in California, the answer to this question appears to be "yes." Insurers, including admitted sureties, are required to report suspected fraud within sixty (60) days of making a reasonable determination that an insurance fraud is being perpetrated. The only applicable exception to reporting is when subsequent investigation reveals there was no fraud.[4] Sureties should check state requirements in this regard.

[4] Per the NICB, Washington at least also has a requirement to report fraudulent claims to the Washington Office of the Insurance Commissioner. This can be done directly to them or through NICB's questionable claims feature in the Insurance Services Office database for those companies that are members.

In the foregoing hypothetical, the submission of padded invoices to a public entity that intentionally and falsely misstate the quantity of material actually supplied to a project seemed to clearly violate the California False Claims Act ("FCA", Gov. Code. Sec. 12650, et seq.). Such conduct would almost certainly violate similar laws in most if not all states. In this hypothetical, if the surety were to have subsequently sought contract payments based on the alleged fraudulent invoices, the surety might then be charged with itself having made a false claim.

In California, the California Insurance Code makes it unlawful to make a knowingly false or fraudulent statement or material misrepresentation for the purpose of obtaining or denying insurance compensation or benefits. (Ins. Code, § 1871.4). For an "admitted surety insurer" certified by the Insurance Commissioner to "transact surety insurance" in California, as defined in Ins. Code sec. 105. Cal. Code of Civ. Pro sec. 995.120, the law seems clear: "Any company licensed to write insurance in this state that reasonably believes or knows that a fraudulent claim is being made shall, within sixty (60) days after determination by the insurer that the claim appears to be a fraudulent claim, send to the Fraud Division," information required by the Fraud Division's form. (Cal. Ins. Code, § 1872.4). Further, again as in most states, the insurer must establish and maintain an internal Special Investigation Unit ("SIU") for purposes of investigating suspected insurance fraud. (Cal. Code Regs., Tit. 10, § 2698.30(o)). An insurer's integral anti-fraud personnel, including its claims handlers, are in California responsible for identifying suspected insurance fraud during the handling of insurance transactions and referring them to the SIU as part of their regular duties. (Cal. Code Regs., Tit. 10, § 2698.35). Where the facts and circumstances create a "reasonable belief" that insurance fraud has been or is being committed, the SIU, in turn, must refer them to the California Dept. of Insurance Fraud Division and, as required, to district attorneys. (Cal. Code Regs., Tit. 10, § 2698.37).

This paper makes two central points in this regard. First, when confronted with what looks like fraud or criminal conduct, a surety is well advised to check the regulatory scheme of the relevant jurisdiction to determine if it has any obligations to report same. Second, working with clients to develop and package effective submissions to SIUs or law enforcement personnel is a task NICB performs with regularity, and could perhaps assist sureties with if called upon to do so.

VII. CONCLUSION

Sureties are sometimes confronted with fraud, arising from many sources. Hopefully, this paper and the session will introduce sureties to the NICB and any NICB capabilities which might assist them.

SESSION 9

BANKRUPTCY: WHAT'S CHANGING

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PEARLMAN 2018

September 6-7, 2018

Columbia Winery | Woodinville, WA

BANKRUPTCY – OLD AND NEW AND WHAT MATTERS RIGHT NOW

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September 6, 2018

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BANKRUPTCY – OLD AND NEW AND WHAT MATTERS RIGHT NOW

I. Are Letters of Credit Really Invincible Collateral in a Bankruptcy?

The standby letter of credit is often viewed as the "gold standard" collateral for commercial sureties—a fixed, liquid, and reliable source of collateral from which the surety can draw if the principal fails to perform its obligations. A letter of credit "is an undertaking by the issuing bank . . . that it will pay a draft drawn on it . . . upon presentation of specified documents."[1] This simple definition suggests the letter of credit's central feature: The letter of credit confers primary liability on the issuing bank. Unlike liability on a guaranty, which is conditioned on the principal's default, the bank's obligation to pay on the letter of credit is altogether independent of the underlying contracts.[2] This feature is known as the "independence principle."[3]

The Uniform Commercial Code (UCC) codifies the independence principle as follows:

> Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.[4]

Thus, the surety beneficiary of a letter of credit has the right to compel payment from the issuing bank directly; the principal has no right to step in and stop payment or direct how the surety uses the proceeds; and the issuing bank has no right to refuse to honor the surety's complying draft or demand. "[T]he [independence] principle facilitates the use of letters of credit to shift credit risk by relieving issuers and other banks from having to investigate the underlying transaction, and allow the financial intermediaries to ascertain their liability to pay on the instrument quickly and with minimal expense."[5]

In the bankruptcy context, the independence principle confers a distinct advantage upon the letter of credit as collateral for the surety beneficiary. First and foremost, it is generally "well established" that letters of credit and their proceeds are not property of the debtor-principal's bankruptcy estate under 11 U.S.C. § 541.[6] The issuing bank distributes the bank's own assets upon the surety's demand, not the assets of the principal (the bankruptcy debtor) that caused the letter of credit to be issued.[7]

Because the letter of credit does not qualify as property of the bankruptcy estate, the automatic stay of 11 U.S.C. § 362 does not prevent the surety from drawing on a letter of credit, even during the principal's bankruptcy.[8]

But, are letters of credit really invincible collateral, even in a principal bankruptcy, or can the surety be at risk of losing its collateral position in a bankruptcy preference or turnover action? [9] It turns out that the notion of LOC invincibility is not quite as clean and unequivocal as the surety might like, and real risk does exist, in certain circumstances.

A. The secured letter of credit and preference liability

Some courts have drawn distinctions between unsecured and secured letters of credit. The unsecured letter of credit scenario does not present a risk of preference attack. However, when the principal gives *security* to the bank issuing the letter of credit, cases in the Fifth, Ninth, and Eleventh Circuit support the notion that the granting of a security interest in the debtor's property could be a preferential transfer. That transfer might be avoided and the preference may be recoverable from the surety, as the party <u>for whose benefit the transfer</u> of the security interest <u>was made</u>.[10] For example, in *In re Compton Corp.*, the Fifth Circuit concluded: "When a debtor pledges its assets to secure a letter of credit, a transfer of debtor's property has occurred under the provisions of 11 U.S.C. § 547. . . . Overall, the letter of credit itself and the payments thereunder may not be property of debtor, but the collateral pledged as a security interest for the letter of credit is."[11]

So, if the debtor–principal gave a security interest to the bank in order to permit issuance of the letter of credit in favor of the surety, while the surety's letter of credit proceeds may be beyond the reach of the bankruptcy trustee, the surety may nevertheless have risk of preference exposure to the trustee. The surety is the "party for whose benefit" the debtor transferred a security interest to the issuing bank in the first place because the surety is the beneficiary of the resultant letter of credit. Under 11 U.S.C. § 550,[12] then, the trustee may seek to recover from the surety the extent of the preferential transfer, *i.e.*, the value of the collateral that the debtor–principal pledged to the bank for issuing the letter of credit.

Secured letter of credit transactions merit additional investigation on the part of the surety. Even if it does not appear that the principal contemporaneously gave the bank collateral to secure the issuance of the particular letter of credit in favor of the surety, the bank may have a longstanding relationship with the principal and a preexisting and continuing security interest in its assets to secure issuance of letters of credit.

Whether or not the surety has a defense in a secured LOC based preference action may also turn on the nature of the principal–surety relationship. Did the surety write new bonds, or receive the letter of credit to secure existing bonds?[13] If the letter of credit issues contemporaneously with a new principal–surety contract relationship or a wholly new transaction—like the surety's issuance of a new bond or bonds—then the surety has a stronger argument to avoid preference liability.

The surety's affirmative defense to preference liability in this scenario arises statutorily, from 11 U.S.C. § 547(c)(1), more fully discussed in the preference section of these materials. Section 547(c)(1) "provides a defense to preference liability where the transfer is a substantially contemporaneous exchange for *new value*."[14] New bond(s) written in exchange for the letter of credit may qualify as such a contemporaneous exchange for new value. But how much new value, exactly, did the principal receive? In other words, what was the value of the newly issued surety bond(s): The penal sum? The premium? The value of the bonded contracts and the principal's profits and overhead thereon? The correct quantification of the "new value" received in the surety context is an untested and complex issue. Ultimately, it is important to keep in mind that, "[w]hen evaluating a new value defense, the key question is whether the alleged preferential transfer diminished the debtor's estate, i.e., whether the debtor in fact acquired a new asset that offset the loss in value to the estate when the debtor transferred existing assets to acquire the new asset at issue."

B. Issues with swaps, renewals, and substituted collateral

As discussed above, the surety may be interested in whether the letter of credit it receives is secured or unsecured. More particularly, the surety beneficiary of a letter of credit should carefully determine: (1) whether the principal gave security for the issuance of the letter of credit (now or in the past), which could subject the surety to preference liability; and (2) if so, whether the surety has a new value defense (or another preference defense) because of the issuance of a new bond or line of bonds.

Changes or modifications to a letter of credit arrangement may seem as if they pose no risk to the surety, but in fact, may require investigation. The surety seeking to protect itself from preference attack in the event of a principal bankruptcy should be particularly on guard with a "new," swapped letter of credit (instead of an evergreen renewal of an existing letter), or a request from its principal to substitute cash collateral for a letter of credit. These scenarios are briefly discussed in turn.

When the principal renews a previously expired or provides a "new" letter of credit with the same issuer, an inquiry might be made whether there are any changes in the borrowing terms with the issuer bank. If new or additional collateral is pledged by the principal as a condition of renewal, the amount of this collateral may be subject to avoidance as a preference (including a claim against the surety). Under the *Compton* line of cases, collateral pledged for issuance of a letter of credit qualifies as property of the debtor's estate, and the surety who is the beneficiary of the renewed letter of credit risks losing that value to a bankruptcy trustee in a preference action. The same issue arises with letter of credit "swaps." Not uncommonly, a principal may approach the surety and offer a new letter of credit, from a new issuing bank, to replace an existing letter of credit. When the principal replaces an existing letter of credit upon which the surety is entitled to draw with one issued by another financial institution, particular care should be exercised to ensure that no different or additional collateral is pledged by the principal, no different or additional borrowers are added to the transaction—essentially, that the only thing that has changed is the identity of the issuer. Both these scenarios—novated and swapped letters of credit—could expose the surety to preference actions in a subsequent principal bankruptcy.

Concern also arises when the principal offers cash or other real or personal property collateral to the surety to secure the release of an existing letter of credit. As a hypothetical, imagine a surety is the beneficiary of a $3 million irrevocable standby letter of credit. One of the principal's projects turns sour, and the surety is forced to pay bond claims of $2 million. The surety could recover the full amount of the claims it has paid by drawing on the letter of credit. But instead, let us assume the principal offers substitute collateral in the form of a direct payment to the surety. The surety has no cause to draw on the letter of credit; it now has the principal's cash collateral in hand, fully covering its losses. Yet, this seemingly idyllic situation is not so idyllic if the principal subsequently files bankruptcy.[15] Whereas the surety would have been shielded from liability had it drawn on the letter of credit, because letter of credit proceeds are not "property of the state," the surety faces potential preference liability by accepting payment directly from the debtor, a clear transfer of "property of the estate." In bankruptcy, it matters from whence the money comes ...

C. The "excess funds" problem

Although the majority view is that letters of credit *and* their proceeds do not constitute property of the bankruptcy estate, several courts have held that so-called "excess" letter of credit proceeds—that is, proceeds above and beyond what the beneficiary is owed under the terms of the underlying agreement between principal and beneficiary—are property the estate:

> Once the proceeds of a letter of credit have been drawn down, the underlying contracts become pertinent in determining which parties have a right to those proceeds. In other words, an irrevocable standby letter of credit *does not nullify the obligations set forth in the underlying contracts* . . . . Rather the letter of credit serves, among other things, to shift the burden of litigation . . . [The] beneficiary of the letter of credit holds the stake during the litigation.[16]

Because the independence principle only stretches so far, underlying contracts again become relevant when determining entitlement to "excess' letter of credit proceeds. To vary our previous hypothetical slightly, if the surety draws on a $3 million letter of credit, and pays $2 million in claims, thereby obtaining full releases on all bonds it has written for the bankrupt principal, the principal would have a right to receive the remaining letter of credit proceeds (net of surety expenses). The trustee can compel the delivery of the excess back to the estate by way of an 11 U.S.C. § 542 "turnover" action. This outcome is of no great concern to the surety, who has secured a full release of liability. But, what if the surety has contingent (however unlikely) exposure on some bonds?

In re Oakwood Homes Corp. is good authority for the position that the bankruptcy estate cannot immediately invoke the turnover remedy to seize excess letter of credit proceeds in the hands of the surety.[17] The bankruptcy trustee may not exercise the turnover remedy "to recover claimed debts which remain unliquidated and/or in dispute."[18] In the same vein, *Oakwood Homes* supports the trustee's right to continue to hold funds presently within the bankruptcy estate—at least until disputes are resolved as to the debtor–principal's rights to excess letter of credit proceeds.

II. SURETY COMMUNICATION TO THE OBLIGEE DURING BANKRUPTCY

In addition to protecting its cash collateral by way of litigation in bankruptcy proceedings, the surety may find it advisable to communicate directly with the bond obligee. Notwithstanding the bankruptcy filing, the surety has a right to communicate directly with the bond obligee regarding the proper handling of bonded contract funds.[19] Such notice communicates that the debtor is in default and that the surety has a superior interest in the bonded contract funds.

A surety letter containing demands and directions may be attacked by the debtor as a violation of the automatic stay of 11 U.S.C. § 362. A violation of the stay entitles the bankruptcy court to assess damages if determined to be "willful."[20] The threat of sanctions and penalties suggests that the surety should hew very closely to previously court-sanctioned phraseology when advising a bond obligee of its rights to withhold funds from the debtor.

Two decisions from the United States Bankruptcy Court for the Southern District of Ohio provide a template for how the surety may communicate without violating the automatic stay.[21] Helpfully, the *Hughes-Bechtol* court appended the full text of the surety's letters to its opinion, so there is no ambiguity about what language a permissible communication to the obligee by a surety should or should not contain.[22]

The *Hughes-Bechtol* court held that, "absent coercion or harassment, mildly worded correspondence which does not adversely impact on the estate, does not constitute an actionable violation of the automatic stay."[23] The court stressed that "isolated and informational" correspondence, as opposed to that which is repetitive and demanding, is less likely to result in an automatic stay violation.[24] The particular letters endorsed by the *Hughes-Bechtol* court contain no demand for funds. Instead, they merely advise the bond obligee of certain facts and state the surety believes its claim to the contract funds to be superior.

Hughes-Bechtol letters can be important and necessary, because bond obligees can be surprisingly unaware of the equitable subrogation rights of the surety in the proceeds of the bonded contract. It is a rare obligee who is aware of the surety's equitable subrogation rights to contract funds or security that the obligee may hold <u>not arising from or related to the contract the surety bonded</u>. The surety certainly has such rights.[25] And, for the reasons and within the limitations stated in the *Hughes-Bechtol* decision, a surety can and should communicate with a common obligee about such rights, where there is reason to believe that rights to setoff may exist.[26]

Even if a particular bankruptcy court were to disagree with the District of Ohio, the surety that sends a *Hughes-Bechtol* letter, using verbatim text, would have exceedingly solid grounds to argue that its alleged violation of the automatic stay was not "willful." When sending an "informational notice" to a fellow creditor about its rights to withhold funds, the risks of deviating from court sanctioned language should dissuade the surety from attempting to "improve" upon the *Hughes-Bechtol* phraseology with its own verbiage.

III. PROPERTY OF THE ESTATE: WHO OWNS CONTRACT PROCEEDS

Under 11 U.S.C. § 541, property of the estate includes any property in which the debtor has a legal or equitable interest. In construction bankruptcies, issues arise when an owner or lender holds retainage for a general contractor who files bankruptcy. A battle then ensues between the general contractor (or its bankruptcy trustee), the secured lender, and the surety that has been required to pay or will be required to pay the general contractor's unpaid suppliers and subcontractors. The majority of courts addressing this issue hold that the surety is entitled to contract proceeds through the doctrine of equitable subrogation when the contractor breaches its contractual duty to pay its suppliers and subcontractors, and the surety is obligated to pay such amounts under its bond.[27]

The seminal case recognizing the surety's priority rights is *Pearlman v. Reliance Insurance Company*.[28] In *Pearlman*, the Supreme Court held that when a contractor defaults, neither the contractor as debtor nor his trustee in bankruptcy acquire any property interest in contract proceeds to the extent necessary to reimburse the surety for its costs of completion or its payment of labor and material bills.[29] In considering the position of the surety, the court concluded that the surety had ownership of an equitable lien on the contract proceeds prior to bankruptcy proceedings. Because of these rights, the property interest vested in the surety upon default did not become a part of the debtor's property.[30] Thus, the trustee cannot "distribute other people's money among a bankrupt's creditors."[31]

Although *Pearlman* involved only retainages, courts have subsequently held that *Pearlman* also applies to unpaid progress payments.[32]

In *In re Pacific Marine Dredging & Construction*,[33] the court held that contract funds were not property of the estate. In this case, the surety prevailed over the secured lender and the debtor. When a surety posts a bond on a public contract, it acquires an equitable right or lien on funds the owner withholds from the contractor.[34] These funds are held in the form of a trust to reimburse the surety who is forced to pay on his bond.[35] When a contractor defaults, the surety's equitable rights attach and relate back to the date the surety executed the bond with the general contractor.[36] The court specifically held that "[d]ue to debtor's breach of contract, the debtor does not have any legal or equitable interest in the fund. Accordingly, the fund is not property of the estate."[37]

In a subsequent decision, a bankruptcy court held that the surety's equitable subrogation rights were prior to the secured lender in funds that had already been paid by a public owner to the contractor.[38]

Washington courts also recognize the surety's priority to contract proceeds. The United States District Court for the Western District of Washington reversed a decision by the bankruptcy court which denied the surety's right to contract proceeds from bonded jobs after the debtor's default.[39] The district court held that the surety's interest in progress payments was superior to that of the debtor's bankruptcy estate, even though the surety did not pay creditors under the bond until after the debtor had filed the bankruptcy petition.[40] The court specifically found and held that progress payments were not property of the bankruptcy estate and required the trustee to turn progress payments in its possession over to the surety.[41]

The issue of *Pearlman*'s continuing validity under the expansive definition of property of the estate under the bankruptcy code was settled by the bankruptcy appellate panel of the Ninth Circuit.[42] The bankruptcy appellate panel was faced with the issue of whether a debtor's payment to two subcontractors constituted voidable preferences where the subcontractors released their unsecured claims against the debtor and their claims against the surety.[43] First, the court noted that the trustee had conceded that *Pearlman* had continuing validity as applied to cases filed under the Code.[44] Nevertheless, the trustee argued that *Pearlman* does not apply to Miller Act "progress payments," but only retainage.[45] In response, the Bankruptcy Appellate Panel stated:

> We conclude that the surety would have been entitled to assert a lien for both any unpaid progress payments or funds held as retainage. Also, we doubt that any court would rely on the distinction between progress payments and retainage in a case such as this where the party seeking to assert such a superior right, vis-a-vis a surety, is a Chapter 7 trustee concerned solely with liquidation of the estate and not in fulfilling the contractual commitments of the debtor.[46]

In short, the court rejected the trustee's attempt to limit the application of *Pearlman* to cases decided under the Bankruptcy Act in situations involving retainage.

As mentioned previously, a minority of decisions have held that contract proceeds are property of the estate. However, in many of these cases, the courts have refused to allow either the debtor or the trustee to use the funds for any purpose *until* laborers and materialmen have been paid and the surety's rights to subrogation satisfied.[47]

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IV. PREFERENCE ISSUES AND THE ABILITY OF THE DEBTOR OR THE TRUSTEE TO RECOVER PAYMENTS MADE TO SUBCONTRACTORS OR SUPPLIERS

A. Generally

The Bankruptcy Code's preference law allows a bankruptcy trustee (or other authorized individuals or entities) to recover—for the benefit of the bankruptcy estate—payments made to creditors shortly before a bankruptcy filing. This power is known as "avoidance." This means that a creditor is forced to repay to the bankruptcy estate a payment the creditor received from the debtor for an existing debt.

This power of avoidance can be frustrating for a creditor who has been paid for a debt it was owed for providing goods or services. What is this law's purpose? The preference doctrine is designed to prevent creditors from racing to the courthouse to dismember a debtor immediately prior to the debtor's imminent bankruptcy and to facilitate equality of distribution.[48] By discouraging this behavior and nullifying transfers made shortly before filing, the court will be able to achieve a more equitable distribution of the bankrupt estate's assets under bankruptcy law.[49]

Under 11 U.S.C. § 547(b), a trustee or debtor may avoid certain transfers made by a debtor within 90 days prior to the bankruptcy filing (one year for insiders).[50] For such a transfer to be deemed an avoidable preference, the following elements must be present:

1. A transfer must be made;
2. The transfer must be property of the debtor;
3. The transfer must be to or for the benefit of a creditor;
4. The transfer must be for or on account of an antecedent debt owed by the debtor before the transfer was made;
5. The transfer must have been made while the debtor was insolvent;
6. The transfer must have been made within ninety days of filing or within one year for transfers to an insider as defined under 11 U.S.C. § 101(31); and
7. The transfer must enable the creditor to receive more than it would if the case was a Chapter 7 case. [51]

For sureties, issues of bankruptcy preferences tend to arise in one of three ways. First, sometimes a bankrupt bond principal's trustee will claim that the principal's payments to its subcontractors or suppliers within 90 days of the filing are avoidable preferences and sue to recover those payments in a preference action. Second, a bankrupt principal will sometimes bring an "indirect preference action" against the surety. Third, after a successful preference action in which a subcontractor or supplier is forced to disgorge funds to the bankruptcy estate, that subcontractor or supplier might then make a claim on the principal's payment bond.

B. Defenses and Exceptions to Preference Actions and Indirect Preference Actions

When faced with a preference action, a defendant can argue either (1) that the required elements for an avoidable preference are not met or (2) that the alleged preference fits into one of the seven statutory exceptions.[52]

1. Defenses: Attacking the Case in Chief

As stated above, for a preference action to be successful in avoiding a transaction, all seven elements of 11 U.S.C. § 547(b) must be met; absent that, the preference action fails.[53] Therefore, one course of action available to a preference action defendant is to prove that the disputed transaction does not meet all seven criteria. Although successfully disputing any element will necessarily cause the preference action to fail, the three most promising elements to attack are the "benefit of a creditor" element,[54] the "property of the debtor" element,[55] and the "more than it would receive in a Chapter 7 case" element.[56] Only the latter one will be discussed in more detail.

i. "More than in a Chapter 7 Liquidation" Element

In evaluating whether a pre-petition payment enables a creditor to receive more than in a Chapter 7 case, courts disagree on whether a creditor's ability to make a claim on a payment bond or file a mechanics' lien should be considered.

A number of courts expressly consider payment bonds and mechanic's liens in this analysis.[57] Consider for example, *In re ML & Associates, Inc.*[58] In that case, the prime contractor's trustee in bankruptcy sued a subcontractor on a public works project to recover a payment made within 90 days prior to the bankruptcy.[59] The bankruptcy court held that the payment was not a preference because it did not enable the subcontractor to receive more than it would have received in a Chapter 7 liquidation.[60] Specifically, the court found that the public works payment bond on the project would have paid the subcontractor 100% of what it was owed if the debtor had not made the challenged payment.[61] Therefore, according to the court, the challenged payment did not enable the subcontractor to receive any more than it would have received had the payment not been made, and the requirement of section 547(b)(5) was not met. If the reasoning of the court in the *In re ML & Associates* case is correct, there will never be a preference on a bonded construction project simply because the surety will pay the subcontractor. If there is no preference to the subcontractor, there is no preference to recover from the surety. As a result, under this case there would be no need to litigate over what contract funds secured the surety's lien.

In contrast, other courts expressly refuse to consider payment bonds and mechanic's liens in this analysis, emphasizing that such sources are simply not part of the bankruptcy estate.[62] In one prominent case, *United Rentals, Inc. v. Angell*,[63] the Fourth Circuit rejected a creditor's argument that 547(b)(5) was not met because "had the transfers not been made, [it] could have received full payment from the Surety by enforcing its bond rights," thus, it did not receive more money than it would have if the case were a Chapter 7 case.[64] The Fourth Circuit explained that the 547(b)(5) inquiry "focuses 'not on whether a creditor may have recovered all of the monies owed by the debtor *from any source whatsoever*, but instead upon whether the creditor would have received less than a 100% payout' from the bankruptcy estate."[65]

2. Statutory Exceptions/Affirmative Defenses to Preference Actions

The trustee (or debtor in possession) has the burden of proving the avoidability of a transfer, and the creditor against whom recovery or avoidance is sought has the burden of proving the non-avoidability of the transfer.[66] Accordingly, the trustee must prove all of the requirements set forth above under § 547(b); if any requirement is not proven, the preference action fails.[67]

In the event that a creditor receives a transfer that appears to meet the seven elements outlined above, the creditor has two general courses of action to prevent the avoidance of a transfer. The creditor can demonstrate that at least one of the elements required for a preference action is not met. Alternatively, the creditor can prove that the transfer fits into one of the seven statutory exceptions to preference found in 11 U.S.C. § 547(c).[68] Importantly, as discussed below, those exceptions can also be used by sureties seeking to avoid preference liability in an indirect preference action.

If a transaction meets the requirements of any of the exceptions, the creditor is protected from avoidance of the preference to the extent of the applicable exception. If the transaction meets the elements of more than one exception, the creditor is protected to the extent of each exception. The two exceptions defendants most commonly assert are that the transfer constituted a "contemporaneous exchange for new value" or was made in the "ordinary course of business." I will discuss in detail only the former defense.

Courts have held that payments by a debtor to a supplier or subcontractor who has claims under the Miller Act[69] or a Little Miller Act[70] against a surety are excepted under § 547(c)(1) because the surety would have subrogated claims for indemnity against the debtor.[71] This is the important *Fegert* line of cases. Payment by the debtor in exchange for the subcontractor's release of its bond claim (security interest) also falls within § 547(c)(1).[72] The release of these claims is the "new value" that is "contemporaneously exchanged"—the value of debtor's estate is enhanced rather than diminished.[73] However, the source of the funds from which a challenged payment is made must be investigated to ensure that such funds were subject to the surety's lien.[74] Thus, if the source of the funds were contract proceeds for which the surety would have an equitable lien, then there would be no avoidable transfer.

The Fourth Circuit's decision in *Angell*, however, has potentially limited the application of *Fegert*. First, the court held that for *Fegert* to apply, the debtor must have *actually* made a claim on the bond so that the surety would have a security interest that it could release as a contemporaneously exchanged new value.[75] Next, the court held that the new value exchanged must be truly contemporaneous.[76] The creditor had tried to argue that the new value given to the debtor was "*money* that it eventually received from the general contractor that might have instead been paid to the Surety had the Surety paid a bond claim."[77] The court rejected this reasoning and stated that "[i]t is the precise benefit received . . . and not the secondary or tertiary effects thereof, that must fit within one of the five categories of 'new value.'"[78] Finally, the court implied that for the contemporaneous exchange for new value exception to apply, the party invoking it must produce evidence that the parties *intended* the transfer to be a contemporaneous exchange for new value and not simply the payment of a debt.[79] It is unclear at this point whether the creditor failed to make the appropriate arguments and produce the necessary evidence, or whether the Fourth Circuit intended to limit the application of *Fegert*.[80]

In re JWJ Contracting Co., Inc.[81] is a case that makes clear that the exchange must be contemporaneous. Within the 90-day preference period, the debtor prime contractor gave a subcontractor a check and in return the subcontractor unconditionally released its claim against the prime contractor's bond, but the check bounced.[82] The debtor then gave the subcontractor a cashier's check which was honored.[83] The Court recognized that the original transaction was a contemporaneous exchange for new value (and therefore not a preference) because release of the subcontractor's bond rights was new value.[84] There was no new value for the cashier's check, however, because the subcontractor had already unconditionally released its bond rights.[85] The cashier's check was a credit transaction.[86] The Ninth Circuit affirmed the Bankruptcy Appellate Panel and held that the payment was an avoidable preference.[87]

A recent decision that focused more on the element of new value is *In re Charwill Construction, Inc*.[88] In that case, the court held that payments made by the debtor to a supplier within 90 days of the bankruptcy petition were not avoidable preferences because of the contemporaneous exchange for new value defense.[89] In exchange for the payments, the supplier executed releases of its lien rights under New Hampshire law against contract funds.[90] The court thought that the key question was whether, at the time the payments were made, there were contract funds that exceeded the payments.[91] Since such funds existed, the supplier's lien rights against those funds made it a secured creditor and the payments did not reduce the bankruptcy estate available for distribution.[92] The case does not mention any role of the surety or the debtor's payment bond, but the court's analysis was consistent with the *Fegert* line of cases holding that the surety's priority rights to contract funds prevented payments to bond beneficiaries from being set aside as preferences.

3. Defenses to Payment Bond Claims that Result from Successful Preference Actions

Above, we considered how a subcontractor/supplier can defend itself when faced with a preference action and how a surety can defend itself when faced with an indirect preference action. Now we consider what can happen if a debtor in possession or trustee prevails in a preference action against one of the principal's creditors. If a subcontractor or supplier gets paid by the bond principal for its work on a contract, the principal subsequently files bankruptcy, and the trustee or debtor-in-possession prevails in a preference action against the claimant and recovers the payment, the claimant might then make a claim on the principal's payment bond. Does a surety have a defense to payment? Payment made to the claimant by the debtor that gets avoided as a preference does not discharge the surety,[93] but there are at least four possible defenses to a creditor's payment bond claim in this situation: (1) the application of the automatic stay, (2) a stay under the court's equitable powers, (3) the running of the statute of limitations, and (4) release of the surety.

V. BACKGROUND ON PROMESA

On June 30, 2016, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA, 48 U.S.C. §§ 2101-2241) to address Puerto Rico's worsening financial crisis.[94] Puerto Rico's public debt has skyrocketed to roughly $70 billion, not including the tens of billions owed to Puerto Ricans in the form of pension payments.[95] The reasons for Puerto Rico's woes are manifold. Poor government spending decisions, a flagging economy, emigration and demographic shifts,[96] a strained pension system,[97] and even Puerto Rico's status as a U.S. territory—all these factors have caused or compounded the crisis in Puerto Rico.

As *The New York Times* reported:

> In 1917, Congress passed a law making Puerto Ricans United States citizens. That same law, still on the books today, empowered the island to raise money by issuing tax-exempt bonds, but with a special twist—the interest paid by the bonds cannot be taxed by any body of government, regardless of the state or city in which the bondholder lives. This has inspired people with eyes on easy profits to dive in for decades. Using these bonds, successive Puerto Rican governments built up a debt big enough to crush the island.[98]

The fact that states and territories cannot declare bankruptcy further emboldened investors in scooping up Puerto Rican tax-exempt bonds. At least until PROMESA.

PROMESA, and specifically its Title III, creates a bankruptcy-like remedy for Puerto Rico and its government entities, providing for debt restructuring "akin to municipal debt restructuring under Chapter 9 of the bankruptcy code."[99] For Title III proceedings, PROMESA incorporates various provisions of the bankruptcy code directly, such as the automatic stay provision of 11 U.S.C. § 362(a).[100] Significantly, PROMESA also authorized the formation of the Financial Oversight and Management Board for Puerto Rico (Oversight Board).[101] The Board is entrusted with determining the adequacy of budgets and fiscal plans for Commonwealth entities, ensuring access to capital markets, designating government instrumentalities as eligible to petition for debt restructuring, and acting as the debtor's representatives in restructuring proceedings.[102]

Currently, the Commonwealth of Puerto Rico and its departments—as well as over sixty other entities—are designated as covered entities subject to PROMESA oversight.[103] The Oversight Board has filed Title III petitions for five entities: the Commonwealth of Puerto Rico, the Puerto Rico Sales Tax Financing Corporation (COFINA), the Employees' Retirement System (ERS), the Puerto Rico Highways and Transportation Authority (HTA), and the Puerto Rico Electric Power Authority (PREPA). The five cases are being jointly administered under the lead Case No. 17 BK 03283-LTS in the District Court for the District of Puerto Rico.

The jointly administered Title III debt restructuring case has already spawned adversary proceedings and appeals that probe how and to what extent the PROMESA framework differs from that of traditional bankruptcy. In a significant recent decision, the United States Court of Appeals for the First Circuit recently confirmed that not only does the automatic stay of 11 U.S.C. § 362(a) apply to Title III proceedings, but that PROMESA creditors may seek relief from the automatic stay under § 362(d)(1).[104] The First Circuit additionally held that a Title III court may allow a creditor to seek the appointment of a receiver in another court upon a determination of "cause."[105] Another recent significant decision of the First Circuit has set out the basic ground rules for ascertaining and classifying security interests[106]; still another ruling from the District Court for the District of Puerto Rico affirms the Oversight Board's broad power to make binding policy choices for the Commonwealth, notwithstanding the Governor's rejection of the proposed solutions.[107]

The impact of PROMESA and the Title III petitions filed thus far has the potential to be extremely broad and far-reaching from the surety's perspective. Puerto Rican governmental entities are obligees on huge numbers of bonds (utility bonds, tax and custom bonds, performance and payment bonds, etc.). The surety's ability to assert its rights under such bonds—and conversely, the extent and duration of the surety's liability on such bonds—may significantly depend on the unfolding proceedings in the District of Puerto Rico and First Circuit.

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1 *In re Hamada*, 291 F.3d 645, 650 (9th Cir. 2002) (citing *H. Ray Baker, Inc. v. Assoc. Banking Corp.*, 592 F.2d 550, 551 (9th Cir. 1979)).

2 *See* Baird, *Standby Letters of Credit in Bankruptcy*, U. CHIC. LAW REV., 134-35 (Winter 1982) (noting that the letter of credit "is a binding and irrevocable obligation of the bank itself, not of the customer who procured it."); *Tudor Dev. Grp., Inc. v. U.S. Fid. & Guar. Co.*, 968 F.2d 357, 362 (3d Cir. 1992) (discussing the independent nature of the issuing bank's obligation and the differences between guarantees and letters of credit).

3 *See, e.g., Lincoln Nat. Life Ins. Co v. TCF Nat. Bank*, 875 F. Supp. 2d 817, 829 (N.D. Ill. 2012) ("Th[e] rule was developed to protect the commercial viability of letters of credit . . . To follow [the argument that equitable considerations should excuse the issuer from honoring the letter] would effectively emasculate the purpose and value of letters of credit in commercial transactions.") (internal citation and quotation omitted).

4 UCC § 5-103(d).

5 *In re Lancaster Steel Co.*, 284 B.R. 152, 158 (S.D. Fla. 2002).

6 *See Willis v. Celotex Corp.*, 978 F.2d 145, 148 n.3 (4th Cir. 1992); *In re Oakwood Homes Corp.*, 342 B.R. 59 (Bankr. D. Del. 2006); *In re Zenith Laboratories, Inc.*, 104 B.R. 667 (Bankr. D.N.J. 1989); *In re Illinois-California Exp., Inc.*, 50 B.R. 232 (Bankr. Colo. 1985); *In re Leisure Dynamics, Inc.*, 33 B.R. 171 (Bankr. Minn. 1983); *In re North Shore & Central Illinois Freight Co.*, 30 B.R. 377 (Bankr. N.D. Ill. 1983); *In re M.J. Sales & Distrib. Co.*, 25 B.R. 608 (Bankr. S.D.N.Y. 1982)).

7 George J. Bachrach, Michael A. Stover, & Caryn Mohan-Maxfield, *The Commercial Surety's Collateral In A Principal's Bankruptcy Case*, THE LAW OF COMMERCIAL SURETY AND MISC. BONDS 626 (Bruce C. King et al., eds., 2d ed., 2012) (collecting cases).

8 *See, e.g., In re War Eagle Constr. Co.*, 283 B.R. 193, 201 (Bankr. S.D.W. Va. 2002) ("Because the letter of credit and its proceeds are not property of the debtor's estate, they are not subject to the automatic stay.")

9 11 U.S.C. § 547(b) provides that the trustee may avoid any transfer of an interest of the debtor in property: (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made on or within the preference period (90 days or between 90 days and one year before the petition if the creditor was an insider); (5) that enables the creditor to receive more than it would have if the transfer had not been made and the creditor had asserted its claim in a Chapter 7 liquidation. The turnover remedy of 11 U.S.C. § 542 entitles the trustee to seek return of property that is clearly the property of the debtor's bankruptcy estate.

10 *In re Mayan Networks Corp.*, 306 B.R. 295 (9th Cir. BAP 2004); *In re Air Conditioning, Inc. of Stuart*, 845 F.2d 293 (11th Cir. 1988); *In re Compton Corp.*, 831 F.2d 586 (5th Cir. 1987); *In re Metro Comms., Inc.*, 115 B.R. 849, 854 (W.D. Pa. 1990).

11 *In re Compton Corp.*, 831 F.2d at 590-91.

12 "[T]he trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from . . . the initial transferee of such transfer or the entity for whose benefit such transfer was made[.]" 11 U.S.C. §550(a)(1) (emphasis added).

13 For example, *In re Compton* involved a letter of credit issued for an "antecedent debt" due to the creditor. The court therefore held that "when a creditor receives a secured letter of credit to cover an unsecured antecedent debt, [it will] be subject to a preferential attack under 11 U.S.C. § 547(b)." 831 F.2d at 595.

14 *In re The Truland Grp., Inc.*, No. 14-12766-BFK, 2018 WL 333865, at *7 (Bankr. E.D. Va. Jan. 8, 2018) (emphasis added). The Bankruptcy Code defines "new value" as, among other things, "money or money's worth in goods, services, or new credit." 11 U.S.C. § 547(a)(2).

15 The case of *In re Powerine Oil Co.*, 59 F.3d 969 (9th Cir. 1995) illustrates some of the hazards of accepting a soon-to-be-bankrupt principal's substitute payment instead of drawing on an available line of credit.

16 *Two Tress v. Builders Transp., Inc.*, 471 F.3d 1178, 1186 (11th Cir. 2006) (quoting *Resolution Trust Corp. v. United Trust Fund, Inc.*, 57 F.3d 1025, 1034–35 (11th Cir. 1995)) (emphasis original) (finding that letter of credit beneficiary had the duty to return excess proceeds drawn down from the letter of credit that were not used to secure the debtor's obligations). *See also In re Onecast Media, Inc.*, 439 F.3d 558 (9th Cir. 2006); *In re S-Tran Holdings, Inc.*, 414 B.R. 28, 34–35 (Bankr. D. Del. 2009) (endorsing *Two Trees*); *Litzler v. Chamblee & Ryan, P.C.*, 2008 WL 24378658, 6 (Bankr. N.D. Tex. June 17, 2008): *Phar–Mor, Inc. v. Florida Self-Insurers Guaranty Assoc., Inc.*, 344 B.R. 852, 856 (Bankr. N.D. Ohio 2005) (denying motion to dismiss complaint seeking turnover of excess letter of credit proceeds on grounds that such proceeds were part of the estate and due to be returned); *In re Lancaster Steel Co.*, 284 B.R. 152, 161–62 (S.D. Fla. 2002).

17 342 B.R. 59, 67–68 (Bankr. D. Del. 2006).

18 *Id. at* 68 (quoting *Hechinger Inv. Co. of Del., Inc. v. Allfirst Bank*, 282 B.R. 149, 161–62 (Bankr. D. Del. 2002)).

19 For a discussion of the basis for the surety's claim of entitlement to bonded contract funds, see Chad Schexnayder & Kirsten Worley, *The Bonded Contract Funds before the Bankruptcy Court*, BOND DEFAULT MANUAL 784 (Michael F. Pipkin et al., eds., 4th ed. 2015).

[20] 11 U.S.C. § 362(k)(1) ("[A]n individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages.").

[21] *In re U.S. Electric, Inc.*, 123 B.R. 262 (Bankr. S.D. Ohio 1990); *In re Hughes-Bechtol, Inc.*, 117 B.R. 890 (Bankr. S.D. Ohio 1990).

[22] The letters read, verbatim

(1) Paid Claims letter:

The Ohio Farmers Insurance Company is the surety for Hughes-Bechtol, Inc. on the above contract. Hughes-Bechtol, Inc. has failed to pay for certain labor and material which it used in the performance of work on the above contract. The creditors who supplied the labor and material have made claim against the contract bond executed by Ohio Farmers Insurance Company as surety and Hughes-Bechtol, Inc. as principal.

Ohio Farmers Insurance Company has paid $10,721.48 to those claimants and may receive further valid claims. Ohio Farmers therefore believes it has a direct right, up to the amount which it may pay, to receive prepetition contract funds, including retainage, which would have been earned by Hughes-Bechtol, Inc. if it had paid the claimants, (Ohio Farmers anticipates that Hughes-Bechtol, Inc. or others will disagree and contend that all contract funds belong to the bankruptcy estate.)

Whatever others contend, Ohio Farmers Insurance Company believes that it will continue to have a claim against you for these funds if you take any action which prejudices Ohio Farmers Insurance Company's rights to the funds.

(2) Received Valid Claims Letter:

The Ohio Farmers Insurance Company is the surety for Hughes-Bechtol, Inc. on the above contract. Hughes-Bechtol, Inc. has failed to pay for certain labor and material which it used in the performance of work on the above contract. The creditors who supplied the labor and material have made claim against the contract bond executed by Ohio Farmers Insurance Company as surety and Hughes-Bechtol, Inc. as principal.

Ohio Farmers Insurance Company has received valid claims in excess of the $10,000 remaining in the above contract, and may receive further valid claims. Ohio Farmers therefore believes it has a direct right, up to the amount which it may pay, to receive prepetition contract funds, including retainage, which would have been earned by Hughes-Bechtol, Inc. if it had paid the claimants. (Ohio Farmers anticipates that Hughes-Bechtol, Inc. or others will disagree and contend that all contract funds belong to the bankruptcy estate.)

Whatever others contend, Ohio Farmers Insurance Company believes that it will continue to have a claim against you for these funds if you take any action which prejudices Ohio Farmers Insurance Company's right to the funds.

[23] 117 B.R. at 906.

[24] *Id.*

[25] Schexnayder & Worley, *supra*, "Appendix B" p. 795 (collecting cases and discussing the nature of the surety's superior rights to contract funds in the hands of a common obligee).

[26] The *Bond Default Manual* contains Form 13.1, "Notice to Common Obligee," reproduced in full as follows:

[Obligee Address]

Principal:Surety:

Project:

Bond No.:

Obligee:

[*Surety*] issued performance and payment bonds (collectively, the "Bonds") on the captioned project. The Bonds name [*Obligee*] as Obligee. Surety is informed that Obligee holds rights under other bonded or unbonded contracts or other collateral or security ("Offset Rights") held by Obligee for Principal's obligations. A claim or claims have been asserted against Surety under the Bonds, for obligations under the bonded contract, which Principal has allegedly or actually failed to discharge.

The law obligates Obligee to apply its Offset Rights to reduce the exposure of Surety for the unperformed obligations of Principal under the Bonds. See *Merritt Commercial Sav. & Loan, Inc. v. Guinee*, 766 F.2d 850 (4th Cir. 1985) (holding that the surety has the right to compel the bond obligee county to assert the county's right of setoff against other monies in its possession deposited by the bond principal to satisfy any claims against the surety's bond.), *citing In re Yale Express System, Inc*., 362 F.2d 111 (2d Cir. 1966); *United States ex rel. Johnson v. Morley Constr. Co*., 98 F.2d 781 (2d Cir.), *cert. den. sub nom*., *Maryland Cas. Co. v. United States ex rel. Harrington*, 305 U.S. 651, 59 S.Ct. 244, 83 L.Ed. 421 (1938); *In re Eastern Freight Ways, Inc*., 577 F.2d 175 (2d Cir. 1978).

Based upon the foregoing, Surety demands that Obligee immediately exercise its Offset Rights to mitigate Surety's exposure under the Bonds. Obligee's failure to mitigate as set forth herein may reduce or eliminate Obligee's rights under the Bonds. Please contact the undersigned if you have any questions regarding this communication.

[27] *See, e.g.*, *In re* QC Piping Installations, 225 B.R. 553, 566 (Bankr. E.D.N.Y. 1998) (explaining that "[t]he majority of bankruptcy courts . . . have concluded that retainage is not property of the debtor-contractor's estate where there has been a pre-petition default and a surety has stepped in under its bonds").

[28] 371 U.S. 132 (1962) ("*Pearlman*") (pre-code).

[29] *Id.* at 141–42.

[30] *Id.* at 140–41. *Pearlman* was decided under the former Bankruptcy Act. Under 11 U.S.C. § 541, property of the estate includes any property in which debtor has a legal or equitable interest.

[31] *Id.* at 135–36.

[32] *See, e.g.*, *In re E.R. Fegert, Inc*., 88 B.R. 258, 261 (9th Cir. BAP 1988) ("*Fegert*") ("We conclude that the surety would have been entitled to assert a lien for both any unpaid progress payments or funds held as retainage."), *aff'd*, 887 F.2d 955 (9th Cir. 1989) ; *Balboa Ins. Co. v. United States*, 775 F.2d 1158, 1163 (Fed. Cir. 1985) ("[T]here is no valid distinction between money held by the [owner] which is a 'retainage' and a 'progress payment.' In either case, the 'total fund' remaining in the [owner]'s possession, to the extent the surety has obligations arising under the contract, is available to the surety."); *Am. Fire & Cas. Co. v. First Nat'l City Bank*, 411 F.2d 755, 758 (1st Cir. 1969) ("[W]e hold that the surety has a superior claim to unpaid progress payments and retainage."), *cert. denied*, 396 U.S. 1007 (1970); *Nat'l Shawmut Bank of Boston v. New Amsterdam Cas. Co*., 411 F.2d 843, 848 (1st Cir. 1969) ("[The surety] is subrogated not only to the right of the [owner] to pay laborers and materialmen from funds retained out of progress payments, but also to the [owner]'s right to apply to the cost of completion the earned but unpaid progress payments in its hands at the time of default." (internal citations omitted)); *Capitol Indem. Corp. v. Heidkamp*, 312 B.R. 437, 442 (M.D. Fla. 2003) (emphasizing that "the distinction between contract and retainage funds is misguided"); *Nat'l Sur. Corp. v. United States*, 319 F. Supp. 45, 49 (N.D. Ala. 1970) ("It is clear from a review of the cases that the courts make no distinction between earned progress payments and retained percentages in determining the surety's equitable rights upon the contractor's default."); *In re* Pihl, Inc., 560 B.R. 1, 9–11 (Bankr. D. Mass. 2016) ("[A]s soon as the [s]ureties incurred a legal obligation to the [owners], they were entitled to contract retainages and progress payments that were earned by but not yet paid by the [contractor]"); *In re* Alliance Props., Inc., 104 B.R. 306, 311–312 (Bankr. S.D. Cal. 1989) (explaining that "resolution" of whether a fund was "attributable to retentions, progress payments or contract damages" was "not crucial" because the funds were subject to the surety's equitable lien); *In re*

Massart Co., 105 B.R. 610, 613 (W.D. Wash. 1989) (explaining that the surety "should have a superior lien on the progress payment").

33 79 B.R. 924 (Bankr. D. Or. 1987).

34 *Id.* at 928.

35 *Id.*; *accord United Pac. Ins. Co. v. First Nat'l Bank of Or.*, 222 F. Supp. 243, 250 (D. Or. 1963) ("*First National Bank*") (recognizing that surety's equitable lien to contract proceeds was "superior to the Trustee's claim"); *In re* Massart, 105 B.R. at 613 (recognizing in part that surety "should have a superior right to the progress payment" than the debtor).

36 *In re* Pac. Marine Dredging & Constr., 79 B.R. at 929; *First Nat'l Bank*, 222 F. Supp. at 250.

37 *In re* Pac. Marine Dredging & Constr., 79 B.R. at 929.

38 *In re* Comcraft, Inc., 206 B.R. 551, 554–56 (Bankr. D. Or. 1997).

39 *In re* Massart Co., 105 B.R. 610 (W.D. Wash. 1989). The author represented the surety in connection with this action.

40 *Id.* at 613.

41 *Id.*

42 *Fegert*, 88 B.R. at 260 –61.

43 *Id.* at 259.

44 *Id.* at 260.

45 *Id.* at 260–61.

46 *Id.* at 261 (internal citations omitted).

47 *Universal Bonding Ins. Co. v. Gittens & Sprinkle Enters., Inc.*, 960 F.2d 366, 371–76 (3rd Cir. 1992);*In re* Maxon Eng'g Servs., 332 B.R. 495, 500 (Bankr. D. P.R. 2005); *In re* Alliance Props, Inc., 104 B.R. at 312; *In re* Glover Constr. Co., Inc., 30 B.R. 873, 881 (Bankr. W.D. Ky. 1983).

48 *In re* C.W. Mining Co., 798 F.3d 983, 987 (10th Cir. 2015); *In re* Silverman, 616 F.3d 1001, 1006 (9th Cir. 2010).

49 *In re* Silverman, 616 F.3d at 1006.

50 *Union Bank v. Wolas*, 502 U.S. 151, 154–55 (1991).

51 11 U.S.C. § 547(b); *In re* Net-Velazquez, 625 F.3d 34, 38 (1st Cir. 2010); *In re* Stinson, 443 B.R. 438, 442 (9th Cir. BAP 2010).

52 *In re Stinson*, 443 B.R. at 442.

53 *Id.*

54 11 U.S.C. § 547(b)(1).

55 *Id.* § 547(b).

56 *Id.* § 547(b)(5).

57 *In re* Electron Corp., 336 B.R. 809, 813 (B.A.P. 10th Cir. 2006) (mechanic's lien); *Askenaizer v. Seacoast Redimix Concrete, LLC*, 2007 U.S. Dist. LEXIS 24632, at *10–13 (D. N.H. Mar. 29, 2007) (payment bond); *In re* 360Networks (USA) Inc., 327 B.R. 187, 190–92 (Bankr. S.D. N.Y. 2005) (mechanic's lien) (collecting cases); *In re* Golfview Dev. Ctr., Inc., 309 B.R. 758, 765–71 (Bankr. N.D. Ill. 2004) (mechanic's lien); *In re* R.M. Taylor, Inc., 257 B.R. 289, 293–95 (Bankr. W.D. Mo. 2000) (mechanic's lien).

58 301 B.R. 195 (Bankr. N.D. Tex. 2003).

59 *Id.* at 198.

60 *Id.* at 202–23.

61 *Id.*

62 *In re* VCW Enters., 2015 U.S. Dist. LEXIS 5565, at *9, 2015 WL 224385 (E.D. Pa. Jan. 15, 2015) (bond and mechanic's lien); *In re* J.A. Jones, 361 B.R. 94, 100–01 (Bankr. W.D.N.C. 2007) (mechanic's lien); *In re* Pameco Corp., 356 B.R. 327, 335–36 (Bankr. S.D.N.Y. 2006) (mechanic's lien).

63 592 F.3d 525 (4th Cir. 2010).

[64] *Id.* at 531.
[65] *Id.* (quoting *In re* Virginia-Carolina Fin. Corp., 954 F.2d 193, 199 (4th Cir. 1992)).
[66] 11 U.S.C. § 547(g).
[67] *See Angell*, 592 F.3d at 531.
[68] 11 U.S.C. § 547(c).
[69] 40 U.S.C. §§ 3131–3134.
[70] *See, e.g.*, OR. REV. STAT. §§ 279C.380–279C.390, 279C.515, 279C.600–279C.625; WASH. REV. CODE §§ 39.08.010–39.08.100.
[71] *In re* E.R. Fegert, Inc., 887 F.2d 955, 959 (9th Cir. 1989).
[72] *In re* George Rodman, Inc., 792 F.2d 125, 127–28 (10th Cir. 1986); *In re* WB Servs., LLC, 2018 Bankr. LEXIS 1911, at *37–41 (Bankr. D. Kan. June 25, 2018); *In re* Instrumentation & Controls, Inc., 506 B.R. 677, 681–82 (Bankr. E.D. Pa. 2014); *In re* Modtech Holdings, Inc., 503 B.R. 737, 746–50 (Bankr. C.D. Cal. 2013); *In re* Partitions Plus of Wilmington, Inc., 2008 Bankr. LEXIS 1994, at *7–17 (Bankr. E.D. N.C. Mar. 20, 2008); *In re* Phillip Servs. Corp., 359 B.R. 616, 631–34 (Bankr. S.D. Tex. 2006); *Newbery Corp. v. Fireman's Fund Ins. Co.*, 106 B.R. 186, 188 (D. Ariz. 1989); *see generally* William H. Henley, *Worlds in Collision: Mechanic's Liens and Federal Bankruptcy Schemes Confront Each Other and How the Courts Reconcile the Conflict*, 31 WHITTIER L. REV. 621, 643–49 (2010) (collecting cases).
[73] *See Fegert*, 887 F.2d at 959; *In re* GEM Constr. Corp. of Va., 262 B.R. 638, 650–52 (Bankr. E.D. Va. 2000).
[74] *In re* Abatement Envtl. Res., Inc., 307 B.R. 491, 499 (Bankr. D. Md. 2004).
[75] 592 F.3d at 532.
[76] *Id.* at 532–33.
[77] *Id*
[78] *Id.* at 533 (quoting *In re* Ramba, Inc., 416 F.3d 394, 399–400 (5th Cir. 2005)).
[79] *Id.* at 533.
[80] *See In re* Truland Grp., Inc., 2018 Bankr. LEXIS 42, at *17–18 (Bankr. E.D. Va. Jan. 8, 2018) (applying *Angell* to reject new value defense where contractor "never actually made a bond claim").
[81] 371 F.3d 1079 (9th Cir. 2004).
[82] *Id.* at 1081.
[83] *Id.*
[84] *Id.* at 1082.
[85] *Id.* at 1083.
[86] *Id.*
[87] *Id.*; *cf. In re* Phillip Servs. Corp., 359 B.R. 616, 635–36 (Bankr. S.D. Tex. 2006) (finding contemporaneous exchange notwithstanding dishonored check when release of lien was dependent on payment)
[88] 391 B.R. 7 (Bankr. D.N.H. 2007).
[89] *Id.* at 12–13.
[90] *Id.* at 9–10.
[91] *See id.* at 11–12.
[92] *Id.* at 13.
[93] *In re* SNTL Corp., 571 F.3d 826, 836 (9th Cir. 2009) ("Although a surety usually is discharged by payment of the debt, he continues to be liable if the payment constitutes a preference under bankruptcy law. A preferential payment is deemed by law to be no payment at all." (quoting *In re* Herman Cantor Corp., 15 B.R. 747, 750 (Bankr. E.D. Va. 1981))).
[94] *See Peaje Investments LLC v. García-Padilla*, 845 F.3d 505, 513 (1st Cir. 2017); *Vázquez-Carmona v. Dep't of Educ. of Puerto Rico*, 255 F. Supp. 3d 298, 298 (D.P.R. 2017).

[95] Michael Kranz, *Here's how Puerto Rico got into so much debt*, Business Insider (Oct. 9, 2017), https://www.businessinsider.com/puerto-rico-debt-2017-10.

[96] *See* Eric Platt, *Puerto Rico: An island's exodus*, Financial Times (Aug. 25, 2016), https://www.ft.com/content/f9251a80-652b-11e6-a08a-c7ac04ef00aa; Leonor Ayala Polley, *'Forced Exile,' Say Puerto Ricans Leaving Island Amid Financial Crisis*, NBC News (May 3, 2016), http://www.nbcnews.com/news/latino/forced-exile-say-puerto-ricans-leaving-island-amid-financial-crisis-n566781; Jonathan Levin & Rebecca Spalding, *Puerto Rico's Exodus is Speeding the Island's Economic Collapse*, Bloomberg (June 2, 2017), https://www.bloomberg.com/news/articles/2017-06-02/-i-had-to-choose-for-my-family-thousands-fleeing-puerto-rico.

[97] Lydia DePillis, *Puerto Rico's pension system was in crisis. Hurricane Maria made it into a* catastrophe. CNNMoney (Oct. 5, 2017), https://money.cnn.com/2017/10/05/news/economy/hurricane-maria-puerto-rico-pensions/index.html.

[98] Mary Williams Walsh, *How Puerto Rico Is Grappling With a Debt Crisis*, N.Y. Times (May. 16, 2017), https://www.nytimes.com/interactive/2017/business/dealbook/puerto-rico-debt-bankruptcy.html.

[99] *In re The Financial Oversight and Mgmt. Bd. For Puerto Rico*, No. 17-2079, -- F.3d --, 2018 WL 3751014, at *1 (1st Cir. Aug. 8, 2018).

[100] PROMESA, § 2161(a) (incorporating 11 U.S.C. § 362).

[101] See PROMESA, §§ 2121, 2141.

[102] *In re The Financial Oversight and Mgmt. Bd.*, No. 17-2079, 2018 WL 3751014 at *1.

[103] *See* "Covered Entities," Exhibit B to the Petition for Relief by The Financial Oversight and Management Board for Puerto Rico on behalf of the Commonwealth of Puerto Rico Pursuant to Title III of PROMESA, Case No. 17 BK 03283-LTS, *In re The Financial Oversight and Mgmt. Bd. For Puerto Rico*, Dkt., 1-4, (D.P.R. May 9, 2017), available at: https://cases.primeclerk.com/puertorico/Home-DocketInfo?DocAttribute=3257&DocAttrName=PETITION

[104] *In re The Financial Oversight and Mgmt. Bd.*, No. 17-2079, 2018 WL 3751014 at *2-4.

[105] *Id.* at *1.

[106] *Peaje Investm'ts LLC v. Financial Oversight and Mgmt. Bd. for Puerto Rico (In re Financial Oversight and Mgmt. Bd. for Puerto Rico*, Nos. 17-2165, 17-2166, 17-2167, -- F.3d --, 2018 WL 3750930 (1st Cir. Aug. 8, 2018)

[107] *In Re Financial Oversight and Mgmt. Bd. for Puerto Rico* (), No. 17-3283 (LTS), Adv. Proc. No. 18-080-LTS in 17 BK 3283-LTS, -- F. Supp. 3d -- , 2018 WL 3760979 (D.P.R. Aug. 7, 2018).

SESSION 10

EXTRA CONTRACTUAL CLAIMS AND HOW TO AVOID THEM

Meredith Dishaw | Williams Kastner | Seattle, WA

Paul Friedrich | Williams Kastner | Seattle, WA

Andrew Torrance | Liberty Mutual Surety | Seattle, WA

Thomas Duke | Amtrust Surety | Frisco, TX

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EXTRA-CONTRACTUAL CLAIMS

AND

HOW TO AVOID THEM

Paul K. Friedrich
Meredith E. Dishaw

Introduction

While originally a claim largely relegated to the insurance industry, the concept of bad faith, and the potential for extra-contractual liability, has become a more frequent concern for surety professionals. Jurisdictions treat bad faith claims against sureties under distinct and varying theories. Often liability can be imposed under statutes or the common law, either of which may subject the surety to a variety of damages, including punitive damages or liability for attorneys' fees, costs, or prejudgment interest. The concept of bad faith in the suretyship context creates a minefield of potential liabilities. As a result, it is important to have a comprehensive understanding of applicable claims handling regulations, the law of the governing jurisdiction, and to adhere to surety-specific claims handling guidelines in order to mitigate exposure to extra-contractual claims. This paper will provide an overview of the regulatory and legal context within which extra-contractual claims exist, discuss applicable case law, and offer practical advice and recommendations to sureties in order to minimize risk of extra-contractual claims.

I. Extra-Contractual Liability of Sureties

Prior to the rise of the bad faith claim, a surety's liability was limited to the contractual damages available under the bond. Courts across the country have long held that there is an implied covenant of good faith and fair dealing in every contract.[1] This contractual obligation requires that the parties cooperate with each other so that each may receive the benefit of the bargain.[2] Historically, a breach of this implied duty only subjected the breaching party to contractual damages. However, courts have since held that breach of the implied covenant of good faith and fair dealing, otherwise known as bad faith, may subject a surety to extra-contractual damages.

Since the inception of the doctrine of bad faith, courts across the country have routinely held that it applies in contracts of insurance and, generally, requires an insurer to not only perform a reasonable investigation in good faith into every claim, but also requires insurers to pay covered claims.[3]

The obligations imposed on sureties and insurers are different. The performance bond creates a tripartite relationship between the surety, the principal, and the obligee:

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1 *See, e.g., ABN AMRO Bank, N.V. v. MBIA Inc.*, 952 N.E.2d 463, 474-75 (N.Y. 2011); *Rekhter v. Dep't of Soc. & Health Servs.*, 323 P.3d 1036, 1041(Wash. 2014).

2 *See, e.g., MBIA Inc.*, 952 N.E.2d at 475 (stating that the duty "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") (quoting *Dalton v. Educ. Testing Serv.*, 663 N.E.2d 289 (N.Y. 1995)); *Rekhter*, 323 P.3d at 1041 (stating that the duty "obligates the parties to cooperate with each other so that each may obtain the full benefit of performance") (quoting *Badgett v. Sec. State Bank*, 807 P.2d 356 (Wash. 1991)).

3 *See, e.g., Willis v. Swain*, 304 P.3d 619, 627 (Haw. 2013); *Bi-Economy Mkt., Inc. v. Harleysville Ins. Co. of N.Y.*, 886 N.E.2d 127, 131(N.Y. 2008); *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.*, 196 P.3d 664 (Wash. 2008); *Roehl Transp., Inc. v. Liberty Mut. Ins. Co.*, 784 N.W.2d 542, 553 (Wis. 2010).

> In general, suretyship has been described as a contractual tripartite relationship in which one party (the surety) guarantees to another party (the obligee) that a third party (the principal) will perform a contract in accordance with its terms and conditions. The surety promises the obligee to answer the debt, default, or miscarriage of the principal. Suretyship is a form of guaranty. In exchange for a premium, the surety lends its financial strength and credit to the principal on the condition that, if the surety has to satisfy the principal's debt or default, the principal will indemnify the surety for its losses and expenses. In essence, the surety becomes the guarantor of the principal's ability to perform its obligations to the obligee.[4]

This tripartite relationship imposes dual, competing obligations on the surety in its investigation of claims under a performance bond. Notably, in spite of the fundamental distinctions between suretyship and insurance, more and more jurisdictions are applying bad faith insurance law concepts, and the consequences thereof, to sureties.

A. Recovery from Surety by Obligee for Surety's alleged Bad Faith

Prior to the modern doctrine of bad faith, a breach of this implied covenant of good faith and fair dealing was limited to contractual damages. Commencing in the early 1970s, however, courts expanded this good faith obligation in the context of the insurer-insured relationship.[5] Courts expanding the duty of good faith to apply to insurers did so based on the notion that there was a "special relationship" between the insured and the insurer.[6] As noted by the Oklahoma Supreme Court, this special relationship arises out of the quasi-public nature of the insurance industry:

> …[T]he industry has a quasi-public nature, that it involves the public interest and for that reason is largely governmentally regulated. The consumer has no bargaining power and no means of protecting himself from the kinds of abuses set forth in appellant's petition.[7]

More and more states began recognizing this concept of tort liability for an alleged failure to act in good faith by an insurer. Following the advent of the common law bad faith claim, some states adopted statutes governing the fair practices applicable to an insurer's handling of claims. While the applicable statutes are addressed in greater detail below, many statutory schemes broadly defined "insurance" to incorporate suretyship. Thus, certain states apply insurance bad faith concepts to the surety-obligee relationship. Other states, however, have firmly held that the concept of "bad faith" does not apply in the suretyship context. The two approaches are evaluated below.

1. Recovery Against Surety Allowed

Jurisdictions applying the concept of bad faith to the surety-obligee relationship typically conclude that sureties are substantially similar to insurers.[8] The Supreme Court of Alaska, in holding that the tort of bad faith was applicable to sureties, concluded that:

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4 *Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co.*, 945 So. 2d 1216, 1226 (Fla. 2006) (quoting Edward Etcheverry, *Rights and Liabilities of Sureties, in Florida Construction Law and Practice* at 8-7 (5th ed. 2006)). *See also*, *PSE Consulting, Inc. v. Franke Mercede & Sons, Inc.*, 838 A.2d 136, 159 (Conn. 2004).

5 *See, e.g., Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973).

6 *See, e.g., Christian v. Am. Home Assur. Co.*, 577 P.2d 899 (Okla. 1977).

7 *Id.* at 901 (citing *Fletcher v. Western Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78 (Cal. App. Ct. 1970)).

8 *See, e.g., Loyal Order of Moose, Lodge 1392 v. Int'l Fid. Ins. Co.*, 797 P.2d 622 (Alaska 1990); *Dodge v. Fid. & Deposit Co. of Md.*, 778 P.2d 1240 (Ariz. 1989); *Transamerica Premier Ins. Co. v. Brighton Sch. Dist. 27J*, 940 P.2d 348 (Colo. 1997); *Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins. Co.*, 945 So. 2d 1216 (Fla. 2006); *Suver v. Pers. Serv. Ins. Co.*, 462 N.E. 2d 415 (Ohio 1984).

> [T]he relationship of a surety to its obligee—an intended creditor third-party beneficiary—is more analogous to that of an insurer to its insured…. A surety may satisfy its duty of good faith to its obligee by acting reasonably in response to a claim by its obligee, and by acting promptly to remedy or perform the principal's duties where default is clear.[9]

The Alaska court relied largely on the Arizona Supreme Court's decision in *Dodge v. Fidelity & Deposit Co.*[10] There, the Arizona Supreme Court discussed, in great detail, why the surety-obligee relationship was analogous to the insurer-insured relationship.

> The purpose of the construction performance bond required by [obligees'] contract with [principal] was not for [obligees'] commercial advantage, but to protect [obligees] from calamity – [principal's] default on the contract. A contractor's default has the potential for creating great financial and personal hardship to a homeowner. Surety insurance is obtained with the hope of avoiding such hardships. Imposing tort damages on a surety who in bad faith refuses to pay a valid claim will deter such conduct. …
>
> In *Noble* [*and Rawlings v. Apodaca*, 726 P.2d 565 (1986)] we noted that '[t]he whole purpose of insurance is defeated if an insurance company can refuse or fail, without justification, to pay a valid claim.' The same is true with construction performance bonds and other types of surety insurance. Permitting a surety to withhold performance of its obligations without reason would defeat the purpose for which surety insurance is intended.[11]

Courts have also held that the tort of bad faith applies in the suretyship context after looking at the state's statutory scheme.[12] The *Dodge* court noted that the Arizona statutory scheme broadly defined "insurer" as "every person engaged in the business of making contracts of insurance."[13] After examining the entirety of the regulatory statutes, the *Dodge* court concluded that "[o]ur statutes thus make clear our legislature's intent to include sureties within the coverage of the insurance statutes."[14]

Similarly, the Montana Supreme Court concluded that a surety was an "insurer" and, subject to tort claims of bad faith under Montana law, in *K-W Industries v. National Surety Corp.*[15] The Montana statute defined "insurer" to "includ[e] every person engaged as an indemnitor, *surety*, or contractor in the business of entering insurance."[16] The Montana statutes also defined "insurance" "as a contract whereby one undertakes to indemnify another or to pay or provide a specified or determinable amount or benefit upon determinable contingencies."[17] Finally, the Court looked to the statutory definition of "surety insurance" which "includ[es] insurance guaranteeing the performance of contracts, other than insurance policies, and guaranteeing and executing bonds, undertakings, and contracts of suretyship."[18] After an examination of Montana's statutory code, the Supreme Court concluded that "by plain and explicit language, the legislature made suretyship a 'class' of insurance subject to regulation under the code.

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9 *Loyal Order of Moose, Lodge 1392*, 797 P.2d at 628.

10 778 P.2d 1240 (Ariz. 1989).

11 *Id.* at 1242-1243.

12 *See, e.g., Dodge*, 778 P.2d at 1242; *Transamerica*, 940 P.2d at 352; *Dadeland Depot*, 945 So. 2d at 1225, 1231; *K-W Indus., a Div. of Associated Techs., Ltd. v. Nat'l Sur. Corp.*, 754 P.2d 502 (Mont. 1988); *Szarkowski v. Reliance Ins. Co.*, 404 N.W.2d 502 (N.D. 1987).

13 778 P.2d at 1242 (citing A.R.S. § 20-104).

14 *Id.* (internal citations omitted).

15 754 P.2d 502 (1988).

16 *Id.* at 504 (citing MCA § 33-1-201(6)).

17 *Id.* (citing MCA § 33-1-201(5)).

18 *Id.* (citing MCA § 33-1-211).

Therefore, for the purpose of the insurance code, one who issues surety bonds is in 'the business of insurance,' and subject to the provisions prohibiting unfair and deceptive practices."[19]

Even without reliance upon a statutory or regulatory scheme, some courts will allow bad faith claims to proceed against a surety.[20] As one example, the Colorado Supreme Court concluded that there was a "special relationship" between the surety and the obligee and that imposing tort liability on sureties for bad faith would encourage prompt resolution of claims.

> Although the parties to a suretyship agreement are on equal footing in terms of bargaining power when they enter into the agreement, it is the commercial surety who controls the ultimate decision of whether to pay claims made by the obligee under the terms of the surety bond. For this reason, the commercial surety has a distinct advantage over the obligee in its ability to control performance under the secondary agreement. As with insurers, commercial sureties must proceed with the payment of claims made pursuant to a surety bond in good faith. Otherwise, the core purpose of the suretyship agreement, which is to insulate the obligee from the risk of default, is defeated.
>
> Recognizing a cause of action in tort for a commercial surety's breach of its duty to act in good faith compels commercial sureties to handle claims responsibly. When the commercial surety withholds payment of an obligee's claim in bad faith, contract damages do not compensate the obligee for the commercial surety's misconduct and have no deterrent effect to prevent such misconduct in the future.[21]

The *Transamerica* court also identified a secondary reason to apply the tort of bad faith in the context of suretyship – the surety is in a position of superior bargaining power as compared to its obligee once a claim is made on the bond. According to the *Transamerica* court, the surety has the power to determine whether to pay a claim made upon the surety bond.[22]

The states holding that a surety may be held liable in tort for breach of the covenant of good faith and fair dealing look to the reasons set forth above to do so. These courts find that it is appropriate to impose tort liability because of: the "special relationship" between a surety and an obligee; the broad definition of surety in statutory insurance regulations; the unequal bargaining power between an obligee and a surety; and the belief that tort liability will encourage prompt resolution of surety bond claims or, stated in the alternative, deter sureties from acting improperly in resolving any claims under the performance bond.

2. Recovery Against Surety Not Allowed

In contrast, states refusing to impose tort liability upon the surety for alleged bad faith conduct typically look to the vast distinctions, and competing obligations, inherent in the tripartite relationship between the surety, obligee, and the principal.[23] These courts also reject the arguments made above.

The tripartite relationship at the heart of every suretyship arrangement creates different and distinct obligations than those present in the dual insured-insurer relationship.[24] The court in *Cates*

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19 *Id.*

20 *See, e.g.*, *Transamerica Premier Ins. Co.*, 940 P.2d at 353; *Suver*, 462 N.E. 2d at 417 (Ohio 1984).

21 *Transamerica*, 940 P.2d at 353.

22 *Id.* at 353.

23 *See, e.g.*, *Cates Constr., Inc. v. Talbot Partners*, 980 P.2d 407 (Cal. 1999); *Masterclean, Inc. v. Star Ins. Co.*, 556 S.E.2d 371 (S.C. 2001); *Great Am. Ins. Co. v. N. Austin Mun. Util. Dist. No. 1*, 908 S.W.2d 415 (Tex. 1995).

24 *Cates*, 980 P.2d at 425-26.

Construction, Inc. v. Talbot Partner engaged in a detailed analysis of the potential benefits and drawbacks of allowing sureties to be held liable in tort for alleged bad faith. The Court stated:

> Unlike insurance relationships, which involve the interests of only two parties, the surety relationship is a tripartite one implicating the separate legal interests of the principal, the obligee and the surety. When contract disputes arise between an obligee and a principal as to whether the principal is in default, it may prove difficult for the surety to determine which party is in the right and whether its own performance is due under the bond. …
>
> …[C]onstruction disputes may be complicated enough to resolve when all three parties are on a level playing field. But it is rational to assume that making tort remedies available may encourage obligees to allege a principal's default more readily than they would in the absence of such remedies. It is also reasonable to conclude that allowing obligees to wield the club of tort and punitive damages may make it easier to pressure sureties into paying questionable default claims, or paying more on properly disputed claims, because the sureties will be reluctant to risk the outcome of a tort action. Thus, permitting obligees to sue sureties in tort may allow obligees to gain additional leverage with sureties that principals do not have in contract disputes.
>
> With such increased leverage, obligees will have sufficient power to detrimentally affect the interests of principals when disagreements arise during construction. Claims of default by the obligee may impair the principal's ability to secure bonding on other projects, thus automatically disqualifying the principal from bidding on all public projects and many private ones. Moreover, indemnity agreements executed by principals often give sureties the right to pursue them for reimbursement of any loss, including legal expenses and the costs of investigation. In efforts to avoid bad faith liability, sureties may strive to 'find' bond coverage for obligees while, at the same time, charging their investigation costs to the principal. Accordingly, even if the surety's investigation ultimately leads to the conclusion that the principal is not in default, the faultless principal may still suffer adverse consequences. These considerations, which have no parallel in disputes involving insurance policies, weigh against the recognition of extracontractual liability in the performance bond context[25].

Ultimately, the *Cates* court held that tort liability for an alleged breach of the covenant of good faith and fair dealing was not available against sureties. The Court stated: "A construction performance bond is not an insurance policy. Nor is it a contract otherwise marked by elements of adhesion, public interest or fiduciary responsibility, such that an extra-contractual remedy is necessitated in the interests of social policy. Obligees have ample power to protect their interests through negotiation, and sureties, for the most part, are deterred from acting unreasonably by the threat of stiff statutory and administrative sanctions and penalties, including license suspension and revocation."[26]

In a substantially similar decision, the Texas Supreme Court noted that the factors present in finding a "special relationship" between an insured and an insurer were not present in the suretyship context.[27] First, the court held that the concerns regarding unequal bargaining power between the insured and the insurer were not present in the suretyship context.[28] The surety had no control over the bond form used on the project and, instead, it was the obligee that "had the ability to exercise control over the form of the bonds."[29] Second, the appellate court found that it was not concerned that a surety would be able to take advantage of an obligee during the claims handling process based on the structure of the suretyship tripartite relationship.[30] Unlike the insurer-insured relationship, the surety's liability was secondary to that

[25] *Id.* at 426.
[26] *Id.* at 427.
[27] *Great Am. Ins. Co.*, *supra*, 908 S.W.2d at 418.
[28] *Id*.
[29] *Id.*
[30] *Id.* at 418-419.

of its principal and an obligee would also be able to seek recovery from the principal.[31] Ultimately, the Court held that "[t]he derivative nature of a surety's liability and its right to rely upon the defenses of its principal compel the conclusion that a surety, like its principal, should be entitled to test the merits of an obligee's claim without the imposition of extra-contractual duties to the bond obligee."[32] The Texas appellate court also held that the Texas statutory scheme providing for a cause of action against an insurer for damages resulting from the insurer's unfair or deceptive practices did not apply to sureties.[33] Similar results have been reached in several eastern states.[34]

In examining the same factors and policies, courts holding that the surety cannot be held liable in tort for an alleged breach of the covenant of good faith and fair dealing come to the exact opposite conclusion as those jurisdictions previously discussed. In evaluating the law and policies, many of these courts find that the differences between suretyship and insurance dictate a different result.

B. Recovery from Surety by Principal or Indemnitor for Surety's Alleged Bad Faith

While some courts have been able justify the extension of the insurance bad faith doctrine to the surety-obligee relationship, they have had a more difficult time extending this concept to the surety-principal relationship. While courts find that the surety-obligee relationship is analogous to the insurer-insured relationship, these courts cannot draw the same correlation to the surety-principal relationship. As noted by one court "[t]he bond is issued for the benefit of the obligee, not the principal. The principal, who remains primarily liable, does not look to the surety for protection as the insured does to the insurer. Therefore, while an obligee may bring a bad faith claim against a surety, a principal may not."[35] Thus, several courts have held that a surety does not owe a duty of good faith to its principal and have held that a principal is barred from bringing a bad faith claim against its surety.[36]

It should be noted, however, that even if jurisdictions do not allow a principal to maintain a bad faith tort claim against the surety, a principal may still be entitled to assert, as a defense, that the surety paid or settled a claim in bad faith when faced with an indemnity action. As an example, the South Carolina Supreme Court ruled:

> In holding that a principal cannot sue a surety in tort for a bad faith refusal to pay a first party claim, it is important to note we do not preclude a principal from using a surety's bad faith in all instances. Several courts, including those not recognizing a principal's right to sue on bad faith in tort, allow the principal to assert a surety's bad faith as a defense to indemnification. Our Court of Appeals dealt with this issue in dicta in *American Fire and Casualty Co. v. Johnson*, 504 S.E.2d 356 (S.C. Ct. App. 1998). While a principal may not use bad faith as a sword to extract damages from a surety in tort, a principal is not precluded from using bad faith as a shield in contract against a surety seeking indemnification.[37]

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31 *Id.*

32 *Id.* at 420.

33 *Id.* at 424.

34 A federal district court examined whether Pennsylvania's Bad Faith Statute should apply in the suretyship context and, for similar reasons, held that the statute did not apply to sureties. *Superior Precast, Inc. v. Safeco Ins. Co. of Am.*, 71 F. Supp. 2d 438, 450 (E.D. Pa. 1999). *See also*, *Fed. Ins. Co v. Me. Yankee Atomic Power Co.*, 183 F. Supp. 2d 76 (D. Me. 2001) (holding that Maine's insurance claims handling statute did not apply to sureties).

35 *Int'l Fid. Ins. Co. v. Vimas Painting Co.*, No. 2:07-cv-298, 2008 U.S. Dist. LEXIS 27018, *16 (S.D. Ohio Apr. 3, 2008) (citing *Shannon R. Ginn Constr. Co. v. Reliance Ins. Co.*, 51 F. Supp. 2d 1347, 1352-53 (S.D. Fla. 1999))

36 *Int'l Fid. Ins. Co.*, 2008 U.S. Dist. LEXIS 27018 at *16.

37 *Masterclean, Inc. v. Star Ins. Co.*, 556 S.E.2d 371, 376-77 (S.C. 2001) (internal citations omitted).

Jurisdictions which hold that the principal can raise an alleged violation of the breach of the covenant of good faith and fair dealing as an affirmative defense start with the same proposition that the covenant is inherent in every contract, including the general indemnity agreement between the surety and the principal.[38] The Oregon Court of Appeals concluded that:

> Parties to an indemnity agreement which subjects the right to compromise a claim against the principal to the sole discretion of the surety must reasonably expect that compromise and payment will be made only after reasonable investigation of the claims, counterclaims and defenses asserted in the underlying action. *In order to prove lack of good faith in settling the claim, [the principal and indemnitors] needed only to prove that [surety] failed to make a reasonable investigation of the validity of the claims against them or to consider reasonably the viability of their counterclaims and defenses*, not that [surety] acted for dishonest purposes or improper motives.[39]

The Oregon appellate court concluded that there was evidence to support the trial court's denial of the surety's motion for a directed verdict on the conclusion that the surety had failed to act in good faith.[40] Nevertheless, the appellate court affirmed the trial court's conclusion that the surety was entitled to an award of attorneys' fees under the indemnity agreement.[41]

In the context of a surety's indemnity claim, the Oregon appellate court adopted the minority rule, which imposes a reasonableness standard in determining whether the surety acted in bad faith.[42] The majority rule, however, holds "that the principal must establish something more than mere negligence to prove bad faith."[43] In the context of the surety's indemnity claim, the Connecticut Supreme Court adopted a standard to "define bad faith as requiring an 'improper motive' or 'dishonest purpose' on the part of the surety."[44] The Court was clear to state that the principal need not prove that the surety acted fraudulently to establish the surety's bad faith.[45] In doing so, the Court distinguished itself from the few jurisdictions which appear to have held that the principal must prove a higher standard of fraud or collusion.[46]

Whether a principal's defense is available and the applicable standard for determining whether the surety's actions or inactions constitute a bad faith affirmative defense will be dependent upon the applicable jurisdiction and any choice of law analysis. Sureties should be aware of the potential defenses

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38 *See, e.g.,* City of Portland v. George D. Ward & Assocs., Inc., 750 P.2d 171, 174 (Or. Ct. App. 1988).

39 *Id.* at 175 (emphasis added).

40 *Id.*

41 *Id*. at 176.

42 *See, e.g., PSE Consulting Inc.*, 838 A.2d at 151. The Connecticut Supreme Court found that the following minority of jurisdictions evaluated the surety's conduct under a definition of bad faith as "conduct that was unreasonable or negligent." *Id.* (citing to *Rush Presbyterian St. Luke's Med. Ctr. v. Safeco Ins. Co. of Am.*, 712 F. Supp. 1344, 1346 (N.D. Ill. 1989); *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.*, 54 Cal. Rptr. 2d 888, 899 (1996); *Hawaiian Ins. & Guar. Co., Ltd. v. Higashi*, 675 P.2d 767, 768 (1984); *Hartford v. Tanner*, 910 P.2d 872, 877 (Kan. Ct. App. 1996); *Portland*, 750 P.2d at 175.

43 The *PSE Consulting* court cites to the following jurisdictions as the majority: *Engbrock v. Fed. Ins. Co.*, 370 F.2d 784, 786 (5th Cir. 1967); *Frontier Ins. Co. v. Int'l, Inc.*, 124 F. Supp. 2d 1211, 1214 (N.D. Ala. 2000); *U.S. Fid. & Guar. Co. v. Feibus,* 15 F. Supp. 579, 587 (M.D. Pa. 1998); *Emp'rs Ins. of Wausau v. Able Green, Inc.*, 749 F. Supp. 1100, 1103 (S.D. Fla. 1990); *Am. Emp'rs' Ins. Co. v. Horton*, 622 N.E.2d 283 (Mass. Ct. App. 1993); *Fid. & Deposit Co. of Md. v. Wu*, 552 A.2d 1196, 1200 (Vt. 1988)

44 *PSE Consulting*, 838 A.2d at 152-53.

45 *Id.* at 153.

46 *Id.* at 153 n. 13 (citing *Fireman's Ins. Co. of Newark, N.J. v. Todesca Equip. Co.*, 310 F.3d 32, 37 (1st Cir. 2002); *Gen. Accident Ins. Co. of Am. v. Merritt-Meridian Constr. Corp.*, 975 F. Supp. 511, 516 (S.D.N.Y. 1997); *Reliance Ins. Co. v. Romine*, 707 F. Supp. 550, 552 (S.D. Ga. 1989), *aff'd*, 888 F.2d 1344 (11th Cir. 1989); *Hess v. Am. States Ins. Co.*, 589 S.W.2d 548, 551 (Tex. Ct. App. 1979)).

they may face from their principals and indemnitors when investigating and resolving claims against the performance bond.

C. Statutory Causes of Action against Surety for Alleged Unfair Claims Handling Practices

Almost every state has adopted statutes governing the conduct of insurers in the claims handling process. These statutes may create a private cause of action against an insurer to recover damages as a result of the insurer's bad faith conduct. As noted above, some states hold that such statutes affirmatively apply to sureties, whereas others have held that the insurance statutes do not apply to sureties.[47] Each state has different statutes, and often regulations, which govern claim handling practices, and provide varying potential remedies to a plaintiff. The entire range of the statutory schemes across the country are beyond the scope of this paper, however, a few examples are discussed below. These examples will identify potential roadblocks that a surety professional may encounter when confronted with any statutory scheme.

Colorado's Insurance Unfair Competition–Deceptive Practices statute defines "insurance policy" or "insurance contract" as "any contract of insurance, indemnity, medical or hospital service, ***<u>suretyship</u>***, or annuity issued, proposed for issuance, or intended for issuance by any person."[48] The statute includes a comprehensive definition of the "unfair methods of competition and unfair or deceptive acts or practices in the business of insurance."[49] The Colorado's statutory definition largely follows the model "Unfair Claims Settlement Practices Act" addressed in detail below. The Colorado statute does not provide a clear remedy for an alleged unfair claims settlement practice by an insurer. However, the statute provides that "[a] person engaged in the business of insurance shall not unreasonably delay or deny payment of a claim for benefits owed to or on behalf of any first-party claimant."[50] "A First-party claimant…whose claim for payment of benefits has been unreasonably delayed or denied may bring an action in a district court to recover reasonable attorney fees and court costs and two times the covered benefit."[51]

The Colorado Unfair Competition and Deceptive Practices statute is emblematic of a vast majority of insurance claims handling statutes. These statutes, and applicable regulations, set forth the requirements and conduct for an insurer's receipt, processing, determination, and resolution of a claim. While each statute is unique in its requirements, each statute also generally provides a definition of "unfair claims settlement practices," provides for a private cause of action, provides an avenue for the recovery of attorneys' fees and court costs, and often provides some type of penalty, in Colorado's case, punitive damages equal to double the amount of the benefit sought under the policy. It is important for sureties, and their representatives, to be aware of the applicable statutes and regulations and their obligations in each applicable jurisdiction.

II. Surety's Exposure to Damages, Attorneys' Fees, or Interest under Extra-Contractual Causes of Action

A. Damages

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47 Notably, at least one statute affirmatively excludes "surety insurance" from its insurance unfair claims practices statute. *See*, Md. Code. Ann., Ins. § 27-302 (b)(3).

48 Colo. Rev. Stat. § 10-3-1102 (emphasis added). Colorado has held that an insurer may be liable in tort for alleged bad faith conduct. *See*, *Transamerica Premier Ins. Co.*, 940 P.2d 348.

49 Colo. Rev. Stat. § 10-3-1104(1).

50 *Id.* § 10-3-1115(1)(a). "First-party claimant" is defined as "an individual, corporation, association, partnership, or other legal entity asserting an entitlement to benefits owed directly to or on behalf of an insured under an insurance policy." *Id.* § 10-3-1115(1)(b)(I).

51 *Id.* § 10-3-1116(1).

In jurisdictions that refuse to impose tort liability upon a surety for breach of the implied covenant of good faith and fair dealing, damages are limited to the available contract damages and the surety's liability may not exceed the penal sum of the performance bond. However, where there is an actionable tort claim for bad faith, sureties may face "extra-contractual" damages, i.e., the surety's liability will not be limited to the penal sum of the performance bond. Such extra-contractual damages may include compensatory damages in excess of the penal sum as well as potentially punitive damages for "bad faith" conduct. As noted above, the statutory schemes often contain provisions that allow a claimant to seek recovery of damages in double or treble the amount of the benefit sought.[52] Similarly, courts in some jurisdictions have held that sureties may be liable for punitive damages if the surety is held liable in bad faith.[53] Claimants may also be entitled to recover their costs incurred in pursuing their claims in litigation, which could include costs for an expert witness.

B. Attorneys' Fees

In the event a surety is held liable for acting in bad faith, it may be obligated to pay the claimant's attorneys' fees incurred in bringing the lawsuit. Some states that provide for the recovery of attorneys' fees have looked to the language of the performance bond. In *C & I Entm't, LLC v. Fid. & Deposit Co.*, the district court examined the language of the AIA A312 performance bond and found that various provisions allowed the claimant to recover its attorneys' fees.[54] If the surety had performed under the bond, then Paragraph 6 "unambiguously" provided the claimant its attorneys' fees.[55] However, the surety denied the claimant's request to perform.[56] Nevertheless, the Court found that a separate provision, Paragraph 5, "can serve as a basis for [claimant's] recovery of attorney's fees…."[57] The court stated that "Paragraph 5 provides that if [surety] proceeds in accordance with Paragraph 4.4 – specifically, if [surety] waives its right to perform and denies liability, in whole or in part, and notifies [claimant] of the reasons for such denial – [claimant] 'shall be entitled to enforce ***any remedy available to [it].***'"[58] The district court could not find any decisions interpreting the bond language, but, concluded that "'any remedy' broadly implies no restriction on the amount, type or nature of damages a bond obligee may seek."[59]

Other jurisdictions have provided this remedy pursuant to the statute, including, where applicable, the unfair claims practices statutes.[60] However, some jurisdictions have required a surety to reimburse a

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52 *See, e.g., id.*

53 *See, e.g., C & I Entm't, LLC v. Fid. & Deposit Co.*, No. 1:08CV00016-DMB-DAS, 2014 U.S. Dist. LEXIS 99505 *42-43 (N.D. Miss. Jul. 22, 2014) (citing *Sentinel Indus. Contracting Corp. v. Kimmins Indus. Serv. Corp.*, 743 So. 2d 954 (Miss. 1999); *McQueen Contracting, Inc. v. Fid. & Deposit Co. of Md.*, 871 F.2d 32 (5th Cir. 1989)).

54 2014 U.S. Dist. LEXIS 99505 at *41.

55 *Id.* at *38-39.

56 *Id.* at *39-40.

57 *Id.* at *40.

58 *Id.* (emphasis added).

59 *Id.*

60 *See, e.g.*, Colo. Rev. Stat. § 10-3-1116; Nev. Rev. Stat. 18.010(2)(b). Nev. Rev. Stat. 18.010(2)(b) allows the court to award "attorney's fees to a prevailing party...when the court finds that the claim, counterclaim, cross-claim or third-party complaint or defense of the opposing party was brought or maintained without reasonable ground or to harass the prevailing party." The statute further provides that a "court shall liberally construe the provisions of this paragraph in favor of awarding attorney's fees in all appropriate situations. It is the intent of the Legislature that the court award attorney's fees pursuant to this paragraph and impose sanctions pursuant to Rule 1 of the Nevada Rules of Civil Procedure in all appropriate situations to punish for and deter frivolous or vexatious claims and defenses because such claims and defenses overburden limited judicial resources, hinder the timely resolution of meritorious claims and increase the costs of engaging in business and providing provisions services to the public." The Nevada Supreme Court has held that "[t]he Legislature's

claimant for its incurred attorneys' fees based on equitable considerations. For example, the Washington Supreme Court held that a performance bond claimant may recover its attorneys' fees when the surety has forced the claimant to litigate an undisputed claim in order to receive the benefit of the bond.[61] However, attorneys' fees will only be awarded "when the surety wrongfully denies coverage."[62] More specifically, Washington courts hold that attorneys' fees may be awarded under considerations of equity only where the surety "forces the insured to litigate coverage and then loses."[63] Such questions of coverage focus on "whether there is a contractual duty to pay, who is insured, the type of risk insured against, or whether an insurance contract exists at all."[64] In contrast, attorneys' fees are not available in the event of a "claims dispute," which "involves factual questions as to the extent of damages."[65] Where the surety's liability for bad faith is recognized, state courts may have discretion to award attorneys' fees to the claimant under the bond, statute, or in equity and sureties should be aware of the potential avenues of recovery of a claimant's attorneys' fees.

C. Interest

Whether prejudgment interest will be awarded against the surety in excess of the penal sum of the bond has been addressed only to a limited extent. However, at least some courts have held the surety liable for prejudgment interest.[66]

III. Mitigating the Surety's Exposure to Extra-Contractual Liability

As set forth above, each jurisdiction provides its own insurance claim handling regulations. Some jurisdictions include suretyship within the scope of regulated insurance activities, some expressly exclude suretyship, and others are silent as to whether sureties fall within the scope of insurance claim handling regulations. Furthermore, jurisdictions differ on whether a violation of insurance claim handling regulations gives rise to a private cause of action as opposed to an administrative penalty. Although suretyship and insurance are fundamentally different, convincing a court that a surety is not subject to statutes imposing extra-contractual liability on insurers is no easy task. It is a best practice to assume that courts will, despite statutory language or case law to the contrary, apply statutes imposing extra-contractual liability on insurers to sureties. A surety claim professional should be mindful that his or her conduct, however well-intentioned, has the potential to expose a surety to extra-contractual liability.

A. Legislative Framework for Regulation of Suretyship

1. Unfair Trade Practices Act

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express policy of discouraging frivolous litigation applies when the surety is involved in direct bond litigation with the secured entity." *Trs. of the Plumbers & Pipefitters Union Local 525 Health & Welfare Trust Plan v. Developers Sur. & Indem. Co.*, 84 P.3d 59, 63-64 (Nev. 2004). If fees are awarded against the surety pursuant to this statute, the surety will face liability in excess of the penal sum. *Id.* at 62-63. *See also*, *Glazing Health & Welfare Fund v. Accuracy Glass & Mirror Co.*, No. 2:13-CV-1106-KJD-NJK, 2016 U.S. Dist. LEXIS 43509 (D. Nev. Mar. 30, 2016).

61 *See*, *King Cty. v. Vinci Constr. Grands Projects/Parsons RCI/Frontier-Kemper, JV*, 398 P.3d 1093 (Wash. 2017).

62 *Id.* at 1097 (quoting *Colo. Structures v. Ins. Co. of the West*, 167 P3d. 1125, 1137 (Wash. 2007)).

63 *Id.* at 1099.

64 *Id.* (citing *Solnicka v. Safeco Ins. Co. of Ill.*, 969 P.2d 124, 125-26 (Wash. Ct. App. 1999)).

65 *Id.* (citing *Solnicka*, 969 P.2d at 125-26; *Axess Int'l Ltd v. Intercargo Ins. Co.*, 30 P.3d 1, 5 (Wash. Ct. App. 2001)).

66 *See*, *e.g.*, *U.S. Fid. & Guar. Co. v. Braspetro Oil Servs. Co.*, 369 F.3d 34 (2nd Cir. 2004) (applying New York law); *Howze v. Surety Corp. of Am.*, 584 S.W.2d 263 (Tex. 1979) (holding that the surety was liable for prejudgment interest which began accruing the date the claimant made a demand for payment).

Insurance regulation has generally been left to the oversight of the individual states. However, in 1871, state insurance regulators created the National Association of Insurance Commissioners ("NAIC"), an organization comprised of the elected or appointed regulators of the individual states, to coordinate regulation of multistate insurers.[67] The Unfair Trade Practices Act ("UTPA"), drafted in 1947, proposed a comprehensive framework of regulations for nearly all aspects of insurance, including claims handling practices.[68] The UTPA specifically included "suretyship" within its scope. The UTPA was widely adopted and those states that adopted it generally included suretyship within the scope of insurance activities.

2. Unfair Claims Settlement Practices Act

In 1991, the NAIC adopted the model "Unfair Claims Settlement Practices Act," ("UCSPA") which was intended to further clarify unfair claims practices, by adding greater specificity. While not uniformly adopted by all states, the model UCSPA identifies the specific acts, or failures to act, that constitute an unfair claims settlement practice, including:

- knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue;
- failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;
- failing to adopt and implement reasonable standards for prompt investigation and settlement of claims arising under its policies;
- not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear;
- compelling insureds or beneficiaries to institute suits to recover amounts due under their policies by offering substantially less than the amounts ultimately recovered in suits brought by them;
- refusing to pay claims without conducting a reasonable investigation;
- failing to affirm or deny coverage of claims within a reasonable time after having completed its investigation related to such claim or claims;
- attempting to settle or settling claims for less than the amount that a reasonable person would believe the insured or beneficiary was entitled by reference to written or printed advertising material accompanying or made part of an application;
- attempting to settle or settling claims on the basis of an application that was materially altered without notice to, or knowledge or consent of, the insured;
- making claims payments to an insured or beneficiary without indicating the coverage under which each payment is being made;
- unreasonably delaying the investigation or payment of claims by requiring both a formal proof of loss form and subsequent verification that would result in duplication of information and verification appearing in the formal proof of loss form;
- failing in the case of claims denials or offers of compromise settlement to promptly provide a reasonable and accurate explanation of the basis of such actions;
- failing to provide forms necessary to present claims within fifteen (15) calendar days of a request with reasonable explanations regarding their use;
- failing to adopt and implement reasonable standards to assure that the repairs of a repairer owned by or required to be used by the insurer are performed in a workmanlike manner.[69]

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67 Cynthia E. Rodgers-Waire & Omar J. Harb, *Regulating Ethics – Attempts to Regulate Surety Claims Practices*, 21ST ANNUAL NORTHEAST SURETY AND FIDELITY CLAIMS CONFERENCE (2010).

68 *Id.*; NAIC, Unfair Trade Practices Act (1947).

69 Unfair Claims Settlement Practices Act (1991).

Like the UTPA, the UCSPA was adopted by many of the states in the years following its original promulgation. Unlike the UTPA, the UCSPA intentionally excluded suretyship from its scope. However, because individual states have enacted modified versions of the UTPA and/or the UCSPA, there is no uniformity between individual states as to whether unfair claims settlement practices apply to sureties. Merely by way of example, in Washington[70] and Colorado,[71] any of the above-referenced prohibited practices may give rise to a cause of action exposing a surety to extra-contractual liability. In contrast, a few states, by their own legislation, explicitly exclude sureties from coverage. For example, Texas has enacted its Unfair Claims Settlement Practices Act, which excludes sureties from the definition of the types of insurers to which the Act is applicable.[72]

B. Practice Tips

Although each jurisdiction is different, sureties, including their representatives and counsel, should minimize activities during the claim stage which can be exaggerated, mischaracterized, or exploited to support potential extra-contractual claims. Diligence during the claim investigation process can save hundreds of thousands of dollars in defense expenses incurred in defending unfounded charges of bad faith.

The practices recommended below are not necessarily required in every situation but may help mitigate exposure to allegations of bad faith and/or assist in the defense of a bad faith claim.[73]

- *Understand the applicable laws of the jurisdiction*. As an initial starting point, it is crucial for a claims professional to understand the statutes, regulations, common law, and standards applicable to a surety's investigation in the relevant jurisdiction. Where the jurisdiction allows bad faith claims against sureties or where a claim professional may be unfamiliar with the law of the applicable jurisdiction, a claim professional may want to consider retaining local counsel to provide legal advice during the investigation.

- *Respond promptly to claims*. Obligees often maintain that a surety's lengthy and time-consuming investigation is evidence of bad faith. Document all reasons for the length of investigation, implement a system for reminders to update the obligee on the status of the claim, and notify the obligee when additional time is needed to investigate a claim.

- *Conduct a reasonable and independent investigation*. The basis for most bad faith claims is that the surety did not conduct a reasonable and/or independent investigation. Thus, it is prudent to conduct a thorough and impartial investigation of the claim in order to demonstrate that the surety exercised its own judgment and did not merely adopt the position of its principal.

- *Conduct a site investigation*. Depending on the nature and complexity of the claim, a site visit may be necessary in order to obtain a comprehensive understanding of the underlying claim and may prevent allegations that the surety did not thoroughly investigate.

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70 Wash. Rev. Code Ann. § 48.30.010 (West 2007).

71 Colo. Rev. Stat. Ann. § 10-3-1102(2) (West).

72 Tex. Ins. Code Ann. § 542.002 (West 2005).

73 *See generally* Patrick R. Kingsley, *Bad Faith Claims Against Sureties*, DRI FIDELITY AND SURETY ROUNDTABLE CONFERENCE (2010).

- *Meet face-to-face with the obligee and the principal*. Meeting face-to-face with the obligee and the principal is a great opportunity to establish a rapport with each side and to demonstrate the surety's commitment to conducting an independent investigation.

- *Retain claims consultants*. Many surety claims involve complex construction issues beyond the expertise of an attorney or surety claim professional. Retaining competent claim consultants will ensure that the claim is thoroughly, competently, and independently investigated.

- *Respond promptly to correspondence*. Not only is it good practice, but prompt communication with the obligee demonstrates that the surety takes the claim seriously and will prevent the obligee from becoming frustrated or angry, which may prevent future allegations of bad faith.

- *Respond in writing*. Written correspondence, whether by letter or email, can confirm important points discussed in phone calls and will help create a timeline that cannot later be denied or misrepresented by the obligee.

- *Keep a log or diary of conversations*. There are two important reasons to document oral conversations: 1) substantive communications by the obligee may help defend both the underlying claim and any bad faith component; and 2) the process of documenting oral conversations is evidence of a thorough and reasonable investigation.

- *Comprehensively document any claim determination*. The surety's determination of a claim should be clearly communicated to the obligee. The surety's claim determination letter will likely be a key piece of evidence in any bad faith claim. As such, a well-documented and thorough analysis of the claim is crucial to persuade a judge or jury that the surety's determination was in good faith and based on a reasonable investigation. Further, if the surety decides to pay the claim, a thorough claim determination will prevent allegations of bad faith by the principal or indemnitor in a subsequent indemnity action.

- *Afford the obligee an opportunity to address a claim determination*. On some claims it is prudent to afford the obligee an opportunity to address any factual or legal conclusions to which it takes exception. An obligee should be invited to address these types of issues. Once the obligee's position has been evaluated, and unless further investigation is called for, the surety can finalize its determination and communicate it to the obligee.

- *Be courteous and professional*. Being kind and courteous can go a long way to preventing knee-jerk allegations of bad faith and may facilitate a mutually beneficial resolution of a claim, short of litigation. Assume any and all communications with the obligee will be used as evidence in a bad faith claim.

Given that each jurisdiction has its own regulatory scheme and that every claim is unique, there is no one-size-fits-all approach to handling a surety claim; however, surety claim professionals can significantly minimize the risk of exposure to extra-contractual liability by adhering to the above-referenced practices.

CONCLUSION

As evidenced above, the situations where sureties face the possibility of extra-contractual liability are wide-ranging and create significant potential exposure. The concept of bad faith, while not the only source of such liability, is one of the most controversial and frequent issues facing sureties today. Bad faith concepts, when applied to suretyship create a complicated minefield of potential issues between the surety, the obligee, and the principal. Because each jurisdiction treats surety bad faith differently, sureties must be aware of the applicable regulations and law governing their conduct in the course of a claim investigation. Further, surety professionals should consult the above-referenced recommended practices in order to minimize exposure to extra-contractual liability.

SESSION 11

SUPPLEMENTATION:
HOW TO RESPOND

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Surety Risks associated with a General Contractor's Supplementation of a Bonded Subcontractor's Work

by

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I. Executive Summary

Many standard forms of subcontract agreements used by general contractors ("GCs") now provide GCs with the swift remedy of supplementation to mitigate subcontractor-caused delays. Supplementation clauses often do not require the GC to place the subcontractor in default, which would normally trigger notice to a bonded subcontractor's surety provider. Thus, supplementation frequently takes place unbeknownst to subcontractor sureties. This is of concern to sureties because supplementation exhausts contract balances that sureties rely upon in default situations. In addition, supplementation backcharges often include damage components that are typically not covered by performance bonds, such as the GC's home office overhead, GC profit, attorney fees, etc.

In many instances, when a GC realizes that the subcontractor's remaining contract funds will be insufficient to cover supplementation backcharges, the GC will only then default terminate the subcontractor to trigger the performance bond. As a result, supplementation is more and more the topic of disputes between GCs and sureties for subcontractors. This report: defines supplementation; reviews several example supplementation clauses; identifies common issues with supplementation; reviews existing case law on supplementation issues; and provides recommendations to surety underwriters and claims handlers on how to mitigate and administer supplementation issues.

II. What is Supplementation

Most subcontract forms used by GCs today provide the GC with a supplementation remedy to address subcontractor performance issues. Supplementation typically involves a GC's retention of additional contractors to cure subcontractor-caused delays. For instance, if a GC engages a framer through a subcontract agreement that allows for supplementation, and the framer later falls behind schedule due to deficient work and insufficient manpower, then the GC has the contractual right to engage subcontractors and vendors to supplement the original framer's work to mitigate the delay. The GC can then backcharge the costs associated with the supplementation against the original framer.

GCs benefit from supplementation as it is a tool to address subcontractor issues in a timely fashion; GCs with supplementation ability are no longer forced to sit back and wait for a subcontractor to address its problems and hope for the best. While it is not uncommon for subcontractors and/or their sureties to consent to supplementation, supplementation efforts are often disputed due to counterclaims maintained by subcontractors and the significant and broad damages often associated with supplementation backcharges.

III. Typical Supplementation Clauses

The following section provides a review of four supplementation clauses included within subcontract agreements used by GCs. The first example is a supplementation clause that is found in the standard form of subcontract agreement used by a middle market GC that is based in the Rocky Mountain region of the US:

> *If, in the Contractor's opinion, the Subcontractor fails or refuses to proceed with its work on any Work Authorization Form as directed by the Contractor, or fails to perform said work materially in accordance herewith, in whole or in part, or fails to materially perform any term, covenant, or condition contained in this Multi-Project Subcontract or any Work Authorization Form, the Contractor may, at the Contractor's option, upon seventy-two (72) hour written notice to the Subcontractor's last known email address or fax number (deemed received upon sending), take the following steps:*
>
> - *Take any steps Contractor deems necessary to supplement Subcontractor's labor and/or materials, equipment, services, etc., for any project listed on a Work Authorization form, and may take over all, or a portion of, the Subcontractor's equipment, materials, etc. and prosecute the work to completion on any or all of the Work Authorization Forms then in effect. In case the Contractor deems the foregoing procedure necessary, all moneys expended and all of the losses, damages and extra expenses, including, but not limited to, Contractor overhead, home office personnel, Contractor fees, bond and insurance, any Owner's liquidated damages, Contractor's personnel assigned, in whole or in part, to the project (calculated as set forth above), costs incurred by other subcontractors to Contractor, and legal fees, expenses and costs (regardless if an arbitration or court proceeding is initiated) shall be paid by the Subcontractor to the Contractor deducted from the Work Authorization Form price(s). If such expenditures, together with said losses, damages and extra expenses or liquidated damages exceed the amount otherwise due to the Subcontractor thereunder, the Subcontractor agrees to pay to the Contractor, on demand, the full amount of such excess, together with interest thereon at the rate of eighteen percent (18%) per annum, compounded annually, until paid.*
>
> - *Terminate the Subcontract for default and contract with a replacement subcontractor to perform all, or a part of, Subcontractor's work, perform the work itself, or a combination of the two.*
>
> - *Both supplement and terminate the work, as Contractor shall determine in its reasonable discretion.*

The preceding supplementation clause allows the GC to supplement the subcontractor's work after issuance of a three-day cure notice if the subcontractor fails to proceed with its work or fails to perform its work per contract. Recoverable supplementation costs are broad and include: GC overhead; costs for the GC's home office personnel; GC fees; bond and insurance; owner-assessed liquidated damages; costs for GC project personnel; costs for supplementing subcontractors; legal fees; and other expenses and costs.

The second example supplementation clause that is listed below is included in the standard form of subcontract agreement used by one of the largest GCs in the country.

> ***Failure of Performance and Default****. If the Subcontractor refuses or fails to supply enough properly skilled workers, proper materials, or maintain the Schedule of Work, or it fails to make prompt payment for its workers, subcontractors, disregards Laws or orders of any public authority having jurisdiction, or otherwise materially breaches a provision of this Agreement, and fails within seventy-two (72) hours after receipt of written notice (confirmed facsimile transmission shall constitute sufficient notice) to commence and continue satisfactory correction of such default with diligence and promptness, the Contractor, without prejudice to any other rights or 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 such part of the Subcontractor's Work as the Contractor shall determine will provide the most expeditious completion of the Work and charge the cost thereof to the Subcontractor; and/or (iii) withhold payment of any moneys due the Subcontractor pending corrective action to the extent required by and to the satisfaction of the Contractor and the Architect/Engineer. In the event of an emergency affecting the safety of persons or property, the Contractor may proceed as outlined above without notice.*

Here, like in the first example, the GC can supplement the subcontractor's work after a three-day cure notice. Supplementation is proper if the subcontractor fails to provide sufficient labor or materials, fails to maintain its schedule, fails to make prompt payment to its labor or material vendors, disregards laws, or materially breaches a provision of the subcontract. This provision also notes that the GC can use its forces to supplement the subcontractor's work or contract with one or more additional contractors. The recoverable expenses related to supplementation under this subcontract include costs of additional workers, materials, equipment, and "other facilities." Moreover, the GC is entitled to recover GC overhead, profit, and attorney fees.

The third supplementation clause example is taken from a middle market general contractor that primarily operates on the West Coast.

8.3 If the Contractor determines at its sole discretion that (a) the Subcontractor

> *has refused or failed to supply enough properly skilled workers, proper materials, or maintain the Schedule of Work; (b) the Subcontractor materially breached a provision of this Agreement; or (c) there is reasonable doubt that this Agreement can be completed for the balance then unpaid or before the applicable milestone, then the Contractor, without prejudice to any other rights or remedies, shall have the right to any or all of the following remedies: (i) supply workers, materials, equipment and other facilities as the Contractor deems necessary for the completion of the Subcontractor's Work, or any part thereof; or (ii) contract with one or more additional contractors to perform all or part of the Subcontractor's Work as the Contractor shall determine will provide the most expeditious completion of the total Work, after which the Contractor shall charge the cost thereof to the Subcontractor, who shall be liable for the payment of same including reasonable overhead, profit and attorney's fees.*

Supplementation is proper under this example if the subcontractor fails to provide enough workers or materials, fails to maintain the schedule, breaches a subcontract provision, or if there is reasonable doubt that the subcontractor can complete its remaining work for its remaining contract funds. This clause provides the GC with two remedies. The first remedy is for the GC to supply its own workers, materials, equipment and other facilities necessary for the completion of the of the subcontractor's work. The second remedy allows the GC to contract with other contractors to perform all or part of the subcontractor's work. This provision also notes that the GC can backcharge the original subcontractor with all supplementation costs, including overhead, profit, and attorney's fees. This clause differs from the three other examples because the GC is not required to provide the subcontractor with notice before supplementing its work.

The fourth example relates to the American Institute of Architects' ("AIA") standard subcontract form. AIA Document A401 is the AIA's "Standard Form of Agreement Between Contractor and Subcontractor". The A401 form does not explicitly use the work "supplement", but it allows for such action. Section 3.4 of the A401 form notes:

> *§ 3.4 Contractor's Remedies: If the Subcontractor defaults or neglects to carry out the Work in accordance with this Agreement and fails within five working days after receipt of written notice from the Contractor to commence and continue correction of such default or neglect with diligence and promptness, the*

Contractor may, by appropriate Modification, and without prejudice to any other remedy the Contractor may have, make good such deficiencies and may deduct the reasonable cost thereof from the payments then or thereafter due the Subcontractor.

The A401 form requires the GC to provide its subcontractor with a five-day written notice before it supplements the work if the "Subcontractor defaults or neglects to carry out the Work in accordance with this Agreement." The recoverable damages under this clause are vague—it simply notes that the GC can backcharge the subcontractor for the "reasonable cost" associated with the supplementation effort.

IV. Common Issues with Supplementation

For contract sureties, the most common issues with supplementation backcharges are (1) lack of notice and (2) excessive damages. As indicated in the four examples above, the GC is often required to provide the subcontractor with notice and an opportunity to cure before implementing supplementation. The GC, however, is <u>not</u> contractually required to provide similar notice to the subcontractor's surety.

Supplementation backcharges often deplete much of a subcontractor's remaining contract funds. GCs often undertake supplementation prior to default termination. Specifically, a GC will generally terminate after supplementation has commenced if it believes that the subcontractor's remaining contract balance is going to be insufficient to cover anticipated supplementation charges. Hence, by the time a GC typically gets around to termination, the surety's collateral is compromised, and this is often unbeknownst to the surety.

When a GC's supplementation charges are excessive, a subcontractor's surety is prejudiced accordingly. In addition, the surety's ability to mitigate damages via options such as a competitive relet of the work, financing the principal, or a reasonable financial settlement, are often not possible if the majority of the subcontractor's work is complete as of the date of termination. Lastly, supplementation backcharges often include costs that not normally included in surety completion work, such as GC overhead, GC profit, GC attorney fees, etc.

V. Case Law Review

To date, several courts have held that supplementation clauses are proper and notice to surety providers is not necessary unless required by contract. For instance, in *Commercial Cas. Ins. Co. v. Mar. Trade Ctr. Builders* (257 Ga. Ct. App. 2002, 572 S.E. 2d 319), the Court held that the GC, per the subcontract agreement, was only required to give notice to the subcontractor prior to supplementation. Because the bond incorporated the subcontract by reference, the GC was not required to give similar notice to the surety and, accordingly, the Court deemed that the GC's backcharge against the subcontractor's remaining balance was appropriate.

The Courts' holdings in *Colo. Structures v. Ins. Co. of the West* (125 Wn. App. 907, 106 P.3d 815, 2005 Wash. App. 293.) were particularly harsh against the subject surety provider. Here, the Appellate Court upheld the Trial Court's finding that the GC was not required to place the subcontractor into default prior to supplementing the work and that the GC was not required to formally declare the subcontractor in default before the surety was liable on the performance bond. Moreover, the Appellate Court expanded the Trial Court's award to include reasonable attorney fees without regard to the penal limit of the bond. The Washington State Supreme Court upheld the Appellate Court's ruling.

To the contrary, the Court in *Commercial Painting Co. v. Weitz Co. LLC* (2016 Tenn. App. 418, 2016 WL 3519015), which is the most recent ruling on this issue, held in favor of the subcontractor. In this matter, the GC supplemented its subcontractor in an effort to capture an early completion bonus from the owner. The Court held that the GC improperly supplemented the work of the subcontractor because the GC was given time extensions by the owner but did not inform the subcontractor of those extensions. Thus, the GC fraudulently and improperly back-charged the subcontractor for the supplementation costs. This holding reminds subcontractors and sureties that they should research whether the owner has issued the GC any time extensions that would mitigate the subcontractor's exposure to delay damages.

VI. Recommendations for Surety Underwriters and Claims Handlers

A. Recommendations to Surety Underwriters

To mitigate the common downside effects of supplementation, surety underwriters could push for an inclusion within proposed performance bond forms that would require the GC to provide the subcontractor's surety with a reasonable cure notice prior to any supplementation of the subcontractor's work. This would provide the surety with the option to work with its principal before the bond is triggered, through financing and other tools.

In addition, surety underwriters could lobby for a requirement that the GC places the subcontractor in default or formally terminates the contract prior to supplementation. This would ensure a tangible trigger to the performance bond rather than discretional GC actions. Lastly, a provision that would make supplementation subject to the surety's rights to decide the course of action would mitigate supplementation disputes; such surety actions could include financed subcontractor completion, surety completion, a relet of the work, and payment of the amount that the surety determines that it is liable to the GC.

B. Recommendations to Surety Claims Handlers

First, surety claims handlers should react swiftly if the GC places the surety on notice of its plan for imminent supplementation or notice that it is currently supplementing the surety's bond principal. Swift action might include contacting the GC to understand the basis behind the GC's supplementation effort. Next, the surety should make a call to the subcontractor to understand the subcontractor's position with regards to the supplementation.

Claims handlers should be wary of GC statements that the bonded work is nearly complete and that supplementation will simply get the principal over the finish line, because it often comes as a surprise to the surety several weeks or months later that the subcontractor's remaining contract balance is nearly or fully depleted, and the GC has a significant claim against the performance bond. Accordingly, is important for the surety to document the specific representations made by the GC. For example, if the GC represents that the remaining subcontract balance is $100,000, and the supplementation should only take a couple weeks and should cost approximately $20,000, the surety should put this in writing to the GC with instruction to contact the surety in the event the GC learns that this $20,000 budget might be insufficient.

Second, the surety's correspondence to the GC should identify the type of supplementation charges that the GC plans on asserting against the subcontractor. For instance, are the charges limited to the directs costs of the supplementation work, or does the GC plan on asserting charges for home office overhead, legal fees, home office personnel, project personnel, extended general conditions, etc.? Typically, the soft cost charges from GCs make up a large portion of overall supplementation backcharges, and these soft costs often come as a surprise to sureties.

Third, if a GC makes a performance bond claim and the subcontractor's remaining balance is nearly depleted due to prior supplementation directives by the GC, the surety should interview its principal and review the subcontract agreement, attachments thereto, the bond, meeting minutes, and project schedules to determine: (1) if supplementation was indeed warranted; (2) if the supplementation backcharges were reasonable; (3) if the GC should have provided notice to the surety about its supplementation plans prior to the depletion of the subcontractor's remaining balance; and (4) if the subcontractor has counterclaims and other defenses to the GC's supplementation program. Based on an evaluation of these four items, the surety should be able to make a reasoned decision on the claim.

Fourth, if a surety consents to a GC's supplementation program, the surety should consider retaining a consultant to periodically monitor the supplementation work to verify if the work is being performed efficiently and to determine if the subcontractor's work is in fact impacting the project schedule or if concurrent delays exist on the project, which would mitigate the subcontractor's exposure to potential delay damages. In addition, a surety should request documentation from the GC such as weekly job cost reports related to the supplementation effort, project schedules, and daily reports generated by the GC. It is not uncommon for project schedules to tell one story, and daily reports to tell another.

Fifth, concurrent with a supplementation effort, a surety should consider retaining lump sum bids from specialty contractors to complete the remaining work. This, at a minimum, will provide the surety with an understanding of the anticipated total cost of the supplementation work. Bid packages should potentially be sent to contractors that have previously engaged by the GC to supplement the work on a time and materials basis.

Sixth, if the subcontractor has strong defenses to ongoing supplementation or the threat of supplementation, the surety should consider standing behind its principal and/or pushing for swift dispute resolution such as mediation. For instance, if the project delays are a result of the GC or other subcontractors, and this compressed the subcontractor's work and the GC is simply looking to supplement the subcontractor's work to accelerate the schedule, such an analysis will need to be completed in a timely fashion.

VII. Conclusions

Supplementation is a common remedy used by GCs as it is a swift remedy to subcontractor-caused delays. In most instances, subcontract agreements that provide the GC with a supplementation remedy only require notice to the subcontractor, and not the surety. As a result, surety collateral is often depleted due to direct supplementation costs and softs cost related to GC overhead, supervision, profit, attorney fees, etc. To date, courts have ruled that GCs are not required to provide sureties with notice of supplementation if it is not explicitly required by contract. To help prevent unwarranted and excessive supplementation charges, surety underwriters might push to add notice requirements for supplementation within the bond form and mandate that the GC place the subcontractor into default prior to supplementation, so there is a formal trigger of the performance bond.

Surety claims handlers should react quickly once there is actual or constructive notice of a GC's supplementation of the work to understand the potential offset that the subcontractor will face. Also, once known, the claims handler should push the GC for a budget for the supplementation costs and should concurrently consider cost effective alternatives to the GC's supplementation campaign. Lastly, if the subcontractor has strong defenses to the GC's supplementation, it should consider standing behind the subcontractor and push for expedited dispute resolution, if possible.

SESSION 12

WHEN TO SETTLE AROUND YOUR PRINCIPAL

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SURETY'S RIGHT TO SETTLE OVER PRINCIPAL and INDEMNITORS' OBJECTIONS

I. Intro./Surety's Dilemma:

- The Surety who is considering settling claims of all sorts over its principal's objections, faces a dilemma. We, as surety professionals are caught between our principal who is our account and customer and who believes in its defenses, versus, our obligations obligees and claimants under our bond form.
- All of the parties have strongly held points of view of the surety, the principal, the claimant and the obligee, all of which are real and valid.
- Nonetheless, certain scenarios and circumstances lead to both payment and performance bond settlements, even where the principal objects. Some of these circumstances include but are not limited to: (i) principal is uncooperative or lacks documentation; (ii) principal is insolvent or has filed for bankruptcy; (ii) principal is not trustworthy/misappropriating funds; (iv) principal is overly optimistic or not willing to consider business reasons for settlement. .
- There are also scenarios which lead to the settlement of affirmative claims over the principal's objections, such as a bad project for principal with a non-documented or poorly reasoned claim, who expects to recoup losses through claims against owner, despite shortcomings.

II. Sources of Surety's Rights to Settle:

Surety's rights to settle over objections derived from the General Indemnity Agreement ("GIA"); GIA provisions, in tandem, that allow the surety to settle both bond and affirmative claims are:

A. Indemnity Clause

> *The principals and indemnitors shall exonerate, indemnify, and keep indemnified the surety from and against any and all liability for losses and/or expenses of whatsoever kind or nature (including, but not limited to, interest, court costs, and counsel fees) and from and against any and all such losses and/or expenses which the Surety may sustain and incur: (1) By reason of having executed or procured the execution of the Bonds, (2) By reason of the failure of the Principals or Indemnitors to perform or comply with the covenants and conditions of this Agreement or (3) In enforcing any of the covenants and conditions of this Agreement.*

B. A “Right to Settle Clause” gives surety absolute discretion in settling claims against the bond(s) and a principal’s affirmative claims. Sample clause follows:

> *The Surety shall have the exclusive right for itself and for the Undersigned to decide and determine whether any claim, demand, suit or judgment upon [the payment or performance bond] shall, on the basis of liability, expediency or otherwise, be paid, settled, defended or appealed, and its determination shall be final, conclusive and binding upon the Undersigned.*

C. Takeover Clause grants surety right to take possession of and complete bonded project work at its own discretion.

> *In the event of a default, the surety at its sole discretion, is hereby authorized, but not required, to take possession of the work under any contract and, at the expense of the indemnitors, complete the contract work, or cause same to be completed, or to consent to the completion thereof, or to take any other action which the surety may deem appropriate to obtain the discharge of the Surety’s obligations, as Surety for the Indemnitors, including but not limited to a monetary settlement with the obligee at the Indemnitors’ expense.*

Surety must oblige by prerequisite of “default” in this clause, plus any other prerequisites in the bond.

D. Assignment Clause

> *In the event of a default, but retroactive to the date of the first Bond, the Undersigned assign, transfer and convey to the Surety all monies due or to become due to the Undersigned arising out of or in any way related to Contracts, or to other contracts, including, but not limited to, progress payments, deferred payments, retained percentages, compensation for extra work, and claims and the proceeds thereof. The Undersigned hereby authorize the Surety, at its option, to prosecute said assigned rights in the name of the Surety or in that of the Undersigned and to endorse in the name of the payee, and to collect any checks, drafts, warrants or other instruments made or issued in payment of any such assigned rights and to disburse the proceeds thereof. The cost of enforcing such rights shall be an expense for which the Undersigned are obligated to indemnify the Surety hereunder.*

The assignment clause minimizes the surety's loss by giving the surety rights to the principal's assets, realized or potential, stemming from bonded and, in some instances, non-bonded projects. Such clauses assign the surety rights to any and all of the following: subcontracts; material and equipment on bonded projects; receivables on bonded projects; receivables on non-bonded projects; and affirmative claims and the right to prosecute them.

E. Attorney in Fact: This provision, coupled with the settlement and assignment provisions, gives the surety the right to settle a principal's affirmative claims.

> *The principals and Indemnitors hereby irrevocably nominate, constitute, appoint and designate the Surety as the attorney-in-fact with the right, but not the obligation, to exercise all the rights of the Principals and Indemnitors assigned, transferred and set over to the Surety in this Agreement, and in the name of the Principals and Indemnitors to make, execute, and deliver any and all additional or other assignments, documents or papers deemed necessary and property by the Surety in order to give full effect not only to the intent and meaning of the within assignments, but also to the full protection intended to be herein given to the Surety under all other provisions of this Agreement. The principals and Indemnitors hereby ratify and confirm all acts and actions taken and done by the Surety and Such attorney-in-fact.*

F. Collateral Deposit Clause

> *The Undersigned will deposit with the Company as collateral security, immediately upon demand, a sum or money, at the option of the Company, equal to: (1) the liability of the Company, If established; (2)the liability asserted against the Company; or (3) the reserve established by the Company, or any increase thereof, to cover any liability, loss, expense, or possible liability for any loss or expense for which the undersigned may be obligated to indemnity the Company under the terms of this agreement.*

<u>III.</u> Surety's Bond Obligations, and Where they Meet Duties to Principal.

A. Performance Bond

1. Acknowledgement of claim to claimant, principal and indemnitors.
2. Investigation that is prompt and thorough.

    a. Have conditions precedent been met? E.g. pre-default meeting; formal default and termination; obligee's notice of default to surety.

b. Did principal default? Surety liable?
c. Gather info from as many sources as possible.
d. Use of construction consultants, if necessary.
e. Use of legal consultant
    i. Defenses?
    ii. Draft documents; attend meetings; etc.
f. Takeover?
g. Etc.

B. Payment Bond

1. Acknowledgement of claim to claimant and principal.
2. Investigation
    a. Contact principal for info regarding non-payment.
    b. Contact claimant for same.
    c. Hire construction and/or legal consultant, if necessary.
    d. Defenses?
    e. Pay claimant, in part or whole, if proper, or deny claim.

IV. Surety's Considerations re: Settlement

A. Merit of claim
B. Value of claim
C. Capabilities of contractor
D. Trustworthiness of contractor
E. Level of cooperation from principal
F. Financial security of principal

V. When settlement made over principals' and/or indemnitors' objections, they may raise following defenses when surety seeks indemnification.

A. Breach of Contract

1. Are the GIA provision(s) absolute?

B. Allege surety did not settle in good faith. Most common allegation: Surety did not do adequate investigation.

1. In GIA/contractual: Some GIAs require Surety to settle in good faith.

2. Implied/common law: Most states impose an obligation of good faith and fair dealing on sureties and hold that surety not entitled to indemnification when settlement made in bad faith. Jurisdiction vary in defining bad faith.

i. Majority view: Bad faith is defined as being made with an "improper motive" or "dishonest purpose" or "deliberate malfeasance." *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 267 Conn. 279 (Conn. Sup. Ct. 2004) (Surety failed to respond promptly to a claim and settled when the obligee threatened to file a complaint with the state's insurance commission. When surety sought indemnification, principal and indemnitors successfully alleged that, because, *inter alia*, the surety did not do a proper investigation, it breached its obligation of good faith and was not entitled to indemnification.)); Auto-Owners Ins. Co. v. Southeast Floating Docks, Inc., 571 F.3d 1143 (11th Cir. 2009) (Surety settled performance bond claim with obligee to avoid bad faith action by obligee. Also negotiated secretly, intentionally excluding principal, and performed minimal investigation of obligee's claims, and hired conflicted attorney.); *Lumbermans Mut. Cas. Co. v. Dinow*, 06-CV-3881 (TCP), 2012 U.S. Dist. LEXIS 140945 (E.D.N.Y. Sept. 28, 2012) (Summary Judgment Motion denied when surety brought suit against single indemnitor who did not consent to settlement and vigorously litigated the case before settling for an amount far less that the bond claim because court held there were issues of material fact for jury.). *Int'l Fid. Ins. Co. v. Kerri A. Noyes Constr.*, Case No. 17-cv-80937-MIDDLEBROOKS, 2018 U.S. Dist. LEXIS 65432, *39 (S.D. Fla. April 17, 2018) ("To establish bad faith, an indemnitor must demonstrate that the surety acted with "deliberate malfeasance" which means an intentional wrongful act which the actor has no legal right to do, or any wrongful conduct which affects, interrupts, or interferes with the performance of official legal duty.") (internal quotation marks and citation omitted).

ii. Minority view (California, Illinois, Hawaii, Kansas, and Oregon) (*see PSE Consulting* 267 Conn. at 304): Bad faith is that which is objectively unreasonable or negligent, regardless of intent. *Yakima Co. v. Lincoln Gen. Ins. Co.* (583 Fed. Appx. 744 (9th Cir. 2014) (citing *Arntz Contracting Co. v. St. Paul Fire & Marine Ins. Co.* (54 Cal. Rptr. 2d 888 (Cal. Ct. App. 1996))) (Surety that incurred excessive attorneys' fees acted in bad faith because the fees constituted "unreasonable economic waste."); Surety seeking indemnification must show that its actions were reasonable. *Westfield Ins. Co. v. Harvest Construction General contracting, Inc.* (288 P.3d 159) (Kan. Ct. App. 2012).

iii. Some states hold that bad faith requires a showing of fraud or collusion (NY, Mass., RI, Ga.). *Star Insurance Co. v. A&J*

Construction of New York, No. 15-CV-8798 (CS), 2017 LEXIS U.S. Dist. 211081 (S.D.N.Y. Dec. 22, 2017).

C. UCC: Surety's settlement of affirmative claims derived from security interest created by assignment clause, therefore subject to UCC §§ 9-607 and 9-608: creditor which disposes of debtor's collateral over his objection must show that it acted in a "commercially reasonable manner" (consistent with commercial practices in the industry). *Assoc. Indem. Corp. v. CAT*, 964 S.W.2d 276 (Tex. 1998).

D. Notice of settlement

1.

VI. Guidance for Surety Compelled to Settle over Principal's Objection

A. Honor the Obligation in Your Bond
B. Follow GIA

1. Conditions precedent met?

C. Good faith investigation

1. *PSE Consulting, Inc. v. Frank Mercede and Sons, Inc.*, 267 Conn. 279 (Conn. Sup. Ct. 2004) (Surety failed to respond promptly to a claim and settled when the obligee threatened to file a complaint with the state's insurance commission. When surety sought indemnification, principal and indemnitors successfully alleged that, because, *inter alia*, the surety did not do a proper investigation, it breached its obligation of good faith and was not entitled to indemnification.)).

D. Good faith settlement:

1. Include principal and indemnitors in settlement discussions.

2. *Lumberman's* case: Surety vigorously defended action and then settled when litigation was well under way for much less than the bond claim. Brought action against indemnitors and move for summary judgment. Court denied because outstanding issues of fact – surety may have settled in bad faith because it appeared that it could have prevailed on motion before settling.

3. *Carles Constr., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 56 F. Supp. 3d 1259, 1283 (S.D. Fla. 2014))). On motion for summary judgment, plaintiff, a subcontractor, asserted that defendant, a surety, acted in bad faith in carrying out its duties under an indemnity agreement by settling

claims when defendant was the surety for both parties to a single construction contract. The court denied the motion, finding the surety’s conflict a genuine issue of material fact for the jury.

E. Obtain court approval of settlement

SESSION 13

PRODUCTIVITY LOSS: CALCULATION AND PROOF

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PEARLMAN 2018

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PRESENTED BEFORE THE PEARLMAN ASSOCIATION
SEPTEMBER 7, 2018
BILL SCHWARTZKOPF, JASON FAIR, JIM CARLSON

PRODUCTIVITY

I. What is productivity and why does a bond claim professional care?

Production and productivity are related but different concepts:

- Production is a measure of quantities of work completed, output per period. Examples are square yards of paving placed per day or cubic yards of backfill per day. It does not consider the labor hours expended (the input).
- Productivity is a measure of the effort expended to accomplish a particular scope of work (the output per unit of input). Examples are square yards of paving placed per labor hour or the cubic yards of backfill per labor hour.

It is possible and often observed that high production can be accompanied by low productivities, the result of overmanning the work to achieve maximum output, and low production can have high productivities, the result of having a small crew of the best people.

Bond claim professionals must be cognizant of the principles behind productivity, and more importantly, be prepared for claims of productivity loss, because bond claim professionals will encounter claims of productivity loss by payment bond claimants and inherited from defaulted principals.

The largest variable cost on most construction projects is labor, and unanticipated and uncompensable increases in costs of labor are most commonly the result of changes in anticipated productivity.

II. What causes productivity losses?

1. Excessive planned overtime.

2. Congestion caused by the stacking of multiple trades.

3. Adverse weather.

4. Unanticipated third-party events such as delays in the availability of major equipment, damage to material or equipment being delivered to the site.

5. Reassignment of crews/stop-start work activities.

6. Changes or lack of site access.

7. Dilution of supervision.

8. Changes in crew size.

9. Changes in shifts.

10. Poorly trained workforce.

11. Poorly managed workforce.

12. Inefficient sequencing.

13. Absenteeism.

14. Inappropriate tools and equipment.

15. Lack of tools and equipment.

16. Defective and incomplete design.

17. Changes in work/impact of changes.

18. The appearance of labor productivity—that is, spending more hours to perform the work than planned—also can come from other than productivity losses:

    a. Underbidding/underestimating the labor required

    b. Underestimating the quantity of work required

    These causes are not productivity losses because they don't relate to spending more hours per unit of work; rather, they relate to spending more hours than estimated to perform more work.

III. <u>What are the ways to calculate productivity loss?</u>

1. Measured mile:

Comparison of the actual performance on the same project comparing the productivity on an unimpacted portion of the work to the productivity on the impacted portion of the work.

S. Leo Harmonay, Inc. v. Binks Mfg., 597 F. Supp. 1014 (S.D.N.Y. 1984).

2. Measured mile using comparable work on a similar project by the same contractor.

   Bell BCI Co. v. United States, 81 Fed. Cl. 617 (2008).

   A contractor's expert calculated loss of labor productivity by analyzing earned and unearned hours expended each week during the project and comparing it to productivity rates on past projects, which the contractor had been recording for years.

3. Applying specific industry studies such as academic studies of:

   - The effects of changes on work
   - The effects of changes on schedule
   - The effects of specific causations on productivity such as temperature, crew size, and overtime

4. Applying general industry studies/estimating guides

   - MCAA
   - NECA
   - Corps of Engineers, Bulletin 415 (withdrawn many years ago, but still used)

IV. <u>What do you need to calculate productivity?</u>

1. Periodic labor reports with both quantity information and labor by type of work.

2. What do you do when your contractor doesn't have that information?

   a. Recreate the information using:

      - Daily progress reports
      - Payroll records
      - Time and material reports
      - Quality control reports
      - Payment requisitions
      - Daily reports

V. Are labor productivity losses recovered with:

a. Payment Bond - Yes

Aetna Casualty & Surety Co. v. Doleac Electrical Co., Inc., 471 So. 2d 325 (Miss. 1985).

Aetna principal, the mechanical prime, defaulted Aetna completely. Electrical prime sued for impact damage, caused by mechanical, and prevailed.

Southern Seeding v. W.C. English, Inc., 735 S.E. 2d 829 (N.C. Ct. App. 2012).

Southern, a second-tier subcontractor, sued the sureties of both the first-tier subcontractor and the prime contractor for impact damages caused by delay and prevailed despite that no damages for delay were provided for in its subcontract. The Court found that Southern's damages claim was a request for equitable adjustment.

b. Substantial case law for productivity damages being an element of damage against owner.

United States Steel Corp. v. Missouri Pac. R.R., Co., 668 F.2d 435 (8th Cir.), cert. denied, 459 U.S. 836 (1982); E.C. Ernst, Inc. v. Koppers Co., 520 F. Supp. 830, 833 (W.D. Pa. 1981); J.D. Hedin Constr. Co. v. United States, 347 F.2d 235 (Ct. Cl. 1965); McDevitt & Street Co. v. Department of Gen. Servs., 377 So. 2d 191 (Fla. Dist. Ct. App. 1979); Pebble Bldg. Co. v. G.J. Hopkins, 288 S.E.2d 437 (Va. 1982); Consolidated Elec. & Mechanicals, Inc. v. Biggs Gen. Contracting, Inc., 167 F.3d 432 (8th Cir. 1999).

VI. Presentation/analysis of claims

1. Damages: Analysis must be based on actual data and supported by research.

2. Causal linkage needs to be supported by first testing boots on the ground with:

- Superintendent
- Foreman
- Project managers

Not sufficient to have only expert testimony stating that the types of events correlate with the labor productivity loss. Requires evidence, including percipient testimony, establishing the actual impacts encountered.

VII. How common is productivity loss/cost growth?

1. Data from the late 1980s to the early 1990s suggest that cost growth on projects is in the neighborhood of 10 percent.

2. More recent data collected and published by William Ibbs suggests that labor growth on larger projects from both changes and labor impacts is significantly greater than 10 percent.

SESSION 14

RISK ASSESSMENT IN LITIGATION AND PRE-LITIGATION: EMPHASIS ON FEE

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Risk Assessment in Litigation and the Impact of Attorney Fee Shifting Provisions

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Under the “American Rule” each party to a lawsuit is responsible for paying its own legal fees, unless a specific statute or contract provides otherwise. Fee-shifting statutes require the losing party to pay legal fees to the prevailing party.

The move toward fee-shifting is designed to prevent meritless claims or defenses, and to promote pre-litigation resolutions. For example, most states have enacted a prompt pay act or statute to ensure payment is made on construction contracts within a specified time. The failure to make timely payment may subject the owner, contractor and the surety to penalties. Several of the prompt pay statutes permit the prevailing party to recover attorney’s fees if they succeed in an action. Whereas, other prompt payment statutes shift fees only if the payment was wrongfully withheld or the defense to the claim was without merit.

An exception to the American Rule is to permit parties to contract for the payment of attorney’s fees. With the move toward fee-shifting, states have enacted statutes to prohibit unilateral fee provisions, and turn such provisions into reciprocal fee provisions that award fees to the prevailing party.

Fee shifting provisions in statutes and contracts should be considered by all parties in evaluating potential disputes prior to and during litigation.

The following is a brief survey of U.S. fee-shifting statutes that permit the recovery of attorney’s fees to prevailing parties in actions on surety bonds, prompt payment claims and lien foreclosure. The survey is not an exhaustive list of all statutes or cases related to construction and surety industry, but only a sample to highlight the trend toward fee-shifting provisions.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Alabama	Ala. Code § 39-1-1(a): Reasonable attorney's fees incurred by successful claimants or plaintiffs in civil actions on public works payment bonds.	Ala. Code §§ 41-16-3; 8-29-4. Ala. Code § 8-29-6: Reasonable attorney's fees to prevailing party in civil action on prompt payment claim.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Alaska	Alaska R. Civ. Proc. 82: Prevailing party in civil action shall be awarded attorney's fees fixed by statute.	Alaska Stat. § 36.90.210 *et seq.* No attorney's fees by statute for prompt payment claims.	Alaska R. Civ. Proc. 82: Prevailing party in civil action shall be awarded attorney's fees fixed by statute.	Alaska Stat. § 34.35.005(b): Reasonable attorney's fees in lien enforcement action.
Arizona	Ariz. Rev. Stat. § 34-222(B): Reasonable attorney's fees to prevailing party on public works payment and performance bonds. Ariz. Rev. Stat. § 33-1003: Attorney's fees in claims under payment bond. Ariz. Rev. Stat. § 32-1152(E): Reasonable attorney's fees to prevailing party on contractor license bond.	Ariz. Rev. Stat. §§ 34-221; § 32-1129 *et seq.* Ariz. Rev. Stat. § 32-1129.01(S): Reasonable attorney's fees to "successful party."	Ariz. Rev. Stat. § 12-341.01(A): Reasonable attorney's fees to successful party in contested action arising out of an express or implied contract.	Ariz. Rev. Stat. §§ 33-995(E) and 33-998(B): Reasonable attorney's fees to prevailing party in action to foreclose lien.
Arkansas	Ark. Code § 23-79-208(a): Reasonable attorney's fees in suit against insurer (including surety) for delay or refusal to pay claim. *See Ray Ross Constr. v. Raney*, 266 Ark. 606 (1979).	Ark. Code §§ 19-4-1411; 22-9-205. No attorney's fees by statute for prompt payment claims.	Ark. Code § 16-22-308: Reasonable attorney's fees to prevailing party in civil action on open account, contract for labor or services, or breach of contract.	Ark. Code § 18-44-128: Reasonable attorney's to prevailing party for enforcement of mechanic's lien.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
California	Cal. Civ. Code § 9564: Reasonable attorney's fees to prevailing party in action on public works payment bond. Cal. Public Cont. Code § 20464: Reasonable attorney's fees to prevailing party on public works payment bond. Cal. Civ. Code § 8558: Reasonable attorney's fees to prevailing party in action to enforce bonded stop payment notice. Cal. Civ. Code § 2808: Surety's liability commensurate with principal. Surety may be liable for attorney's fees if principal liable for attorney's fees. *See Boliver v. Surety Co.*, 72 Cal.App.3d Supp. 22 (1977); *T&R Painting Constr., Inc. v. St. Paul Fire & Marine Ins. Co.*, 23 Cal.App.4th 738 (1994).	Cal. Public Cont. Code § 10262.5: Reasonable attorney's fees to prevailing party for wrongfully withheld progress payments. Cal. Public Cont. Code § 7107: Reasonable attorney's fees to prevailing party for wrongfully withheld retention. Cal. Bus. & Prof. Code § 7108.5: Reasonable attorney's fees to prevailing party on wrongfully withheld progress payments on private works contract. Cal. Civ. Code § 8800: Reasonable attorney's fees to prevailing party on wrongfully withheld progress payment on private works contract.	Cal. Civ. Code § 1717: No unilateral attorney's fees provisions in contracts. If written contract provides for attorney's fees, provision will be reciprocal to prevailing party.	No attorney's fees by statute in lien foreclosure action.
Colorado	No attorney's fees by statute for bond claims.	Colo. Rev. Stat. § 24-91-103. No attorney's fees by statute for prompt payment claims.	American Rule	No attorney's fees by statute in lien foreclosure action.
Connecticut	Conn. Gen. Stat. § 49-42: Attorney's fees for surety's failure to pay or deny liability within 90 days.	Conn. Gen. Stat. §§ 4a-71 *et seq.*; 49-41c; 42-158i *et seq.* Conn. Gen. Stat. § 42-158j(c)(4): Attorney's fees for unreasonably withheld payments.	Conn. Gen. Stat. § 42-150bb: Unilateral attorney's fees provisions in contract between "consumer" and a "commercial party" are enforced as bilateral attorney's fee provisions.	Conn. Gen. Stat. § 52-249: Reasonable attorney's fees to prevailing party on lien foreclosure action. Same costs and fees recoverable as part of judgment in any action upon a bond substituted for lien.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Delaware	Del. Code Title 10, § 3912: Recovery of attorney's fees not to exceed twenty percent (20%) of amount awarded on bond claim.	Del. Code tit. 6, § 3501 *et seq*. Del. Code, tit. 6, § 3506(e): Attorney's fees for bad faith withholding payment or retainage or "frivolous or bad faith" conduct in prompt payment action. Del. Code, tit. 6, § 3509(b): Attorney's fees to substantially prevailing party in arbitration on prompt payment action.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Florida	Fla. Stat. §§ 627.428 and 627.756: Attorney's fees to prevailing party in action against surety on payment and performance bond by owners, subcontractors, laborer and materialman.	Fla. Stat. §§ 218.70 *et seq.*; 255.071 *et seq.*; 287.0585 *et seq.*; 337.14; 715.12. Fla. Stat. § 255.071(7): Reasonable attorney's fees to prevailing party on amounts due under public construction contracts. Fla. Stat. § 255.076: Reasonable attorney's fees to prevailing party on amounts due under construction contract with State. Fla. Stat. § 287.0585: Reasonable attorney's fees to prevailing party in action against contractor on public project. Fla. Stat. § 713.346(7): Reasonable attorney's fees to prevailing party for amounts due under private construction contracts.	American Rule.	Fla. Stat. § 713.29: Attorney's fees to prevailing party in action to enforce a lien or to enforce a claim against a bond issued under Chapter 713.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Georgia	Ga. Code § 10-7-30: Reasonable attorney's fees to prevailing party for bad faith refusal to pay claim.	Ga. Code § 13-11-1 *et seq*. Ga. Code § 13-11-8: Reasonable attorney's fees to prevailing party on prompt payment action.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Hawaii	Haw. Rev. Stat. § 607-14: Reasonable attorney's fees to prevailing party in an action on assumpsit or contracts in writing that provide for attorney's fees.	Haw. Rev. Stat. § 103-10 *et seq*. No attorney's fees by statute for prompt payment claims.	Haw. Rev. Stat. § 607-14: Attorney's fees to prevailing party in all actions on assumpsit and contracts in writing that provide for attorney's fees. No unilateral attorney's fees provisions in contracts. If written contract provides for attorney's fees, provision will be reciprocal to prevailing party. *See Cooper v. Schmidt*, 4 Haw.App.115 (Haw. App. 1983).	Haw. Rev. Stat. § 507-47: Attorney's fees are recoverable in actions to foreclose mechanic's liens.
Idaho	Idaho Code § 54-1929: Attorney's fees to prevailing party in action on payment or performance bond on public contracts. Idaho Code § 41-1839: Attorney's fees recoverable against in suits or arbitration with sureties if proper notice of claim.	Idaho Code § 67-2302: Reasonable attorney's fees to party not paid in a timely manner by State.	American Rule.	Idaho Code § 45-513: Attorney's fees recoverable on successful mechanic's lien foreclosure action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Illinois	215 Ill. Comp. Stat. 5/155: Reasonable attorney's fees in action against insurer for "vexatious delay" in settling claim and extends only to party insured and does not extend to third parties (i.e., payment bond claimants).	30 Ill. Comp. Stat. § 540/0.01 *et seq.*; 50 Ill. Comp. Stat. § 505/1 *et seq.*; 815 Ill. Comp. Stat. § 603/1 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	770 Ill. Comp. Stat. § 60/17: Reasonable attorney's fees on mechanic's lien if failure to pay is without just cause or right.
Indiana	No attorney's fees by statute for bond claims.	Ind. Code § 5-17-5-1 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	Ind. Code § 32-28-3-14(a): Attorney's fees recoverable by lienholder on judgment in lien enforcement action.
Iowa	Iowa Code § 573.21: Reasonable attorney's fees in favor of claimant on payment bond for labor or materials.	Iowa Code § 573.12 *et seq.* Iowa Code § 573.21: Reasonable attorney's fees in favor of any claimant for labor or materials.	American Rule.	Iowa Code § 572.32: Reasonable attorney's fees to prevailing part in action to enforce mechanic's lien.
Kansas	Ken. Rev. Stat. § 304.12-235: Reasonable attorney's fees incurred in action against insurer who fails to settle claim without reasonable foundation.	Kan. Stat. §§ 75-6401 *et seq.*; 16-1801 *et seq.* Kan. Stat. § 16-1806: Reasonable attorney's fees to prevailing party under Fairness in Private Construction Contract Act. Kan. Stat. § 75-6403: Attorney's fees to prevailing party on public works contract.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Kentucky	Ky. Rev. Stat. § 337.200: Attorney's fees recoverable by employee for wages under performance bond on public works contracts.	Ky. Rev. Stat. § 45.453 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Louisiana	La. Rev. Stat. § 9:3902: Surety on bond liable for ten percent (10%) attorney's fees on amount recovered in action to enforce payment under demand after 30 days from written demand. La. Rev. Stat. § 38:2246(A): Surety on public works payment bond liable for ten percent (10%) attorney's fees on amount recovered in action to enforce payment after 30 days from written demand. La. Rev. Stat. § 38:2246(B): Surety on public works payment bond entitled to reasonable attorney's fees for defending action by claimant without just cause or in bad faith. La. Rev. Stat. § 48:255.2: Surety liable for reasonable attorney's fees to public entity for surety's failure to timely complete DOTD project.	La. Rev. Stat. § 9:2784; 38:2191; 48:251.5. La. Rev. Stat. § 9:2784(C): Reasonable attorney's fees for the collection of payment or defense of claim without merit.	American Rule.	La. Rev. Stat. § 38:2246(A): Principal and surety on public works payment bond liable for ten percent (10%) attorney's fees on amount recovered in action to enforce recorded or sworn claim payment after 30 days from written demand.
Maine	No attorney's fees by statute for bond claims.	10 Me. Rev. Stat. § 1111 *et seq*. 10 Me. Rev. Stat. § 1118(4): Reasonable attorney's fees to substantially prevailing party in any proceeding to recover payment under construction contract.	American Rule.	No attorney's fees by statute in lien foreclosure action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Maryland	No attorney's fees by statute for bond claims.	Md. State & Fin. Proc. § 15-101 *et seq.*; Md. Code, Real Prop. § 9-301. Md. Code, Real Prop. § 9-303: Reasonable attorney's fees for bad faith for failing to pay any undisputed amounts.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Massachusetts	Mass. Gen. Laws ch. 149, § 29: Reasonable legal fees in favor of any claimant on performance and payment bond required on public works contracts.	Mass. Gen. Laws ch. 30, §§ 39F, 39K. No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Michigan	No attorney's fees statute for bond claims.	Mich. Comp. Laws §§ 125.1561 *et seq*. No attorney's fees by statute for prompt payment claims.	American Rule.	Mich. Comp. Laws § 570.1118(2): Reasonable attorney's fees to prevailing party in action for enforcement of construction lien foreclosure.
Minnesota	Minn. Stat. § 574.26(2): Reasonable attorney's fees against surety to enforce claims against public works bond if the action is successfully maintained or successfully appealed.	Minn. Stat. §§ 16A.124 *et seq.*; 137.36; 337.10; 429.041; 471.425. Minn. Stat. § 16A.1245: Attorney's fees to prevailing party in civil action to collect payment. Minn. Stat. § 137.36: Attorney's fees to subcontractor in civil action to collect on university contracts. Minn. Stat. § 337.10: Attorney's fees to prevailing party in action to collect payment on public contract. Minn. Stat. § 471.425: Attorney's fees to vendor for bad faith delay of payment by local government.	American Rule.	Minn. Stat. § 514.14: Attorney's fees to prevailing party in action to foreclose mechanic's lien.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Mississippi	Miss. Code § 31-5-57: Reasonable attorney's fees to claimant on public work's payment bond if surety's defense not reasonable, not in good faith, or merely for the purpose of delaying payment. Miss. Code § 85-7-193: Reasonable attorney's fees to claimant on private works performance bond.	Miss. Code §§ 31-5-25; 31-5-27; 87-7-3. No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Missouri	Mo. Stat. § 290.300: Reasonable attorney's fees against bond for action for prevailing wages. Mo. Stat. § 375.420: Reasonable recovery of attorney's fees against surety under Insurance Code for vexatious failure to pay claims.	Mo. Stat. §§ 34.057; 431.180. Mo. Stat. §34.057: Reasonable attorney's fees to prevailing party if cause of action or defense frivolous and in bad faith. Mo. Stat. § 431.180: Reasonable attorney's fees to prevailing party in action for payment.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Montana	Mont. Code § 18-2-207: Reasonable attorney's fees to prevailing party in action against surety under public works performance and payment bonds.	Mont. Code § 28-2-2101 *et seq.* Mont. Code. Ann. § 28-2-2105: Reasonable attorney's fees to prevailing party for both trial and appeal.	American Rule.	Mont. Code. Ann. § 71-3-124(1): Reasonable attorney's fees to prevailing party in any judicial proceeding brought on bond to foreclose lien.
Nebraska	Neb. Rev. Stat. § 44-359: Reasonable attorney's fees after judgment on any type of insurance policy. Section 44-359 has been applied to sureties. *See Reischick Drilling Co. v. Am. Cas. Co.*, 208 Neb. 142 (1981).	Neb. Rev. Stat. § 81-2401 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	Neb. Rev. Stat. § 52-141(6): Reasonable attorney's fees to prevailing party on construction lien bond.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Nevada	No attorney's fees statute for bond claims.	Nev. Rev. Stat. §§ 338.160 *et seq.*; 624.620 *et seq*. Nev. Rev. Stat. § 338.640(1): Reasonable attorney's fees in an action or arbitration for prompt payment on public works project. Nev. Rev. Stat. § 624.610(6): Reasonable attorney's fees in an action or arbitration for prompt payment on private works projects.	American Rule.	Nev. Rev. Stat. § 108.237: Reasonable attorney's fees to prevailing lien claimant on lien or surety bond.
New Hampshire	No attorney's fees by statute for bond claims.	No Prompt Payment Statutes.	American Rule.	No attorney's fees by statute in lien foreclosure action.
New Jersey	No attorney's fees by statute for bond claims.	N.J. Stat. §2A-30A-1. N.J. Stat. § 2A:30A-2(f): Reasonable attorney's fees to prevailing party in civil action to collect payments.	American Rule.	N.J. Stat. § 2A:44A-15: Reasonable attorney's fees to prevailing party in lien claim action if lien claim is without basis or willfully overstated.
New Mexico	N.M. Stat. § 13-4-19(A): State shall have right to sue on public works payment bond for all taxes due arising out of construction services rendered by contractor without principal place of business in New Mexico.	N.M. Stat. § 57-28-1 *et seq*. N.M. Stat. § 57-28-11: Reasonable attorney's fees may be awarded in an action to enforce the Prompt Payment Act.	American Rule.	N.M. Stat. § 48-2-14: Reasonable attorney's fees to prevailing party in dispute arising out of or related to lien action.
New York	N.Y. State Fin. Law § 137(4)(c): Reasonable attorney's fees to prevailing party in action on a public works payment bond if claim or defense is without substantial basis in fact or law.	N.Y. State Fin. §§ 139-f; 179-f *et seq.*; N.Y. Pub. Auth. §§ 2880; 2880-a. No attorney's fees by statute for prompt payment claims.	American Rule.	N.Y. Lien Law 39-a: Reasonable attorney's fees to discharge a willfully exaggerated lien.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
North Carolina	N.C. Gen. Stat. § 44A-35: Reasonable attorney's fees to prevailing party on payment and performance bond claims if unreasonable refusal of losing party to fully resolve matter.	N.C. Gen. Stat. §§ 143-134.1 *et seq.*; 22C-1 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.
North Dakota	No attorney's fees by statute for bond claims.	N.D. Cent. Code § 13-01.1 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	N.D. Cent. Code § 35-27-24.1: Any owner that successfully contests validity or accuracy of construction lien in any action must be awarded reasonable attorney's fees.
Ohio	No attorney's fees by statute for bond claims.	Ohio Rev. Code § 4113.61. Ohio Rev. Code § 4113.61(B)(1): Reasonable attorney's fees to prevailing party.	American Rule.	Ohio Rev. Code § 1311.16: Reasonable attorney's fees in action to foreclose mechanic's lien.
Oklahoma	Okla. Stat. tit. 12, § 936(A): Reasonable attorney's fees to prevailing party in suit for labor and services rendered.	Okla. Stat., tit. 61, §113.1 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	Okla. Stat. tit. 42, § 176: Reasonable attorney's fees for prevailing party on judgment in action to enforce lien.
Oregon	Or. Rev. Stat. § 742.061: Reasonable attorney's fees to prevailing party in action on bond provided under Section 279B.055 (bid bond), 279B.060 (bid bond), 279C.380 (performance bond public contract) or 701.430 (performance bond) if plaintiff's recovery does not exceed the amount of any tender made by defendant in such action.	Or. Rev. Stat. §§ 279.435 *et seq.*; 701.420. Or. Rev. Stat. § 279C.570(6): Reasonable attorney's fees to prevailing party on prompt payment claim on public contracts.	Or. Rev. Stat. § 20.096: No unilateral attorney's fees provisions in contracts. If written contract provides for attorney's fees, provision will be reciprocal to prevailing party. Or. Rev. Stat. § 20.082: Attorney's fees to prevailing party on claim based on contract under $10,000 if written demand 20 days before action.	Or. Rev. Stat. § 87.060(5): Reasonable attorney's fees to prevailing party on action to enforce perfected mechanic's lien.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Pennsylvania	No attorney's fees by statute for bond claims.	73 Pa. Stat. § 501 *et seq.* 73 Pa. Stat. § 512(b): Reasonable attorney's fees to the substantially prevailing party in any proceeding to recover payment under Contractor and Subcontractor Payment Act. 62 Pa. Stat. § 3935(b): Reasonable attorney's fees to prevailing party in action to recover payment under Pennsylvania Procurement Code if amount withheld in bad faith.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Rhode Island	No attorney's fees by statute for bond claims.	R.I. Gen. Laws. § 42.11.1-1. No attorney's fees by statute for prompt payment claims.	American Rule.	R.I. Gen. Laws § 34-28-19: Reasonable attorney's fees to prevailing party as costs of proceedings on mechanic's lien.
South Carolina	S.C. Code § 27-1-15: Reasonable attorney's fees on payment bond if surety fails to make fair investigation or unreasonably refuses to pay claim.	S.C. Code § 29-6-10 *et seq.* No attorney's fees by statute for prompt payment claims.	American Rule.	S.C. Code § 29-5-10(a): Reasonable attorney's fees to prevailing party in lien enforcement action.
South Dakota	S.D. Codified Laws § 58-12-3: Attorney's fees recoverable in all actions or proceedings against insurance company that refuses to pay damages "without reasonable cause."	S.D. Codified Laws § 5-26-1. No attorney's fees by statute for prompt payment claims.	American Rule.	S.D. Codified Laws § 44-9-42: Court shall have discretion to allow attorney's fees may be awarded in lien foreclosure action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Tennessee	No attorney's fees by statute for bond claims.	Tenn. Code §§ 12-4-701; 66-34-101 *et seq*. Tenn. Code § 66-34-602(b): Reasonable attorney's fees to prevailing party if nonprevailing party acted in bad faith.	American Rule.	Tenn. Code § 66-11-135(a): Reasonable attorney's fees to owner for failure to release forfeited, expired, satisfied or adjudged lien. Tenn. Code §66-11-139: Attorney's fees for willfully and grossly exaggerating lien amount.
Texas	Tex. Gov. Code § 2253.074: Reasonable attorney's fees in a proceeding to enforce claim on public works payment bond or to declare claim invalid.	Tex. Gov. Code § 2251.001 *et seq.*; Tex. Prop. Code § 28.001 *et seq*. Tex. Gov. Code § 2251.043: Reasonable attorney's fees to prevailing party on Public Prompt Pay Act. Tex. Prop. Code § 28.005: Reasonable attorney's fees to prevailing party in action on Private Prompt Pay Act.	Tex. Civ. Prac. & Rem. Code § 38.001(8): Attorney's fees to prevailing party in suit for breach of oral or written contract.	Tex. Prop. Code § 53.156: Reasonable attorney's fees in an action to foreclose or discharge lien.
Utah	Utah Code § 63G-6a-1103(6): Reasonable attorney's fees to the prevailing party, to be taxed as costs, in any suit on a public works payment bond. Utah Code § 14-2-1(7): Reasonable attorney's fees to the prevailing party in any suit on private works payment bond.	Utah Code §§ 15-6-2 *et seq.*; 58-55-603. Utah Code § 58-55-603(2): Reasonable attorney's fees to successful contractor on prompt payment action.	Utah Code § 78B-5-826: No unilateral attorney's fees provisions in contracts. If written contract provides for attorney's fees, provision will be reciprocal to prevailing party.	Utah Code § 38-1a-707(1): Reasonable attorney's fees to successful party, taxed as costs, in action to enforce mechanic's lien action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Vermont	No attorney's fees by statute for bond claims.	Vt. Stat., title 19 § 10. Vt. Stat., tit., § 4007: Reasonable attorney's fees to prevailing party amounts wrongfully withheld payments under a construction contract.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Virginia	No attorney's fees by statute for bond claims.	Va. Code §2.2-4300 *et seq*. No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Washington	Wash. Rev. Code § 39.08.030(b): Reasonable attorney's fees in any suit or action against surety to recover on public works payment bond. Wash. Rev. Code § 18.27.040(6): Attorney's fees are recoverable in action against contractor registration bonds up to penal sum.	Wash. Rev. Code §§ 39.04.250; 39.76.011 *et seq*. Wash. Rev. Code § 39.76.040: Reasonable attorney's fees to prevailing party in any action to collect interest on unpaid public contract. Wash. Rev. Code § 39.04.250(3): Reasonable attorney's fees to prevailing party in action for collection of funds wrongfully withheld.	Wash. Rev. Code § 4.84.330: No unilateral attorney's fees provisions in contracts. If written contract provides for attorney's fees, provision will be reciprocal to prevailing party.	Wash. Rev. Code § 60.04.181(3): Attorney's fees to prevailing party in lien foreclosure action.
West Virginia	No attorney's fees by statute for bond claims.	W.Va. Code §§ 8-13-22d; 14-3-1. No attorney's fees by statute for prompt payment claims.	American Rule.	No attorney's fees by statute in lien foreclosure action.

STATE	BOND ATTORNEY'S FEE STATUTES	PROMPT PAYMENT & PROMPT PAYMENT ATTORNEY'S FEES STATUTES	CONTRACT ATTORNEY'S FEES STATUTES	LIEN FORECLOSURE ATTORNEY'S FEES STATUTES
Wisconsin	No attorney's fees by statute for bond claims.	Wis. Stat. §§ 16.528; 66.0135. Wis. Stat. § 16.528(6): Reasonable attorney's fees to prevailing party in action to recover interest due on public contract with state. Wis. Stat. § 66.0135(6): Reasonable attorney's fees to prevailing party in action to recover interest due on public contract with municipality.	American Rule.	No attorney's fees by statute in lien foreclosure action.
Wyoming	No attorney's fees by statute for bond claims.	Wyo. Stat. § 16-6-602. No attorney's fees by statute for prompt payment claims.	American Rule.	Wyo. Stat. § 29-2-103: Reasonable attorney's fees and costs to prevailing party in action to foreclose on contractor or materialmen lien.

SESSION 15

UCC ARTICLE 9: RIGHTS OF THE SURETY

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PEARLMAN 2018

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Columbia Winery | Woodinville, WA

UCC Article 9 Rights of the Surety

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I. INTRODUCTION

As most surety professionals know, the surety's subrogation rights are not subject to perfection or priority as those terms are used in Article 9 of the Uniform Commercial Code ("UCC"). The equitably subrogated surety takes bonded contract proceeds prior to any financing bank or bankruptcy trustee[1] without having filed a UCC-1 financing statement under Article 9. However, as preeminent as equitable subrogation rights are, they typically apply only to bonded contract proceeds and retention that have yet to be paid to the principal. To establish rights in other collateral, the surety must perfect its interests pursuant to Article 9 of the UCC.

This paper will identify and discuss the steps a surety may take to obtain and perfect a security interest in indemnitors' collateral in addition to unpaid bonded contract proceeds and the issues with such filings. Hopefully this paper will provide a basis for understanding the processes and the potential shortfalls to assist sureties in perfecting rights in additional indemnitor assets under Article 9.

II. ARTICLE 9 OF THE UCC – A SHORT HISTORY

Although perhaps not so surprising to some[2], Article 9 of the UCC, entitled "Secured Transactions" has been with us for over sixty-five years. Article 9, as first adopted in 1952 along with the rest of the UCC, was envisioned as a national scheme to govern security interests in personal property. In its first iteration, Article 9 retained elements of the chattel mortgage system, including the option for local filing of UCC records. Ten years later, the entire UCC was revised with an improved version that was adopted by a majority of states over the next few years. That revision was the last for the entire UCC; thereafter, each individual article was addressed at various times.

Pertinent here, Article 9 was revised ten years later in 1972, with significant amendments based on several years of experience with the 1962 version. However, with computerization, banking deregulation, and increasing mobility of debtors and collateral, the 1972 version was becoming obsolete. Non-uniform enactments of Article 9 by individual states and use of state-specific forms begin to complicate multistate transactions. Enter the 1990 amendments for Article 9, which lasted only eight years before a revised Article 9 was promulgated in 1998.

The 1998 revision included significant changes that affected the UCC search and filing process, including when perfection can be accomplished by methods other than filing a financing statement. The 1998 changes also affected what law applies. Under original UCC Article 9, the law of the state where the collateral was located governed perfection and priority, with UCC records generally filed where the collateral was located. The 1998 revision changed the governing law from the location of the collateral to the law of the state where the debtor was located. After the effective date and once adopted by a state, and the law applicable today, UCC records generally must be filed where the debtor is located. The 1998 revision of Article 9 established a central filing office for most UCC records and most states designated the secretary of state as the central filing office, with safe harbor forms accepted by all filing offices nationwide.

The 2001 and 2003 revisions were stop-gap revisions to the latest version in 2010, which pre-2010 revisions mostly clarified, but did not change, the existing law. The 2010 revision's most visible impact was on the UCC search and filing process regarding the sufficiency of individual debtor names (discussed below) and revisions to the form and format of written UCC records to remove unnecessary data fields, accommodate the new individual debtor name rules, and make the forms more user-friendly. By 2013, nearly all states had enacted the 2010 amendments, most with an effective date of July 1, 2013. The transition period for the 2010 Amendments ended in most states on June 30, 2018, which concludes, for now, the evolutionary saga of Article 9.

While not provided to make anyone a UCC historian, first, the 2010 version of Article 9 controls today's perfection practice under Article 9. The surety must comply with these requirements or its attempts at perfection in collateral will fail. Further, be aware that citations to decisions may be distinguished based on the particular version of Article 9 that applied at the time of the decision. However, following the methods outlined in this paper, along with the suggestions offered, should provide the surety the path to perfection (in collateral, that is!)

III. PERFECTING RIGHTS IN INDEMNITOR COLLATERAL UNDER ARTICLE 9

Most general indemnity agreements ("GAI") include a security agreement component, whereby the principal and other indemnitors grant to the surety a security interest in a broad list of indemnitor property. However, as noted previously, because this listed collateral includes many other assets besides bonded contract proceeds, to perfect its interest in such collateral, the surety must comply with the requirements of the version of Article 9 as adopted by the particular state (or states) involved.[3]

A valid security agreement is one of the requirements for a security interest to "attach" to indemnitors' collateral.[4] Although the GAI and the included security agreement language governs rights between the surety and its indemnitors, that document does nothing to perfect the surety's rights against third-parties with claims against the same collateral, such as a financing bank, other secured creditors, such as equipment providers, judgment-lien creditors, or bankruptcy trustees.[5] To perfect its interest in any listed collateral against other creditors, the surety must file the UCC-1 with the appropriate state agency to put these other creditors on notice of the surety's security interest.[6]

A. It's All In A Name: Naming the Debtor Under Article 9

As noted in the historical summary, one aspect of the 2010 amendments to Article 9 involved the naming of debtors in the UCC-1 filing. In short, the surety must ensure that the indemnitor's names are exactly correct on the UCC-1 financing statement. Financing statements are indexed by debtor name[7] and are only effective if they "provide the name of the debtor."

i. Business indemnitors – Review Public Organic Records.

When the indemnitor is a business entity, the financing statement must list the entity's name exactly as it is shown in its record of organization within the public records of the state where it was organized (defined by the UCC as the entity's "public organic record").[8] That would be the Articles of Incorporation of a corporation and the Operating Agreement of a limited liability company.

As one commentator has observed,

> The only way that you can be certain that the [business] name you place on the UCC-1 is sufficient to perfect is to have in your possession a certified copy of the current certificate of organization obtained from the state in which the debtor is organized. It may be the standard of practice for lawyers to rely on a copy of a debtor's articles of incorporation and then to verify the name of debtor corporation, LP or LLC by consulting the Secretary of State's online "Business Search."[9]

Additionally, the surety should verify that there is not more than one such record and, if so, that the record is the one most recently filed. Further, if the record contains multiple name references, the surety should use the reference that is identified as indicating the name of the debtor.[10]

ii. Individual Indemnitors – Consult State Law for Alternative A or B.

If the indemnitor is an individual, identifying and listing the "correct" legal name is trickier. Individual indemnitors might go by a first name that differs from the name on their birth certificates, such as a middle name or nickname. Others may omit or include a maiden name. And some cultures switch the order of a surname with a given name or use more than one surname (in different combinations). A surety cannot search a central database that contains every individual's correct legal name, as it can for business entities.[11] As a result of this uncertainty with individual names—as well as some controversy over the right method of determining the correct name—the 2010 version of Article 9 gave states two alternative methods of establishing an individual's correct "legal name" for filing purposes.

"Alternative A"--also called the "only if" approach--provides that, to be correct, the name on the filing must be the *exact* name shown on the individual's valid, unexpired driver's license or state-issued identification card; the name on the UCC-1 is "sufficient" "only if" it matches the name on the driver's license.[12] If the state has not issued the individual a driver's license or identification card, the filing must list either (1) the "individual name" (which is not defined and rather unhelpful, given the problems described above), or (2) the individual's surname and first personal name. From a practical standpoint, however, it would probably be uncommon for a surety to have an indemnitor who does <u>not</u> have a valid driver's license (an expired one, possibly). Further, if the surety does not obtain a copy of the driver's license and just uses the indemnitor's first name and surname, it might have to prove, in a priority dispute, that the indemnitor did not actually have a driver's license at the time of the filing. That might be a daunting task.

"Alternative B," on the other hand, has been called the "safe-harbor" approach. In states that have adopted this approach, the creditor has three options for the debtor's correct name: (i) using the "individual name" (which, again, is unhelpful), (ii) using the individual's surname and first personal name, or (iii) using the name on the individual's driver's license. Because any one of these three alternatives may be used in these jurisdictions, filing is easier (but searching may be more difficult).[13]

iii. The "Not Seriously Misleading" Exception.

Regardless of whether the indemnitor is an entity or individual (under either alternative), the UCC allows the financing statement to be less-than-perfect on one condition: if a search using the "correct name" would still pull up the financing statement with the *incorrect* name under the state database's "standard search logic," the incorrect financing statement would then not be considered "seriously misleading" to the searcher.[14] In other words, if the searcher is still given notice of the incorrect filing, the filing perfects the interest of the filer as to the debtor(s).

Unfortunately, there is no consistency from state to state. A missing comma, space, or period in the debtor's name in a UCC-1 filing may potentially result in the UCC-1 not showing up in a search using the debtor's "correct" name. And while the creditor with the "slightly incorrect" UCC-1 may argue that it is harsh, unfair, drastic—or just flat-out wrong—it is likely that the court, in a priority dispute, may rule that such omission rendered the financing statement "seriously misleading" and ineffective against other creditors, thus forfeiting priority. As discussed below, this occurred in *Host America v. Coastline Fin., Inc.*,[15] where a mere extra space in the business-debtor's name was fatal to the financing statement and, thus, to the creditor's efforts to perfect.

iv. Cross your "T's" and dot your periods.

Host America involved a dispute between two creditors over the perfection and priority of security interests in the debtor's collateral. The public record of organization of the debtor listed the name of the debtor as "K.W.M. Electronics Corporation". When creditor Host America acquired a security interest in the debtor's assets, however, its financing statement listed the debtor's name as "K W M Electronics Corporation," with spaces instead of periods. Host America later filed another financing statement listing the debtor as "K. W.M. Electronics Corporation." *In case you missed it* . . . the difference was a single space between K and W but not between W and M.

The other creditor asked the court to determine whether the incorrect variations from the debtor's correct name rendered the financing statement "seriously misleading."[16] The Utah federal court concluded that it did. And frankly, it did not undertake a lot of analysis to come to this conclusion. The court reasoned:

> The evidence is undisputed that a search under KWM's correct name using the filing office's standard search logic would not have revealed [the] security interest . . . . As a result, the conclusion seems foregone that the escape hatch provision of subsection (3) is not available to Host America.[17]

The court could have left it at that, but it instead left creditors with an ominous warning about how critical it is to exactly comply with the UCC to begin with:

> Although sympathetic with Host America's position, the court concludes that the historical limitations of the state's filing office—though severe indeed—do not excuse . . . failure to comply with [the UCC]. The plain language . . . establishes an escape hatch to creditors who list an improper debtor name *only to the extent* that the state's standard search logic can compensate for that error. . . . In short, the legislature elected to leave the fate of those creditors that fail to comply with the strict naming requirement . . . *in the hands of those that develop and manage the filing office's search logic*.[18]

The court concluded, "Given the importance of the debtor's name, it should come as no surprise that a failure to adequately provide that name will render a financing statement "seriously misleading."[19]

For an example of how an *individual's* name can be mistaken while filing a financing statement, take the following where an indemnitor signed the general indemnity agreement as "John Public" but his driver's license states "John Q. Public." In a state that has adopted Alternative A (the "only if" approach), it is incumbent on the surety to obtain a copy of all indemnitors' drivers' licenses (probably during the underwriting process), ensure that they are valid and not expired, and list the indemnitors' names on the financing statement *exactly* as they appear on the drivers' licenses—embarrassing middle names and all. In the example, the name listed on the financing statement must be identical to the driver's license. If the UCC-1 was filed just as "John Public," a search using the "correct" driver's license name—John Quincy Public (which is more specific)—might not turn up the UCC-1 that only lists "John Public" (which is more general). Thus, the absence of the full middle name on the financing statement—if it is, indeed, listed on the indemnitor's driver's license—may render the financing statement "seriously misleading" and invalid.

In a state that has adopted Alternate B "the "safe harbor" approach), the surety should again list the name exactly as it is listed on the driver's license. Otherwise, the surety would have to determine other correct legal names of the indemnitor, thereby risking that these other iterations, including the way the indemnitor actually signed the indemnity agreement, were not legally correct. The surety should go with the "safe harbor" of the driver's license, even in states that have adopted Alternative B.[20]

As both *Host America* and this illustration demonstrate, unless the UCC-1 filed by the surety states the indemnitor's name correctly, other creditors of the indemnitors may successfully challenge the validity of the surety's UCC-1 and even may jump ahead of the surety to priority in the indemnitors' collateral. Or if the indemnitor files for bankruptcy, a bankruptcy trustee may challenge the filing, leaving the surety completely unsecured.[21] It is therefore critically important to get the name in the financing statement right, in order to avoid this "trap."

B. **Collateral Descriptions in the Security Agreement and Financing Statement.**

In addition to correctly naming the indemnitors, the surety must identify ("describe") the types of collateral within the security agreement itself (included in the indemnity agreement) and the financing statement. Although broad, generic descriptions such as "all assets of the debtor" or "all personal property of the debtor" may be used in financing statements[22] they are not proper in the security agreement language.[23] For the description of collateral in a security agreement to be deemed "sufficient", it must "reasonably identif[y] what is described."[24] Section 9-108(b) provides a list—with some limited exceptions—of what type of descriptions will satisfy the "reasonably identifies" standard. A "specific listing" of the specific collateral will obviously qualify, as will identification by category or type of collateral defined in the UCC, by quantity, by computational or allocational formula or procedure, or "any other method if the identity of the collateral is objectively determinable."[25] Most indemnity agreements—as they should--contain broad collateral descriptions to cast a wide "net" over the indemnitors' personal property. Sureties (and counsel) might consider periodically reviewing the grant of security interest in their standard GAI to make sure the collateral description conforms to Section 9-108 and, if it is a description by "collateral type defined in the Code," that it reflects any collateral categories added (or modified) by any amendments to the Code in that particular state.

While not appropriate in a security agreement, a generic, all-inclusive collateral description may be used in a financing statement. It gives the world notice that the surety purports to have a lien on all personal property of the debtor (or close). One thing to keep in mind with generic descriptions, however, is that regardless of how broad the financing statement may be, it will not cover collateral to which a security interest has not attached. The security agreement language still governs what collateral is actually pledged and covered. Even if the financing statement says "all assets of the debtor", the surety only has a security interest in the property properly identified in the security agreement.

This leads to the related issue of "authorization". The UCC indicates that although the financing statement need not be signed by the indemnitor, it must be "authorized."[26] Authorization is automatic for collateral (and identifiable proceeds) described in the security agreement, on execution (or "authentication") of the security agreement. If, however, the list of collateral in the financing statement is different or broader than in the security agreement, then the debtor has not "authorized" the filing of a financing statement as to the "extra" collateral listed in the financing statement. No security interest has attached, and, therefore, there is no perfection as to that extra collateral.

If the financing statement simply attaches the identical list of collateral as in the security agreement (or attaches a copy of the security interest itself), the issue is easy. The two lists of collateral are the same. Thus, the surety can attach a copy of the GAI (redacting all personal identifying information, of course) to the UCC-1 or, more appropriately, set out in the financing statement (or addenda) the identical description of the collateral as it appears in the security agreement portion of the GAI.

C. <u>In What Types Of Collateral Does the Surety Wish to Perfect its Interest</u>?

Merely filing a UCC-1 financing statement with the correct names of the indemnitors and a sufficient description of the collateral, either by attaching the GAI and/or naming the collateral in the financing statement does not guarantee perfection of a security interest in all identified collateral. Security interests in some collateral cannot be perfected by filing and must be perfected by other processes.

One example is vehicles. Security interests in vehicles can be perfected only by complying with applicable state laws governing certificates of title, usually by notating the security interest on the title itself. A UCC-1 that lists the indemnitor's vehicles will be useless against other creditors whose interests are depicted on the vehicle's title or, in the case of a bankruptcy filing, the interest of a bankruptcy trustee.[27] However, an exception applies if the vehicle is "inventory" for sale or lease by an indemnitor who is in that business (i.e., car dealerships). In such instances, perfection is by filing.[28]

Important to the surety context, many construction company indemnitors own construction equipment or vehicles that might also require perfection by notation on the title, depending on the applicable state laws.[29] Note that in these cases, perfection might still be achieved by "possession" of the equipment, but only in very limited circumstances, where the indemnitor changes states.[30]

Filing a UCC-1 will also be ineffective to perfect a security interest in the indemnitors' bank accounts, defined by the UCC as "deposit accounts". A security interest in a deposit account *cannot* be perfected by filing; it may *only* be perfected by "control"—another term defined by the UCC.[31] For sureties, "control" over a deposit account requires that the indemnitor, the surety, and the bank enter into an agreement whereby the bank agrees to comply with the surety's instructions concerning disposition of the funds in the account without further consent by the indemnitor/debtor.[32]

Most banks insist on using their own proprietary control agreement (you can imagine the banks' liability concerns in agreeing to heed the creditor's instruction and not that of their customer, the debtor…). Nonetheless, a copy of the American Bar Association's sample "Deposit Account Control Agreement" is attached as Addendum A, for reference. If the list of collateral in the indemnity agreement includes deposit accounts, the surety might consider, as part of the underwriting process, insistence on a control agreement with respect to certain accounts of the indemnitor, particularly if the surety is aware of certain "healthy" accounts. From a practical perspective, however, the existence of a control agreement does not prevent the indemnitor from accessing that account until the day when another secured creditor instructs the bank to turn over the funds. As such, it is possible that if the surety is at the point where it is looking to make a "call" on that control agreement, the funds may be long gone.

Another practical problem with a control agreement is the fact that the bank may be a competing creditor. If the indemnitor is defaulting on his indemnity obligations, he may be defaulting on other obligations, as well—including any loan obligations with the actual bank holding the account. Section 9-104 provides that the bank, itself, may have control—and priority—over the account, if the bank is a secured creditor.[33] The surety may overcome this in one of two ways. First, the surety can become an actual "customer"[34] of the bank with respect to the bank account.[35] Alternatively, the surety can include a subordination clause in the control agreement, whereby the bank agrees to subordinate its security interest to that of the surety.[36]

Likewise, if the collateral consists of securities (stocks and bonds, which the UCC terms "investment property"),[37] the surety *should* perfect them by "control." The reason this is a "should" is because, although securities may *technically* be perfected by a UCC-1 filing,[38] the code allows a subsequent creditor to trump a UCC-1 filing by taking "control" of the securities.[39] Thus, a surety is advised to perfect a security interest in securities by control. Importantly, the way to obtain "control" over securities differs from "control" of a deposit account, described above.[40] The method of control depends on a number of factors that this paper will not explore in detail but are, generally: whether the securities are "certificated" or "uncertificated", in bearer form or registered form, whether they have been delivered to the secured party or indorsed, as well as other factors. Generally speaking, the concept of control, however, is essentially the same—the secured party becomes in a position to "control" the securities and make determinations as to their disposition.[41]

For these reasons, sureties should not operate under the mistaken belief that a UCC-1 financing statement perfects its security interest in all types of collateral. Although a filing may perfect a security interest in many categories of collateral, those categories discussed previously require additional steps or alternative methods of perfection. In all cases, a surety should consult counsel with respect to the proper method of perfection for each type of the indemnitor's collateral and nuances in the state's version of the UCC for each.

D. First in Time, First in Right: The Mantra for Perfection.

Under the UCC, priority is everything. Granted, at the time the indemnity agreement is signed, the principal and other indemnitors already may have general financing in place. As such, a surety's UCC-1 financing statement may often be behind a financing bank's blanket lien. But if the indemnitors have equity in such collateral, the surety should "get in line" as soon as possible to protect its priority over any subsequent creditors. Practically speaking, the surety sees no reason to file a UCC-1 until the indemnitor is in financial trouble, has refused to reimburse the surety for a loss, or has refused a collateral demand. By taking that approach, however, the surety runs the risk that other creditors—including judgment-lien creditors—obtain priority over the surety. Further, a financing statement filed within 90 days of an indemnitor's bankruptcy allows the bankruptcy trustee to set aside the surety's lien as a preferential transfer.[42] Unless there is a compelling business reason to delay filing a financing statement, the surety can avoid potential issues by filing the UCC-1 shortly after the indemnity agreement is signed.

E. Authority to Sign: Is the Indemnity Agreement Signed by the Right Person Who Has the Right Legal Capacity?

As with the requirement to correctly name the indemnitors, the signature line of the GAI, particularly with entity indemnitors, must be signed by an individual that has authority to sign on behalf of the entity in the correct capacity. Otherwise, under the requirements of Article 9, the security agreement granting an interest in the collateral may be deemed unauthorized. Construction groups often utilize "single project" entities with dedicated "managing" companies formed to add layer on layer of authority necessary for the *first* layer of companies to sign the indemnity agreement. As such, the surety must understand the business layers, and who has authority at each level, by obtaining authentic records of each company's formation (i.e., operating agreements, articles of incorporation, charter, company bylaws, etc.). Without this due diligence, the surety risks losing any interest in the company indemnitors' collateral.

Although not an Article 9 decision, the relatively recent case of *Int'l Fid. Ins. Co. v. La Porte Constr., Inc.*,[43] demonstrates the authority issue. In *La Porte Construction*, the federal court held that seventeen LLC's, listed as indemnitors in an indemnity agreement, were "not bound by the Indemnity Agreement."[44] One man, "Mr. Logue", had signed the indemnity agreement as the purported "Managing Member" of each of the 17 LLC's. To "cover its bases," the surety had also prepared "Resolutions" for Mr. Logue to sign on behalf of each LLC, which stated that a special meeting of the LLC members was held to give the "managing members" authority to execute the indemnity agreements on behalf of the LLC's. But no such special meetings were held.

The *La Porte Construction* court concluded the undisputed evidence showed Mr. Logue was not the managing member of fifteen of the seventeen LLC's. Rather, the managing members of fifteen of the LLC's were separate *managing* LLC's. Although Mr. Logue was the managing member of these 15 *managing* LLC's, he was not the manager of the LLC's themselves.[45]

The surety argued that this "would elevate form over substance" just because Mr. Logue did not sign the indemnity agreement as "Manager of the Managing Member of the LLC's." The court rejected this argument, reasoning, "[t]he formalities required to create a business entity and the formalities required for such an entity to transact business exist as a protection for people conducting business and must be strictly followed. In the world of business entities and organizations, form is the *sine qua non*."[46]

While this is certainly harsh, the court did not hide its displeasure that the surety never reviewed the operating agreements of each of the LLCs before Mr. Logue signed the agreements and resolutions the surety prepared. The court observed:

> a sophisticated surety that enters into contracts like the Indemnity Agreement on a routine basis, had an obligation to request and examine the . . . Operating Agreements to ascertain whether Mr. Logue had the authority to execute the documents prepared and presented by [the surety]. This is basic due diligence. A review of the . . . Operating Agreements would have made it clear that Mr. Logue was not authorized to adopt the Resolutions and that he lacked the authority to enter into the Indemnity Agreement on behalf of the [LLC's].[47]

The surety also argued, "the Resolutions executed by Mr. Logue gave him actual authority to execute the Indemnity Agreement." The court disagreed, reasoning that the resolutions were not approved by all the members, and that, at any rate, Mr. Logue was neither a Member nor a Manager of the LLCs (i.e., the first layer). Even with respect to the *managing* LLCs (second layer), Mr. Logue owned 0.1% or less of each. The other owners were never consulted to authorize Mr. Logue's signing of the indemnity agreement.[48]

After concluding that Mr. Logue had no *actual* authority to sign the indemnity agreements, the court next explored the possibility that he had *apparent* authority to do so. The court concluded that the LLC's (or their respective managing LLC's) did not "clothe" their agent (Mr. Logue) with apparent authority. Rather, everything Mr. Logue signed was his *own* representation of his authority. The court explained that the agent cannot "create his own authority by signing resolutions professing to give him authority."[49] The LLC's themselves made no "manifestations to [the surety] that Mr. Logue was authorized to sign the Indemnity Agreement on behalf of any of them."[50]

IV. CONCLUSION

A proper understanding of the principles and concepts discussed above will hopefully help the surety obtain—and perfect—rights in additional collateral of the indemnitor, further securing the surety's rights of indemnification, while avoiding some of the traps and pitfalls of Article 9 of the UCC.

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[1] See, *e.g.*, *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 141, 83 S. Ct. 232, 237 (1962).

[2] For example, Armen Shahinian who it is believed may have represented the surety in *Pearlman*.

[3] This paper will cite, generically, to sections of Article 9. The surety should consult the specific version of Article 9 adopted by the jurisdictions in which the collateral to be secured is found. Unless otherwise indicated, a reference to the "Code" or any particular section (by word or symbol) is a reference to the general UCC.

[4] *See, generally*, U.C.C. § 9-203. The other requirements are that the creditor give "value" and that the debtor/indemnitor have rights in the collateral.

[5] Under 11 U.S.C. § 544, also known as the "strong arm clause," the bankruptcy trustee is allowed to avoid all security interests that are not properly noticed ("perfected") with regard to other creditors.

[6] *See* U.C.C. § 9-322 ("A perfected security interest . . . has priority over a conflicting unperfected security interest."); *see also* U.C.C. § 308(a).

[7] Steven N. Cohen, Bryon Mulligan and Lech Kalembka, UNITED STATES: THE 2010 AMENDMENTS TO ARTICLE 9 OF THE UCC: A PRIMER (July 11, 2013).

[8] *See* U.C.C. § 9-503(a)(1) (explaining that the financing statement must list the name of a registered organization, including a registered organization holding the collateral in trust, as it appears on the public organic record); *see also* U.C.C. § 9-503(a)(2), (f) (collateral held by the personal representative of a deceased indemnitor), U.C.C. § 9-503(a)(3) (collateral held in a trust that is not a registered organization), and U.C.C. § 9-503(a)(6) (unnamed organizations).

[9] Dean T. Kirby, Jr., *Alternative A v. Alternative B – Can the Imperfect Attain Perfection?* (January 28, 2013), http://www.kirbymac.com/2013/01/28/alternative-a-v-alternative-b-can-the-imperfect-attain-perfection/.

[10] *See* U.C.C. § 9-503(a).

[11] *See id.*

[12] *See* Cohen, Mulligan, Kalembka, *supra*.

[13] Alternative A has been adopted by Arizona, California, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Utah, and Washington. Alternative B has been adopted by Alaska, Colorado, and Wyoming.

[14] U.C.C. § 9-506.

[15] *Host Am. Corp. v. Coastline Fin., Inc.*, No. 2:06CV5, 2006 WL 1579614, at *1 (D. Utah May 30, 2006).

[16] *Id.* at *3.

[17] *Id.* at *5.

[18] *Id.* (emphasis added) (citing Note, *Good Technology and Bad Law: How Computerization Threatens Notice Filing Under Revised Article 9*, Meghan M. Sercombe, 84 TEX. L. REV. 1065, 1068 (March 2006) ("[T]he drafters of the revised Article 9 opted for a bright-line rule, rejecting any language that would have measured validity against principles of fairness or equity.").

[19] *Id.* (internal quotation marks omitted). Many commentators have concluded that the "seriously misleading" provisions of the UCC are "harsh" and "draconian" and lead to "dire results". *See* Eric Snyder, *Naming Names: Getting the Name Right on a UCC Financing Statement*, WILK AUSLANDER NEWSL., July 15, 2007, available at http://www.wilkauslander.com/news-and-insights/insights/Getting-The-Name-Right-On-a-UCC-Financing-Statement. Under the prior version of Article 9, courts imposed a

duty on searchers to be "reasonably diligent" in conducting a UCC search. While Revised Article 9 puts the burden more on the filer of the UCC-1 than the searcher, at least one court has ruled that the "reasonably diligent searcher" standard survived the enactment of Revised Article 9—not with respect to the name utilized in the initial search, but with respect to the actions taken by the searcher in evaluating the search results. In *In re Summit Staffing Polk County, Inc.*, 305 B.R. 347, 354 (Bankr. M.D. Fla. 2003), a Florida UCC search under the debtor's correct legal name produced an alphabetical list of names with twenty names displayed on each computer screen. Although the test search did not disclose any exact matches to the debtor's current legal name, it did reveal a number of financing statements with similar names, including the one filed by the secured party. With respect to the argument that the searcher should have to examine the names on those pages, the court stated as follows:

> Although Revised Article 9 does not require that a searcher exercise reasonable diligence in the selection of the names to be searched or the number of searches to conduct, the revisions to Article 9 do not entirely remove the duty imposed on a searcher to be reasonably diligent. *One who searches the filings of a state must examine the results of a proper search with reasonable diligence.* A searcher is not required to conduct multiple searches; however, a searcher must reasonably examine the results of the proper search using the debtor's correct name to determine if any financing statements relating to the debtor are disclosed by that search.

Id. at 355 (emphasis added). The court stated that a searcher must use reasonable diligence in moving forward and back through the list of names produced by the initial search, using the "Previous" and "Next" keys to scan the list. Had the searcher employed such reasonable diligence, the searcher inevitably would have seen the secured party's filing with the same address as the successor corporate debtor. Thus, the court held that pursuant to Section 9-506(c), the secured party's financing statement was not seriously misleading and therefore effective to perfect its security interest. *Id.*

[20] Significantly, however, when the surety ***searches*** for prior financing statements on the indemnitor in an "Alternative B" state, it will need to search all possible iterations of the indemnitor's name, in case a prior creditor correctly listed the name under one of these perfectly acceptable variations. In such a case, the surety is advised to also obtain other documents from the indemnitor, such as a social security card, a birth certificate, and other evidence of the indemnitor's "correct name."

[21] *See generally* the Bankruptcy "strong arm clause," 11 U.S.C. § 544.

[22] *See* U.C.C. §§ 9-504, 9-108.

[23] *See* U.C.C. § 108(c) ("A description of collateral as "all the debtor's assets" or "all the debtor's personal property" or using words of similar import does not reasonably identify the collateral."). *See also* 9-203(b)(3)(A). *See* comment 2 to Section 9-504.

[24] *See* U.C.C. § 9-108(a).

[25] U.C.C. § 9-108(b); *See also §* 9-108:1 [Rev] General rule, 9A Hawkland UCC Series § 9-108:1 [Rev]. Note that this list of "reasonable identifiers" does not work for commercial tort claims or some categories of collateral in consumer transactions. *See* 108(e).

[26] *See* U.C.C. § 9-509.

[27] *See* U.C.C. § 9-311(a)(2), (3) (explaining that a UCC-1 filing is "not necessary or effective" to perfect property subject to the state certificate of title system that requires "a security interests to be indicated on a certificate of title.")

[28] *See* U.C.C. § 9-311(d).

[29] U.C.C. § 9-311(a)(2) (contemplating state laws governing perfection of "trailers . . . farm tractors, or the like" via a certificate of title system).

[30] U.C.C. § 9-313(b); *see* U.C.C. §§ 9-313(a) (explaining perfection by possession of "goods"), 9-102(44) (defining "goods" as "all things that are movable when a security interest attaches."), and 9-102(33) (defining "equipment" as "goods other than inventory, farm products, or consumer goods.").

[31] *See* U.C.C. § 9-312(b) ("a security interest in a deposit account may be perfected <u>only by control</u> under Section 9-314."); *see also id.* §§ 9-314(a) and 9-102(29) (defining "deposit account" as a "savings . . . or similar account maintained with a bank."). *Cf.* U.C.C. § 9-327(1) ("a secured party having control of the deposit account . . . has priority over a conflicting security interest held by a secured party that does not have control.").

[32] *See* U.C.C. § 9-104(b). Section 9-104 provides:

> (1) A secured party has control of a deposit account if:
>
> (a) the secured party is the bank with which the deposit account is maintained;
>
> (b) the debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or
>
> (c) the secured party becomes the bank's customer with respect to the deposit account.
>
> (2) A secured party that has satisfied Subsection (1) has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

[33] *Compare* U.C.C. § 9-104(b) *with* U.C.C. § 9-327(c) (explaining that a bank that is also a creditor to the indemnitor will prevail over a surety with only a control agreement).

[34] *See* U.C.C. § 4-104(5) (defining "customer" as "a person having an account with a bank or for whom a bank has agreed to collect items including a bank that maintains an account at another bank). In other words, the Surety would sign up for an account with that bank and be the customer, "with respect to the deposit account" of the indemnitor.

[35] *See* U.C.C. § 9-327(4) (explaining that a surety that is a customer of the bank with respect to the bank account will prevail over even a bank-creditor.)

[36] *See* Official Comment #4 to U.C.C. § 9-327 and U.C.C. § 9-339 (permitting subordination agreements to change priority among creditors).

[37] *See* U.C.C. § 9-102(49) (defining "investment property" as "securities"); *see also* U.C.C. § 8-102(15) (defining "security")

[38] *See* U.C.C. § 9-312(a) (perfection of "investment property" aka securities by filing a UCC-1).

[39] *See* U.C.C. § 9-328 (explaining that control of stocks/bonds has priority over a security interest created merely by filing). *See* Official Note #4 to U.C.C. § 9-312 (control will have greater priority rights).

[40] *See* U.C.C. § 9-106 (control of "investment property," which is defined as "securities" under section 9-102(49))

[41] *See* U.C.C. § 8-106. If the collateral includes securities, surety is encouraged to consult counsel—and the specific state statutes—to address the issues of perfect. Note that if the securities are "certificated," they may also be perfected by "delivery." *See* U.C.C. § 9-313(a).

[42] *See* 11 U.S.C. § 547.

[43] *Int'l Fid. Ins. Co. v. La Porte Constr., Inc.*, No. 2:16-CV-00032, 2017 WL 876261, at *13 (D. Utah Mar. 3, 2017).

[44] *Id.*

[45] *Id.* at *9 ("Mr. Logue was not the manager of any of the Movants. At the time the Indemnity Agreement and Resolutions were signed, the manager of each Movant was its respective Managing LLC."). Moreover, under the terms of the Operating Agreements, "only the Managing Member was authorized to execute a document like the Indemnity Agreement" on behalf of any of the companies. *Id.* at *7. The court found issues with the other two of seventeen LLC's, primarily reasoning that the Resolutions for those companies suffered from the "same fatal flaw" as the Resolutions

for the other LLCs, namely, that no actual special meeting was held to authorize Mr. Logue to sign the indemnity agreements. *Id.* at *12 n.22.

[46] *Id.* at *8.

[47] *Id.*

[48] The Court concluded that the LLC's (that is, the members of the LLCs' *Managing* LLC's) would have "no reason" to authorize Mr. Logue to execute the Indemnity Agreement on their behalf because the LLC's had no ownership interest in the bonded project and it would have contradicted the sole stated purposes of each LLC, which was to build single, unrelated projects in different cities. *See id.* at *9.

[49] *Id.*; *see id.* *11 ("The authority of an agent is not 'apparent' merely because it looks so to the person with whom he deals, but rather it is the principal who must cause third parties to believe that the agent is clothed with apparent authority." (citing *Burdick v. Horner Townsend & Kent, Inc.*, 345 P.3d 531, 539 (Utah 2015))); *id.* ("an analysis of apparent authority focuses on the acts of the *principal* from a third party's perspective." (emphasis added)).

[50] *Id.*

SESSION 16

OVERVIEW OF THE NEW AIA A201 (2007 v. 2017): EMPHASIS ON DISPUTE RESOLUTION

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DIFFERENCES BETWEEN THE 2007 AND 2017 UPDATE TO THE AIA A201 CONTRACT DOCUMENTS

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Introduction

The last revision to the AIA contract documents was in 2007. In April of 2017, the AIA issued the 2017 update to the AIA 201. In general, the 2007 may continue to be used for eighteen (18) months after the 2017 update was issued. After that date, only the 2017 edition will be authorized for use. The AIA has encouraged users to adopt the update as soon as practicable.

Contract Articles

1. General Provisions

   - The 2017 version contains a more robust savings clause. Under this provision, if a court determines that a particular clause in the contract is void and unenforceable, the court is directed to enforce the remaining terms and provisions of the contract. In addition, if a particular clause runs afoul of a state law or statute, the court is directed to apply the provision to "the fullest extent permitted by law" to give effect to the respective parties intentions under the terms and conditions of the contract.

2. Owner

- During the intervening years between the 2007 version of the contract and the 2017 update, the United States experienced the "Great Recession". The 2017 revisions provides for a detailed procedure that allows a contractor to refuse to proceed with the work, or even suspend work, if the owner does not give the contractor current information regarding the owner's ability to pay for the primary scope of the work and any changes to the scope of the work that substantially alters the contract sum. The contractor is required to keep this information confidential under most circumstances.

3. Contractor

- If the project contract documents spell out the means and methods then the contractor has the responsibility to evaluate the jobsite with respect to the safety of the same. If the contractor decides that the specified means and methods are not safe, the contractor must notify the owner and the architect of the problem(s) and propose alternatives to those specified in the contract. If the contractor's means and methods are accepted, the Architect is relieved from responsibility for the contractors proposed means and methods. Under the 2007 version if the contractor advised that the architects means and methods were not safe, and the owner elected to proceed without accepting the contractors changes then the owner would ultimately be responsible for any loss attributable to that decision. (Does this section eliminate the affirmative assumption of risk by the owner?)

- Warranty: The 2017 version of the AIA contract to either be in the owner's name or transferrable to the owner to facilitate the warranty process. Further, the 2017 version differentiates between certain contractor warranties that may occur before substantial completion and those that arise afterward.

4. Architect

- This revision relates to communications between the architect, the contractor and the owner. Any communication between the contractor and owner that would impinge on the architect's services must also be communicated to the architect. Similarly, the owner should alert the architect to any substantive direct communications between the owner and the contractor about the project.

5. Subcontractors

- Section 5.3 has been revised and now requires the contractor to obtain a written agreement that its subcontractors assume the same obligations to the contractor that the contractor has with the owner.

6. Construction by Owner or by Separate Contractor

- The 2017 version specifically defines a separate contractor as "other contractors retained by the owner under separate agreement. The previous version required that the separate contractor have general contract provisions that were identical or substantially similar to those of the primary contract. The term "identical" was eliminated.

- The 2017 version makes the contractor responsible for reporting deficiencies with the work performed by any other separate contractor who contracted with the owner before proceeding with its own related work. If the contractor fails to do so, the contractor is deemed to have acknowledged that the work of the owner's other separate contractors was proper.

7. Changes in the Work

- The 2017 version provides a mechanism under which the contractor can challenge whether a change is minor, i.e. not affecting the contract amount or the time for performance, or substantial. If the contractor believes the change will in fact change the contract amount or completion time, the contractor can refuse to perform until the issue is resolved or a change order is issued.

8. Time

- The 2007 version precluded a contractor from knowingly prematurely commencing "operations on the site or elsewhere" before the effective date of the required insurance to be furnished by the contractor to the owner. The more definitive term "Work" has been substituted in the 2017 version.

- In the section pertaining to delays and extensions of time, the 2017 version includes "adverse weather conditions documented in accordance with § 15.1.6.2" as an additional event that could entitle the contractor to a reasonable time extension of the contract time as determined by the Architect. Some commentators have suggested that this addition is in recognition of the possible effects of climate change on a project.

- The 2017 version deletes a requirement in the 2007 version that time extensions provided for in 8.3.1 be made by change order.

9. Payments and Completion

- Requires the contractor to submit releases and lien waivers with respect to subcontractors with an application for a progress payment.

- There is also a new provision that calls for the contractor to indemnify the owner from any damages suffered by the owner should a subcontractor file a lien/claim if the owner has complied with its contractual payment obligations.

- Allows either party to dispute the architect's decision regarding a certificate for payment under section 9.5.1 in whole or in part, by submitting a claim in accordance with Article 15.

10. Protection of Persons and Property

- The 2017 version clarifies the contractor's right to make a claim for the cost to remedy the damage or loss attributable to anyone directly or "indirectly" employed by either the owner or the architect, or by anyone for whose acts either of them may be liable.

11. Insurance and Bonds

- For the first time, there is an insurance exhibit that provides greater detail regarding the insurance requirements between the owner and the contractor.

- It requires the contractor to provide surety bonds of the types and of such penal sums, subject to the terms and conditions as required by the contract documents. The contractor must purchase the bonds from a company lawfully authorized to issue surety bonds in the jurisdiction where the project is located. The contractor must promptly furnish a copy of any such bond to any person or entity appearing to be a potential beneficiary under the bond(s).

- It describes the parameters of Builders Risk Insurance and provides that if the contractor is unable to procure such insurance, the owner can require the contractor to provide it.

- It provides for certain optional property coverages.

- In the 2007 version of the AIA 201 the requirements for insurance and bonds was, for the most part, set out in the contract itself. In the 2017 version, most of the insurance and bond requirements are set out in an exhibit to be read in concert with the remaining provisions of Article 11. The new exhibit allows the parties to the contract to have more options specific to the actual needs for the project.

- This version consolidates several separates provisions pertaining to waivers of subrogation into one more concise provision.

12. Uncovering and Corrections of Work

- The 2017 version states that the architect may request to see work that the architect did not specifically request to examine prior to it being covered by the contractor and that the contractor shall uncover the work. If the work is in accordance with the contract documents the contractor shall be entitled to an equitable adjustment to the contract sum and contract time as may be appropriate. No change order is required. If the work is not in accordance with the contract documents, the cost of uncovering the work and the cost of correction shall be at the Contractor's expense. It eliminates the exception for conditions caused by the owner or a separate contractor.

13. Miscellaneous Provisions

- This version eliminates the written notice served by certified mail requirement.

  Note: The 2017 version allows for most notices to be sent via electronic transmission where it is provided. However, a distinction is made between certain types of notices and notice of a claim. Notice of a claim must still be sent by personal delivery, certified or registered mail or courier.

14. Termination or Suspension of the Contract

- If the contractor has been terminated for convenience, the 2017 version now requires the owner to pay the costs attributable to the termination of subcontracts and a termination fee, rather than reasonable overhead and profit for the work not performed.

15. Claims and Disputes

- This provision affects a party's ability to be able to file a claim in arbitration or proceed with litigation. After an initial decision and mediation, either party to the contract can make a demand on the other party to file its claim in arbitration or proceed with litigation. If the other party does not proceed as demanded within sixty (60) days after the same, then both parties waive their rights to arbitration or litigation regarding the initial decision. This provision also provides more detail about the initial decision maker's role.

SESSION 17

WHEN YOUR PRINCIPAL IS DE-BARRED – NOW WHAT?

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Christine Bartholdt | Liberty Mutual Surety | Seattle, WA

Todd Bauer | Guardian Group | Torrance, CA

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SEPTEMBER 7, 2018

DAVID W. KASH
DENNIS C. CAVANAGH

DEBARMENT

I. What are suspension and debarment and why are companies and individuals suspended and debarred?

Suspension is an action taken by a suspending official that excludes or disqualifies a contractor or a person from bidding on or participating in a federally funded contract for a temporary period of time. Suspension applies to all federal programs and procurement.

Debarment is an action taken by a debarring official. It excludes or disqualifies a person or a contractor for a specific period of time from all federal government programs and procurement.

II. Purpose

The purpose is to protect the integrity of government programs by ensuring that only honest, ethical and "responsible persons" participate in government programs.

Bonding is simply not enough protection to the government.

The contractor or individual must be "presently responsible."

III. Government Agencies having procedures to bar contractors

A. Federal:

1. Department of Transportation

2. Department of Interior

3. Department of Defense

4. Small Business Administration

5. Housing and Urban Development

6. Environmental Protection Agency

7. Others

B. State:

a. Arizona:
A.R.S. 41§ 2613

b. Connecticut:
C.G.S. §31-53a; C.G.S. § 31-57(c)(d)

c. Massachusetts:
ALM GL ch. 29, §29F; ALM GL ch. 149, §44C

IV. <u>Bases – can be fact-based or judicially based.</u>
FAR-48 CFR 9.406-2

FAR-48 CFR 9.407

A. Conviction of criminal offenses

B. Conviction or civil judgment for fraud, theft, embezzlement, false records, bribery, conflict of interest, gratuity violations

C. Any other offense indicating a lack of business integrity that seriously and directly affects "present responsibility"

D. Lack of business integrity or honesty

1. Willful failure to perform contract, history of poor performance, or willful statutory violation

2. Unfair trade practices

3. Delinquent federal taxes

4. Failure to disclose

5. Overpayments under the contract

E. Statutory bases for debarment

- False Claims Act – 31 U.S.C.A. 3729 *et seq.*
- Buy American Act -- 41 U.S.C.A. §8303(c)
- Clean Air Act – 42 U.S.C.A. §7606
- Clean Water Act – 33 U.S.C.A. §1368
- Davis-Bacon Act – 40 U.S.C.A. §1344
- And many others

V. <u>Penalties</u>

1. Suspension

a. Probable cause

b. Ex Parte

c. Government does not have to share evidence

d. Effects: Not more than 12 months

2. Debarment

a. Notice

b. 30 days to respond

c. Preponderance of the evidence standard for the government

d. Effects: Not more than three years

VI. <u>Who is subject to debarment?</u>

1. Contractor or responsible person (may also include affiliates).

2. Surety

3. Both

VII. Recent examples

1. Highest risk is False Claims Act and Davis-Bacon Act violations.

   a. The "Implied Certification Doctrine" under the FCA-the contractor's failure to comply with a contract requirement makes any invoice submitted for payment, false (treble damage penalty). The failure must be "material" to the government's payment decision.

   b. Davis-Bacon Act – a 1931 law requiring federal contractors to compensate certain "laborers" and "mechanics" specified rates for labor on federal public construction jobs; significant record keeping is required and it requires "certified payrolls" on a weekly basis.

2. Hanover v. The United States, 134 Fed. Cl. 51 (2017). A CDA suit by a contractor and surety challenging the Army Corps. of Engineers default termination. The government filed False Claims Act counterclaims against both. The claims against the surety were that it allowed a false claim to be presented by failing to alert the government that the principal's $1.16 million pass-through claim was overstated, because the surety had settled the claim for $370,000. The counterclaim was held to state a cause of action for fraud and FCA violation against contractor and surety.

3. United States Ex. Rel. Scollick, 2017 WL 3268857 (D.C. D. Columbia). Scollick filed suit on behalf of the United States against several contractors and their sureties, alleging a scheme to defraud the government by submitting bids for government contracts fraudulently claiming service-disabled veteran-owned small business status. The allegations were: conspiracy to violate the FCA. Claims were asserted against the surety because the plaintiff alleged that the sureties provided bonds for dozens of federal contracts worth millions of dollars with the "knowledge" that the bonded contractor was not a

disabled veteran-qualified business under the law. It was alleged that the sureties continued to do business with these contractors perpetrating the fraud. It was further alleged that because bonding was a “critical action” it furthered the scheme. The sureties knew or should have known “shell companies” were not in compliance, that they did not “qualify” and the shell companies were not “certified” companies. The government alleged it received nothing of value, essentially a reverse FCA claim, all payments made were sought to be recovered as damages by the plaintiff.

VIII. Practice Pointers

A. S.B.A. – Falsely claiming small business status.

1. Understand contractor's "small business" status

2. Affiliates, subsidiaries, must be investigated for "separateness"

B. General Business Practices – Be Proactive

1. Before entering into relationship with government

a. Education/Ethics programs

b. Confidential self-reporting

2. Onset of government investigation

a. Internal investigation

b. Engage government officials

C. Surety must review and have oversight over payment applications and submissions to the federal government by its takeover contractor. Federal government will not accept a disclaimer or waiver of FCA liability in a takeover agreement. The surety should also demand a defense and indemnity from the takeover contractor and its owners to any FCA or *qui tam* claims as a result of its performance of the takeover agreement.

SESSION 18

FEES, COSTS, AND INTEREST UNDER THE GAI

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ATTORNEYS' FEES, COSTS, AND INTEREST UNDER THE GENERAL AGREEMENT OF INDEMNITY

I. Introduction

This paper examines the surety's rights to attorneys' fees, costs and interest under the general agreement of indemnity ("GAI"[1]). We have attempted to give attention to recent case law. The first section deals with attorneys' fees. The second section identifies those categories of costs that can potentially be recovered. The third section discusses interest on fees and costs that the surety may be able to recover against indemnitors.

Of course, the starting point to any discussion about the surety's rights to attorneys' fees, costs and interest has to be the general agreement of indemnity. The GAI is the contract which sets forth the rights and obligations of the parties related to the surety's underwriting of bonds on behalf of the principal.

The parties to the GAI are normally the surety, the principal, and indemnitors. The principal or the legal entity is always an indemnitor. In addition, the Surety may also require that the owners, shareholders, members, or partners of the principal sign the GAI as indemnitors. Sometimes, indemnitors are other related parties to the indemnitors or principal, such as spouses, trusts, and other companies controlled or owned by the principal's owners, who have financial assets that the indemnitors are willing to pledge on behalf of the principal.

[1] Often also referred to as general indemnity agreement.

In addition to setting forth the obligations and rights of the parties when there has been a claim against a bond issued by the surety, the GAI forms the basis for which sureties may seek to recover its attorneys' fees, costs and interest from the indemnitors that were incurred related to any breach of the GAI or having to perform under a bond issued by the surety.

The mantra that any surety and its counsel (inhouse and outside) need to keep in mind in understand the surety's rights to recover attorneys' fees, costs and interest is: READ the GAI, READ the GAI, READ the GAI.

II. Recovering Attorneys' Fees

Almost all GAIs specifically define loss to include fees incurred by the surety as a result of having issued surety bonds on behalf of the principal or enforcing the conditions of the GAI and/or provide for indemnification for the same. Some GAIs provide that the fact and amount of the surety's payments, whether to bond claimants or to counsel, are prima facie evidence of the indemnitors' liability. When seeking judgment against indemnitors, surety professionals should use the provisions of the GAI as the basis for declarations/affidavits setting forth the surety's payments of attorneys' fees to represent prima facie evidence of the indemnitors' liability. Based solely on the language of the GAI, the surety should be able to recover the attorneys' fees it has expended. However, the amount of attorneys' fees which may be recovered by the surety is dependent on the facts of the case and the relevant case law in the jurisdiction.

As an example, in a very recent case, *Travelers Casualty and Surety Company of America v. Coyle/Reno Joint Venture, et al.*, 2018 WL 3344661, the U.S. District Court for the Northern District of California held that Travelers was entitled to its attorneys' fees and costs against indemnitors incurred in defending, investigating and resolving bond claims. The defendant, the indemnitors under the GAI, argued that summary judgment should not be granted as to Travelers' attorneys' fees because Travelers failed to substantiate the reasonableness of the fees and costs. However, the court held that because "[t]he presumption of recovery under the [GAI] based on the prima facie evidence clause applies equally to recovery of attorneys' fees since the indemnitors—Defendants—agreed to indemnify Travelers for all losses, including fees and costs, incurred in connection with bond claims." *Id.* at *6 citing Cas. v. Dunmore, No. 2:07-CV-02493-TLN-DB, 2016 WL 6611184 at *6 (E.D. Cal. Nov. 9, 2016). Further, the court held that it was defendants' burden, not Travelers, to dispute the accuracy of the fees and costs sought or their reasonableness. *Id.* The court held that the defendant had failed to met their burden and the court awarded the surety its attorneys' fees (as well as damages for performing under the bonds). *Id.* There are numerous other cases in many jurisdictions which support the same conclusion that the court in *Coyle* reached based on similar language contained in the GAI.

Notwithstanding the above, other courts have held that indemnitors may present evidence to challenge the reasonableness of and/or their liability for attorneys' fees. In *Travelers Cas. & Sur. Co. of America v. Grace & Naeem*

Uddin, Inc., the U.S. District Court of the Southern District of Florida held that the concept of "reasonableness" must be applied to any claim for indemnification of attorneys' fees. 2009 WL 3878297 (Nov. 18, 2009). In fact, based on Florida law, the court there held that "the question of reasonableness of the attorneys' fees under the contract of indemnity involved herein must be determined by a jury." *Id.* at *7 citing *Sork v. United Ben. Fire Ins. Co.*, 161 So.2d 54, 56 (Fla. 3d DCA 1964). Thankfully, most jurisdictions do not require a jury trial to determine the reasonableness of a surety's attorneys' fees under the GAI. *See Hartford Fire Ins. Co. v. P & H Cattle Co., Inc.*, 451 F.Supp.2d 1262 (U.S.D.C. of Kansas 2006); *Hanover Ins. Co. v. Hudak & Dawson Const.*, 946 F.Supp.2d 1208 (U.S.D.C. N.D. of Alabama, Southern Division 2013); *First Nat. Ins. Co. of America v. Joseph R. Wunderlich, Inc.*, 358 F.Supp.2d 44 (U.S.D.C. of N.D. of New York 2004).

However, in a very good case for sureties, the Nevada Supreme Court has held that the standard in determining attorneys' fees is **not** based on reasonableness but rather that "court should consider only whether the attorneys' fees were incurred in good faith as a result of or in consequence of the issuance of a bond." *Transamerica Premier Ins. Co. v. Nelson*, 878 P.2d 314, 317, 110 Nev. 951, 956 (1994). However, the *Nelson* ruling was based on specific language in the GAI which stated that the indemnitors are to hold the surety harmless for all expenses consequential to the issuance of the bond. *Id.*

In contrast, in a somewhat recent Ninth Circuit Court of Appeals decision, the court there has held that "[w]hile the [GAI] does not expressly require that [the surety's] attorneys' fees be 'reasonable,' courts routinely imply such a limitation on contractual fee-shifting provisions-including those contained in indemnity agreements." *Yakima Co., Inc. v. Lincoln Gen. Ins. Co.*, 583 Fed.Appx. 744, 746 (9th Cir. 2014) citing *Spirtas Co. v. Ins. Co. of State of Pa.*, 555 F.3d 647, 653 (8th Cir. 2009) and *et al.*

As evident from the small sampling of case law around the country, the surety's right to attorneys' fees is based on the language of the GAI. However the manner and method of determining the amount of attorneys' fees to be awarded to the surety is dependent on law in each jurisdiction.

III. Recovering Costs

The analysis of determining what costs the surety may recover under the terms of the GAI is essentially the same as that under the surety's rights to recover its attorneys' fees. In fact, in most analysis by the courts, there is no distinction between the legal analyses of the surety's rights to costs from the surety's right to attorneys' fees. *See Great American Insurance Company v. Nelson, Inc.*, 276 F.Supp.3d 762 (U.S.D.C. W.D. of Tenn, 2017). However, the question of what constitutes costs has not been clearly determined by the courts. Most GAIs provides explicitly for expert and consultant fees to be recoverable against the indemnitors and therefore those fees are not included in the determination of costs.

Courts have repeatedly held that the surety has a right to recover costs from the indemnitors. *See Travelers Cas. and Sur. Co. of America v. Evans*, 2012 WL 3132653 (E.D. of Cal, July 31, 2012). The Nevada Supreme Court affirmed that a surety is “entitled to pursue an indemnity claim against [principal] for costs incurred in enforcing the terms of the [GAI].” *Ins. Co. of the W. v. Gibson Tile Co., Inc.*, 122 Nev. 455, 460-61, 134 P.3d 698, 701 (2006). The Nevada Supreme Court further held that “the right to subrogation distinguishes suretyship from insurance, and such right is considered by the surety in arriving at the amount of bond premiums. Therefore, a surety is entitled under a [GAI], to indemnity for costs incurred in defending an action brought against it on a bond, regardless of whether any payment is ultimately made by the surety.” *Id.* quoting *Nelson*, 878 P.2d at 316 and 317 and citing *Federal Ins. Co. v. Toiyabe Supply*, 82 Nev. 14, 20, 409 P.2d 623, 626-27 (1966).

The costs that some courts have held are properly chargeable to the indemnitors include travel costs for the surety’s claims adjuster, consultant’s costs, court costs and investigative costs. *See Wunderlich, Inc.*, 358 F.Supp.2d 44, 57; *Berkley Regional Ins. Co. v. Weir Bros., Inc.,* 2013 WL 6020785, at *7, 12; and *Liberty Mutual Ins. Co. v. Sumo-Nan LLC*; 2017 WL 810277 at *14 (D. Hawaii, March 1, 2017). The above is not an exhaustive list of costs that the surety may recover against the indemnitors.

IV. Interest

The right of the surety to recover pre and post judgment interest is largely dependent on the applicable law of the venue and jurisdiction. A review of case law from various jurisdictions indicates that when sureties are awarded attorneys’ fees the courts generally look at the applicable law rather than the

GAI. However, it is important to note that language in GAIs normally include a right of the surety to recover pre- and post-judgment interest on any amounts it has incurred.

In recent decision, *Fairmont Specialty Insurance Company v. Apodaca*, 234 F.Supp.3d 843 (S.D. Texas, Houston Division February 10, 2017), the court there held that the surety was entitled to pre-judgment interest under Texas law as the prevailing party. Under the applicable Texas statute, the court awarded the surety 5% pre-judgment interest from the date of the complaint. *Id.* at 855. However, the court using federal law, awarded post-judgment interest of 0.83% to the surety as the prevailing party under 28 U.S.C. § 1961. *Id.*

In another recent decision, the U.S. District Court of Hawaii in *Sumo-Nan, LLC* held that the surety was entitled to pre-judgment interest "[u]nder the plain language of the GAI." 2017 WL 810277 at *4. The court there, using Hawaii law, awarded the surety 10% pre-judgment and also used the date of the complaint as the date of the breach to calculate the date to start pre-judgment interest. *Id.* at *5. The total amount of pre-judgment interest awarded by the court was $243,812.77 as compared to payment bond claims of approximately $1,800,000 on a performance bond with a penal sum of $15,996,619. *Id.* at *1. The court also awarded pre-judgment interest on the attorneys' fees, costs and other fees that the surety incurred. *Id.* at *15.

Finally, another fairly recent case where the surety was awarded pre-judgment interest worth mentioning is *XL Specialty Ins. Co. v. Truland*, 2015

WL 2195181 (E.D. Va. May 11, 2015). There, the court held Virgina law applied to determining pre-judgment interest since the GAI provided that the surety is entitled to "interest from the date of SURETY'S payment at the maximum rate permitted in the jurisdiction in which this AGREEMENT is enforced, or is enforceable." *Id.* at *10 citing *Hitachi Credit Am. Corp. v. Signet Bank*, 166 F.3d 614, 633 (4th Cir.1999). Again the court calculated the prejudgment interest in this case from the date the suit was filed to the date of judgment. *Id.* The court awarded the surety $698,364.48 in pre-judment interest. *Id.* at *10.