WELCOME TO

PEARLMAN 2021

Pearlman 2021

Building Relationships – Keeping Them Strong

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On behalf of the Board of Directors and Sustaining Members of the Pearlman Association, I want to express our sincere appreciation to you for choosing to attend the Pearlman events this year. Whether you traveled across the country or across town, whether this is your first visit or your 26th, 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 very special thanks to **Melissa Bowers** for her tireless effort helping put this year's program together.

Schedule of Events

Wednesday, September 8th

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 9th

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

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

Espresso Bar
Hosted by Partner Engineering and Science, Inc.

8:00-8:15 **Welcome/Introductory Remarks**
R. Jeffrey Olson
Co-Chairs: Ryan Dry, Jack Costenbader, and Gina Lockwood

So You Think You Know Surety: Seemingly Simple Questions with Not So Simple Answers

8:15-9:00 **Anatomy of a Program Default**
Panelists: Jon Bondy, Brian Kantar, Rachel Walsh, and Amy Bernadas

9:00-9:45 **A Toolkit for Claim Intake**
Panelists: Jason Leiker, Jim Carlson, and Elizabeth Henderson

9:45-10:30 **A312 Performance Bond**
Panelists: David Kash, Todd Bauer, and Cassie Hewlings

10:30-10:45 **Break**

10:45-11:30 **The Surety's Right to Use Its Defaulted Principal to Complete if the Bond is Silent in that Regard**
Panelists: Todd Braggins, Matthew Holmes, Pete Fascia, and Bruce Kahn

11:30-12:15 **Surety's Performance Options on Federal Contracts**
Panelists: John Sebastian, Chris Brasco, and Terry Dahl

12:15-1:30 **Lunch**
Hosted by Wolkin Curran, LLP, Sage Consulting Group, and Weinstein Radcliff Pipkin, LLP

1:30-2:15 **Establishing Prejudice to the Surety when Performance Bond Notice Provisions are Not Followed**
Panelists: Patrick Hustead, Sam Reed, Diana Minchella, and Jason Stonefeld

2:15-3:00 **Surety Exposure in Design/Build and CM at Risk Delivery Methods**
Panelists: Ty Oksuzler and Will Beasley

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

3:15-4:00 **The Surety's Ability to Assert Defenses of Its Bond Principal**
Panelists: Paul Friedrich, Brittany Rose, and Connie Boudreau

4:00-4:45 **Are Attorneys' Fees Recoverable from a Miller Act Payment Bond?**
Panelists: Jason Fair, John Egbert, and Shauna Szczechowicz

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

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

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

Cocktails
Hosted by Krebs Farley & Dry, PLLC

Friday, September 10th

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

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

Bloody Mary Bar
Hosted by SMTD Law LLP

Espresso Bar
Hosted by Partner Engineering and Science, Inc.

8:20-8:30 **Welcome/Program Introduction**
R. Jeffrey Olson, Jack Costenbader, Ryan Dry, Gina Lockwood

8:30-9:00 **Insights from 30 Years of Surety Engineering in 30 Minutes**
Panelists: Ali Salamirad, Rodney Tompkins, Jr., and Doug Dearie

9:00-9:30 **How to Quantify and Prove COVID-19 Impact Claims**
Panelists: Jarrod Stone, Rick Tasker, and Chris Simmelink

9:30-10:00 **Salvage by Encumbrance of Real Property**
Panelists: Charles Evans, Nick Bajwa, and Gerry Carozza

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

10:15-10:45 **Construction Arbitration: Fact vs. Fallacy – A Debate**
Panelists: Chris Ward, Patricia Thompson, and Bob Riggs

10:45-11:15 **Legal Effects of Electronic Signatures**
Panelists: John Fallat and Steve Watters

11:15-11:25 **Closing Comments**
R. Jeffrey Olson

11:25 **Lunch – On Your Own**

11:50	**Bus Service to/from Harbour Pointe Golf Club** **Hosted by Law Offices of Larry Rothstein** Bus leaves Willows Lodge at 11:45AM
1:00	**Sign In/Warm Up –** Harbour Pointe Golf Club
1:30	**Scramble Tournament – Shotgun Start** Harbour Pointe Golf Club, 11817 Harbour Pointe Blvd, Mukilteo, WA 98275
	Beverage Cart **Hosted by Watt, Tieder, Hoffar & Fitzgerald, LLP,** **Ernstrom & Dreste, LLP, and The Sutor Group**
7:00	**Dinner** – Harbour Pointe Golf Club **Hosted by Ward, Hocker & Thornton, PLLC and** **Chiesa Shahinian & Giantomasi PC**
	Cocktails **Hosted by Stewart Sokol & Larkin, LLC**
7:45	**Awards – Scholarships – Closing**
8:00	**Buses return to Columbia Winery and Willows Lodge**

Saturday, September 11th - "On Your Own"

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

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

Woodinville Wine Tour

Torre, Lentz, Gamell, Gary & Rittmaster,LLP
SMTD Law LLP
Law Offices of T. Scott Leo, P.C.

Program Co-Chairs

JACK COSTENBADER

Jack Costenbader, president of PCA Consulting Group, a San Francisco based construction consulting firm that has both an A & B California contractor's licenses and PCA Disbursements, Inc. a licensed California Funds Control Agent. Jack has 44 years of direct experience in contract surety, and property insurance claims consulting throughout the country.

In Jack's spare time he plays Pool and Bocce. He also enjoys watching his grandchildren play Lacrosse and Soccer.

RYAN DRY

Ryan is a partner with Krebs Farley & Dry, PLLC. His practice focuses on the resolution of complex construction claims with an emphasis on both creativity and efficiency. Over the years, he has successfully obtained over $22 million in collateral orders through injunctions filed all over the South, including Texas, Oklahoma, Arkansas, Alabama, and Georgia. When not practicing law, Ryan enjoys fishing with his three children, and drinking wine on the dock with his wife when the fish are not biting.

GINA LOCKWOOD

Gina is the Director of Claims at Merchants Bonding Company where she handles complex contract bond claims and manages the company's contract and commercial claims associates. She joined Merchants in 2019 after spending nearly 10 years in private practice representing sureties in all aspects of litigation. When she's not talking surety to anyone who will listen, Gina spends her time hanging upside down in pursuit of her backup career as an aerial acrobat. She regularly choreographs and performs solo and duo acts on silks, trapeze, and rope.

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.

NICHOLAS BAJWA

Nicholas has practiced law in Anchorage, Alaska since 2007, where he has handled a wide variety of commercial matters, including surety law. He is an of counsel member of the law firm Jermain Dunnagan and Owens and graduated from the University of Minnesota Law School in 2006.

TODD M. BAUER

Todd Bauer is 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 is also a licensed Drone Pilot. Mr. Bauer has also acted as lead on Claim Department outsourcing and claims runoff assignments for surety companies and state's Departments of Insurance.

WILL BEASLEY

Will Beasley is a Dallas-based claims attorney at Merchants Bonding Company who handles contract bond claims across the country. He joined Merchants in 2020 after spending over five years in private practice litigating construction, surety, and insurance matters. Will focuses his practice on finding common-sense solutions to complex issues in the surety and construction industry.

AMY BERNADAS

Amy Bernadas is a Senior Claims Professional for Zurich North America where she has worked since 2018. Prior to joining Zurich, she was in private practice for 15 years, most recently with Krebs, Farley and Dry in its New Orleans office. Amy obtained her JD from Tulane University School of Law and a BA in History from Baylor University.

JONATHAN BONDY

Jonathan Bondy's practice is concentrated in the field of commercial litigation, with a focus on construction, surety and contract issues in New York and New Jersey. As a member of the firm, Jon represents and advises sureties with respect to performance and payment bond claims, the defense of prevailing wage claims, affirmative surety claims, loss recovery, bankruptcy issues and contractor workouts.

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

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

CONNIE BOUDREAU

Connie Boudreau is a Surety Claims Specialist at Liberty Mutual Insurance Company, where she specializes in handling commercial bond claims, with an emphasis on probate. Connie is currently furthering her education at Washington State University, with a focus on Psychology and Communications.

TODD BRAGGINS

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

CHRIS BRASCO

With more than 30 years of experience untangling complex liability-knots on high profile construction projects across the globe, Chris Brasco is uniquely qualified to protect his clients' bottom-line interests by crafting solutions which appreciate the varied perspectives and issues affecting their projects. He continues to sharpen his knowledge by lecturing nationally to leading industry groups on the risk-shifting trends and claims pricing developments that inspire breakthrough project solving. In recognition of his work delivering talks to construction industry trade groups on trend-setting issues, Chris was recently awarded the Paul F. Phelan Memorial Award by the American Road & Transportation Builders Association on November 6, 2019. He is also a frequent lecturer at national events hosted by the Construction Management Association of America (CMAA) and the Association for the Advancement of Cost Engineering International (AACE). Emblematic of Chris' difference making skill set, he was involved with the federal government in negotiating the successful reprocurement of mission-critical projects throughout Afghanistan after the program-wide default of a large government contractor which occurred during the height of U.S. involvement.

Chris is often engaged by clients to tackle their most challenging problems. His experience includes successfully representing owners, contractors and sureties in myriad disputes involving diverse construction projects, from bridges and tunnels to high-rise buildings. Also a trained mediator, Chris' experience and personal skills make him an able advocate, ready to quickly grasp the underlying construction and legal issues and offer innovative solutions to meet the needs of the clients he serves.

JIM CARLSON, BS, MBA, JD

Mr. Carlson serves Partner Engineering and Science, Inc. (Partner) as a Technical Director. He leads the Owner's Representative, Surety Bond Claim Review, and Subject Matter Expert/Expert Witness teams. He also provides direction and review of projects related to Fire Life Safety. He has worked on project scopes that range from minor repairs to large-scale and technically complex.

Mr. Carlson has been in the construction industry for 20 years. His expertise includes mechanical, electrical, plumbing systems and controls. He is also well versed in surety completion and fire life safety review and analysis. Notably, Mr. Carlson has performed a significant amount of work in the Middle East where he worked on construction and commissioning of pumping lifting forwarding stations, mechanical cooling for the primary pump motor systems, and substation connection and cooling systems. In addition, he was routinely relied upon to source difficult to find materials, and creatively expedited approvals and deliveries through multiple borders and customs processes.

GERRY CAROZZA

Gerry is an Assistant Vice President at Selective Insurance Company of America where he oversees their Surety and Fidelity bond claims. He earned a law degree from Villanova University and a Bachelor of Arts degree from Boston University where he majored in Economics and Mathematics and minored in Computer Science. Gerry is also a retired Army Colonel.

TERENCE J. DAHL, ESQ.

Terry Dahl is currently the Vice President and Claims Counsel for Intact Insurance Surety Group / One Beacon Surety. Prior to working at Intact, Mr. Dahl worked for Hudson Insurance Company in NY handling surety and environmental claims and coverage. Mr. Dahl also worked at Markel Insurance and AIG handling environmental insurance claims and coverage. After attending law school, Mr. Dahl worked as law clerk in the Superior Court of New Jersey. Prior to attending law school, Mr. Dahl worked in waste management and demolition industry for 10 years. Mr. Dahl received his B.A. in Environmental Science from University of Rhode Island in 1990 and his J.D. from Seton Hall University School of Law in 2003.

DOUGLAS S. DEARIE

Doug Dearie has over 45 years' experience in the construction management, construction consulting and surety claims fields.

Doug earned a degree in Civil Engineering at Newark College of Engineering. He began his career with over 10 years in construction management at Fluor Corporation, being assigned to projects around the world including Alaska, South Africa, Saudi Arabia and Iran. After over 10 years' experience in the construction claims and consulting field, he joined Safeco Surety in 1996 as their first in-house construction engineer. He just celebrated his 25-year anniversary with Liberty Mutual Surety as Manager of Construction Services.

JOHN EGBERT

John T. Egbert, P.E., President of Global Construction Services Inc., is widely recognized as an expert in construction management, construction claims and disputes, and schedule analysis. He has provided expert witness testimony before various courts, boards of contract appeal, and alternative dispute resolution panels. John has over 25 years of experience that encompass engineering, project management, surety loss management, contract administration, and dispute resolution. He specializes in the use of Critical Path Method (CPM) scheduling techniques for complex delay and disruption claims. He has prepared claims on behalf of contractors and subcontractors involving many different types of work including earthwork, concrete, steel erection, HVAC, piping, electrical, fire alarm, controls, water intrusion, and mold and asbestos abatement. John has defended

similar claims brought against owners, sureties and design professionals. In the case of surety losses, he has extensive experience in assessing the status of unfinished work and the principal's ability to complete the work, analyzing known and contingent liabilities, and then managing the contracts needed to complete the work in the most cost-effective manner. His clients have included national law firms, most of the major surety companies, contractors, subcontractors, government agencies, private owners, architects and engineers. Past projects have included schools, hospitals, prisons, public buildings, office buildings, highway construction, power plants, light industrial facilities, water and wastewater treatment plants, and material handling facilities. John is a registered Professional Engineer in the state of Alaska. He holds a Bachelor of Science degree from the United States Coast Guard Academy, a Masters Degree in Structural Engineering from Stanford University, and the Degree of Engineer from Stanford University.

CHARLES G. EVANS

Charles is a Mac-Nescaire having practiced surety law in Alaska, now in Homer, Alaska since 1977. He is an of counsel member of the law firm Jermain Dunnagan and Owens and graduated from the University of Virginia with a JD in 1976 and a B.A. with distinction in 1972.

JASON FAIR

Mr. Fair handles high-value and industry-critical matters in the construction, fidelity, and surety fields. He guides and counsels general contractors, subcontractors, owner/developers, and sureties through complex default scenarios and he applies pragmatic and cost-effective strategies to mitigate losses and complete troubled projects. He 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. He is also admitted to the Federal Court of Claims to counsel clients through payment disputes with the Federal Government.

Mr. Fair actively represents clients on a pro bono basis. He frequently partners with outside agencies to protect the rights of impoverished, abused, neglected children and youth by providing free legal services and advocacy with the goal of ensuring they have safe, stable homes, healthcare, and education these individuals need to thrive.

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 surety claims and lawsuits. He opened the Law Offices of John L. Fallat in 1989 representing sureties throughout California. The firm currently has two associates and two paralegals. The firm also represents clients in other civil litigation such as consumer class actions, employment litigation, and real estate disputes.

PETE FASCIA CPA, ESQ., LLM

Peter is a CPA and attorney in both Pennsylvania and New Jersey and has been a forensic accountant for more than 26 years. Over the course of his career, he has handled all aspects of bond loss matters. This includes initial financial evaluations, assisting in setting loss reserves, ongoing management of losses, analyzing fidelity claims, maintaining escrow accounts, preparing internal and published reports, aiding in recovery actions against indemnitors and overseeing the disposition of assets.

He has extensive litigation support experience, providing expert reports on matters involving bonds, taxes, corporate governance, financial issues, business loss damages and malpractice. He has provided expert witness testimony in federal and state courts.

Peter has published articles and presented at the DRI Fidelity and Surety Roundtable, Pearlman Association, Eastern Bonds Claims Review, and National Bond Claims Association. Peter serves as Treasurer of the Philadelphia Surety Claims Association and was the former Chair of the Fidelity and Surety Committee of the IADC.

He received his Bachelor's degree from Rutgers University with dual majors in Accounting and Business Administration. He earned his Juris Doctor from Temple University School of Law and received a Masters of Law in Taxation while attending Temple University School of Law and Villanova University School of Law.

PAUL K. FRIEDRICH

Paul Friedrich is a Member in the Seattle office of Williams Kastner, is a Co-Chair of the firm's Construction Litigation & Surety Practices Team, and is licensed to practice in both Washington and Oregon. His practice is focused on representing sureties and insurers in all aspects of contract, commercial, and fidelity bond claims, with a particular emphasis on construction law, including the representation of general contractors and subcontractors on a wide range of issues involving public and private projects. Mr. Friedrich has extensive experience defending against surety-related bad faith claims and is a frequent speaker and author on surety and construction related legal issues.

MARK S. GAMELL

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

ELIZABETH HENDERSON

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

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

CASSANDRA R. HEWLINGS

Cassie Hewlings joined Liberty's Seattle office as Surety Claims Counsel in February 2020 after several years in private practice with Krebs Farley & Dry, PLLC in New Orleans, Louisiana. 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. Cassie is a member of the Washington State Bar Association, and outside of work, she enjoys hiking, skiing, and hanging with her two dogs, Barb and Wyatt.

MATTHEW D. HOLMES

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

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.

BRUCE KAHN, ESQ.

Bruce Kahn is a Senior Vice President and head of the claims department at Berkley Surety a Berkley Company. He is a commercial attorney whose practice focuses on the construction and real estate industries. Prior to becoming an in-house surety claims professional, Bruce practiced at Peckar & Abramson, Kaye Scholer, and Kalkines Arky Zall & Bernstein in New York City, primarily as a construction litigator. He is a member of the American Arbitration Association's Roster of Construction and Commercial neutrals. Bruce is a magna cum laude graduate of Albany Law School, where he was managing editor of the Albany Law Review. He also holds a master of business administration degree from Cornell University's S. C. Johnson School of Business.

BRIAN KANTAR

Brian Kantar is a partner with the law firm of Chiesa Shahinian Giantomasi, where he primarily practices in the areas of surety, construction, and bankruptcy law. He is a Vice-Chair of the ABA's Fidelity & Surety Law Committee, where he most recently served as co-chair of the 2020 Mid-Winter Meeting's surety program. He also serves as a co-chair of the FSLC's Extra-Contractual Subcommittee for which he recently published an article in the FSLC's Fall 2020 Newsletter. In addition to service on the ABA's Fidelity and Surety Law

Committee, Brian serves as managing editor of the Surety Claims Institute's Newsletter, in which he authors a surety case law update three times annually for the Surety Claims Institute. Over the years, Brian has published several articles and made several presentations in the area of surety law. Brian received his law degree from Seton Hall Law School, *magna cum laude*, Order of the Coif, and his undergraduate degree from Hofstra University, *summa cum laude*, Phi Beta Kappa.

DAVID W. KASH

David 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. 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.

JASON S. LEIKER, ESQ.

Mr. Leiker serves as lead counsel to sureties located throughout the United States, handling claims in federal and state court and working closely with his surety clients to resolve issues pre-suit. Mr. Leiker also serves as outside general counsel to several large Midwest companies. In this role, Mr. Leiker counsels his clients on construction, commercial, contract, and employment issues. He also drafts and negotiates contracts, assists in the resolution of complex disputes, and counsels on employment issues.

In February 2021, amidst the pandemic, Mr. Leiker proudly served as Co-Chair of the Fidelity and Surety Law 2021 Virtual Midwinter Conference: Construction Lawyer as Disaster Artist.

Mr. Leiker learns the ins and outs of his client's business and treats them like a partner. He uses the term "we" when talking to opposing counsel about his client. Mr. Leiker enjoys solving problems and finding solutions to difficult situations. He uses hard work, intelligent thinking, and creativity to leverage solutions.

When away from his work, Mr. Leiker loves to hang with his two teenage sons, their dog Bentley, and watch his favorite KC sports teams.

TY OKSUZLER

Ty Oksuzler is a Director at J.S. Held LLC based out of San Antonio Texas. He joined J.S. Held in January 2018 after a few years as freelance consultant. Ty served as project engineer, estimator, project manager, chief estimator, and operations manager for two Texas based general contractors prior to becoming a surety consultant. Ty has accumulated over 27 years of construction experience including, cost estimating, competitive bidding, contract negotiation, value engineering, buyout and procurement, scheduling, complex project phasing, project management, and project closeout. His project portfolio includes a wide array of healthcare, educational, industrial, hospitality, multifamily, transportation, and retail construction projects. As a consultant, Ty has served surety clients with cost to complete estimates, subcontractor ratifications, on-site construction monitoring and inspections, on-site construction management, relet bid procurement, processing of payment bond claims, dispute analysis and resolution, construction defect analyses, loss mitigation, and litigation support. Ty graduated from the University of Texas at Austin with a Bachelor of Science degree in Civil Engineering.

SAM REED

Sam Reed is the Vice President of Surety Claims Consulting services for Vertex, responsible for oversight of Vertex's services across the county. He has consulted for sureties on matters around the world, and he is recognized in particular as an industry leader in issues pertaining to construction contract administration. While currently residing in Asheville, North Carolina, he graduated from the University of Hawaii with a Doctor of Architecture degree and is a registered Architect in multiple jurisdictions around the country.

ROBERT D. RIGGS

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

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

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

BRITTANY ROSE, ESQ.

Brittany joined Travelers in July 2013 after more than a year in private practice. Brittany graduated from Seattle University School of Law in May 2011, where she was a finalist for the 2011 Mark Reutlinger Scholarship for Excellency in Legal Writing award. Prior to attending law school, Brittany graduated from Loyola Marymount University, with a B.A. in English, cum laude, where she was a member of the Sigma Tau Delta, National English Honors Society. Brittany is a member of the Washington State Bar Association.

ALI SALAMIRAD

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

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

JOHN SEBASTIAN

John Sebastian joined Watt, Tieder, Hoffar & Fitzgerald in 2013 as the managing partner of the firm's new Chicago office. He focuses his practice primarily in the areas of surety bond, construction and commercial litigation. With an undergraduate degree in Construction Engineering Technology and a wealth of practice experience in-house and in private practice, he is well equipped to both counsel and protect his construction industry clients in their challenging legal matters. John received his J.D. from Northern Illinois University College of Law, J.D. in 1995 and his B.S. in Construction Engineering Technology from Purdue University in 1990.

JEREMY SENTMAN

Jeremy Sentman is the Senior Vice President and Head of Surety Claims for Sompo International Insurance. Jeremy previously served as the Senior Vice President of Surety Claims and General Claims Counsel for Lexon Surety Group where he managed the surety claims department for the 8th largest surety in the United States. Prior to joining Lexon in 2007, Jeremy served as the Vice President of Acquisition, Planning and Development for a national homebuilder directing the entitlement and development of the company's real estate holdings. Prior to that, Jeremy held various leadership roles with a regional civil engineering and land surveying firm which included client development, risk analysis, market expansion, permitting, design and plan preparation. Jeremy also formerly worked as a project manager for a national construction company, managing the construction and rehabilitation of complex capital improvement building projects. Jeremy is a licensed attorney, professional engineer and professional land surveyor. He holds a Bachelor of Science degree in Civil Engineering from the University of Illinois at Urbana-Champaign and earned his Juris Doctor degree with honors from the Northern Illinois University College of Law.

CHRIS SIMMELINK

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

JARROD W. STONE

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

Mr. Stone received his B.S. (2001), magna cum laude, from Middle Tennessee State University. He received his J.D. (2004), summa cum laude, Order of the Coif, and Order of

Barristers from the University of Tennessee College of Law. While at the College of Law, Mr. Stone competed on the National Moot Court Team, for which he was awarded the Susan B. Devitt National Moot Court Award. He also competed on the College of Law's National Trial Team, for which he received a Medal for Excellence in Advocacy from the American College of Trial Lawyers. Mr. Stone also twice won the College of Law's Advocate's Prize Moot Court Competition.

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

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

JASON STONEFELD

Jason Stonefeld has been handling payment and performance bond claims since 2002. He is currently with Liberty Mutual Surety in the Western Region Claims office.

SHAUNA SZCZECHOWICZ

Shauna is a Senior Claims Professional with Zurich North America. Prior to joining Zurich in 2020, Shauna was a partner with Wolkin Curran, LLP, located in San Francisco and San Diego, California. While in private practice, she handled a wide range of cases for sureties on federal, state, and private construction projects, and commercial probate fiduciary claims. Shauna graduated from Loyola University New Orleans College of Law and Florida State University.

RICHARD E. TASKER

Mr. Tasker was born in a manger, well not really a manger, it was more a small dairy farm in upstate New York. But there was straw. And it was near where Joseph Smith found those tablets, but though he dug and dug Mr. Tasker didn't find any. He had no shoes, walked to and from school, both ways uphill, in all types of weather including lots of snow. But all three days of summer were really nice. But he done got a purty good eduacation.

After serving time with the U.S. Government, well not really "with," well though couple of years are not too relevant anyway, mostly cause he didn't do it. After his release he decided to become a Surety claims consultant. It was a tough decision, between former Governor of Illinois and Surety consultant, there were a number of each in his cell block, but being Governor seemed too similar to what got him into trouble with the G-men. Besides, politics was a short-term gig, until recently when they seem pretty damn old. And Surety consultants seem to go on forever. They get to go to cool places and have somebody else pay for it and go to lots of meetings where people yell and hate each other, which allows him to practice things he learned while in the "Big House."

And all these years later, well finally he gets a speaking spot at a prestigious winery, it was the right call.

Rick 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 +20 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 2021 Pearlman.

PATRICIA THOMPSON (JAMS)

Patricia H. Thompson, Esq. is a full-time arbitrator and mediator, with JAMS Miami, concentrating her practice in construction, surety, fidelity, employment, financial insurance matters, and other complex commercial disputes in state and federal courts, and internationally. Ms. Thompson is regularly listed by The Best Lawyers in America, Chambers USA Guide to America's Leading Business Lawyers, The International Who's Who of Construction and Business Lawyers, as well as similar Florida publications ranking attorneys in her areas of practice concentration, such as the South Florida Legal Guide. She is a fellow of the Chartered Institute of Arbitrators and the American College of Construction Lawyers. Before joining JAMS in 2017, Ms. Thompson enjoyed a successful career as trial and appellate lawyer and arbitrator, most recently with the law firm of Carlton Fields. She has long been active in the ABA, where she chaired the Fidelity and Surety Law Committee of the Tort Trial and Insurance Practice Section, and co-chaired the Construction Litigation Committee of the Litigation Section. She is a frequent author and lecturer for both ABA sections, the Forum on Construction, and the Florida Bar Association.

RODNEY J. TOMPKINS, JR., JD

Rodney J. Tompkins Jr. is a managing partner of RJT Construction Inc., Consulting Services. Mr. Tompkins is based in RJT's Southern California office, and has successfully managed Surety claims, completion, and litigation matters for over 19 years.

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

Mr. Tompkins educational background includes a bachelor's degree at University of San Diego and Post Graduate Construction Management at U.C. Berkley School of Engineering. Mr. Tompkins also earned his J.D. at Lincoln Law School of Sacramento where he was Editor-In-Chief of the Voir Dire and won multiple awards in law school including Moot Court, ADR and state-wide Negotiations competition.

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

RACHEL WALSH

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

CHRISTOPHER R. WARD

Chris is a member with Clark Hill in its Frisco, Texas office. He is a graduate of University of Colorado, B.A., *summa cum laude*, and The University of Texas School of Law, J.D., *with honors*. He is the Vice-Chair of the ABA/TIPS Fidelity and Surety Law General Committee, serves as Executive Editor of the FSLC Newsletter, and is a member of the CLE Board Standing Committee and the Membership Standing Committee.

Chris is a frequent speaker at fidelity and surety law seminars and is the author of numerous articles. Chris is licensed in Texas, Oklahoma, Colorado, and Arkansas.

STEVE WATTERS

Steven Watters is the Surety Claims Manager for United Fire Group. He has been handling performance & payment bond claims since 1999, after spending the previous decade handling claims in the property & casualty world. He graduated from the University of Iowa and has earned the AFSB and CPCU designations.

Sustaining Members

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.

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

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

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

Rated AV by Martindale-Hubbell, Booth, Mitchel & Strange LLP handles private and commercial lawsuits and arbitrations involving tort, contract, environmental, construction,

surety, commercial, employment, professional liability, landlord-tenant and real estate disputes. We represent both plaintiffs and defendants and have thereby developed a breath of insight that facilitates prompt and accurate analysis of our client's problem and an ability to obtain the most favorable resolution in the most efficient and cost effective way.

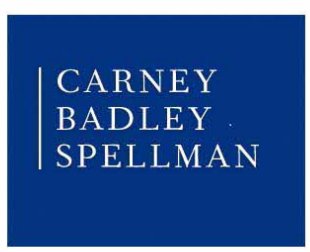
We are also available to consult in the areas of commercial and construction contracting, real estate transactions, leasing, surety and employment.

Please visit our website at www.boothmitchel.com.

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

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

Please visit our website at www.bfrhawaii.com.



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

Please visit our website at www.carneylaw.com.

Cashin Spinelli & Ferretti, LLC is a multi-disciplinary firm providing consulting and construction management services to the Surety and construction industries. Since 2000, Cashin Spinelli & Ferretti has been providing expert advice and analysis to the nation's leading Surety companies. Drawing on the expertise of its staff of Professional Engineers, Architects, Attorneys, Certified Public Accounts, Field Inspectors and Claims experts, Cashin Spinelli & Ferretti is well poised to offer Surety consulting and litigation support services to the industry. Cashin Spinelli & Ferretti's workforce is large enough to handle any surety matter, but still maintain the client contact that is so important in our industry.

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

Please visit our website at www.csfllc.com

Chiesa Shahinian & Giantomasi PC

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

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

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

Please visit our website at www.csglaw.com.

Clark Hill | Strasburger

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

Clark Hill | Strasburger's surety lawyers provide experienced representation in all facets of

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

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

Please visit our website at www.clarkhillstrasburger.com.

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

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

Please visit our website at: www.dunlapfiore.com

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

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

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

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

Please visit our website at www.fasanoacchione.com.

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

Please visit our website at www.fauxlaw.com.

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

Please visit our website at www.forcon.com.

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

Please visit our website at www.consultgcsi.com.

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

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

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

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

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

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

Please visit our website at www.jamsadr.com.

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

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

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

Please visit our website at www.jhc.law.

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

Please visit our website at www.jdolaw.com.

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

Please visit our website at www.jsheld.com.

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

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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.

Please visit our website at www.knchlaw.com.

The nationally recognized attorneys of Krebs Farley & Dry, PLLC have litigated cases all over the United States. Our attorneys' skills show not only in the courtroom, but also in negotiation. The personal commitment and dedicated effort that our attorneys put forth make a difference in every case we handle. We are smart, pragmatic and diligent. And we are dedicated to creatively pursuing the best solutions for our clients.

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

Please visit our website at www.kfplaw.com.

Langley, LLP is a Texas civil trial, commercial bankruptcy, and appellate firm that represents Fortune 500 and middle- market industry leaders in disputes throughout the United States. Our firm is made up of ambitious and smart lawyers who demonstrate passion and zeal in representation of the firm's clients. We help our clients solve their legal

challenges through aggressive negotiation or litigation. Our areas of specialty include surety and construction, property insurance claims, commercial litigation, and commercial bankruptcy.

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

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

Law Offices of John L. Fallat

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

Please visit our website at www.fallat.com.

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

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

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

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

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

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

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.

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

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

Please visit our website at www.pcacg.com.

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

Please visit our website at www.rjtconstruction.com.

ROBINS KAPLAN LLP

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

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

Please visit our website at www.robinskaplan.com.

Robinson+Cole

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

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

Please visit our website at www.rc.com.

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

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

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

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

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

Please visit our website at www.sageconsulting.com.

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

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

Please visit our website at www.smtdlaw.com.

Shields | Mott LLP has grown from four attorneys in 1995 to a firm that bears an elite name in Construction Law and Surety Law, with a record of successful litigation outcomes. Our varied other practices enable us to represent clients in related areas including insurance defense, contractor licensing issues, products liability, and land use and zoning. The firm has attained the highest AV Martindale Hubbell® rating. Many of our attorneys are named in Chambers, Super Lawyers, Best Lawyers in America and other superlative listings. Our attorneys also have degrees in other areas related to the practices, such as Architecture, Business, Biomedical and Electrical Engineering, Economics and Civil Engineering. As regards surety work, all aspects of construction performance and claims are handled by Shields | Mott. The firm tackles each phase of bond work from adjusting claims through working out settlements, and, when appropriate and necessary, through detailed discovery, trial of the claim and handling any appeals, and associated indemnity actions. The firm provide a full range of surety related legal services including, but not limited to, defaults,

claim analysis, management and coordination, project takeovers, indemnity issues, subrogation issues, workouts, and mediation, arbitration, and litigation.

Please visit our website at www.shieldsmott.com.

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

Please visit our website at www.scmlaw.com.

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

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

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

Please visit our website at www.lawssl.com.

THE HUSTEAD LAW FIRM
A Professional Corporation

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

Please visit our website at www.thlf.com.

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

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

Please visit our website at www.tlggr.com.

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

Please visit our website at www.vertexeng.com.

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

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

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

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

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

Please visit our website at www.whtlaw.com.

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

Watt, Tieder is one of the premier surety law firms in the country. We represent more than a dozen sureties in North America, acting as national, regional or public contract counsel

for them. Our surety clients include industry leaders like Arch Insurance Company, Cincinnati Insurance Company, Hartford Fire Insurance Company, Liberty Mutual Insurance Company, RLI Corp., SureTec Insurance Company, Travelers Casualty and Surety Company and Zurich North America. In our thirty years of practicing surety law, Watt, Tieder has gained particular expertise in default terminations, affirmative construction claims, surety "abuse of discretion" cases, government contract disputes, surety bad faith claims and all forms of contract bond defaults.

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

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

Please visit our website at www.WattTieder.com.

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

Please visit our website at www.weinrad.com.

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

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

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

Please visit our website at www.williamskastner.com.

WOLKIN • CURRAN, LLP

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

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

Please visit our website at www.wolkincurran.com.

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

PANEL 1

ANATOMY OF A PROGRAM DEFAULT

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PEARLMAN 2021

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Columbia Winery | Woodinville, WA

ANATOMY OF A PROGRAM DEFAULT

By: Amy Bernadas, Jonathan Bondy, Brian Kantar, and Rachel Walsh

I. Introduction

Sureties routinely administer claims. Some even argue that handling claims is the ordinary course of a surety's business. *U.S. Fid. & Guar. Co. v. Braspetro Oil Servs. Co.*, 2000 WL 744369, *9 (S.D.N.Y. 2000). This makes sense because even a principal that has done everything "right" is subject to improper claims or unanticipated circumstances. What is not routine, however, is when a principal with open bonds on several projects in various stages of completion finds itself in a position where it is on the precipice of, or actually in, default on several or all of its pending projects. This is colloquially referred to as a "program default".[1]

This paper will briefly highlight some of the issues a surety might have to consider and address when faced with a program default. This paper is not intended to provide a one size fits all approach, or set forth best practices for every program default, as each default presents unique circumstances. A surety's approach will largely depend on, among other things, the status and complexity of the projects, the principal's financial condition (including willingness to provide collateral), the applicable bond form, the obligee's position, applicable defenses, potential bankruptcy issues, and the principal's relationship with subcontractors. A surety's approach will also be guided by the level of cooperation shown by the principal/indemnitors. If they are hands on and cooperative, a surety's learning curve may not be as steep. If the principal buries its head like an ostrich, the surety's approach may vary significantly. And the extent to which the obligee is willing to work with the principal will also affect the surety's approach.

II. First Steps

It's 4:00 p.m. on a Friday afternoon (because bad things seem to find a way to ruin weekends) and you receive a call from an underwriter. She, in turn, receives a call from the principal's broker who advises that the principal is experiencing significant cash flow issues and is about thirty days away from being unable to make payroll or pay its suppliers. The news gets worse: there are 20 performance and payment bonds out there in the aggregate penal sum of over $100 million. Perhaps, ordinarily, a surety might wait for there to be a claim before doing anything. After all, several bonds, such as the AIA A312 Bond, provide that the surety's obligations do not arise until after certain conditions precedent are met. That said, if the surety were to wait until the claims started rolling in, the losses could be catastrophic. Under these circumstances, sureties will generally undertake to evaluate their potential exposure to determine whether it makes sense to take steps to proactively mitigate damages. This first step is not a commitment to act. It is simply a fact-finding exercise to determine the surety's options, which include the option to do nothing (which is sometimes the appropriate decision).

So, what does this first step involve? First and foremost, a surety should obtain its line card, reach out to its principal, and determine the status of each and every open project. Perhaps, the principal is not underwater on every project—only some. That said, these issues seem to spread like

[1] This paper is focused on contract surety. There are also program defaults relating to commercial bond accounts. Depending on the types of bonds at issue in the commercial context, the considerations reviewed in this paper may or may not be applicable.

a contagion (an analogy to which we can all sadly relate). Maybe the principal is having issues because the obligees have been slow to pay. For example, public agencies in the City of New York can be notoriously slow to approve and process progress payments and include draconian terms in their contracts that require continued performance even where payment is significantly delayed. Where the principal works almost exclusively for such an obligee, cash flow issues can snowball and have cascading effects on several projects. Alternatively, the principal may be having cash flow issues because it underbid a number of projects. There are several reasons a principal may find itself in this unfortunate position.

There is no right way to obtain information. In large part, the approach will depend on how the surety's claims department is organized. Some sureties have extensive claims operations with in-house engineering, accounting and legal departments that can undertake such an investigation without outside assistance. Other sureties may not maintain this type of a claims department, in which case it may be advisable to retain the assistance of outside professionals. Either way, the key is to act quickly, and obtain as much information as possible. Ideally, the principal will reach out to the surety in the first instance and open its books and records (as is typically the surety's right under its indemnity agreement) for unfettered inspection. In a perfect world, the principal will also make its project management team and in-house and outside accountants available to the surety to review the construction and financial status of open projects. Unfortunately, it does not always happen this way. Sometimes, having heard about the principal's potential financial issues, it is the surety that makes inquiry of its principal in the first instance. Although there can be reasons for a principal to delay in communicating with its surety (e.g., a sense of shame or guilt, or an overestimated ability to solve the issues without assistance), it is ordinarily not a good sign where the principal is not proactively communicating with its surety. In a worst-case scenario, a principal could decide to shut its doors and effectively hand the surety the proverbial keys to the company. This sometimes happens where the principal files for bankruptcy and the surety does not have personal indemnity as to any of the owners of the company. Under these circumstances, a surety may receive no cooperation or information from its principal and could be left scrambling to learn a great deal of information in a short period of time to minimize potential losses. A surety should carefully consider its legal options if it finds itself in such a situation.

III. Addressing Incomplete Projects

After having met with the principal and evaluating its exposure, the surety may decide it is in its interest to take action to mitigate against potential losses. The surety can approach this in any number of ways, including:

a. Financing the principal (with or without the obligee's knowledge). This might include so-called "back door financing" by clearing up the principal's accounts payable (and ensuring the subcontractors and suppliers provide releases so that the surety obtains appropriate reductions to the penal sums of the applicable payment bonds). Ideally, the principal will put up some collateral.

b. Reaching out to the obligees and advising of the principal's situation. The surety can then decide on a case-by-case basis whether it makes sense to finance the principal, obtain a completion contractor, tender a completion contractor, buy back its bond, authorize the obligee to complete, or take the position that the surety has no liability. These options will, of course, be influenced by the surety's options under the applicable bond. And where the surety determines the obligee itself is in default, perhaps the surety will decide it has no obligation to act. For example, where the principal finds itself defaulting because the obligee

has failed to make payments, perhaps the surety can argue that it is the obligee that breached the contract and not the other way around (bonds often condition the surety's obligation on the obligee's compliance with its obligations under the bonded contract).

c. Reacting, on a case-by-case basis, to notices of default/termination that may have started rolling in subsequent to the surety learning of the principal's issues.

d. Where the principal has filed for bankruptcy, the bankruptcy process may prevent the obligee from declaring a default and invoking the bond without first obtaining stay relief. This may provide the surety with additional options and/or time.

Whatever the approach, where the surety has decided to undertake to complete projects, there are several steps that a surety will generally take. Several of these steps are outlined below.

Request Information & Meeting with Principal

The surety's communications with the principal and obligee should request information and documents relating to the status of the projects.

A surety almost always benefits from meeting with its principal in person. Besides obtaining the principal's view of the projects, an in-person meeting presents the surety with an opportunity to assess and identify the roles each person plays at the principal's organization and to determine whether working with the principal on a going forward basis is a viable option. As a threshold matter, it is important to determine whether the principal is even capable of completing some or all of the bonded projects. This involves an analysis of the principal's resources, finances, staff, and technical capabilities. Assuming the principal can complete the project, a surety should then determine whether the principal actually has the desire to do so. Some principals will provide as much assistance as is required in order to mitigate their indemnity obligations to the surety. Other principals may have different priorities. Most importantly, is the principal trustworthy? For example, if the principal has embezzled funds, it likely makes no sense to finance the principal.

Where the surety is contemplating financing its principal, the in-person meeting may be an opportune time to begin working out the details and procedures that will be formalized in a subsequent financing agreement. If the individual indemnitors are solvent, a discussion of collateral and indemnity obligations may be appropriate. Although information about the principal's finances may have been disclosed to the surety's underwriters, such information may be outdated and/or drastically different due, in part, to the program default. It is critical to review and discuss the principal's current financial wherewithal. It is similarly important to develop an understanding of the principal's other creditors, such as banks and lenders. If the creditors' rights are secured by liens in contract proceeds, the surety may need to reach out to those creditors to discuss the surety's equitable subrogation rights in contract proceeds. Some creditors may agree to enter into an inter-creditor agreement with respect to contract proceeds.

Beyond bank and trade creditors, it is important to evaluate the principal's tax liability. Existing tax liens may affect the surety's rights with respect to contract balance and the surety's projections. *See Fid & Deposit Co. of Md. V. Ohio Dept. of Transp.*, 806 F. App'x 364 (6th Cir. 2020). In addition, some bond forms (such as the Miller Act bond form) provide that the surety has liability for some of the principal's tax obligations with respect to the bonded project(s).

In addition, where the principal has one or more collective bargaining agreements, it is advisable to determine the status of the principal's compliance with its obligations under those agreements. For example, if the principal has failed to remit benefits, which are considered part of the laborers' wages in prevailing wage jurisdictions, the surety may have additional exposure under its payment bond or a bond specific to the collective bargaining agreement.

Meeting with Subcontractors and Suppliers

Since a surety has not lived the projects on a day-to-day basis, the principal and its staff are often in the best position to provide information and feedback about the principal's subcontractors and suppliers. Although a surety may find such information to be helpful, the surety will ultimately make its own independent judgments about subcontractors and suppliers. After identifying critical subcontractors and suppliers, it can sometimes be helpful for the surety or its consultant to meet with them. Where there are disputes about, *inter alia*, amounts due, warranty obligations, or the cost to complete their work, it may be advisable for each party's respective counsel to assist in negotiating these issues.

Meeting with Obligee

The obligee may be most cooperative during its first meeting with the surety. The initial meeting with the obligee presents the surety with a significant opportunity to gather as much information as possible about the obligee's view of the project(s). It is important to document and confirm any representations made by the obligee (e.g., remaining scope of work, remaining contract balance, etc.) so that all parties are operating under the same set of assumptions. Confirming such representations in a letter offers the obligee the ability to clarify any misunderstandings before the surety makes decisions based upon incorrect or otherwise disputed information.

A meeting with the obligee may allow the surety and its team to identify and assess the individuals with whom the surety may be working over the next several months and possibly years. It is important for the surety to identify decision makers and to understand each person's role (from executive to administrative to field) with respect to the project(s). Where the surety's consultant is expected to work with the obligee's project team on a day-to-day basis, it may be advisable for the consultant to meet and establish relationships with such personnel from the inception. Where the obligee is not the actual owner, but rather a general contractor or construction manager, the surety should consider whether it is appropriate to ask that the owner be present at the meeting with the obligee.[2]

Just as with the principal, it is equally important to obtain an understanding of the obligee's views with respect to the principal's prior performance as well as the performance of the principal's subcontractors and suppliers. Understanding the obligee's views may assist the surety in determining the reasons for the default and the surety's future course of action. Sometimes, the surety may be able to mediate what initially seems to be an impasse between the obligee and principal and the project may continue without the surety's continued involvement. For example, an obligee may feel more comfortable releasing funds to the surety, which might defray some of the potential cash flow issues that put the principal in a program default posture.

[2] The surety may also consider requesting attendance of the obligee's design professionals and engineers, if appropriate.

On occasion, it may be helpful for the principal to attend a meeting with the obligee. For example, where a default is not based upon a termination, but instead due to a principal no longer being able to finance completion of the project, the principal and obligee may have a positive relationship and all parties may benefit from a meeting where each party's collective views and insights are shared. Of course, there are instances where having the principal at a meeting with the obligee may be counterproductive. The surety will determine on a case-by-case basis if it is advisable to include the principal in such meetings.

Although not every meeting is intended to serve the same purpose (there may be several meetings), and each obligee conducts itself differently, the following considerations may be appropriate to address at one or more meetings with the obligee:

a. An agreement with respect to access to the site and project information/documents for the purposes of the surety's investigation.

b. Determining whether the obligee would consider a tender or allow the surety to buy back its bond at a negotiated amount.

c. Determining whether the surety will enter into a takeover agreement and under what terms. At a minimum, the obligee should agree to provide a project accounting, define the remaining scope of work, and permit the surety to fulfill its insurance obligations through a third party (because the surety cannot usually provide its own insurance).

d. An understanding of the obligee's expectations with respect to the surety's obligations and the completion of the project. The surety should use this opportunity to address any misunderstandings with respect to the surety's obligations (e.g., a surety bond is not an insurance policy).

e. Will the obligee provide the surety with penal sum credit if it decides to finance the principal? If not, the surety may want to carefully consider the risk of the principal not completing the work and the surety having expended funds that are not credited against the penal sum.

Walkthrough of the Project Site

Assuming reasonable access is granted by the obligee, the surety should aim to inspect and photograph (and video, if necessary) the project sites as soon as possible in order to evaluate the sites in the condition they were left by the principal. This is especially important where the obligee is completing a project using its own or other forces and expects the surety to pay for any shortfalls between the contract balance and the cost of completion—in such situations, it is critical for the surety to establish what work was previously completed by the principal. Where possible, it is helpful to walk the site with both the obligee and the principal. More than one walkthrough may be necessary. Having both perspectives can assist the surety in developing a more thorough appreciation for the issues that it may face should the surety determine it will complete the project. In some instances, it may be advisable to have critical subcontractors participate in walkthroughs.

Walkthroughs and site inspections provide an opportunity to identify and assess actual and potential challenges. For example, between a review of drawings and the site, a surety can determine whether there are any design issues, scope gaps or site conditions that may impact the cost to complete the project. In the event such issues do arise, the surety may be able to address them with

the obligee in a takeover or other type of agreement. Sometimes, the obligee will agree to provide a change order or to modify the scope in order to address problematic issues. For example, where expediency in completing the project is of paramount concern (e.g., the surrounding community is unhappy with the condition of the project), an obligee may agree to modify or even eliminate a potentially long term, non-critical element of a project.

Often, the obligee and principal disagree as to the status of the project or the reasons for delays in completion of the work, and the project documents (including specifications, bid documents, contract documents, daily reports and correspondence) do not tell the entire story. Walking the site provides the surety with the ability to reach an independent conclusion as to where the project actually stands. The surety should compare the actual work completed to date to the approved schedule of values. Sometimes, the obligee overpaid because it approved too much payment relative to the work completed to date, and other times the obligee may have underpaid by acting unreasonably in failing to approve work in place (which is why the principal may be in its current position). Either way, it is important to understand where the project stands relative to the remaining contract balance in order to develop an accurate cost to complete. Where there are questions, the surety should not hesitate to seek clarification and/or submit requests for information.

Walkthrough of Offsite Facilities

Some projects call for offsite fabrication of materials. This can be for economic reasons (e.g., prevailing wage must be paid onsite, but not offsite) or for logistical reasons (e.g., specialized equipment or space is required to fabricate certain materials). If the principal fabricates some or all of the materials for the project, the surety should consider inspecting the principal's facilities in order to evaluate the principal's capabilities with respect to completion of the work. The same considerations apply with respect to critical subcontractor offsite facilities.

Document Collection/Financial Records

Perhaps the most critical aspect of the surety's investigation is the collection and analysis of project and financial records from both the obligee and the principal (and its subcontractors). Set forth below is a list of documents,[3] which the surety should consider requesting from all relevant parties:

i. Complete set of contract documents, including:
   a. Bid documents
   b. Specifications
   c. Drawings
   d. General Conditions
   e. Special Conditions
   f. Supplemental Conditions
   g. Bulletins
   h. Change Orders
   i. If outside documents are referenced, they too should be requested.

[3] This list simply provides examples and is not meant to delineate every document that should be requested. Every project is different. Some projects require a more exhaustive analysis of documents and others do not merit a review of all of the documents set forth on this list.

j. Obviously – read the bond too.

ii. All requisitions:
   a. Submitted
   b. Approved
   c. Unapproved
   d. Pencil
   e. Schedule of Values
   f. Status of unit price items
      i. Some contracts prohibit payment if overruns exceed a certain percentage without advance agreement. Careful consideration should be given to this issue.

iii. Daily Reports/Monthly Reports

iv. Meeting Minutes

v. Project correspondence

vi. Formal/informal notices exchanges between the parties

vii. Requests for change orders (whether or not approved)

viii. Field notices/directives

ix. Shop drawings and as-built drawings (if submitted)
   a. Including rejected, approved and approved as-noted

x. Information about allowances and owner-provided services
   a. Sometimes, the contract requires the principals to pay for these services after these allowances have been expended without additional allowances having been agreed upon.

xi. Liens/lien claims/lien dockets

xii. Notices from subcontractor claimants as pre-requisite to asserting payment bond claims.

There are certain types of documents that a surety should request directly from the principal. The following is a list of potential documents a surety may consider requesting from its principal:

i. Accounts receivable ledger

ii. Accounts payable ledger
   a. Assists with a determination of whether the principal has diverted contract funds for other purposes (including trust funds, if applicable).

iii. Bank account information

iv. Cash receipts

v. Status of other projects (this may assist with an analysis of the principal's liquidity/capacity)

vi. All subcontracts and purchase orders

vii. Communications with subcontractors and suppliers

viii. Information relating to warranty/guarantee obligations

ix. Financial statements

x. Overhead costs
   a. It is important to determine what is necessary and what is not necessary, especially where the surety is considering financing its principal.

xi. Insurance information

xii. Equipment

Forecasting and Projections

Ultimately, a primary objective of the surety's investigation is to determine how much it will cost and how long it will take to complete the projects. This is why sureties often invest significant time and effort to meet with multiple parties and collect and analyze a wide range of documents. This information also allows a surety to weigh the relative merits of the options available to it under the bonds and by law (e.g., takeover, tender, financing, denial of claim, etc.) and to make informed decisions about mitigation of damages.

Prepare Bid Specifications and Solicit Bids

There are several ways in which a surety can forecast the cost to complete the project, the appropriateness of which depends on the facts, circumstances, and needs of a given project or claim. For instance, one method that often yields a reasonably accurate cost to complete involves the surety (or its consultant) putting together a bid package and soliciting bids from multiple potential completion contractors. Under this scenario, the surety typically has had the opportunity to meet with all stakeholders, has been provided with access to relevant project documents and afforded with sufficient time to undertake this process. Of course, a surety does not always have access to all of this information, may not have sufficient time to prepare or solicit bids and/or the size and/or scope of a project may not merit such a costly and time-consuming endeavor. This approach may also not be viable when quick decisions need to be made in a program default.

Obtaining Estimates from Potential Completion Contractors

Another generally reliable method of forecasting the cost to complete a project involves asking potential completion contractors to evaluate the contract documents, walk the project site and submit proposals with respect to completion of the work. Assuming the completion contractor agrees to complete the remaining scope, without exclusions, and provides its own bonds, the surety may be able to accurately assess the cost to complete the project based with minimal risk of additional exposure. Of course, if the completion contractor includes exclusions for latent defects, refuses to honor warranty obligations for work in place, and/or insists on completing certain items on a time and material basis, the completion contractor's proposal may not be as reliable a tool to determine the cost to complete with certainty. Identifying appropriate completion contractors is not always easy, especially where a contract requires participation by certain demographic groups and/or is a set-aside contract, in whole or in part. Also, consideration should be given to the bond form. Some bonds may give the obligee the right to approve or disapprove a completion/tender contractor.

Completing Project with Principal's Subcontractors

Where the principal is a general contractor that has completed its scope of work or has entirely subcontracted out the work and effectively serves as a construction manager, it may be possible to complete the project by retaining a construction manager (which could be the surety's consultant) to coordinate the subcontractors' work and to satisfy the insurance and other general conditions obligations under the bonded contract. Under this scenario, estimating a cost to complete involves determining the cost for the construction management services and negotiating with each subcontractor to determine whether they are willing to complete their work for the remaining contract balance due under their respective subcontracts or in a different amount.

Surety/Consultant Estimate

There are occasions where the principal is unable or unwilling to cooperate, subcontractors cannot be ratified, or time does not permit estimating the cost to complete in one of the manners set forth above (such, as here, where quick decisions made need to be made). In these situations, a surety can ask its consultant to estimate the cost to complete the remaining scope of work. Typically, the consultant will add a contingency to the price to account for unanticipated issues that may be encountered during construction. Despite a consultant's best efforts, however, this method can be, at times, the least reliable indicator of actual cost to complete because the consultant (through no fault of its own) is usually working with limited information.

Whichever method a surety chooses (or is required to choose based on the status of a given project), the accuracy of a cost to complete estimate is always going to be as good as the information available to the surety. The more information that is provided to the surety, the more accurate the cost to complete analysis should be. Of course, a cost to complete analysis cannot always anticipate certain intangibles, such as:

i. Inflated pricing by subcontractors or suppliers
ii. Latent defects
iii. Unforeseen or differing site conditions
iv. Design defects or issues
v. Owner's failure to provide reasonable access or procure permits on a timely basis
vi. Coordination issues with third party contractors over which the surety, principal and/or completion contractor have no control
vii. Work that is dependent upon third parties entirely outside of the surety's, obligee's or principal's control.

A surety is not always bound by its initial course of action. For example, where a surety first decides to finance its principal, but the cost to complete the work turns out to be well in excess of initial projections (e.g., home office overhead is higher than expected), a surety may re-evaluate the decision to finance its principal and consider re-letting to a completion contractor on a lump sum basis. It may be less costly, in the long run, to change course, especially where the change occurs early on in the process. The takeaway is that forecasting and projections should occur continuously and the surety's costs evaluated on a regular basis.

IV. Preserving and asserting the principal's defenses and claims

It is black letter law that a surety is able to raise any defenses available to its principal. *Great Am. Ins. C. v. N. Austin Mun. Utility Dist. No. 1*, 908 S.W.2d 415, 424 (Tex. 1995) (recognizing that the ability of sureties to rely upon defenses of their principal is a fundamental right of suretyship). Although a surety faced with a program default may need to make decisions on an accelerated basis, the surety should remain mindful of preserving any and all defenses to a potential claim.

Understandably, a surety may be under a great deal of pressure to act to complete a project where, for example, significant liquidated damages are accruing on a daily basis or the surety's exposure might be significantly higher if it does not manage the completion effort. At the same time, the surety might identify certain defenses that its principal might assert to a performance bond claim, in whole or in part. For instance, perhaps the owner did not provide timely access to the site and, in order to meet a schedule, the principal was directed to work on an accelerated basis. In this scenario, the principal would arguably be entitled to a change order for the acceleration costs and/or a time extension. By way of

further example, perhaps the owner generated specifications were not code compliant and the owner has demanded that the principal remove and reinstall its work in a code compliant manner. Here, the owner would be responsible for all such costs under the *Spearin* doctrine. *United States v. Spearin*, 248 U.S. 132 (1918). Where the surety has determined it is expedient to act in such situations, it is recommended that the takeover agreement or memorandum of understanding include a reservation of rights preserving the surety's rights to assert such a claim.[4] If the obligee will not execute an agreement that includes a reservation of rights (some obligees refuse to do so), the surety should make abundantly clear, in writing, that its actions are taken under a full reservation of rights.

Note, that a reservation of rights may not be sufficient to preserve a defense or claim. The bonded contract may contain certain conditions precedent to preserving and/or perfecting a claim. Careful consideration ought to be given to ensuring compliance with such conditions. One word of caution: where the obligee is a governmental entity, the surety should exercise additional caution prior to asserting the principal's claims. If the claim is improper or exaggerated in any way, the surety might find itself subject to liability under the applicable federal or state false claims act. *See, e.g., Hanover Ins. Co. v. United States*, 134 Fed.Cl. 51 (Fed. Cl. 2017) (holding, among other things, that the surety could be liable under false claims act to the extent it pursues principal's false claims in its own right).

The surety might have its own defenses to an actual or potential claim (e.g., overpayment, cardinal change or material modification, impairment of collateral, etc.). A surety's decision with respect to each individual project will be informed by the availability and extent of such defenses. Perhaps, the availability of such defenses may also influence the obligee's approach to negotiating a resolution of a claim with the surety.

V. Bankruptcy Issues

As noted above, the surety's approach or options may be influenced by the principal's decision to file for bankruptcy (whether it be under Chapter 7 or Chapter 11). Where a principal files for bankruptcy prior to some or all of the obligees having declared a default, the automatic stay ought to bar an obligee from terminating the bonded contract (often a condition precedent to making a claim under a performance bond) without first obtaining relief from the automatic stay. Although courts will usually grant the motion and permit an obligee to make a claim, there have been recent decisions to the contrary. *See Durr Mech. Constr., Inc. v. I.K. Constr. Inc. (In re Durr Mech. Constr., Inc.)*, 604 B.R. 131 (Bankr. S.D.N.Y. 2019); *Maguire-O'Hara Constr., Inc. v. Cool Roofing Sys., Inc.*, 2020 WL 674442 (W.D. Okla. Feb 11, 2020). This may be especially so where the termination is or will be contested by the principal and could affect the principal's indemnity obligations, which are being administered in the bankruptcy court. The general rule, however, is that an obligee can make a claim on a surety bond, with respect to an already terminated project, irrespective of the principal's bankruptcy. *McCartney v. Integra Nat'l Bank N.*, 106 F.3d 506, 509-10 (3d Cir. 1997) ("[i]t is universally acknowledged that an automatic stay of proceedings…may not be invoked by entities such as sureties…"). Thus, while it is likely that any motion for relief from the automatic stay will be granted, the additional time it will take to complete this process may afford the surety additional time to investigate its options and negotiate with the obligee.

To the extent the principal files under Chapter 11 and the surety is considering financing, the bankruptcy process offers the surety the opportunity to provide Debtor in Possession (DIP) financing which will often give the surety an administrative or other priority vis-à-vis other creditors. This is in addition to the surety's subrogation rights with respect to unpaid contract balances and claims it has

[4] The obligee may have its own claim that it would like to preserve in an agreement.

satisfied from the principal's subcontractors and suppliers. The DIP financing agreement will usually be approved by the court, which gives it the force of a court order. A DIP financing agreement may also provide for collateral.

The bankruptcy process may also afford the principal (and its surety) the opportunity to preserve and/or assert claims in the bankruptcy court that might otherwise have had to proceed through some other process. A bankruptcy court can be a favorable forum for a principal, especially where the principal's affirmative claim will result in recovery of funds that will be distributed to the principal/debtor's creditors (including its surety).

VI. Maintenance of Privilege

Sometimes, when a surety is undertaking its investigation, particularly in a program default scenario, events unfold rapidly and the parties do not always consider the prospect of litigation. In subsequent litigation, a surety may be served with demands for its communications during its investigation. Such requests may be subject to objection based upon a well-established body of statutes and case law.

The Federal Rules of Civil Procedure recognize a privilege with respect to communications between a surety and its principal. *See* Fed. R. Civ. P. 26(b)(3)(A). In addition, while there may be some dispute with respect to whether communications between a surety and its consultant are privileged, communications with a consultant that is retained by the surety to act on its behalf or by the surety's counsel to assist counsel in providing legal advice may be protected by the attorney-client privilege and/or work product doctrine. *See e.g., Am. Mfrs. Mut. Ins. Co. v. Payton Lane Nursing Home, Inc.*, 2008 WL 5231831 (E.D.N.Y. Dec. 11 2008) (sureties' consultant "can be fairly equated with" the surety "for purposes of analyzing the availability of the attorney-client privilege").

The applicability of the privilege is determined on a case-by-case basis and is subject to the facts and circumstances surrounding the subject document or communication. With careful planning, and the assistance of counsel, a surety may be able to take proactive steps to maintain the protections of applicable privileges.

PANEL 2

A TOOLKIT FOR CLAIM INTAKE

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PEARLMAN 2021

September 9-10, 2021

Columbia Winery | Woodinville, WA

A TOOLKIT FOR CLAIM INTAKE

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Whether you are an inexperienced claim handler or a seasoned veteran that needs to be more mindful of training those inexperienced team members, the process utilized for taking in new claims is important. It should also be dusted off every so often to ensure it meets the needs of today. This is easy to say sitting here at the beautiful Columbia Winery but in order to thrive in the frenzied world we all exist in, it is worthwhile to take a few minutes (35 to be exact 😉) to reflect upon it. The presentation accompanying this paper slows things down for a moment by examining a new claim from inception.

Topic 1: Assessment

The initial step in the process is to identify the issues in dispute. Obvious yes, but nonetheless important and often underemphasized. The key initial question is whether the issue at hand is pre-claim or has a claim formally been made. Work must be done either way, but a formal claim necessitates prompt action as the clock may be ticking on state requirements triggered upon notice. If it is pre-claim, you need to figure out the temperature of the parties so that you know whether you have time to slow things down, investigate, evaluate and work to resolve.

Once an assessment is made on the status of the claim, you must RTFB.[1] Believe it or not, not all bonds are written alike. It is important to determine if the penal sum is at stake. Determine whether the obligee has made an affirmative claim for default against the bonded principal. If so, was proper notice provided to your bonded principal? Assess whether the bonded principal was afforded an opportunity to cure the issues that led to default.[2] If not, you might be

[1] Ask your neighbor at the table.

[2] The surety must know the activities and affairs of its bonded principal. It has been said that sureties have an implied obligation to know their principals and are in the best position to monitor their principals' performance for

able to mitigate by "suggesting" to the obligee it allow the bonded principal to cure. Also, assess whether the bonded principal has any defenses and if so whether they have been preserved.

Determining whether a default has been declared is important for another reason. If there has not been a default declared, but the obligee has made a written demand upon the bonded principal to cure, be careful not to interfere with your bonded principal's contract with the obligee.

An additional assessment that must be made in today's litigation charged world is whether there are potential risks associated with a violation of the False Claims Act. Seemingly discussed at every conference over the past year, we do not address the Act in this presentation or paper. The point is to be cognizant of the requirements of the bonded project and relatedly the bonds. This proves to be a challenge when faced with replacing the bonded principal on a set aside type project. The completing contractor is also likely to be required to be a qualified contractor.

A final assessment that this paper and presentation addresses is the need to determine the legal relationship between the obligee, bonded principal and surety.[3] Besides the risk identified above of the surety interfering with the bonded contract, the surety should also assess what direction it is legally permitted to give to the obligee and bonded principal, respectively.

The claim handler may perform this assessment on his or her own or with the help of outside consultants and counsel. The uniqueness of the situation, complexity, or other factors

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the duration of the bonds. *Fid. & Guar. Ins. Co. v. Blount*, 63 So. 3d 453, 464 (Miss. 2011). Moreover, a surety has a contractual ability to require the principal to keep it apprised of the principal's financial status or proof of performance. *Id*.

[3] Determine whether certain actions caused the bond to be null and void, including failing to give the surety notice of an attempt to cure or hiring a completing contractor without consulting with the surety may be material breaches of the bonded contract. *Lyndon Prop. Ins. Co. v. E. Ky. Univ.*, 2004 Bankr. LEXIS 4, 29 (2004).

may require that outside consultants and/or counsel are engaged. If the penal sum is at issue, it might not be necessary to engage outside help. The claim handler must be cognizant of his or her discussions whether they are with internal claim counsel or outside counsel to ensure privilege is preserved. The end result of this stage of the process is to come up with an early strategy but remain amenable to changing it.

Topic 2: Evaluation

In this stage of the process, the claim handler must take the information learned in the early assessment and make an informed decision of how best to proceed. Even though early action may have been taken in the assessment stage, we are all in the business of getting it right and is important to continually develop the plan in accordance with the evolving situation. Accordingly, the claim handler should consider engaging outside consultants and counsel if the matter appears it will not resolve quickly or easily.

Claim handlers should utilize their team. Have a white board session to evaluate the issues. Talk to underwriting to learn more about the bonded principal's business, personality, strengths and often just as important, weaknesses. Determine whether you need to get boots on the ground to evaluate the situation. Do interviews of key personnel on the project need to happen? In short, do not just trust the file or what you are being told over the phone by the bonded principal or obligee's representative. Ultimately, you need to match the evidence to the allegations. Was there a meeting of the minds or is that in dispute? In other words, is the dispute between the obligee and bonded principal over quality of performance, or did the bonded principal perform in a different manner than expected by the obligee? Knowing this early on will help tremendously in forming the strategy to handle the claim.

Do you need to do a books and records request? Continue to evaluate defenses the bonded principal may have, which must be preserved.[4] Make sure to demand that all records get preserved. Work with outside counsel to evaluate not only known legal risks but the chance for unexpected legal risks. Something to consider early on is venue if the matter were to proceed to litigation. Often times, when able, obligees use very strong venue provisions in their contracts, which obviously favor them.

Key evaluations include determining the surety's obligations under the payment bond and/or performance bond if the bonded principal objects or disputes the claim or a default. In that case, the surety <u>may</u> do certain things and <u>must</u> do other things. Consider taking a recorded statement of the bonded principal before the principal disappears. A seminar topic by itself, the surety should consider whether to tender the claim to the bonded principal. If the issue is performance, should a takeover agreement get put in place?[5] Do you need to bond around?

Topic 3: Implementation

The implementation stage takes a lot from the first two stages of the process and builds upon them. If not done already, set the tone. For outside consultants and counsel, indicate to them early on that you want updates given in a certain way and at a certain frequency. Some claim handlers are old school. Yes, that means pick up the phone and call them. Also, if the written updates and evaluations from outside counsel or consultants are sent up the chain from the claim handler, indicate so. The style and substance for such reports is different than if written to just the claim handler who knows the file well.

[4] The surety must evaluate all defenses available including changes to the scope of work or other material changes not included in the contract it bonded. *Equitable Surety Co. v. United States*, 234 U.S. 448, 458 (1914).

[5] Evaluate almost immediately the money available to the surety including funds held by the government on the contract, including withheld percentages and progress payments, whether earned prior to or subsequent to the bonded principal's default. *United States Sur. Co. v. United States*, 83 Fed. Cl. 306, 312 (2008).

An important consideration is keeping the strategy in line with reserves. Come up with a system to track and have a dialogue with those involved in setting or managing reserves. Determine if it is appropriate to discuss with outside consultants or counsel. If you have a settlement strategy, determine how the reserves play a part. Additionally, is there re-insurance? How does it play a role?

Outside counsel should evaluate bad faith or prompt pay issues for the state the claim is made, or project is located. Counsel should also provide a summary of controlling case law for surety issues in that state.

Case Studies:

Example A: Document, document, document! Insist on documentation, especially when it sounds too good to be true. We had a principal, a general contractor with numerous performance and payment bonds working primarily in the Southern California area. These were largely projects for entities such as NAVFAC, NASA, as well as school campuses, both district and university level. Claims came in on multiple projects over about a six-month period, all of which were accompanied by numerous assurances that all issues would be resolved, and payment claims paid upon completion/release of retentions held. The principal was rather skilled at keeping all the balls in the air as it were and convincing those involved that the end result would be positive for all. Unfortunately, as almost always happens in this type of scenario, eventually one or more of the balls tends to drop. The principal wound up in default on several projects with numerous payment bond claims as well and then entered bankruptcy. This is a matter I took over from another handler well into the process and I was somewhat dismayed to discover precious little documentation confirming the assurances provided by the principal contained in

the file. While in this instance the surety was fortunate to have an individual indemnitor on the account with significant assets, despite any apparently available assets and even when, or perhaps especially when, working with anyone who always has an answer, document that file! Red flags can pop up slowly over time and in such a way that they are not obvious in and of themselves. Had this file been properly documented throughout development, it is likely that the accumulation of issues that the principal was experiencing would have been apparent and the surety could have stepped in earlier on to mitigate losses on all sides. It may even have been a situation where the surety could have assisted the principal financially thereby averting the BK filing and finishing up projects in a timely manner.

Example B: Keep in regular communication with counsel. We had a principal working on a bonded contract to build a new elementary school for a school district up in Washington State. Work on the new campus was completed aside from minor punch list, however a sizeable payment claim was asserted by a plumbing subcontractor who had worked on the project. The principal disputed the claim and when litigation was initiated, the surety's defense in the matter was tendered to principal's counsel. Despite the tender agreement in place which required tendered counsel to provide the surety with updates on any material developments, a settlement between the principal and claimant was entered with no notice whatsoever to the surety. Further, the principal was then unable to comply with the terms of the agreement. The surety was again not notified, and a default judgment was entered in the litigation. It was at this time that tendered counsel advised the surety of the settlement and subsequent default and judgment entry which necessitated payment under the bond. Hopefully an unusual situation, but a good reminder to keep in contact with your counsel and reach out if they do not - always ensure the information

you have is current and accurate. While there was certainly obligation for counsel to communicate here, ultimately, it's the claims handler's responsibility to stay on top of the file.

Example C: Review your documentation, even when voluminous. A few years back I worked on a performance claim pertaining to a project bonded under four bonds over in Utah where the principal provided to the surety as part of their indemnity documentation corporate resolutions of over 300 pages. I was not part of the scenario until the claims were asserted, however either the time was not taken to assure that said resolutions in fact resolved anything or whomever did the review misunderstood the concept, but regardless, the bonds were issued, work began, issues were encountered and the obligee ultimately asserted claims under all four bonds issued in relation to the project. In this instance the claims were valid, at least in part, and the principal was unable to effect adequate corrections. The surety then stepped in to assist with completion, at significant cost as the project was far from complete upon default. Unfortunately, when looking to the indemnitors for reimbursement of the losses incurred, those 300 plus pages of resolutions which should have been closely reviewed at inception, were woefully inadequate and circular, leaving the surety on the hook for project completion with little recourse. Perhaps not the most engaging way to pass an afternoon, but important nonetheless and in my mind anything along these lines is a definite red flag.

PANEL 3

THE A312 PERFORMANCE BOND

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Seattle, Washington
September 9, 2021

The A312 Performance Bond is Not a Blank Check

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Summary of the Default

Your surety has bonded a contractor and the owner has written letters over several weeks claiming that the contractor is falling behind, that the contractor does not have a sufficient number of workers at the job and that the work is substandard. Over a period of several weeks the principal and the surety are delivered letters by the obligee to furnish more workmen, more supervisors, a new schedule and to speed up work.

This the principal does not do. The owner obligee advises that it will rely on the terms of the contract and hire other contractors to complete the job. It also claims a default and terminates the principal. No demand is made upon the surety until approximately 2 months later when the owner has completed the principal's work. The obligee simply makes a demand for payment. What should the surety do?

A Review of the Material Sections of the AIA A312 Performance Bond

2. If the Contractor performs the Construction Contract, the Surety and the Contractor shall have no obligation under this Bond, except when applicable to participate in a conference as provided in Section 3.

3. If there is no Owner default under the Construction Contract, the Surety's obligation under this Bond shall arise after:

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

3.2 The Owner declares a Contractor Default, terminates the Construction Contract and notifies the Surety

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

4. Failure on the part of the Owner to comply with the notice requirement in Section 3.1 shall not constitute a failure to comply with a condition precedent to the Surety's obligations, or release the Surety from its obligations, except to the extent the Surety demonstrates actual prejudice.

5. When the Owner has satisfied the conditions of Section 3, the Surety shall promptly and at the Surety's expense take one of the following actions:

5.1 Arrange for the Contractor, with the consent of the Owner, to perform and complete the Construction Contract;

5.2 Undertake to perform and complete the Construction Contract itself, through its agents or independent contractors;

5.3 Obtain bids or negotiated proposals from qualified contractors acceptable to the Owner for a contract for performance and completion of the Construction Contract, arrange for a contract to be
prepared for execution by the Owner and a contractor selected with the Owner's concurrence, to be secured with performance and payment bonds executed by a qualified surety equivalent to the bonds issued on the Construction Contract, and pay to the Owner the amount of damages as described in Section 7 in excess of the Balance of the Contract Price incurred by the Owner as a result of the Contractor Default; or

5.4 Waive its right to perform and complete, arrange for completion, or obtain a new contractor and with reasonable promptness under the circumstances;

5.4.1 After investigation, determine the amount for which it may be liable to the Owner and, as soon as practicable after the amount is determined, make payment to the Owner; or

5.4.2 Deny liability in whole or in part and notify the Owner, citing reasons for denial.

8. If the Surety elects to act under Section 5.1, 5.3 or 5.4, the Surety's liability is limited to the amount of this Bond.

7. If the Surety elects to act under Section 5.1, 5.2, or 5.3, then the responsibilities of the Surety to the Owner shall not be greater than those of the Contractor under the Construction Contract, and the responsibilities of the Owner to the Surety shall not be greater than those of the Owner under the Construction Contract. Subject to the commitment by the Owner to pay the Balance of the Contract Price, the Surety is obligated, without duplication, for

7.1 the responsibilities of the Contractor for correction of defective work and completion of the Construction Contract;

7.2 additional legal, design professional and delay costs resulting from the Contractor's Default, and resulting from the actions or failure to act of the Surety under Section 5; and

7.3 liquidated damages, or if no liquidated damages are specified in the Construction Contract, actual damages caused by delayed performance or non-performance of the Contractor.

Do the Obligee's Letters Trigger the Surety's Obligations?

As a matter of law, cure letters do not trigger any surety obligations or performance under AIA A312 Performance Bond. Cure letters that contain only allegations of defaults or notices of noncompliance do not constitute the notice of default and termination as required by Section 3.1 of the Bond. *Balfour Beatty Construction, Inc., v. Colonial Ornamental Iron Works, Inc.,* 986 F. Supp. 82, 85 (D. Conn. 1977). It is universally held that giving a surety notice of default under the bond is a mandatory condition precedent and that notice must be "clear, direct and unequivocal." See e.g. L&A Contracting Co., v. Southern Concrete Services, Inc., 17 F.3d 106 (5th Cir. 1994).

Enforcement of Conditions Precedent

Section 3 of the AAA A312 bond has been held by a majority of courts as enumerating conditions precedent each of which must be complied with in order to trigger the surety's obligation to perform. ("Failing to comply with section 3 conditions precedent before completing the work through other subcontractors was a failure of conditions precedent by the obligee"). ("Unilaterally completing" or engaging in "self-help" remedies is a failure of conditions precedent). ("Replacing the principal/contractor before a demand upon the surety to perform is a failure of conditions precedent").

Discharge or Void Bond?

A failure to follow conditions precedent constitutes a material breach (e.g. not following the specific termination and notification procedures of the bond) avoids the bond and excuses the surety's performance. A material breach of the bond as a matter of contract law voids the bond and excuses the surety's performance. Hiring successor contractors without complete consent of the surety and disbursement of the entire contract balance breaches the terms of the performance bond discharging the surety. A failure by the obligee to comply with section 3 of the performance bond before completing the work through other subcontractors constitutes a failure conditions precedent and the surety is discharged. If an obligee hires a new subcontractor before the surety has an opportunity to respond to the termination, the surety's obligations are discharged. By preventing the surety to employ a completion contractor, even without the obligee's consent, constitutes a material breach of the A312 performance bond, and a discharge of the surety.

Reasons for the Surety's Legal Discharge

A seminal rule of contract law is that a material breach excuses the performance of the other party. A failure of conditions precedent constitutes a material breach of contract and that excuses the "performance" of the surety. The failure to follow conditions precedent and the obligee's unilateral decision to hire a substitute contractor deprives the surety of the opportunity to mitigate its damages and constitutes material breaches of the bond. Hiring successor contractors and dispersing the remaining contract balance are material breaches of the express terms of the bond and results in the surety's discharge. The actions of the obligee in contravention to the bond eliminates the surety's rights under the bond and therefore promotes

discharge. The self-help remedies and unilateral decisions of the obligee renders the bond "meaningless".

The actions of the obligee forgoes the surety's ability to choose among the options it has for remedying the principal's default. The surety's performance options contained in the A312 bond are "standard in the industry"
and the obligee has no right to interfere with the surety's selection of its completion contractor unless the bond provides otherwise. An obligee's unilateral hiring of a substitute contractor to complete the project work excuses the surety and deprives it from its ability to choose among options it had for remedying its principal's default and thus the surety's liability is relieved under the bond.

Does the Surety Need Prove "Prejudice?"

If the owner does not comply with Section 3.1 the surety can only be "released" from liability with a showing of "prejudice". The surety is not burdened with having to show prejudice for any other violation of conditions precedent in Section 3 of the bond.

Surety Default and Further Notice

The surety is entitled to an additional notice before it can be placed in default under Section 6 of the bond, which reads:

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

Obligee Arguments

Section 1 of the A312 reads: The Contractor and Surety, jointly and severally, bind themselves, their heirs, executors, administrators, successors and assigns to the Owner for the performance of the Construction Contract, which is incorporated herein by reference. (i) The obligee is not seeking performance but "indemnification" under the bonded contract. (ii) The obligee is seeking "damages" under the underlying contract not performance or completion of the contract.

Obligee Cases

Forest Manor, LLC v. Travelers Casualty and Surety Co., 2018 WL 1137580 holds that because the A312 performance bond expressly incorporates the underlying contract and because under Connecticut law they are to be read together, since the principal can be held liable for breach of the construction contract so can the surety. The obligee sought "indemnification" under the construction contract for the costs associated with "demolishing the structure which was being

built by the principal. The court reasoned that since the obligee did not seek performance of the construction contract it did not have to comply with any of the Section 3 conditions precedent and could seek "indemnification" for the principal's breach of the underlying contract. An obligee may use this strategy to sidestep the bond and seek “indemnity" under the terms of the bonded contract.

Developers Surety And Indemnity Cox v. Archer Western Contractors, LLC 2018 WL 2100032 (D. C. Florida) here another trial court read the subcontract and the bond "in harmony" as required by Florida law and held the surety liable for breaching the bond for failing to take corrective action within 15 days of receiving the claim. Here Archer unilaterally engaged a replacement subcontractor to remedy and complete the principal's work before the surety had a chance to take action under the bond and to mitigate damages. The court agreed that the surety was not required to “perform” but that the underlying contract required the surety to pay for the “costs of completion”.

Why these Arguments Fail

Courts recognize that this bond form is widely used in the construction industry, it terms are based on a compromise amongst interested parties and it has been held <u>as a matter of law</u> as being “unambiguous”. The underlying contract does not change the terms of the bond. There are no provisions in the bond or the underlying contract that distinguishes between claims as to which the bonds' conditions “apply” or are not to apply. The bond is clear and expressly states what the obligee must do/satisfy in order to trigger the surety's obligations. The obligee cases are trial court cases, they are unpublished and no court has cited them as authority. Further, if the obligee wanted to change the terms of the bond it could have easily done so through Section 16 of the bond which reads: “Modifications to this Bond are as follows”.

Cases Favoring the Surety

Here are a sampling of cases:

A good place to start is *St. Paul Fire and Marine Ins. Co. v. City of Green River,* 93 F.Supp.2d 1170, 1178 (D. Wyo. 2000), aff'd, 6 Fed. Appx. 828 (10 Cir. 2001) which holds that an “obligee's action that deprives a surety of its ability to protect itself pursuant to performance options under a performance bond constitutes a material breach which renders the bond null and void”.

Section 3 of an AIA A312 bond enumerates conditions precedent that must be complied with in order to trigger the surety's obligations to perform. *Stonington Water Street Associates, LLC v. Hodess Building Company, Inc.,* 792 F.Supp.2d 253, notes 9-10 (D.C. Conn. 2011). Section 3 of an AIA A312 bond sets forth the conditions precedent that must be complied with in order to trigger the surety's obligation to perform…the hiring of successor contractors without the consent of the surety and disbursement of the entire contract balance without the express approval and consent of National Fire materially breached the terms of the performance bond…National Fire was entitled to summary judgment and is dismissed from the case.” *Id.* at 269.

Dragon Cons. Inc. v. Parkway Bank & Trust, 287 Ill. App. 3d 29, 222 Ill. Dec. 648, 678 N.E.2d 55 (App. Ct. 1997) (finding a material breach where the obligee did not follow the specific termination and notification, procedures provided in the construction contract; hiring a successor contractor without the surety's knowledge, voided the bond and excused the surety's performance). An obligee's "unilateral decision to hire successor contractors to complete the project deprived [the surety] of the opportunity to mitigate its damages and represent material breaches of the bond". *Dragon* at 33.

Relying on *Hunt Construction Group v. National Wrecking Corporation* 587 F.3d 1119 (D.C. Cir. 2009), the court in *Western Surety Company v. U.S. Engineering Construction, LLC,* 955 F.3d 100, 105 (D.C. Cir. 2020), holds that a failure by the obligee to comply with Section 3 of the AIA A312 (2010) before completing the work through other subcontractors "was a failure of "conditions precedent" and "the surety's obligations under the bond are discharged." "By unilaterally completing…U.S. Engineering deprived Western Surety of its contractually agreed upon opportunity to participate in remedying…[the] default." *Id.* at 104. The court recognized that the obligee engaging in "self-help" remedies rendered the options in Section 5 meaningless." *Id.* at 104-104.

The Eleventh Circuit determined that if an obligee hires a new subcontractor before the surety has an opportunity to respond to the termination, the surety's obligations under the bond are discharged. *International Fidelity Insurance Company v. Americaribe-Moriarty JV*, 681 F. App'x 771, 776-77 (11th Cir. 2017). The Eleventh Circuit emphasized that such an action "thwart[s] [the surety's] ability to choose among the options it had for remedying [the subcontractor's] default under §5 of the bond."

The District Court of Nevada in *United States For the Use and Benefit of Agate Steel, Inc., v. Jaynes Corporation,* 2016 WL 873223602 (D.C. Nev.), concluded that the, obligee's failure to comply with the conditions precedent in Section 3 of the performance bond, mainly replacing the principal/contractor before a demand upon the surety to perform, constitutes a material breach that excuses the surety's performance.

In *Developers Surety and Indemnity Company v. Dismal River Club, LLC,* 2008 WL 2223872 (D.C.Neb.) the court held that the language of Section 3 "creates unambiguous preconditions for triggering [the surety's] obligations under the bond." *Id.* at note 7. The *Dismal River* court held that the surety's obligations to act under the AIA A312 performance bond, "does not arise unless such conditions are met." *Id.* at note 8. Furthermore, the language of the AIA A312 performance bond has been considered by many courts to be "unambiguous language." *Id.* at 9.

In *St. Paul Fire & Marine Insurance v. VDE Corp.* 603 F.3d 119 (1st Cir. 2010), the court held that by preventing the surety to employ a completion contractor even without the obligee's consent, constitutes a material breach of the A312 Performance Bond. The court went on to state at 124:

> Our interpretation of Paragraph 4.2 is also consistent with common practices in the construction industry. The surety performance options contained in Paragraph 4 of the

> AIA A-312 bond, the bond at issue here, are "standard in the industry." Green River, 93 F.Supp 2d at 1178; see also Bruner & O'Conner, supra, at §12.16 (describing the A312 performance bond as "one of the clearest, most definitive, and widely used type of traditional common law performance bonds in private construction")….Bruner & O'Conner, supra at §12:80 (stating that "[t]he obligee has no right to unreasonably interfere with the surety's selection of its completion contractor, unless the bond provides otherwise");…

An obligee's unilateral hiring of a substitute contractor to complete the project work eliminates the surety's ability to choose among options it had for remedying its principal's default under Section 5 of the AIA A312 (2010) bond. As stated in *International Fidelity Insurance Co., v. Americaribe-Moriarty JV,* 681 F.App'x 771, 776-77 (11th Cir. 2017) the actions of the obligee "stripped the surety" of its bargained-for the right to elect among options for remedying defaulted work and thus relieved the surety of its liability under the bond.

Courts routinely held that an obligee's failure to follow conditions precedent in a performance bond constitutes a material breach. *See, e.g.,USF & G v. Brastrepo Oil Servs. Co.,* 369 F.3d 34, 51 (2d Cir. 2004); *LBL Skysystems (USA), Inc. v. APG-America, Inc.,* 2006 WL 2590497, at *23 (E.D. Pa. Sept. 6, 2006); *St. Paul Fire & Marine Inc. Co. v. City of Green River,* 93 F. Supp. 2d 1170 (D. Wyo. 2000); *Bank v. Brewton, Inc. v. Int'l Fid. Ins. Co.,* 827 So. 2d 747 (Ala. 2002).

Arch Insurance Co., v. The Graphic Builders, LLC, 2021 WL 534807 (D.C. Mass.), although an unpublished decision, the court enforces the conditions precedent in Section 3 over the arguments of the obligee to enforce the terms of the bonded contract. The obligee must agree to pay over the contract price to the surety to trigger the surety's obligations to perform. In *Sonoma Springs Ltd. Partnerships v. Fidelity and Deposit Co., of Maryland*, 409 F.Supp.3d 946 (D. Nov. 2019), the court held that a failure to do so is a material breach that renders the bond "null and void". Id at 953-954.

Conclusion

The A312 bond form is widely used. Its unambiguous terms and conditions must be satisfied to trigger the surety's performance obligation and options. They cannot be ignored by an obligee owner or general contractor to merely demand payment from the surety.

PANEL 4

IS SILENCE GOLDEN? USING THE DEFAULTED PRINCIPAL WHEN THE BOND IS SILENT

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<u>IS SILENCE GOLDEN?</u>
<u>USING THE DEFAULTED PRINCIPAL WHEN THE BOND IS SILENT</u>

By: Matthew D. Holmes, Esq., Todd R. Braggins, Esq.,
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Introduction

Dealing with a default of the performance bond principal is a part of life for sureties and their counsel. When a default occurs, a surety must craft its plan to address and resolve the incoming performance bond claim. How it decides to manage the claim has significant impacts for the project, the principal, and the surety. There are several options available to the surety, one of which is to complete the work. Yet exactly how the surety completes the work has its own set of considerations. Depending on the facts and circumstances of the project, it may be in the surety's best interest to use its defaulted principal to complete the work.

If the surety makes this election, it should be ready for understandable pushback from the obligee, whether the owner or general contractor. Handling this resistance requires sureties and their attorneys to understand how courts evaluate the surety's right to use the defaulted principal and the typical consequences this choice may create as the project progresses. This paper reviews key cases supporting the surety's right to use a defaulted bond principal to complete the work, and the expected legal impacts.

Refresher: What rights are typically available upon the principal's default?

When a bond is silent as to the surety's completion obligations, a surety is considered to have certain common law rights. These rights include the ability to, upon a principal's default: (1) provide financial assistance so the principal can complete; (2) arrange for completion through a takeover or tender; (3) pay the full costs of completion thereby buying out the completion; or (4) do nothing, forcing the obligee to complete under its duty to mitigate damages. *See Jutte Elec., Ltd. v. Ohio Facilities Constr. Comm'n,* 2016-Ohio-8580 (Ohio Ct. Cl. 2016); *see also Aetna Casualty & Surety Co. v. United States*, 845 F.2d 971 (Fed. Cir. 1988) (holding that a performance bond surety may satisfy its bond obligation in a variety of ways).

While some bonds are silent, which may provide the surety with the opportunity to avail itself of one of the above four options, many expressly state the surety's completion rights. Therefore, if the bond lists the completion options, the analysis of the surety's rights starts with the language of the bond itself. In particular, the AIA 312 performance bond tracks the above four options. Other bond forms may generally give the surety the right to remedy the principal's default, undertake to perform and complete the principal's contract, arrange for the completion of the principal's contract by tendering a completion contractor, or pay.

Under the Miller Act, sureties are able to offer proposals for completing the contract, including, but not limited to, arranging for completion through a takeover or tender. CFR § 49.404 authorizes the contracting officer to "consider carefully the surety's proposals for completing the contract." It also states that "[t]he contracting officer should permit surety offers

to complete the contract, unless the contracting officer believes that the persons or firms proposed by the surety to complete the work are not competent and qualified or the proposal is not in the best interest of the Government." Under CFR §49.405, "[i]f the surety does not arrange for completion of the contract, the contracting officer normally will arrange for completion of the work by awarding a new contract based on the same plans and specifications." Further, "[t]he new contract may be the result of sealed bidding or any other appropriate contracting method or procedure." The regulation states further, that "[t]he contracting officer shall exercise reasonable diligence to obtain the lowest price available for completion." Thus, under a federal performance bond, a surety can elect to either pay for the government's excess completion costs or complete the bonded project.

The surety may also enter into a takeover agreement, which, among other things, essentially makes the surety the "contractor, subject to the terms of the new agreement," and gives the surety "standing to sue … on the takeover [agreement] for extra work that it… perform[s] in excess of that contemplated in the original contract price." *Travelers Indem. Co. v. United States*, 16 Cl. Ct. 142 (1988). Obviously, the surety also retains the right to deny the performance bond claim.

Before a surety makes its decision, it is entitled to investigate the claim. As discussed in more detail herein, if an obligee interferes with the surety's investigation and/or prevents it from exercising its rights under the bond, the surety may be relieved of its bond obligations.

Using the Defaulted Principal – Does the Surety have the right to do it?

Depending on the circumstances, it may be in the surety's best interest to take over and complete the project with its defaulted principal. Whether this is an appropriate strategy can only be determined based on the facts of the claim. However, whether the surety has the right under the bond to choose to complete with its defaulted principal will likely hinge on what the performance bond says or does not say. Many performance bonds are silent on the issue. The silence leads to claims of ambiguity about what the bond allows, and draws such claims into court.

When faced with this question, the surety and its counsel should rely on the basic rules of contract interpretation. *See Caravousanos v. Kings County Hosp.*, 74 AD3d 716 (2d Dep't 2010) (performance bond, like a contract, is to be construed in accordance with its terms); *Colo. Structures, Inc. v. Ins. Co. of the West*, 161 Wash. 2d 577 (Sup. Ct. Wash. 2007) (performance bond should be construed in a way that effectuates all of its provisions); *United States ex. rel. GLF Constr. Corp. v. Fedcon Joint Venture*, 2019 U.S. Dist. LEXIS 180575 (M.D. Fla. 2019) (interpreting a contract begins with the plain meaning of words used, and words are given their natural, ordinary meaning). Next, the surety and counsel should carefully evaluate the language of the bond, determine whether the bond incorporates any other contracts by reference, and review the terms of any incorporated contracts. The key to answering the question is whether there are terms to limit the surety's options, such as a requirement of the owner/general contractor's consent to the surety's completion choice. Absent limiting language, the surety can use the completion contractor of its choosing, including the defaulted principal.

The seminal case addressing the surety's right to use the defaulted principal if the bond is silent is *St. Paul Fire & Marine Ins. Co. v. City of Green River* (93 F. Supp. 2d 1170 [D. Wyo. 2000]). There, the issue was whether the surety, under Paragraph 4 of the performance bond[1], could complete the project using forces from its bond principal without the obligee's express consent.

The *Green River* bond stated as follows:[2]

> When the Owner has satisfied the conditions of Paragraph 3 [requiring, *inter alia*, notice to the Surety, declaration of Contractor default, and Owner's agreement to pay the Surety the balance of the contract price], the Surety shall promptly and at the Surety's expense take one of the following actions:
>
> 4.1 Arrange for the Contractor, with consent of the Owner, to perform and complete the Construction Contract; or
>
> 4.2 Undertake to perform and complete the construction contract itself, through its agents or through independent contractors.

The surety relied on Paragraph 4.2 to support its right to use personnel from the defaulted principal. The obligee argued unsuccessfully that its consent was necessary for the surety's completion contractor. In reviewing Paragraph 4.2, the Court held:

> "…it is clear that there are no limitations on who [the surety] could utilize to complete the Project. In proceeding under Paragraph 4.2, [the surety] assumed primary responsibility to complete the contract, and with that responsibility came the freedom to assemble the project team of its choosing. In contrast, a surety electing to proceed under Paragraph 4.1 does not assume primary responsibility for completing the contract, and the owner is required to maintain an ongoing contractual relationship with the terminated contractor. While it makes sense that the owner would have the right to object to such a "shotgun wedding" to the contractor it just terminated, it does not follow that the [obligee] would have this right when the surety assumes primary contractual responsibility. In fact, the surety performance options contained in the performance bond are standard in the industry, and it is common practice for a surety that elects to perform the project itself to hire the principal's employees under the direction of a consultant, just as [the surety] did here."

Thus, based upon an objective construction of the language of the bond, the surety had the right to select the completion team of its choosing, including personnel from the defaulted principal.

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[1] It is unclear whether the bond was a form AIA A312 bond or something else.

[2] This language is materially the same as that in the current AIA A312 bond at paragraph 5 and so the *Green River* case is as pertinent today as it was in 2000.

A similar issue arose in *St. Paul Fire & Marine Ins. Co. v. VDE Corp.*, 603 F.3d 119 (1st Cir. 2010). The performance bond was, according to the district court, a standard AIA A312 performance bond. In the declaratory judgment action to determine the surety's rights and obligations under the bond, the court determined that the owner materially breached the bond by insisting that the surety could not complete the project with the defaulted principal. On appeal to the First Circuit Court of Appeals, the court analyzed Paragraph 4.2 of the bond and concluded that by its terms, it placed "no restrictions on whom [the surety] can use to complete the project." The court also stated the obvious: "It is common practice for a surety undertaking to complete the project itself to hire the original contractor…" Therefore, the construction of Paragraph 4.2 once again played to the surety's favor, giving it the right to assemble the completion team of its choosing.

The owner's arguments in support of a contrary interpretation of Paragraph 4.2 were unavailing. First, the owner argued that Paragraph 4.2 is ambiguous as to whether it requires owner consent. Specifically, it contented that the term "Contractor," as used in Paragraph 4.1, refers to the original contractor, in this case, the defaulted principal. The owner also reasoned that the term "agents" as used in Paragraph 4.2 cannot also refer to the original contractor. Second, the owner contended that because Paragraph 4.2 neither requires nor expressly dispenses with owner consent, "a well-founded objection to a selected 'agent' prevents its selection and use by the surety." Finally, the owner argued that, even if Paragraph 4.2 did not ordinarily require owner consent to use the original contractor as completion contractor, owner consent was required in this case in light of the owner's allegations that the defaulted principal acted in bad faith. The court rejected each of these arguments, determining that they did not overcome the plain language of the bond.

Similarly, in *Seawatch at Marathon Condo. Ass'n, Inc. v The Guarantee Co. of North America* (2019 WL 4850194 [Fla. 3d DCA 2019]), the Third District Court of Appeal in Florida held that the surety had the right to use the defaulted bond principal in taking over and completing the same work on which the contractor defaulted.

In this case, a condominium association hired a contractor in a $5.4 million construction contract to renovate three condominium buildings located in Marathon, Florida. Later, the association discovered defects in the renovations, declared the contractor in default, and terminated the construction contract, requesting the surety to "promptly make an election under Paragraph 4" of the performance bonds. The surety elected the option under Paragraph 4.2, negotiated takeover agreements, and stated that its completion team included the same contractor that the association had defaulted. Unsurprisingly, the association rejected the takeover agreements, contending that they materially modified the original project terms, and that language within the performance bonds prohibited the surety from retaining the defaulted contractor as its completion contractor.

Just like in *City of Green River* and *VDE Corp.*, the court held that Paragraph 4.2 places no restrictions on the surety in using the defaulted contractor or any other contractor. In affirming the lower court's ruling, the appellate court observed:

> "It is common practice for a surety undertaking to complete the project itself to hire the original contractor, as [the surety] elected to do here. By completing the project itself, the surety obtains greater control than it would have had if it elected to require the obligee to complete, because the surety can select the completing contractor or consultants to finish the project as well as control the costs of completion."

In holding that the surety was within its rights under Paragraph 4.2 to use the defaulted contractor, the court also addressed the option under Paragraph 4.1, noting that the association could not take the "owner consent" language and "graft it on" to Paragraph 4.2.

As explained above, while the surety generally has the right to complete pursuant to a takeover with whomever it wishes, this right is not absolute. Depending upon the circumstances of the case, bringing a defaulted principal back may not be legally sustainable.

For example, in *Bovis Lend Lease (LMB) Inc v. Lower Manhattan Dev. Corp.*, 2015 NY Misc. LEXIS 1347 (Sup Ct, NY Cty 2015), 143 A.D.3d 597 (1st Dep't 2016), the New York State Appellate Division, First Department reversed the decision of the trial court that held the surety was excused from performance where the obligee prohibited use of the defaulting subcontractor to complete.

The bond principal there had two contracts with the general contractor, totaling over $50 million, for the deconstruction and decontamination of a building that was damaged during the September 11, 2001 terrorist attack on the World Trade Center. In the course of its work, the bond principal knowingly dismantled the building's standpipe, which supplied the only source of water to put out a fire. As a result of the bond principal's actions, there was a 42-foot breach in the building's standpipe. Representatives of the general contractor failed to notice the bond principal's actions. Unfortunately, on August 18, 2007 a seven-alarm fire broke out in the building, causing the deaths of two New York City firefighters. The New York City DOB issued a stop work order for the project for over eight months, and then, on August 28, 2007, the general contractor terminated the bond principal for cause.

On December 22, 2008, following a 16-month investigation by the Manhattan District Attorney's Office into the circumstances surrounding the fire, a Manhattan grand jury charged representatives of the bond principal and general contractor in a criminal indictment for manslaughter. *See John Galt Corp. v Travelers Casualty and Surety Company of America*, 2009 N.Y. Misc. LEXIS 4751, n.2 (Sup Ct, NY Cty. 2009).

Representatives of the principal were ultimately convicted of second-degree reckless endangerment.

On the same day the general contractor terminated the bond principal, it also called upon the surety to complete the work described in the principal's contracts. The next day, the general contractor's executive vice president publicly stated that the principal's contracts were terminated; neither the principal, nor any of its forces, were working on the project; and that the principal would never work on it again. In response, the surety informed the general contractor that it was prepared to proceed under paragraph 2 of its performance bonds, which stated that "whenever the Principal shall be, and declared by Obligee to be in default, in breach, and/or have failed to perform in any manner under the Contract, the Surety shall promptly remedy the default by one of the following:

> 2. Obtain a bid or bids for completing the Contract in accordance with its terms and conditions, and upon determination by Surety of the lowest responsible bidder, or if the Obligee elects, upon determination by the Obligee and the Surety jointly of the lowest responsible bidder, arrange for a contract between such bidder and Obligee, and make available as Work progresses...sufficient funds to pay the cost of completion less the balance of the Contract price, but not exceeding including other costs and damages for which the Surety may be liable hereunder, and pursuant to the Contract, the amount set forth in the first paragraph hereof …

According to the surety, it had to proceed under option 2 of the performance bond because the general contractor's statements made it clear that the surety could not exercise its rights under option 1 of the bond, which stated that the surety could "[c]omplete the Contract in accordance with its terms and conditions."

In a third-party lawsuit brought by the general contractor against the surety, the surety moved for summary judgment on the breach of the bonds claim, arguing that by indicating in advance that the surety could not use the defaulted principal, the general contractor materially breached the bonds, as it preemptively deprived the surety of the ability to protect itself.

In examining the bonds, which were not standard AIA A312 bonds, the trial court determined that option 1 of the bonds permitted the surety to complete the trade contracts according to their terms, and "[u]nless the language of a bond provides otherwise, when a surety chooses to complete the contract itself, it can choose any contractor, including the defaulted principal." Therefore, by indicating what the surety could and could not do (i.e. could not use the bond principal to complete the work), the general contractor materially breached the bonds, which were rendered null and void. The court dismissed the claim against the surety for breaching the bonds.

On appeal, the court came to a different conclusion, and determined that the surety *was* liable for breach of the bonds, even though the bonds were silent on the ability to use the defaulted principal. In an unusual extension of authority not typically seen in case law

on this topic, the court looked beyond the plain language of the bond, and looked instead at the language that incorporated provisions of the prime contract, explaining:

> "The [trial] court found that [the surety's] alleged nonperformance was excused by [obligee's] breach of the bonds by prohibiting [the surety] from retaining [defaulted principal] to complete its work after it was terminated. However, the bonds expressly required [the surety's] replacement of [defaulted principal] to be "in accordance with" [defaulted principal's] subcontracts, which incorporated the prime contract. Those contracts required the prior written approval of [obligee] and [owner] for any replacement subcontractor, which applied to the selection of [defaulted principal] to complete its own work after it was terminated upon default.
>
> It is undisputed that [obligee], in terminating [defaulted principal], expressly and unequivocally disapproved of [defaulted principal's] continued performance of the building abatement work. Moreover, [defaulted principal's] criminal conviction arising from its performance on the project showed that [it] was a non-responsible contractor and thus disqualified from serving as a subcontractor on the public New York City project. (*citations omitted*). [Obligee] is entitled to judgment as a matter of law on this claim regardless of which option of the bonds [the surety] is deemed to have pursued."

The court's decision appears to be an anomaly, and based on an uncommon factual background. Based on the nature and extent of the principal's default, which resulted in the death of two firefighters, it is not unreasonable to believe that the appellate court was motivated to perform a stricter evaluation of the record than the trial court.

Another lesson that one can glean from this case is the importance of evaluating the principal's default. Though the surety may have the right to use the defaulted principal, it should consider whether it is prudent under the circumstances to do so and/or how that decision may affect future litigation.

Legal Considerations

Sureties and their attorneys understand that any completion choice comes with its own risks and critical considerations. Using the defaulted principal is no different. As indicated in the cases above, the obligee typically has reservations about using the same contractor that it believes negatively affected the project – the contractor was just defaulted, after all. As the defaulted principal will likely be unable to procure a new bond, finishing with a defaulted principal the surety is effectively doubling down on the risk. Besides potentially souring the relationship with the owner, there are legal considerations that impact the surety's defenses in future litigation, which can expose the surety to more liability.

An extreme example of what could happen when the surety uses the defaulted principal to complete the work can be found in a series of decisions out of the New Jersey

District Court, all containing the caption *Delux Bldg. Sys. v. Constructamax, Inc.* 2011 U.S. Dist. LEXIS 12189 (D.N.J. 2011); 2013 U.S. Dist. LEXIS 126464 (D.N.J. 2013) (unpublished opinion). Therefore, the surety received a one-two punch against it: (1) a finding that it had breached the bond and takeover agreement; (2) an order denying its motion for summary judgment attempting to limit its damages to the penal sum of the bond.

In *Delux Bldg. Sys.*, the bond principal was the general contractor on an affordable housing project in Jersey City, New Jersey. Several years into the project, the principal abandoned its work. In response, the owner/obligee demanded the surety to satisfy its obligations on the bond. The surety and the obligee entered into a takeover agreement on February 13, 2007, which set a completion date and determined the surety's obligations on the project. As part of its completion obligations, the surety elected to bring back the principal who had just abandoned the project.

The surety and the principal did not complete the work by the date indicated in the takeover agreement, nor did the surety request an extension of the completion date. In fact, by December 11, 2009, 34 months after the takeover agreement completion date, the surety still had not completed the work on the project. On that date, the surety purported to terminate the takeover agreement and informed the owner of its intention to cease work on December 30, 2009. On October 19, 2010, the owner terminated the surety's right to proceed with the work.

The owner's action against the bond principal for breach of contract and against the surety for breaching the bond and takeover agreement soon followed. In prior decisions, the court had determined that the bond principal materially breached the contract by, among other things, abandoning the project, and that applying the facts of the bond principal's actions to the takeover agreement yields a determination that the surety breached the takeover agreement as a matter of law. More specifically, the court found that the surety's failure to complete the project within several years of the contractually mandated completion date was a material breach of the takeover agreement, and that the surety thus had no right to terminate the takeover agreement. A later decision found that in executing the takeover agreement, "[i]n essence, [the surety] became the contractor, and it took on the obligation to complete the work under the [principal's contract] on or before October 13, 2007."

After the court established liability against the surety, the parties filed motions on the amount of damages available to the owner. The owner argued that the surety's liability exceeded the penal sum of the bond, while the surety argued that the bond itself and the language of the takeover agreement limited the owner's damages to the amount of the bond. The court agreed with the owner's arguments.

First, it held that the surety lost the protection of the bond's penal sum when it took over the project, specifically finding that the surety "did not stand on its bond, but agreed to step into the shoes of [principal] as contractor." Second, it held that a section of the

takeover agreement entitled "Preservation of Penal Sum Limitation on Surety's Liability" could potentially be interpreted in a way that would *not* limit the obligee's breach of contract damages to the amount of the bond. The provision of the takeover agreement at issue stated:

> 10. Preservation of Penal Sum Limitation on Surety's Liability. All payments by Surety (a) toward completion of the Work and (b) for labor performed or materials, provisions, provender, or other supplies or teams, fuels, oils, implements, or machinery furnished in connection with the Contract in excess of the amount of payments actually made by Owner to Surety pursuant to this Takeover Agreement shall be deemed payments under the Bond, and the penal sum of the Bond, which constitutes the limit of Surety's liability thereunder, shall be deemed to have been reduced by the amount of any such payments made by Surety; provided, however, that Surety's legal expenses and any costs Surety has incurred for work performed by [defaulted bond principal]through the date of this Takeover Agreement shall not be deemed payments under the Bond, and thus the penal sum shall not be deemed to have been reduced by the amount of these expenses. Nothing contained in this Takeover Agreement is intended, or shall be construed, to waive, or to increase the liability of Surety beyond, the limit of Surety's liability under the Bond or any other defenses to liability set forth in the Bond. Owner shall not make any claim against Surety, or demand damages or performance from Surety, after Surety has expended or obligated itself to expend the remaining penal sum of the Bond.

According to the court, Paragraph 10 above could plausibly be read to pertain to the surety's liability "under the Bond," *i.e.*, "its liability *as surety*, and to claims against [the surety] *as surety*." Thus, the court held that the "the amount of the bond does not limit the damages that may be assessed against [the surety] for breach of contract as a result of [the surety's] having entered into the Takeover Agreement."

Additionally, the court stressed the importance of the takeover agreement incorporating the principal's contract and how the two must be read together. Specifically, paragraph 13 of the Takeover Agreement provided that the owner had the same rights against the surety that it had against the principal under the principal's contract, unless the takeover agreement provided otherwise. But, according to the court, the takeover agreement has no provisions for remedies in the event of breach, apart from liquidated damages for delay. Therefore, the court determined that the principal's contract remedy provision controls, and that following a material breach by the principal, the surety would be liable to the owner "for any loss . . . damages, or detriment to [owner]," without limitation.

Thus, at this stage of the action, the surety faced a determination that there was an issue of fact as to whether it could limit its damages to the penal sum.[3]

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[3] In 2016, the surety moved for summary judgment again, claiming its liability under the bond was limited to the penal sum and that sum had been expended. A different judge agreed that the surety's liability under the bond was

Another example of the surety's exposure to additional liability for using the defaulted principal to complete the project can be found in *Parkcrest Builders, LLC v. Hous. Auth. of New Orleans*, 2017 U.S. Dist. LEXIS 85661 (E.D. La. 2017). There, the surety retained the bonded principal that was terminated by the owner and was later unable to dismiss a claim that the owner breached the project takeover agreement. The surety intervened in a lawsuit between the owner and bond principal, asserting that the owner breached the takeover agreement. In response, the owner claimed that the surety breached the takeover agreement by working in tandem to increase the amount that would be payable to the defaulted bond principal, and by failing to complete the project according to the contract. The court did not dismiss the claims against the surety for breaching the takeover agreement.

Conclusion

Generally, it appears that even when the bond is silent on the issue of who the surety can use as a completion contractor, the surety will have the right to use the defaulted principal, provided there are no applicable contract provisions that require the obligee's consent to do so. Using the defaulted principal comes with advantages and disadvantages, all of which need to be fully and carefully evaluated before the surety choses how to proceed. Should the surety choose to use the defaulted principal, it should be aware of the potential risk of increased exposure as the project continues.

limited to the penal sum, noting that in the 2013 decision, the court determined that the surety's liability may exceed the penal sum to the extent the surety was liable for breach of the subsequent takeover agreement. *Deluxe Bldg. Sys. v. Constructamax, Inc.*, 2016 U.S. Dist. LEXIS 100642.

PANEL 5

TAKEOVER ON FEDERAL PROJECTS

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TAKEOVER ON FEDERAL PROJECTS

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I. The Federal Acquisition Regulations and Surety Takeover Agreements (48 C.F.R. §49.404).

1. Considerations

Takeover agreements on federal projects are specifically governed by the FAR. The FAR favors but does not require the government to enter into a takeover agreement with the surety and the terminated principal. Takeover agreements can be between the obligee and the surety, or between the obligee, surety and completing contractor. In some instances, the principal may also be included as a party to a takeover agreement ostensibly to set forth the contractual duties and obligations of all parties involved. The FAR provides that the Contracting Officer should permit the surety to complete the bonded contract "unless the contracting officer believes that the persons or firms proposed by the surety to complete the work are not competent and qualified or the proposal is not in the best interest of the Government."[1]

The FAR acknowledges that a surety could have a claim pursuant to its subrogation rights to the funds earned by the defaulted principal.[2] The FAR provides that the parties include the takeover agreement in the proposal, "fixing the surety's rights to payment from those funds."[3] The takeover agreement is required to provide that (1) the surety will complete the bonded contract; and (2) the government will pay the surety's costs and expenses up to the balance of the contract price that is unpaid at the time of default.[4] The surety's subrogation rights depend on the principal's rights. If the agreement expands the surety's rights, it will be considered contrary to the government's interests.[5]

A takeover agreement is essential for setting forth the rights and expectations of the surety and the government relative to the surety's completion of the bonded project. A takeover agreement also establishes the required contractual relationship between the parties, which is necessary in order for the surety to bring a Contract Disputes Act claim against the government for any issues related to the performance on the project. A surety should consider pushing for a tripartite agreement among the surety, the government and the defaulted principal in an effort to avoid challenges to pre-takeover claims.[6]

2. Issues to Address in the Takeover Agreement

FAR 49.404(e) sets forth the following requirement for a takeover agreement:

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1. FAR 49.404(c).
2. *See* FAR 49.404(d).
3. FAR 49.404(d).
3. FAR 49.404(e).
4. FAR 49.404(e).
5. Security Ins. Co. v. United States, 192 Ct. Cl. 754 (1970).
6. Such an agreement is authorized by 48 U.S.C. § 49.404(d).

a) Any takeover agreement must require the surety to complete the contract and the Government to pay the surety's costs and expenses up to the balance of the contract price unpaid at the time of default, subject to the following conditions:

    1) Any unpaid earnings of the defaulting contractor, including retained percentages and progress estimates for work accomplished before termination, must be subject to debts due the Government by the contractor, except to the extent that the unpaid earnings may be used to pay the completing surety its actual costs and expenses incurred in the completion of the work, but not including its payments and obligations under the payment bond given in connection with the contract.

    2) The surety is bound by contract terms governing liquidated damages for delays in completion of the work, unless the delays are excusable under the contract.

    3) If the contract proceeds have been assigned to a financing institution, the surety must not be paid from unpaid earnings, unless the assignee provides written consent.

    4) The contracting officer must not pay the surety more than the amount it expended completing the work and discharging its liabilities under the defaulting contractor's payment bond. Payments to the surety to reimburse it for discharging its liabilities under the payment bond of the defaulting contractor must be only on authority of—

        i. Mutual agreement among the Government, the defaulting contractor, and the surety;

        ii. Determination of the Comptroller General as to payee and amount; or

        iii. Order of a court of competent jurisdiction.

3. Securing the Bonded Contract Funds

a. Prohibitions on Assignment

The Federal Assignment of Claims Act[7] applies to claims under government contracts that have already been made and the Anti-Assignment Act[8] addresses ongoing contracts and continuing obligations. The Federal Assignment of Claims Act does not allow claims against the United States Government to be transferred or assigned until the claim has been allowed, the amount of the claim decided and a warrant for payment has been issued. Essentially, the Act serves as a ban on the assignment of any claim against the federal government prior to the claim being liquidated. Consequently, it requires that the government deal exclusively with the original claimant which minimizes the risk of multiple liability and ensures that the government has the right to assert counterclaims and set-offs against the claimant.[9] It also prevents the government from having to unnecessarily investigate into the possibility of a transfer.

When a surety is concerned with securing the bonded contract funds, it must also be concerned about the Anti-Assignment Act, which prohibits the transfer or assignment of a contract made with the federal government. Any transfer or violation of this statute can annul the contract.[10]

There is an exception in both statutes for certain assignments to a financial institution.[11] The assignment of a claim is only valid when the assignee financial institution files a written notice of the assignment with the government and provides a copy of the assignment to the surety.[12] A surety is not a financing institution.[13]

b. Involuntary assignments.

There is also an exception to both acts for involuntary assignments that are unlikely to defraud the government. Involuntary assignments include transfers by operation of law, including transfers pursuant to the doctrine of subrogation.[14] This exception is critical because it allows the performing surety to bring a claim under the Tucker Act[15] in the United States

7. 31 U.S.C. § 3727(b) (West 1982).
8. 41 U.S.C. § 6305 (West 2011).
9. Spofford v. Kirk, 97 U.S. 484 (1878).
10. 41 U.S.C. § 6305(a).
11. 31 U.S.C. § 3727(c) (West 1982); 41 U.S.C. § 6305(a) (West 2011).
12. 31 U.S.C. § 3727(c)(3) (West 1982).
13. Fireman's Fund Ins. Co. v. England, 313 F.3d 1344 (Fed. Cir. 2002); Royal Indemnity Co. v. United States, 117 Ct.Cl. 736, 93 F.Supp. 891, 894 (1950) ("Indeed, our predecessor court, whose decisions bind us, held an assignment of a government contract to a surety invalid under the Anti–Assignment Act because the surety was not a "bank, trust company, or other financing institution.").
14. Prairie State Nat. Bank of Chicago v. United States, 164 U.S. 227 (1896); United States v. Aetna Cas. & Sur. Co., 338 U.S. 366 (1949); and United States v. Shannon, 78 S. Ct. 281 (1952).
15. 28 U.S.C. § 1491.

Federal Claims Court or a claim under the Federal Torts Claim Act[16] under a theory of equitable subrogation without running afoul of the anti-assignment statutes.[17]

c. Novation agreement.

If the government chooses, it can enter into a novation agreement with the assignee and formally grant consent to the transfer of the contract.[18] This normally occurs when a company with the current contract with government is part of a merger, is changing its name, or sold some or all of its assets.

d. SAM Registration.

Entities that conduct business with the government are required to register with the System for Award Management ("SAM").SAM consolidated the capabilities of Central Contracting Registration, Online Representations and Certifications Application, and Excluded Parties List System in July 2012. The entire system is automated online at: https://www.sam.gov. Most prospective contractors must be registered in the SAM database prior to award of a contract or agreement.[19] Due to the fact that payment is processed by the government electronically through SAM, simply sending a letter of direction from the principal or surety to the contracting officer directing the government to make payment to the surety may not ensure that future payments will be made to the surety. The surety must ensure that the correct payee information is processed in SAM.

The principal cannot change the name or address for payments in SAM to reflect an assignee for the purpose of an assignment of claims.[20] The surety must be separately registered in the SAM database.[21] Any ultimate recipient other than the principal for payments will be considered to be incorrect information in SAM and result in a suspension of payments.[22]

Before registering in SAM, the surety will need a nine-digit Data Universal Numbering System (DUNS number). This is a means of identifying business entities on a location-specific basis and is the government's contractor identification code for all procurement-related activities.[23] This is a free service and the information used to register for the DUNS number must be identical to the information used to register for the SAM. Instructions to register in SAM can be found at www.sam.gov. Registration typically becomes active three to five days after the IRS has validated the surety's TIN information. Including the DUNS number in the letter of direction

16. 28 U.S.C. § 1346(b).
17. Ins. Co. of the West v. United States, 243 F.3d 1367, 1375 (Fed. Cir. 2011); Lumbermens Mutual Casualty Co. v. United States, 654 F.3d 1305 (Fed. Cir. 2011); *Aetna*, 338 U.S. at 383 ("The fact that some administrative problems may be the unintended by-products of an involuntary assignment was not thought to be an evil within the scope of a statute aimed at fraud and harassment. That interpretation has, for nearly a century, exempted all transfers by operation of law from the prohibition of R.S. § 3477").
18. 48 C.F.R. § 42.1204 (2013).
19. FAR 4.11(a).
20. FAR 4.1102(c).
21. FAR 32.8(d)(4).
22. FAR 4.11(c)3.
23. http://fedgov.dnb.com/webform.

and the takeover agreement will help facilitate the payment of the bonded contract balance to the surety.

4. Differences between the FAR and a typical takeover setting.

It is important to note that certain required conditions in FAR 49.404(e) are contrary to well established surety case law. For instance, FAR 49.404(e)(1) allows for payment of unpaid earnings to the completing surety for its costs and expenses incurred in completion of the work, but not for costs incurred under the payment bond. This section appears to ignore the ruling in *Pearlman v. The Reliance Insurance Company,*[24] which, in part, stands for the proposition that the surety's subrogation rights apply equally to costs incurred under both the performance bond and the payment bond. An argument must be made to the contracting officer that payments made under the two bonds cannot be distinguished for purposes of subrogation. To do so would contradict clear legal precedent.

Also, FAR 49.404(e)(3) places an assignee bank ahead of the surety in priority with respect to the contract balance. This requirement directly conflicts with well-established law that provides a surety's subrogation claim takes precedence over the claim of the defaulted principal, and is thus ahead of the principal's assignees.[25] It is again the surety's burden to convince the contracting officer that this condition is legally unsupported and unfair to impose.

Finally, FAR 49.404(e)(4) imposes requirements upon the surety that go well beyond the basic laws of suretyship. In many cases, the surety may be able to establish the "mutual agreement" requirement by providing the contracting officer with the assignment provision of the indemnity agreement between the principal and the surety. The requirements can also be met through language included in a tripartite takeover agreement.

In addition to the FAR requirements, the takeover agreement should identify the applicable contract documents, the schedule of values, the status of pay estimates as of the date of the takeover agreement, and identify and address if possible any defects in the work or non-compliance with the contract. The surety may also want to reference, to the extent applicable, the completion contract between the surety and the completion contractor so that all parties are aware of its terms and conditions.

If the bonded project contains a set-aside for disadvantaged businesses or disabled veterans, the issue can arise as to whether the completion contractor must also meet the set-aside criteria. The FAR does not specifically address this issue and the contracting officer is left with much discretion to take action in the government's best interest. Further, the completion contractor must be acceptable to the government. Many takeover agreements contain a provision whereby the government acknowledges that the bonded project was a set-aside and that set-aside criteria under which the project was awarded do not apply to the surety or the completion contractor. The surety may also want to consider including language in the takeover agreement that the surety is not liable for any false claims act violations of its principal.

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24. 371 U.S. 132 (1962).
25. Pearlman v. The Reliance Insurance Company, 371 U.S. 132.

II. Resolution of Disputes.

Disagreements between contracting parties can be an unavoidable part of doing business. If a disagreement occurs on a federal government contract, the contractor and surety should know and understand the unique procedures for making claims and adjudicating federal contract disputes. It is important to also understand the risk, time and expense that can come along with obtaining a just result.

In pursuing claims against the government, the surety must also be mindful of the challenges to overcome the jurisdictional bar of sovereign immunity.[26] The United States is "immune from suit absent 'a clear statement… waiving sovereign immunity… together with a claim falling within the terms of the waiver.'"[27] The waiver of sovereign immunity "'must be unequivocally expressed in the text' and 'will be strictly construed, in terms of its scope, in favor of the sovereign.'"[28] The surety may litigate its claims against the United States in the Board of Contract Appeals or the United States Court of Federal Claims under the Contract Dispute Act[29] and the Tucker Act.[30] Both acts provide a limited waiver of sovereign immunity under which certain claims may be pursued.

1. The Contract Dispute Act

The Contract Dispute Act of 1978[31] ("CDA") is the statutory basis for submitting a claim to the Contracting Officer and dispute resolution on claims against the federal government. The CDA also governs the payment of interest on contactor claims, certification of claims, and civil penalties for fraudulent claims.

Although the CDA does not define "claim", the FAR, which has incorporated the CDA defines "claim" as:

> Claim, as used in this subpart, means a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract... However, a written demand or written assertion by the contractor seeking the payment of money exceeding $100,000 is not a claim under the Contract Disputes Act of 1978 until certified as required by the Act and 33.207. A voucher, invoice, or other routine request for payment that is not in dispute when submitted is not a claim. The submission may be converted to a claim, by written notice to the contracting officer as provided in 33.206(a), if it is disputed,

26. Lumbermens Mutual Casualty Co. v. United States, 654 F.3d 1305, 1311 (Fed. Cir. 2011).
27. *Id*. (quoting Dolan v. U.S. Postal Serv., 546 U.S. 481, 498 (2006)).
28. Gomez-Perez v. Potter, 128 S.Ct. 1931, 1942 (2008) (quoting Lane v. Pena, 518 U.S. 187, 192 (1996)).
29. 41 U.S.C. § 7101-7109.
30. 28 U.S.C. § 1491.
31. 41 U.S.C. §§601-613.

> either as to liability or amount, or is not acted upon in a reasonable time.[32]

Ultimately, there are three main requisites for a claim: (1) a written demand to the Contracting Officer asserting specific rights and requesting specific relief; (2) a statement of the amount sought in a sum certain; and (3) a request to the Contracting Officer for a final decision. Typically, claims under the CDA are required to be submitted, in writing, to the contracting officer for a written decision within six years of the accrual of the claim.[33]

A claim in excess of $100,000 must be certified by the contractor that the claim is made in good faith, is accurate and complete, and reflects the amount the contractor believes it is entitled to recover from the government.[34] The FAR states that the aggregate amount of the increases and/or decreases shall be used to determine if the contractor's claim meets the $100,000 threshold. FAR requires that the certification contain the following language:

> I certify that the claim is made in good faith; that the supporting data are accurate and complete to the best of my knowledge and belief; that the amount requested accurately reflects the contract adjustment for which the contractor believes the Government is liable; and that I am duly authorized to certify the claim on behalf of the contractor.[35]

The certification must substantially comply with the statutory certification language. If the certification is defective, it must be corrected before entry of final judgment can be made.[36]

The CDA requires the contracting officer render a decision on claims less than $100,000.00 within 60 days and either issue a decision or notify the contractor of the date of the anticipated decision for claims in excess of $100,000.[37] If the contracting officer fails to issue a decision within the required time period, the claim is deemed denied.[38] The contracting officer's decision is final unless appealed to the appropriate forum.[39] Such decision either must be appealed to the proper agency board within ninety days of the receipt of the contracting officer's final decision or an action must be instituted by the surety by filing a complaint in the Claims Court within twelve months of the receipt of the contracting officer's final decision.[40]

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32. FAR 52.233-1.
33. 41 U.S.C. § 7103(a)(1)-(4).
34. 41 U.S.C. § 7103(b)(1).
35. FAR 33.207(C).
36. 41 U.S.C. § 7103(b(3)
    (3) Failure to certify or defective certification.--A contracting officer is not obligated to render a final decision on a claim of more than $100,000 that is not certified in accordance with paragraph (1) if, within 60 days after receipt of the claim, the contracting officer notifies the contractor in writing of the reasons why any attempted certification was found to be defective. A defect in the certification of a claim does not deprive a court or an agency board of jurisdiction over the claim. Prior to the entry of a final judgment by a court or a decision by an agency board, the court or agency board shall require a defective certification to be corrected.
37. 41 U.S.C. § 7103(f).
38. 41 U.S.C. § 7103(f)(5).
39. 41 U.S.C. § 7103(g).
40. 41 U.S.C. § 7104(b).

While the CDA allows the surety to assert post-takeover claims, the surety generally cannot pursue pre-takeover claims--those that arose before the execution of the takeover agreement.[41] This is because the surety was not a "contractor" for purposes of the CDA.[42] However, the surety may seek to avoid this jurisdictional bar by having the governments recognize the surety's rights to pursue pre-takeover claims in the formal takeover agreement executed with the government.

Additionally, even when the surety is jurisdictionally able to assert a claim under the CDA, it can be hindered from doing so effectively because the events on which the claim is based occurred prior to the surety's takeover and management of the project. While the surety must submit a claim certification, the underlying data on which its claim is based may include work that its completion contractor did not perform and amounts that it did not calculate. The surety is still bound by the claim certification requirements and faces liability under the CDA and the False Claims Act ("FCA") for the submission of fraudulent claims.[43]

In addition to utilizing pre-takeover information in its claims, the surety may also be responsible for the submission of the claims of subcontractors and the completion contractor. While the surety is not required to attest that the subcontractor's claim is certain, the surety must believe that the submission is proper based on the information at hand.[44] Such certification criteria places the surety in a difficult position, forced to rely on and potentially face liability under the FCA for documentation and data which it did not produce in order to pursue claims against the government.

2. The Contracting Officer

The Contracting Officer ("CO") is arguably the most important player in the claims process. The Contracting Officer will serve as both the administrator of the contract for the government, as well as the decision maker with regards to disputes between the government and the contractor. The Contracting Officer must be objective when the contractor's issues through settlement or negotiation.[45] If the Contracting Officer is unable to resolve the contractor's issues, the contractor must then present a claim to the CO and request a final decision. The Contracting Officer has the inherent authority to compromise, settle, pay or otherwise adjust any and all claims presented that relates to the federal contract. Specifically, FAR 33.210 provides in relevant part:

> Except as provided in this section, COs are authorized, within specific limitations of their warrants, to decide or resolve all claims arising under or relating to a contract subject to the Act…The authority to decide or resolve claims does not extend to (a) A claim or dispute for penalties or forfeitures prescribed by statute or regulation that another Federal agency is specifically authorized to administer, settle or

41. Fireman's Fund Ins. Co. v. England, 313 F.3d 1344, 1351 (Fed. Cir. 2002).
42. *Id*.
43. 41 U.S.C. § 7103(c).
44. United States v. Turner Constr. Co., 827 F. 2d 1554, 1561 (Fed. Cir. 1987).
45. 41 U.S.C. § 605 (a); *see also* FAR 33.204.

> determine; or (b) The settlement, compromise, payment or adjustment of any claim involving fraud.[46]

The CDA requires that the Contracting Officer render a decision on claims less than $100,000.00 within 60 days and either issue a decision or notify the contractor of the date of the anticipated decision for claims in excess of $100,000.[47] If the contracting officer fails to issue a decision within the required time period, the claim is deemed denied and the contractor may then file an appeal with the Board of Contract Appeals or Court of Federal Claims.[48]

The CDA provides that the Contracting Officer's final decision must state reasons for its decision and inform the contractor of its rights. Specific findings of fact are not required, however, if made, they will not be binding on any subsequent forums.[49] The Contracting Officer must render its decision based on its own "personal and independent" judgment on the merits of the contractors claim. The Contracting Officer may obtain advice and/or assistance from others, but if the contractor suspects that the Contracting Officer's opinion was not independent it may challenge the decision on such grounds.

The contracting officer's decision is final and conclusive unless appealed to the appropriate forum.[50] Such decision either must be appealed to the proper agency board within ninety days of the receipt of the Contracting Officer's final decision or an action must be instituted by the surety by filing a complaint in the Claims Court within twelve months of the receipt of the contracting officer's final decision.[51]

3. Appeal of the Contracting Officer's Decision

The CDA provides the contractor with the option to pursue with appealing its claim to either the appropriate Board of Contract Appeals or the Court of Federal Claims.[52] The government does not get an input on the forum selection. If the contractor elects to file a Notice of Appeal to the Board of Contract Appeals, it has ninety (90) days after the receipt of the Contracting Officer's final decision. The notice must be in writing, signed by the contractor or an appropriate representative, contact number, final decision being appealed and the agency issuing the final decision. Alternatively, if the contractor elects to file an appeal to the Court of Federal Claims, it must commence by filing a complaint within twelve (12) months. Filing a timely notice of appeal with the board or suit in the Court of Federal Claims is a prerequisite to jurisdiction.

If the contractor files an appeal to either the Board of Contract Appeals or the Court of Federal Claims, the findings of fact and conclusions of the Contracting Officer's final decision have no binding effect during the appeal. The proceeding before the Board of Contract Appeals or the Court of Federal Claims is de novo.[53] In the past, decisions of the Contracting Officer that

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46. FAR 33.210.
47. 41 U.S.C. § 7103(f).
48. 41 U.S.C. § 7103(f)(5).
49. FAR 33.211(a).
50. 41 U.S.C. § 7103(g).
51. 41 U.S.C. § 7104(b).
52. 41 U.S.C. §§601-613.
53. 41 U.S.C. §§605(b), 609(a)(3).

were in favor of the contractor were treated as presumptively correct on appeal, however, the Federal Circuit has reversed those holdings and now both the contractor and the government begin with a fresh slate before the Board of Appeals or Court of Federal Claim.[54]

It is important for the contractor to carefully evaluate its decision of whether to appeal to the Board of Contract Appeals or to the Court of Federal Claims. Once a contractor makes his choice of forum it is binding and may not be later changed to the other legal entity[55] nor may it voluntarily dismiss the case and refile in the other forum.[56] Attempting to switch forums has been referred to as "judge shopping" and therefore illegal. However, if the suit is dismissed by the board or Court for lack of jurisdiction, this was not a binding election by the contractor, therefore, it may file suit in the other forum.[57] There is no hard and fast rule to help determine the factors that must be considered in this decision. It varies on a case-by-case basis.

a. Boards of Contract Appeals

There are two Boards of Contract Appeals: (1) the Armed Services Board of Contract Appeals ("ASBCA"); or (2) the Civilian Board of Contract Appeals ("CBCA") (collectively, "Boards").[58] The ASBCA has jurisdiction to hear appeals from the Department of Defense, Department of Army (including Corps of Engineers), the Department of the Navy, the Department of the Air Force, the National Aeronautics and Space Administration, and the Washington Metropolitan Area Transportation Authority.[59] On the other hand, the CBCA has jurisdiction to decide any appeal from any executive agency, other than those within ASBCA's jurisdiction, relative to the contract.[60]

As previously discussed, the CDA requires that each claim by a contractor against the government relating to the contract be submitted within six years after the accrual of the claim.[61] This six year limitation period is not a statute of limitations; rather, it is a time limit prerequisite for the Boards to have jurisdiction over the appeal.[62]

The Boards have their own rules of procedure and are not governed by the Federal Rules of Civil Procedure. However, the Federal Rules and federal decisions are considered persuasive authority.[63] The Boards allow for the use of discovery, such as: requests for production of documents, interrogatories, depositions, and requests for admissions.[64] The Boards are also

54. Wilner Constr. Co. v. United States, 24 F.3d 1397 (Fed. Cir. 1994).
55. Bonneville Assocs., Ltd. v. Barram, 165 F.3d 1360, 1362 (Fed. Cir.).
56. Aviation Transp. Props. V. United States, 11 Cl. Ct. 87 (1986).
57. *Bonneville Assocs*., 165 F.3d 1360; *see also,* Skelley & Loy v. United States, 685 F.2d 414 (Ct. Cl. 1982)(not binding election where no valid claim initially); *see also,* Nat'l Neighbors, Inc. v. United States, 839 F.2d 1539 (Fed. Cir. 1988)(not binding election when appeal is untimely).
58. 41 U.S.C. §607.
59. 41 U.S.C. § 607(d).
[60] 41 U.S.C. § 607(d).
[61] 41 U.S.C. § 7103(a)(1)-(4).
[62] Metlakatla Indiana Cmty. V. Dep't of Health & Human Servs., CBCA 181-ISDA, et al., 2008 WL 3052446 (July 28, 2008).
[63] Beyley Constr. Group Corp., ASBCA 55692, 08-2 BCA ¶33,999.
[64] ASBCA R. 14-15; CBCA R. 14-15.

authorized to issue subpoenas, which are enforceable through the federal district court of the location of the witness.[65]

b. The Court of Federal Claims

Initially, the Court of Federal Claims' ("COFC") did not have the power to issue final judgments until the Tucker Act[66] expanded COFC's jurisdiction to encompass suits for money against the United States. Such suits can be founded upon the Constitution, act of Congress, executive order, regulation of an agency, patent, or contract with the United States. Notably, the government may pursue a claim against the contractor under the False Claims Act ("FCA") by way of a counterclaim in an action initially instituted by the contractor.[67]

Like the Boards, the COFC is not governed by the Federal Rules of Civil Procedure because it has its own rules and procedures. COFC's rules are very similar to the Federal Rules allowing the COFC to look to the Federal Rules and decisions for guidance.[68] Discovery in the COFC is very similar to discovery in the federal courts – requests for production of documents, interrogatories, depositions, etc. are all allowed.

c. The Tucker Act

The Tucker Act's waiver of sovereign immunity permits the COFC and the United States District Courts to preside over monetary claims against the government when the plaintiff possesses a substantive right.[69] The Tucker Act does not impart any independent substantive right on its own. However, the surety may satisfy the Tucker Act's jurisdictional requirements under the doctrine of equitable subrogation.[70] Pursuant to equitable subrogation, a surety "steps into the shoes" of its principal to assert its rights to the contract funds.[71]

To benefit from subrogation, the surety must either complete the project under the performance bond or satisfy claims brought against the payment bond.[72] Provided the surety demonstrates that it discharged its performance or payment bond obligations, it may then take advantage of the Tucker Act's limited waiver of sovereign immunity and proceed against the government on any claims to which it is subrogated.[73]

Conclusion

Construction projects are complicated and risky endeavors, even for the most experienced contractors. Typically, by the time the surety becomes involved the project is wrought with

65. 41 U.S.C. §610; ASBCA R. 21; CBCA R. 16.
66. 28 U.S.C. §1491.
67. 31 U.S.C §3730.
68. *See generally*, Abbey v. United Sates, 82 Fed. Cl. 722 (2008).
69. 28 U.S.C. § 1491(a)(1); *see also* Lloyd N. Shields, Elizabeth L. Gordon & Adrienne C. Barbour, Living with Lumbermens, p. 17 (unpublished paper submitted at the Surety Claims Institute Annual Meeting, June 25-27, 2014).
70. Ins. Co. of the West v. United States, 243 F.3d 1367, 1370-75 (Fed. Cir. 2007).
71. Colonial Surety Co. v. United States, 108 Fed.Cl. 622, 633 (2013).
72. *Id*.
73. *Id*; *see also* George J. Bachrach, James D. Ferrucci, Dennis J. Bartlett: The Contract Bond Surety's Subrogation Rights, Chapter 15 (ABA Publishing, 2013).

issues. As such, a surety should understand its options post-default which may help reduce its damages. If a default termination cannot be avoided, a surety must be prepared to, among other things, propose an acceptable takeover agreement to the government.

PANEL 6

ESTABLISHING PREJUDICE TO THE SURETY WHEN PERFORMANCE BOND NOTICE PROVISIONS ARE NOT FOLLOWED

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Establishing Prejudice to the Surety When Performance Bond Notice Provisions Are Not Followed

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Pearlman 2021

I. Introduction

Like other contracts, performance bonds contain terms setting forth the rights and duties of the contracting parties. When a bond obligee fails to comply with the conditions precedent set forth in a performance bond, the obligee risks losing the benefit of the bond entirely. Indeed, the notice provisions in performance bonds, which are commonly listed as a condition precedent for a surety's performance, are not mere procedural hurdles. They ensure that a surety whose principal has defaulted in its obligations can act swiftly to mitigate its potential losses arising from the default. This article addresses the prejudice to a surety resulting when a surety does not receive timely notice of its principal's default and how the surety may prove that prejudice as a defense to bond liability.

II. Bond Terms Relating to the Surety's Prejudice from Lack of Notice

A. Bonds must be interpreted pursuant to established rules of contract construction.

A performance bond is a contract and, as such, is subject to the general laws of contract construction.[1] And, where the provisions of the performance bond are clear and unambiguous, a court must enforce the terms of the bond as written.[2] In the context of a surety asserting that an obligee has failed to comply with bond provisions, courts examine the language of the

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[1] *Cates Constr., Inc. v. Talbot Partners*, 980 P.2d 407, 413 (Cal 1999) ("Performance bonds, like all contracts of surety, are construed with reference to the same rules that govern interpretation of other types of contracts"); *Mid-State Sur. Corp. v. Thrasher Eng'g, Inc,*.575 F. Supp. 2d 731, 740–41 (S.D.W. Va. 2008) ("A performance bond is a contract and thus is subject to the general rules of contract interpretation and construction."); *Hightower and Co., Inc. v. U.S. Fidelity &Guar. Co.*, 527 So. 2d 698 (Ala. 1988) (performance bond is subject to general rules of contract interpretation); *Hendricks v. Blake & Pendleton, Inc.*, 472 S.E. 2d 482 (Ga. Ct. App. 1996) (same); *Republic Ins. Co. v. Bd. of County Comm'rs*, 511 A.2d 1136 (Md. 1986) (same).

[2] *Arch Ins. Co. v. Graphic Builders LLC,* No. CV 19-12445-NMG, 2021 WL 534807, at *5 (D. Mass. Feb. 12, 2021) ("Here, this Court concludes that the Performance Bond clearly and unambiguously imposes conditions precedent which must occur before [surety] Arch is required to perform any of its obligations thereunder."

contract/bond to determine the intent of the parties, the subject matter of the contract/bond, and its object and purpose.[3]

B. Bonds typically contain conditions precedent.

The basic principle of a condition precedent is that Party A must perform a certain condition before Party B has any obligation to perform under the contract/bond. Most performance bonds contain specific conditions precent that must be satisfied before the surety's performance obligations arise. For example, the AIA 312 (2010) performance bond contains the following "condition precedent" language:

> § 3 – If there is no Owner Default under the Construction Contract, the Surety's obligations under this Bond shall arise after:
>
> > § 3.1 the Owner first provides notice to the Contractor and the Surety that the Owner is considering declaring a Contractor Default …;
> >
> > § 3.2 the Owner declares a Contractor Default, terminate the Construction Contract and notifies the Surety; and
> >
> > § 3.3 the Owner has agreed to pay the Balance of the Contract Price in accordance with the terms of the Construction Contract to the Surety or to a contractor selected to perform the Construction Contract.

Significantly, however, § 4 of the AIA 312 (2010) performance bond provides that failure on part of owner to comply with the notice requirement in Section 3.1 "shall not constitute a

[3] *American Home Assurance Co. v. Larkin General Hospital, Ltd.*, 593 So. 2d 195, 197-98 (Fla. 1992) ("A bond is a contract, and, therefore, a bond is subject to the general law of contracts ... To determine the intent of the parties, a court should consider the language in the contract, the subject matter of the contract, and the object and purpose of the contract … the surety on a bond does not undertake to do more than that expressed in the bond, and has the right to stand upon the strict terms of the obligation as to his liability thereon.")

failure to comply with a condition precedent to Surety's obligations, or release surety, except to the extent the Surety demonstrates actual prejudice." *Id.* (emphasis added). Thus, a surety will need to demonstrate "actual prejudice" caused by an obligee's failure to provide timely notice of the obligee's intent to declare a bond principal in default, before the surety's obligation may be reduced on account of such prejudice.

C. Courts' Interpretations of Bond Prejudice Requirements.

Courts interpreting the AIA 312 performance bond have noted that § 4's prejudice requirement is limited just to § 3.1.[4] Thus, by logical extension, the limited nature of § 4 supports arguments that: (i) the other enumerated requirements of §§ 3.1 and 3.2 (actually declaring a default, terminating the bonded contract, notifying the surety of the default/termination, and tendering the contract balance) are conditions precedent to a surety's duty to perform; and (ii) the surety need not necessarily prove prejudice resulting from a violation of the conditions precedent listed in §§ 3.1 and 3.2 before a surety may be relieved of its obligations.[5]

Other forms of performance bonds (non-AIA forms) list notice to the surety as a condition precedent to a surety's performance. Take, for example, the following notice language

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[4] *W. Sur. Co. v. U.S. Eng'g Co.*, 375 F. Supp. 3d 1, 6 (D.D.C. 2019) (Performance bond surety was not required to establish that it was prejudiced by contractor's failure to provide timely notice that the subcontractor whose performance was secured by the bond had defaulted in order for such lack of timely notice to excuse surety's performance under the bond; bond's requirement that surety demonstrate actual prejudice in order for a lack of notice to constitute failure of a condition precedent was limited to a separate notice requirement under performance bond section 3.1.); *Independent Temperature Control Services, Inc. v. Parsons Brinckerhoff, Inc.,* 2017 WL 318654 (N.Y. Sup. Ct. Jan. 20, 2017).

[5] *Sch. Bd. of Escambia County, v. TIG Premier*, 110 F. Supp. 2d 1351, 1354 (N.D. Fla. 2000) (entering summary judgment in favor of surety where school board did not make claim on performance bond until two months after project was completed and stating "courts have consistently held that an obligee's action that deprives a surety of its ability to protect itself pursuant to performance options granted under a Performance Bond constitutes a material breach, which renders the bond null and void"); *Arch Ins. Co. v. Graphic Builders LLC,* Civil Action No. 19-12445-NMG, 2021 WL 534807 (D. Mass. Feb. 12, 2021) (granting surety's motion for summary judgment and finding that obligee materially breached the bond by failing to terminate the subcontract, a condition precedent, thereby rendering the bond null and void and discharging the surety from liability under the bond.)

from a non-AIA form performance bond: "Obligee, after providing reasonable notice to Surety may, or Surety upon demand of Obligee, may arrange for the performance of Principal's obligation …" Courts have enforced this performance bond notice provision to discharge a surety's obligations when an obligee failed to timely declare a default:

> "As soon as Hunt [obligee] knew that NWC [principal] would not complete the job on time, it had an obligation to decide whether to declare NWC in default and notify the Sureties (who might have done something to aid NWC in speeding up the work, whether by hiring more trucks, more workers, more oversight, or whatever, in its judgment, would assist the obligor) … Where the obligee fails to notify a surety of an obligor's default in a timely fashion, so that the surety can exercise its options under the controlling performance bond, the obligee renders the bond null and void." *Hunt Constr. Group v. Nat'l Wrecking Corp.*, 542 F.Supp.2d 87, 95-96 (D.D.C. 2008) (emphasis added).

When there is no notice provision in the performance bond, a *pro tanto* reduction in the surety's liability may be proper to the extent the surety shows prejudice. In the case of *Blackhawk Heating & Plumbing Co. v. Seaboard Sur. Co.*, the Federal District Court for the Northern District of Illinois held:

> "To the extent that Seaboard [surety] could have remedied the delays, and thereby avoided the additional costs, if it had been given an opportunity to do so, Seaboard [surety] is not liable to Blackhawk [obligee] for such delays. However, to the extent that notice would have been futile, that is if given notice Seaboard could not have remedied the delays, then the failure to give notice is immaterial and Seaboard is liable to Blackhawk for any delays which could not have been avoided by Seaboard." 534 F. Supp. 309, 316 (N.D. Ill. 1982) (emphasis added).

Thus, a surety may have a defense to liability (either if the obligee failed to give the surety notice of default or notice of termination in accordance with the terms of the bond, at least to the extent the surety was prejudiced by that lack of notice. Proving prejudice to the surety (and the extent of such prejudice) is a central component of defending against untimely performance bond claims.

III. Demonstrating Prejudice to the Surety from a Lack of Notice

As stated *supra*, notice provisions are not mere procedural hurdles – they ensure that a surety can act swiftly to investigate and mitigate its potential losses relating to its principal's claimed default. If a surety is not allowed to promptly investigate a claim, certain categories of prejudice may result. First, project conditions may be altered. In such cases, the surety may be prevented from (i) independently investigating alleged deficient work, (ii) establishing the condition or status of work at time of default, and/or (iii) fully investigating merits of underlying dispute. These sources of prejudice are typically fact-intensive and project-specific, meaning that the surety will likely require expert testimony to prove the extent such prejudice. Additionally, if the surety is deprived of timely notice of the alleged default, individuals with key project information may move on to other projects, thereby resulting in the lost opportunity to obtain key facts and to retain employees with historic project knowledge.

Lack of timely notice of a principal's default also often prejudices sureties by denying them an opportunity to mitigate financial losses through the use of bonded contract funds (which serve as the surety's collateral). Courts have held that a bond obligee may lose the right to demand coverage if the obligee impairs collateral to which the surety could look for reimbursement. *See St. Paul Fire & Marine Ins. Co. v. Commodity Credit Corp.,* 646 F.2d 1064, 1073 (5th Cir. Tex. 1981) (stating, "while discharge of a surety resulting from the impairment of collateral is usually pro tanto, in this case, the loss was so great that the sureties claimed complete exoneration," and finding the surety not liable on the bonds).[6] Impairing collateral may

[6] Citing *United States v. Continental Casualty Co*., 512 F.2d 475, 478 (5th Cir. 1975).

even include early contract payments to the bond principal, since the surety has subrogation rights to the unpaid contract balance.[7]

In relation to a surety's prejudice caused by unearned/over-payments, Courts have long held that the surety's obligation will be discharged only to the extent that the surety proves such prejudice.[8] And importantly, if the bond principal uses early payments to complete the project, the surety may not be considered to have been prejudiced by such payments.[9] A surety may further be able show prejudice resulting from late notice to the extent that the surety can prove loss of subcontractors and vendors. More specifically, a surety may show evidence of (i) missed opportunities to ratify subcontracts and preserve pricing, (ii) lost knowledge of trade-specific conditions, (iii) lost opportunities to repair defective work performed by subcontractors, and (iv) lost subcontractor warranties.

Lost continuity of production of long-lead items causing project delays,[10] lost opportunity to re-let remaining work,[11] lost opportunity to monitor completion work, and the potential for

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[7] *Southwood Builders, Inc. v. Peerless Ins. Co*., 366 S.E.2d 104, 107-08 (Va. 1988) (Subcontractor's surety was discharged from its obligations under performance bond due to contractor's payments to subcontractor without architect's approval, as required by contract).

[8] *Pickens County v. National Surety Co.,* 13 F.2d 758, 762 (4th Cir. S.C. 1926); *Ohio Cas. Ins. Co. v. United States* 12 Cl. Ct. 590, 596 (1987) (holding that surety was discharged to the extent that the obligee failed to terminate the principal and improperly released contract funds to the principal); *Merchants Bonding Co. v. Pima County*, 860 P.2d 510, 513 (Ariz. Ct. App. 1993) (holding that surety was entitled to recover as damages the amount of obligee's final payment to principal made without surety's consent following's principal's default and bankruptcy filing).

[9] *Ramada Development Co. v. United States Fidelity & Guaranty Co.,* 626 F.2d 517, 522 (6th Cir. Mich. 1980) (General contractor departed from terms of surety contract in knowingly making payments to subcontractor for which work had not been completed, but discharge of surety in any amount was improper, where at time that general contractor made payments on estimates, it in good faith believed that subcontractor would be able to complete job if payments were made to it); see also *Transamerica Ins. Co. v. Kennewick*, 785 F.2d 660 (9th Cir. Wash. 1986) (City's premature materials payment to sewer construction contractor did not prejudice contractor's surety, and thus, did not release the surety, where, while technical letter of the contract may have been violated, city acted reasonably to compromise disagreement with contractor while protecting itself and its surety from additional financial exposure by paying only for materials which were in fact on hand at construction site and paid for by the contractor).

[10] Expert scheduling/delay analysis may be necessary to establish this source of prejudice.

increased delay/liquidated damage claims by the obligee are other sources of prejudice to a surety. Indeed, absent receiving timely notice of default, a surety will likely face difficulty establishing competitive bidding procedures for replacement contractors. Further, the lost opportunity to monitor project completion may prejudice the surety by denying the chance to investigate latent defects as they arise, ensure cost-effective completion of change orders, and ensure that the scope of completion work aligns with the bonded scope of work and does not constitute a betterment. The extent of prejudice from these sources will most likely be fact-intensive and require expert testimony from seasoned construction consultants.

Among the host of reasons that an obligee is required to provide timely notice of the principal's default is that sureties can mitigate damages by mediating and potentially resolving the dispute between the principal and obligee before the contract is terminated. Sureties are in a unique position to resolve project disputes because, at the time of alleged default, both the bond obligee and principal will often look to the surety for assistance. The bond obligee will look to the surety to guaranty performance of the contract, whereas the bond principal may look to the surety as a potential ally in a good faith project dispute, while also seeking to minimize its liability (and that of any individual indemnitors) under a general liability agreement.

The surety's influence over both the obligee and its principal could peak near the time of an alleged default and present the best opportunity for the surety to cooperatively resolve project disputes. Again, however, if the surety does not receive timely notice of the alleged default, the relationship between the principal and obligee may be unsalvageable, and the opportunity for meaningful mediation may be lost.

Absent a surety receiving timely notice and meaningful opportunity to resolve project disputes between its bond principal and the obligee, a distressed principal may demobilize, lose

key employees with project knowledge, and not be able to continue performing – even with surety support. Such outcomes would deprive the surety of its right to employ its principal to complete the project, and thereby prejudice the surety. Courts have recognized a surety's right to employ its principal (or even employ its principal's employees if permission to re-employ the principal is withheld by the obligee) to complete bonded work following receipt of a performance bond claim.[12] Accordingly, where a surety is denied the opportunity to mitigate its losses by employing its principal to avoid project delays and increased costs typically associated with hiring replacement contractors, a surety will likely be able to demonstrate prejudice.

IV. Conclusion

The notice provision in performance bonds ensure that a surety whose principal has defaulted in its obligations can act swiftly to mitigate its potential losses arising from the default. When a surety does not receive timely notice of its principal's default, the surety will inevitably be prejudiced. Proving the extent of such prejudice, however, may be accomplished through a variety of means depending on the prevailing law of the jurisdiction and factual circumstances at hand. In most circumstances where a surety has been prejudiced by untimely notice of its principal's default, a surety would be wise to quickly retain a consultant with experience navigating a surety's performance options in complicated, and often hotly-disputed, construction projects.

[12] *R. C. Walters Co. v. DeBower*, 216 N.W.2d 515 (Neb. 1974) (finding prejudice to surety where obligee failed to provide timely written notice of default and deprived surety of opportunity to use principal to complete work and likely reduce damages); *St. Paul Fire & Marine Ins. Co. v. City of Green River, Wyo.*, 93 F. Supp. 2d 1170 (D. Wyo. 2000), aff'd, 6 F. App'x 828 (10th Cir. 2001) (Under Wyoming law, performing surety, which elected not to utilize procedure for completing construction project specified in bond involving completion of project by original bonded principal contractor with consent of owner obligee, was not precluded from using personnel of bonded principal without consent of obligee under second performance option involving surety's assumption of primary responsibility for completion of project.)

PANEL 7

SURETY EXPOSURE IN DESIGN/BUILD & CM AT RISK DELIVERY METHODS

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PEARLMAN 2021

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Columbia Winery | Woodinville, WA

Surety Exposure in Design/Build & CM at Risk Delivery Methods

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Ty Oksuzler – JS Held,
Will Beasley – Merchants Bonding Company

I. Introduction

Sureties are in the business of assessing risk. All construction contracts have risks. From a classic standpoint and project delivery method, the "hammer on nail" performance risk is always there. In traditional lump sum agreements procured through a design-bid-build process, the three key components of any construction contract are generally well defined. The three key components, of course, being cost, schedule, and scope. The contractor has to construct the project. CMAR with GMP and design/build contracts have this basic risk. They also tack on an additional element of nebulous scope at the time of execution because unlike the lump sum agreement, CMAR with GMP and Design-Build Agreements are agreements where the owner and contractor basically agree to finalize a cost and schedule at a future date when the scope is adequately defined. The parties basically agree to "agree again on a price down the road". The reality is that the owner usually has a budgetary constraint and often has time constraints for placing its facilities into use. Therefore, it is the scope that must be adjusted to meet the budgetary and time constraints. These contracts do offer the benefit of contractor input during design which can create opportunities for cost savings by virtue of the contractor's awareness of current market trends and conditions. CMAR with GMP and Design-Build Agreements also offer the option for early start of initial scopes of work as the overall project scope is finalized. However, these forms of agreement do present added risk to contractors if price amendments are executed prematurely with inadequate scope definition. The earlier in the design process the parties execute price amendments the greater the risk. By extension, bonding these jobs means more risk for the surety.

Regardless of the extra risk, owners seem to like these delivery methods. They can provide early completion opportunities and cost savings. Additionally, the contractor serves as the owner's single contact person in the case of the Design-Build Agreement, making that method enticing for inexperienced owners. With owner desire for these delivery methods, they're not going away anytime soon. Accordingly, the surety needs to know how to handle them. This paper addresses the additional risk the surety takes on, offers ways to minimize that risk, and touches on potential claim defenses.

II. Contract Delivery Methods and Their Risks

a. Design/Bid/Build

Conventional Design-Bid-Build projects generally effectively define the cost, schedule, and scope of the project at the time of execution with plans that are 100% complete and approved for permitting by the local authority having jurisdiction. Most conflicts surrounding scope can be resolved by examination of the construction documents. The scopes are defined in writing and if the construction

documents don't adequately communicate the owner's expectations, the owner is faced with change orders to modify the scopes to meet its expectations. CMAR with GMP and Design-Build Agreements, through their provisions for cost development before 100% design completion, pose the potential for issues over the owner's expectations conflicting with the contractor's expectations that can be challenging to reconcile.

b. *CMAR with GMP*

CMAR with GMP projects engage the contractor in the design process before plans are fully developed. The design risks are still borne by the owner and architect, but the owner can enjoy the benefit of the contractor's input on design systems and selections with an awareness of present market conditions. AIA A133 is an industry recognized form of agreement for this delivery method which prescribes a methodology for gradual development of the contract sum culminating in a Guaranteed Maximum Price Amendment. If this prescription is followed, risks to the contractor of scope misunderstandings can be mitigated. The prescriptive path (Article 3.2.3) towards establishment of the Guaranteed Maximum Price Amendment include:

- A listing of plans and specifications upon which the contract price is based.
- A list of clarifications and assumptions by the contractor which attempt to define scopes of work that aren't yet fully developed in the plans and specifications under development by the owner's architect.
- A statement of the Guaranteed Maximum Price (a breakdown of the cost organized in trade categories, allowances, and contingencies.
- An anticipated date of completion (schedule)
- A date by which the owner must accept the GMP (an expiration date that protects the contractor against market fluctuations)

The AIA A133 further stipulates that the contract cost and schedule are established at a time mutually agreed upon by the owner and contractor. Overly eager contractors may assume added risks by prematurely agreeing to cost and schedule before the scope is adequately defined. The stages of design consist of; pre-design, schematic design, design development, and construction documents. A prudent contractor will engage in GMP amendment somewhere in the latter stages of Design-Development and the early stages of Construction Document production. While a GMP can be executed sooner than that, it dramatically increases the possibility of scope disagreements between the owner and contractor. The contractor can mitigate those risks through a robust list of clarifications and assumptions to confine scope possibilities in the incomplete design documents.

Even if the parties choose a form of agreement other than the AIA A133, the prescriptive path outlined in Article 3.2.3 should be incorporated into the form of agreement selected and followed faithfully by the parties.

c. Design Build Delivery Method

The Design-Build delivery method presents the contractor (or Design-Builder) with the same potential risks as the CMAR with GMP but adds a dimension of risk by shifting the design burden from the owner and the owner's architect to the contractor. The AIA A141 is an industry recognized form for this delivery method which, similar to the AIA A133, offers a prescriptive path towards gradual development of the contract sum culminating in the Design-Build Amendment. The prescriptive path (Article 4.4.1) towards establishment of the Guaranteed Maximum Price Amendment include:

- A listing of preliminary design documents and the Design-Builder's list of clarifications, assumptions, and deviations from the owner's criteria upon which the proposal is based.
- The compensation method and a written statement of the estimated cost (a breakdown of the cost organized in trade categories, allowances, and contingencies.
- An anticipated date of completion (schedule)
- An enumeration of qualifications and exclusions.
- A list of the Design-Builder's key personnel and subcontractors/suppliers.
- A date by which the owner must accept the Design-Builder's proposal (an expiration date that protects the contractor against market fluctuations)

Similar to the CMAR with GMP delivery method, the Design-Builder should engage in the Design-Build Amendment at a time at which the Design-Builder is confident that the design documents are sufficiently advanced and that any remaining undefined scopes are documented and confined within its list of clarifications, assumptions, qualifications, and exclusions.

Again, if the parties choose a form of agreement other than the AIA A141, the prescriptive path outlined in Article 4.4.13 should be incorporated into the form of agreement selected and adhered to by the parties.

III. Underwriting Considerations to Minimize Risk

Factors the Surety's underwriters should evaluate in issuing bonds include:

a. Experience and sophistication of the parties. The more versed the owner and contractor are in these delivery methods the better.

b. The form of agreement. Does the agreement provide a prescriptive path for the gradual development of the contract price in tandem with the design?

c. Are the parties following the contract provisions as they pertain to development of the contract price in tandem with the design?

d. Are the design documents sufficiently advanced? Later stage design-development or early-stage Construction Documents should consist of hundreds of plan sheets and comprehensive project manuals.

e. Are the plans and specifications, to the extent they are developed, specifically enumerated in the agreement?

f. Are allowances clearly defined?
g. Are contingencies clearly defined with parameters as to which entities control the contingencies?
h. Has a schedule been developed and incorporated into the agreement?

If the underwriter is uncertain about the form of agreement or that the parties are executing cost amendments prematurely, the underwriter should investigate deeper into the circumstances.

IV. Common Performance Defenses

Performance claims for projects that include a design element or an underdeveloped design can be tricky. The surety must unpack the usual performance disputes and also inquire about the design portion of the job. This can become even more complicated if the design was never fully developed and agreed to by the parties. When investigating these situations, the surety should be attuned to potential defenses. While the specific claim situation will drive what defenses may be available, this section will highlight the three "usual suspects" that may be available, as well as others.

a. Overpayment

The overpayment defense is commonly referred to as impairment of suretyship or collateral. Eric G. Korphage, Derek A. Popeil, and Diane J. Schumaker, *Defenses Available to the Surety* in THE LAW OF PERFORMANCE BONDS (3rd Ed. 2018). By overpaying the contractor, the owner increases the surety's risk by wrongfully releasing collateral (the contract funds). Common examples include: making progress payments for uncompleted work; paying for work that is known (or should be known) to be defective; and by failing to withhold retainage. David J. Krebs and Shannah J. Morris, *The Surety's Obligations under the Performance Bond: To Perform or Not to Perform* in THE BOND DEFAULT MANUAL (4th Ed. 2015). Depending on facts and jurisdiction, overpayment may discharge the surety completely or *pro tanto*.

Overpayment issues are common in the context of project delivery methods that include a design obligation or an underdeveloped design. For example, if the contractor bills, and the owner pays, 100% for a scope of work that is known to be incomplete, the defense would be applicable. However, reference to the particular contract is important. With design/build contracts, it's not uncommon for the certification of payment requirement to be more lax (the contractor is also serving as the designer who would normally perform the certification).

b. Material/Cardinal Change

Material contract changes that prejudice the surety provide a defense and potential discharge. Shannah J. Morris, *The Surety's Obligations under the Performance Bond: To Perform or Not to Perform* in THE BOND DEFAULT MANUAL (4th Ed. 2015). The key concept is that the surety shouldn't be on the hook for a material and nonconsensual increase of its risk. 4A BRUNER & O'CONNOR CONSTRUCTION LAW § 12:70. Thus, the inquiry is often whether a change in the bonded contract imposes materially different risks.

Design/build and CMAR with GMP agreements are rife with the potential for large-scale changes. Accordingly, the surety should be cognizant of what the original agreement was (including original price), and what actually came about on the jobsite. For example, the surety should inquire if there's a significant increase in the contract price or if the type of work itself changed from that which was originally contemplated. To the extent that the parties failed to adequately define the scope of work as prescribed in AIA A133 and A141, betterment arguments can be developed. There are two sides to conflicts over clashing scope expectations.

c. Contractor Defenses

It is a fundamental principle of suretyship that a surety cannot be liable when the principal is not. *See* RESTATEMENT (THIRD) OF SURETYSHIP & GUARANTY § 34 (1996). Thus, it's hornbook law that the surety is entitled to its principal's defenses. Shannah J. Morris, *The Surety's Obligations under the Performance Bond: To Perform or Not to Perform* in THE BOND DEFAULT MANUAL (4th Ed. 2015). Contracts that include a design element or underdeveloped design are no different. Accordingly, the surety must make a careful analysis of the defenses the principal may provide. Such defenses may include, but are not limited to: scope increases/entitlement to additional compensation; failure to make payment; and contract maladministration.

In *Omaha Pollution Control Corp. v. Carver Greenfield Corp*., 413 F. Supp. 1069 (D. Neb 1976), the court held that a contract for the design and construction of a sewage processing plant was a contract for the sale of goods. As such, the court ruled that the design-builder was liable for breaches of the UCC's implied warranties of fitness and merchantability. *See Int'l Prod. Specialists v. Schwing Am.*, 2007 U.S. Dist. LEXIS 77389, *28-30, 2007 WL 2903239 (E.D. Wisc 2007)

d. **Defenses to Warranty Claims**[1]

When an owner supplies design-related information that is to be incorporated into the design or used in the bidding process, the owner may be held to have impliedly warranted that information.

In *Colorado-Ute Electric Ass'n v. Envirotech*, 524 F. Supp. 1152 (D. Colo. 1981), a contract to design and install a portion of an electric power plant contained performance guarantees requiring the design-builder to provide a unit that complied with state air quality standards. When the plant did not achieve those standards, the owner brought suit against the design-builder, which raised, among other defenses, impossibility. The court rejected all of the design-builder's defenses (including owner's deviations from design specifications), holding that it assumed the risk of impossibility by expressly warranting that it could build a compliant unit.

In *Aleutian Constructors v. United States*, 24 Cl. Ct. 372 (1991), a contractor building a hangar and dormitory for the Air Force obtained the government's permission to alter the roof design. When the roof was damaged by high winds, the contractor sued the government to obtain the costs of repair, claiming impossibility and defective design. The court rejected the contractor's

[1] *See generally*, Harold E. Hamersmith and Edward B. Lozowicki, Can the Spearin Doctrine Survive in a Design-Build World: Who Bears Responsibility for Hybrid Specifications? Journal of the ACCL (2008)

claim, holding that the contractor "created its own misfortune" and thereby assumed the risk of impossibility. The court also held that the design builder could not avail itself of the *Spearin* doctrine as a contractor who had a hand in creating its own misfortune, cannot invoke the protection of a Spearin warranty. *See Bethlehem Corp. v. United States*, 199 Ct. Cl. 247, 254 (1972).

In *M.A. Mortenson Co.*, ASBCA No. 39978, 93-3 BCA ¶ 26,189 (June 30, 1993), the Army Corps of Engineers ("Corps") supplied design criteria for a medical facility project. The Corps informed bidders that the information could be used to prepare their bids. The contractor used the quantities for concrete and rebar contained in the design criteria to price its bid. When the final design was approved, the contractor submitted a claim for an equitable adjustment for increased quantities of concrete and rebar required to achieve the final design. The Corps denied the claim on the grounds that the contractor had assumed the risk that extra quantities of materials might be required to complete the project since the contractor had entered into a fixed-price, design-build contract. The Armed Services Board of Contract Appeals, however, ruled in favor of the contractor, holding that the Corps had not indicated that the contractors were to use the information that the Corps had provided at the contractors' risk. As such, the contractor was entitled to recover the costs of the additional concrete and rebar ("At its most basic, the Government's interpretation is that appellant [contractor] assumed the risk of any cost growth in connection with the structural concrete and reinforcing steel when it agreed to a fixed price for the construction phase. As the Government recognizes, this interpretation effectively reads the Changes clause out of the contract." By creating such a specific plan and requesting the contractors to rely on it for their estimates, the Government warranted the specifications and was responsible for paying for any additional materials required.

In *Armour & Co. v. Scott*, 360 F. Supp. 319 (W.D. Pa. 1972), the court found that an owner became so involved in the design process of a design-build project that it became a de facto partner of the design-builder. The owner made substantial changes to the electrical and mechanical systems and increased the size of the plant. The owner and the design-builder sued one another in an attempt to recover the increased costs of constructing the plant. The court found that both parties' conduct amounted to breaches of contract and that it was impossible to determine which party was responsible for the increased cost of construction. Consequently, the court did not award damages to either party.

V. Conclusion

By taking appropriate steps, sureties can mitigate risk in bonding contracts that include a design component. The underwriting process should confirm the principal's experience and skillset and appropriate use of contract documents (including allowances for contingencies etc.). Moreover, when dealing with a claim situation, the surety should be cognizant of common defenses, such as overpayment and material changes.

PANEL 8

THE SURETY'S ABILITY TO ASSERT DEFENSES OF ITS BOND PRINCIPAL

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PEARLMAN 2021

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The Surety's Ability to Assert Defenses of its Bond Principal

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Introduction:

Generally, a surety's liability is measured by the language of the bond, the obligation it guarantees, and applicable statutes or regulations. Under circumstances where the surety agrees to be bound by a judgment against its principal, the entry of judgment against the principal is a condition precedent and generally triggers the surety's liability. However, in those instances where the surety guarantees an obligation, but has not agreed to be bound by a judgment against its principal, the surety's resulting liability is less predictable and may hinge on myriad factors, including but not limited to rights afforded the surety under the indemnity agreement.

Courts recognize that the assignment, right-to-settle, and attorney-in-fact clauses are standard provisions in the Indemnity Agreement in the surety industry. *Harlandale Indep. Sch. Dist. v. C2M Const., Inc.,* 2007 WL 2253510, at *2 (Tex. App. Aug. 8, 2007). While these provisions provide the surety with critical and expansive rights in order to protect the surety's financial interests and mitigate the surety's exposure to loss, the protective nature of these provisions may also be employed to the surety's detriment. Accordingly, it is important for the surety to be fully aware of the rights afforded under indemnity agreement and how courts may interpret those rights in the context of litigation against the principal and surety.

A. Surety and the Principal are sued: Effect of Default Judgment against the Principal

1. The General Rules

i. Judgment on the Merits

To begin, the *Restatement (Third) of Suretyship & Guaranty* § 67 (2) (1996) sets forth the general rule regarding the effect of a ***judgment on the merits*** entered against the bond principal:

> When, in an action by the obligee against the principal obligor to enforce the underlying obligation, a judgment is given in favor of the obligee other than by default, confession, stipulation, or the like, the judgment creates a rebuttable presumption of the principal obligor's liability to the obligee in a subsequent action of the obligee against the secondary obligor to enforce the secondary obligation.

Stated differently, a judgment on the merits against the bond principal is prima facie evidence of the surety's liability – that is, the judgment creates a rebuttable presumption of the surety's liability. Under this rule, when the surety is unable to rebut the presumption in favor of the judgment against the principal, the time and expense of relitigating the same issues of fact

will be saved. Of course, even if the surety is unable to rebut the presumption of the principal's liability, the surety may still raise its independent surety defenses.

ii. Default Judgment

The *Restatement (Third) of Suretyship & Guaranty* § 67 (3) (1996) sets forth the general rule regarding the effect of a ***default judgment*** entered against the bond principal:

> When, in an action by the obligee against the principal obligor to enforce the underlying obligation, a judgment in favor of the obligee is obtained by default, confession, stipulation, or the like, the judgment against the principal obligor is evidence only of its rendition in a subsequent action of the obligee against the secondary obligor to enforce the secondary obligation.

The general rule regarding the effect of a default judgment is premised upon several public policy reasons. First, a judgment by default lacks probative significance compared to a judgment after trial on the merits. Second, the arguments of policy and efficiency against duplication of trials and economic waste have little weight where there has not been a determination made by a fact finder after consideration of evidence introduced by both sides to the litigation. Thus, a judgment against the principal obtained by default does not create a presumption in favor of the principal's liability in the subsequent action by the obligee against the surety; rather such a judgment is evidence only of its rendition.

The general rule in subsection (3) of the Restatement is exemplified by cases such as *United States v. Hayes,* 369 F.2d 671, 675 (9th Cir. 1966) ("When, therefore, a creditor has obtained a judgment against the principal in an action which the principal has not contested, that judgment, in the creditor's subsequent and first suit against the guarantor, cannot and should not, of itself alone, constitute prima facie evidence of the amount of the guarantor's obligation."); *Gearhart v. Pierce Enterprises, Inc.,* 779 P.2d 93, 95 (Nev. 1989) (although a principal may have been properly defaulted, it was improper to enter a default judgment until the matter had been adjudicated with respect to the surety); *United States ex. rel. Vigilanti v. Pfeiffer-Neumeyer Const. Corp.,* 25 F.Supp. 403, 405 (E.D.N.Y. 1938)("The surety was not responsible for the principal defaulting in this action. Upon the trial of this action it was entitled to offer its defenses. It was not in any way bound by the default judgment obtained against the principal").

Again, the reasoning of the *Restatement* is that the probative significance of a default judgment is much less than that of a judgment on the merits. Also, arguments against duplication of trials and economic considerations have little weight where there has not been a determination made by a fact finder after presentation of evidence by both sides to the litigation.

The seminal case establishing the general rule is *United States ex. rel. Fidelity Nat'l Bank v. Rundle,* 107 F. 227, 229 (9th Cir. 1901). *Rundle* involved a lawsuit against a contractor for a debt claimed to be owed and against the contractor's surety. The contractor did not appear or defend and judgment was entered against it. The surety did appear and asserted the defenses of both itself and its principal, the contractor. The plaintiff argued that the surety should be

prevented from contradicting the allegations against the defaulted contractor. The court refused, explaining:

> . . . a judgment against the principal upon a bond such as that here sued upon is not admissible in evidence against the sureties, except: First, in cases where the bond is conditioned to pay such judgment as may be rendered against the principal; and, second, in cases in which the sureties have had the opportunity to appear and defend in the action against the principal . . . The present case does not come within the letter of the first exception to the rule, nor within the spirit and intent of the second. . . . This is not the ordinary case in which a judgment has first been obtained against the principal, and a second action is brought against the sureties to compel its payment. . . . Here the action is brought in the first instance against the principal and his sureties.

Rundle, 107 F. at 229.

Many other jurisdictions have agreed with *Rundle's* reasoning that a principal's silence and failure to appear cannot be shown in evidence against sureties actively defending in same action. *United States ex. rel. Vigilanti*, 25 F.Supp. at 405 (New York law); *Sutter v. Hill,* 101 N.E.2d 502 (Ohio App. 1950)(Ohio law); Gearhart, 779 P.2d at 95 (Nevada law); *Heritage Ins. Co. v. Foster Electric Co.,* 393 So.2d 28 (Fla. App. 1981) (Florida law); *Treasurer and Receiver General v. Macdale Warehouse Co.,* 262 Mass. 588, 160 N.E. 434(1928) ("The entry of default against the principal is not equivalent to a final judgment…. As a judgment by default against a principal is not a final judgment on the merits, the surety is not bound by it.")

The reasoning in *Rundle* clearly is intended to encourage sureties to act when they are not already doing so. The decisions seek to discourage sureties from "standing idly by," and later making claimants re-try their cases. This is related to another important policy of conserving judicial resources. Surety cases addressing this issue have generally adopted the reasoning in *Rundle.* Indeed, some states have codified this rule, including California and West Virginia; however, some jurisdictions take a more nuanced approach and the results are less predictable.

2. Departure from the General Rule

Under the traditional rule, the primary inquiry to determine the effect of a judgment against the principal was on the merits of the controversy, and whether the surety had notice and an opportunity to defend. However, some more recent cases focus on secondary factors, such as the language of the indemnity agreement and the surety's efforts to exercise its contractual remedies in those cases in which the surety appears in the proceeding, but its principal fails to respond.

The Eleventh Circuit departed from the reasoning in *Rundle* in *Drill South, Inc. v. International Fidelity Ins. Co.,* 234 F.3d 1232 (11th Cir. 2000), *reh'g en banc denied,* 248 F.3d 1186 (11th Cir. 2001), *cert. denied,* 532 U.S. 1020 (2001). The facts in *Drill South* were squarely in the *Rundle* pattern - the surety was actively defending in the same action in which the principal was defaulted.

In *Drill South*, the claimant obtained a judgment by default against the principal, the surety having advised that it took no position on a default judgment against its principal, provided that the default judgment was not deemed binding on it as surety. Several months later, the court concluded that the surety was bound by the default judgment and awarded summary judgment against it.

On appeal, the surety, relying upon the general rule, argued it could not be bound by a default judgment against its principal because such judgments are not binding upon a surety actively defending in the same action. Although the court expressly acknowledged the general rule and the "existence of the authority supporting that position," it rejected the general rule on the basis that it did not find the "reasoning persuasive." The Court reasoned that: "[t]he record is replete with instances in which the district court afforded the surety both notice and opportunity to step in and defend the merits of the claims against its principal and the extent of its liability." However, despite the district court's order directing any party wishing to be heard on the request for a judgment by default, the surety "chose not to defend the principal against the default judgment and offered no evidence on principal's liability, and failed to step in and defend the merits of the judgment or damages."

In the opinion, the Court began its analysis, like *Rundle*, by stating the general rule that a surety is bound by its principal's default if the surety had full knowledge of the action and an opportunity to defend. However, the Court seized upon the rights afforded the surety under the Indemnity Agreement, which gave the surety the right to step and defend the principal. Thus, the Court concluded that the surety's failure to do so warrants a departure from the rule established in *Rundle*.

The *Drill South* court's decision is a direct rejection of the *Rundle* conclusion that a default judgment is not binding when the surety is actively defending in the same litigation. However, aside from the surety's opportunity to defend the bond principal under the Indemnity Agreement, the reasons for this departure were not clear in *Drill South*. For example, the court wrote that its decision would discourage sureties from standing idly by while defaults enter against their principals. Of course, this was a policy expressly shared by the *Rundle* line of cases, but those cases concluded that a surety that is actively participating in the same action is not "standing idly by."

In addition, in departing from *Rundle*, *Drill South* relies on two cases that do not hold a default judgment as conclusive, but rebuttable: *Home Insurance Co. of New York v. Savage*, 103 S.W.2d 900 (Mo. App. 1937) and *Charleston & Western Carolina Railway Co. v. Robert G. Lassiter & Co.,* 179 S.E. 879 (N.C. 1935); and on two other cases that are expressly premised upon violations of state statutes: *First Mobil Home Corp. v. Little,* 298 So.2d 676 (Miss. 1974); *Massachusetts Bonding & Insurance Co v. Central Finance Corp.,* 237 P.2d 1079 (Colo. 1951). Thus, none of the cases cited in *Drill South* adequately explains the Eleventh Circuit's rejection of *Rundle*.

The general rule was further undermined by the Supreme Court of Virginia, which followed *Drill South's* holding *in American Safety Cas. Ins. Co. v. C.G. Mitchell Const., Inc.*, 601 S.E.2d 633 (Va. 2004).

In *American Safety*, the Supreme Court of Virginia extended the analysis in *Drill South* to bind a surety with a default judgment imposed as a discovery sanction against its principal.

In *American Safety*, the principal and the surety retained separate counsel and both filed responsive pleadings on their own behalf. However, after the principal's counsel withdrew, its registered agent resigned and its corporate existence was terminated. The claimant then scheduled the principal's corporate deposition. After the principal failed to appear for the deposition, the claimant filed a motion to compel the appearance of the principal's corporate designee and assessment of sanctions. The trial court granted the motion to compel and required a corporate designee to appear on behalf of the principal. As a discovery sanction, the court entered default judgment against the principal, despite the fact that American Safety claimed there were genuine issues of material fact as to damages.

Ultimately, the court entered summary judgment against American Safety, rejecting American Safety's argument that it did not have the ability to make a corporate designee appear on behalf of its principal and that it had a right to defend itself against the payment bond claim.

On appeal, American Safety argued that the discovery sanction was too severe because the claimant suffered no prejudice, among other arguments. The court concluded its opinion with the following observation:

> American Safety had notice of every step in the proceedings that led to the entry of those two orders. In fact, counsel for Mitchell wrote American Safety's counsel in order to obtain available dates before scheduling both the first and the second deposition of Nations' corporate designee. But, as previously stated, American Safety never attempted to designate a corporate representative to appear at a deposition on behalf of Nations. It was not until the hearing on Mitchell's motion for summary judgment that American Safety even argued that it did not have the authority under the Indemnity Agreement to make that designation.

3. Recent Reaffirmation of the General Rule

In *Angelo Iafrate Const., LLC. v. Potashnick Const., Inc.,* 370 F.3d 715 (8th Cir. 2004), a case substantially similar to *Drill South* and *American Safety,* the court expressly declined to extend *Drill South*. In that case, the obligee filed suit against the principal and its surety under a performance bond. The surety answered and actively defended, but the principal did not. A default was noted by the clerk and the matter went to trial as against the surety who substantially prevailed. The obligee then obtained default judgment the principal. On appeal, the Eighth Circuit reasoned that *Drill South* involved a judgment by default "entered without objection by the surety and before the surety fully litigated its own case," and therefore declined to extend it to a circumstances in which the surety had obtained a favorable ruling before the default judgment was entered against its principal. *Iafrate Construction* highlights the importance of the

surety acting quickly and decisively to defeat a payment or performance bond claim where the bond principal has failed to appear or answer.

In *Harris County Water Control v. Philadelphia Indemn. Ins. Co.,* 2019 WL 5191129 (USDC SD Texas), the obligee filed suit against both the principal and the surety. The surety actively defended against the obligee's claim, but the principal failed to file responsive pleadings. The court entered an order of default against the principal; however, the court denied the obligee's subsequent motion for default judgment because of the potential for incongruous and inconsistent rulings, and prejudice to the surety, relying, in part, on the rule set forth in *Frow v. De La Vega, 82 U.S. 552, 554 (1872)* that "when one of multiple defendants who is facing a joint liability action has defaulted, judgment should ***not be*** entered against him until the matter has been adjudicated as to all defendants, or all defendants have defaulted." (emphasis added). Importantly, the Court also noted the surety could raise arguments the principal could have raised.

Most recently, in *Maguire-O'Hara Constr., Inc. v. Cool Roofing Sys., Inc.,* 2020 WL 6532852, (W.D. Okla. Nov. 5, 2020) a Miller Act payment bond claimant filed a Motion in Limine to exclude surety from asserting defenses available to its bond principal because surety lost defenses of its bond principal when an order of default (but not judgment) was entered against bond principal and surety did not defend bond principal despite notice and opportunity to do so.

The Court distinguished itself from *Drill South* on the basis that no judgment had been entered against the bond principal and that, in any event, denying default judgment against the bond principal was appropriate in order to avoid inconsistent judgments. Entry of default *judgment* against one party should not occur "until and unless the claims against the remaining defendants are resolved on the merits." See *Gen. Steel Domestic Sales, LLC v. Chumley*, 306 F.R.D. 666, 668-669 (D. Colo. 2014).

Ultimately, the Court held that the surety "retains…the defenses of" its bond principal. If the Court held otherwise, the surety would have no defenses and would be held liable without an opportunity for adjudication on the merits – an illogical result considering surety law jurisprudence. In reaching this decision, though, the trial court indicated this ruling may have likely been different if a judgment, such as a default judgment, had been entered against the bond principal.

4. Jurisdictions Likely to Follow *Drill South*

New Mexico **-** *Van Meter v. Mr. Z of Albuquerque, LLC,* 2005 WL 8164244 (USDC D. New Mex) (appears to follow *Drill South*); see also *McAlpine v. Zangara Dodge, Inc.,* 183 P.3d 975 (Ct. App. NM 2008)

Georgia - *WFI Georgia, Inc. v. Government Technical Services*, LLC, 2009 WL 10701929 (USDC NDGA) (appears to follow *Drill South*)

Missouri - *Harris v. Mortgage Professionals, Inc.*, 781 F.3d 946 (8th Cir. 2015) (appears to follow *Drill South*)

Arkansas - *Hartford Fire Ins. Co. v. Harris Co. of Fort Smith, Inc.,* 143 F. Supp. 3d 800, 806 (W.D. Ark. 2015) (affirms holding in *Drill South*)

Kansas - *Davis Contracting, L.P v. B.E.N. Construction, Inc.*, 2007 WL 293915 (USDC D Kan) (appears to follow *Drill South*)

5. Jurisdictions Unlikely to Follow *Drill South*

Texas - *Trinity Universal Ins. Co. v. Briarcrest County Club Corp*, 831 S.W.2d 453 (Tex. App. 1992) (where there was issue of fact as to whether surety had adequate opportunity to litigate merits and prevent default from issuing against principal, summary judgment against surety was not appropriate)

California - *All Bay Mill & Lumber Co., Inc. v. Surety Co. of the Pacific*, 208 Cal.App.3rd 11 (1989) (where surety litigated merits and won, after principal had defaulted, judgment against principal was not binding on surety).

Nevada - *Gearhart v. Pierce Enters., Inc.,* 779 P.2d 93 (Nev. 1989) (where surety was not responsible for principal's failure to comply with discovery order, default judgment against principal was not binding on surety).

New York - *Aeschlimann v. Presbyterian Hospital,* 165 NY 296 (1901) (A surety may defend an action against its principal, may assert any legal or equitable defense available to the principal, and may prove the defense at trial, especially when the surety is a party to the action).

Washington - *Ward v. LaMonico*, 47 Wn.App. 373, 380, 735 P.2d 92 (1987).

6. Strategies and Recommendations in light of *Drill South*

The general theme throughout both *Drill South* and *American Safety* is the Courts' reliance upon the sureties' indemnity agreements, specifically the power of attorney, right-to-settle, and assignment clauses. The Courts concluded that the Indemnity Agreements afforded the sureties the right and opportunity to defend their principals. This reasoning is confounding because it effectively turns the indemnity agreement on its head, obligating the surety to defend its bond principal.

Drill South and *American Safety* highlight the importance of the surety's attention to filing an answer and responding to discovery on behalf of its bond principal in order to avoid entry of default judgment. Alternatively, when faced with litigation involving an unresponsive principal who may have a default judgment entered against it, the surety should petition the court to enter an order that the default judgment will not have any preclusive effect against the surety.

Nevertheless, the surety's ability to do so may depend on a variety of factors, including but not limited to whether the surety has the ability to exercise such rights under the indemnity agreement, whether the surety's primary defenses are those belonging to its bond principal, the governing jurisdiction, economic considerations, and other factors.

PANEL 9

ARE ATTORNEYS' FEES RECOVERABLE FROM A MILLER ACT PAYMENT BOND?

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ARE ATTORNEYS' FEES RECOVERABLE FROM A MILLER ACT PAYMENT BOND?

Jason R. Fair, Shauna Szczechowicz, John Egbert

The authorities support a conclusion that attorneys' fees are generally not recoverable under the Miller Act. Under the American Rule, attorneys' fees are recoverable only if such recovery is provided for in contract or statute. The plain language of 40 USC §3133 limits recovery under a Miller Act payment bond to the "amount unpaid" for labor and material furnished in carrying out the work provided in the contract, at the time the civil action is brought. Nowhere does the Miller Act explicitly provide for an award of attorney's fees. This has been the basis for those decisions wherein courts have concluded that Miller Act claimants are not entitled to recover attorney's fees.

In *F.D. Rich Co. v. U.S. ex rel. Lumber Co., Inc.*, the US Supreme Court acknowledged that the Miller Act does not explicitly provide for award of attorney's fees. 417 U.S. 116, 126 (1974). However, its main holding was that Miller Act claimants could not use state law as a basis for attorney's fees, which the claimants were attempting to do here. *Id.* at 130-131. Specifically, the Supreme Court held that the Miller Act provides a federal cause of action and the scope of the remedy as well as the substance of the rights created thereby is a matter of federal not state law. *Id.* at 127. The Supreme Court further concluded that litigants are better served with a rule of uniform national application. *Id.*

The Ninth Circuit later addressed the same issue in *F.D. Rich Co., U.S. ex rel. Leno v. Summit Const. Co.*, where it more concretely concluded that attorney's fees are not recoverable under the Miller Act. 892 F.2d 788, 791 (1989). The court reasoned that "Congress did not intend to incorporate state law governing the award of attorneys' fees into the Miller Act and saw no compelling reason to create a Miller Act exception to the general American rule. Therefore, unless there is a separate state claim at the trial level attorneys' fees are not available in a Miller Act suit even when state law provides for such an award." *Id.* (internal citation omitted).

The decision in *F.D. Rich Co., U.S. ex rel. Leno v. Summit Const. Co.* was followed by similar holdings throughout the jurisdiction. In *Technica LLC ex rel. U.S. v. Carolina Casualty Insurance Co.*, while attorney's fees were not at issue, the court acknowledged that there is a federal interest in the uniform application of law in Miller Act cases in determining that state laws cannot be used to provide an award of attorney fees to a Miller Act claimant where such a right is not provided by federal law. 749 F.3d 1149, 1153 (9th Cir. 2014). The court in *U.S. ex rel. Hajoca Corp. v. Aeroplate Corp.* went even further, holding that attorney's fees are only recoverable if there is a contractual provision providing so. No. 1:12-CV-1287-AWI-BAM, 2013 WL 3729692, at *7 n. 1 (E.D. Cal. July 12, 2013).

However, an earlier case allowed an award of attorney fees to a Miller Act claimant because, unlike the facts in *F.D. Rich Co. v. U.S. ex rel. Lumber Co., Inc.*, the contract at issue contained an attorney fee provision. *U.S. for Use & Benefit of Reed v. Callahan*, 884 F.2d 1180, 1182-1183 (9th Cir. 1989). The Court of Appeal relied on the reciprocal provision of California Civil Code 1717 in awarding the attorney fees. *Id.* at 1185-1186. The Court of Appeal's application of California Civil Code 1717 runs contrary to the holding of *F.D. Rich Co. v. U.S. ex rel. Lumber Co., Inc.*, which provides that state laws cannot be used to provide an award of attorney fees to a Miller Act claimant.

The court in *Prime Mech. Serv., Inc. v. Fed. Sols. Grp., Inc.* is more a recent decision that again denied a fee award, but this time the decision applies to sureties seeking recover. No. 18-CV-03307-MMC, 2019 WL 2423509, at *1 (N.D. Cal. June 10, 2019). The court there held that a surety is not

allowed to recover attorney's fees after defeating a Miller Act claim against it because the Miller Act does not provide for fees. *Id.* at *3. While there was an attorney's fees provision in the subcontract between its principal and the claimant, the court held that the surety could not rely on the provision because it was not a party to the subcontract.

Notably, the old line of cases awarding fees under the former "justly due" language in the Miller Act are no longer controlling because they were based on a version of the Miller Act that has since been repealed. *See U.S. for Benefit of Sherman v. Carter*, 353 U.S. 210 (1957); *see North Star Terminal & Stevedore Co. ex rel. v. Nugget Const. Inc.*, 126 Fed.Appx. 348 (9th Cir. 2005).

In conclusion, the Ninth Circuit has set some bright line parameters in expressing that attorney's fees are generally unavailable under the Miller Act. While that is the case in the Ninth Circuit, the same may not be said for other circuits. It is important to check the case law in the relevant circuit to determine the parameters of what fees or costs are or aren't recoverable under the Miller Act.

PANEL 10

30 IN 30:

INSIGHTS FROM 30 YEARS OF SURETY ENGINEERING IN 30 MINUTES

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30 in 30:
Insights from 30 Years of Surety Engineering in 30 Minutes

Doug Dearie, Liberty Mutual (retired)
Ali Salamirad, SMTD Law LLP
Rodney J. Tompkins Jr., RJT Construction, Inc.

Introduction:

Successful surety claims handling often requires the retention and input of engineering claims consultants to analyze design and construction issues on both public and private work projects. Surety consultants regularly assist sureties with both payment and performance bond claims. On the payment side, consultants are called upon to analyze payment claims by, among other things, confirming that the work performed by the claimant is compliant and that payment of the amount claimed is due. On the performance side, consultants are called upon to determine the remaining work that needs to be completed and identifying the most efficient and responsible manner to complete that work for the obligee.

(Many, many) years ago, Panelist Doug Dearie was hired by Safeco Insurance Company of America to serve as an "in-house" engineer. Safeco felt that having an in-house resource that was available to its claims professionals would benefit the overall claims handling process and mitigate surety loss. The decision paid off. Indeed, since then, many sureties, large and small, have in-house engineers on their team – capable of assisting the entire surety operation (claims and underwriting) with immediate input on construction related matters and, as importantly, managing the retention and supervision of outside consultants hired by the surety for specific issues and disputes.

The following paper discusses just a few of the major "takeaways" from the in-house engineer's perspective, along with input from outside lawyers and consultants.

Principal's Administrative and Project Controls:

Many performance issues relate to the Principal's ability to properly estimate the cost and time required to properly administer increasingly burdensome requirements on public works projects. Contractors, small and large, have consistently shown an inability to adequately account for these requirements.

The administrative requirements for public works construction projects continue to become more voluminous and complex. Furthermore, the requirements are increasingly passed down through the contract chain to subcontractors and sub-tier subcontractors, many of whom do not have the wherewithal to adequately comply.

This is not a new issue or a new trend. However, the actual demand placed upon the contractor's project management team can present a significant issue if those requirements are not clearly understood, and appropriately planned for. One of the critical elements for the Surety professional to get a handle on, is whether or not the contractor has allocated the appropriate

staff, and perhaps more importantly, has the Principal included enough money in their bid or contract to address the administrative and project management demands or requirements. In a competitive bid situation, this is one area of project cost that is often underbid or under allocated.

Additionally, as a claims professional, it is important to understand or gather an understanding as to whether or not the Principal and or their staff have the necessary skills to manage these requirements. The skillset and administrative capabilities of the Principal's project management team is the most critical element. This skillset is entirely different than the Principal's ability to actually construct the job. For example, in a complex $900MM dollar project with a very large and sophisticated general contractor, the contracts and specifications require that even the smallest subcontractor with a $3MM dollar scope of work must adhere to all of the same administrative requirements as the GC. Among other things, these subcontractors are required to prepare schedule updates, Time Impact Analysis, coordinated subcontractor integration, security protocols, use and compliance with project management software, and many more requirements.

Ability To Comply With Schedule Requirements and Time Impact Analysis:

Schedule analysis and monthly Time Impact Analysis (TIA) take both time and expense. It is not uncommon for smaller contractors or certain trades to be unfamiliar with the extent and detail required in these monthly submissions. Many of these contractors may not have an in-house scheduling professional or may not have the skillset or the time to review schedule updates and logic ties to adequately compile a Time Impact Analysis and or the appropriate narrative that is usually required to be submitted with the schedule update.

From the Surety's perspective, a contractor's ability to comply with these requirements is critical, as it may determine whether, and to what extent, the contractor is entitled to additional time and money. It is important that consultants review and determine if the contractor has been keeping up with these requirements and determine if the documents that have been submitted have been accepted.

Many contracts will bar time extensions, and or extended overhead claims or change orders if the corresponding TIA's and schedule updates were not submitted timely, or not accepted. Of course, these provisions are the subject of disputes and litigation and they are rarely a complete bar to equitable solutions. For a Surety claims professional, at the outset of an investigation, it is important to recognize the status of these issues and understand where the argument or fight may be at the conclusion of the project. These schedule and update submission documents should be part of the initial Books and Records review. Whether or not the TIA's and schedule updates are accepted or rejected, review copies of any of the correspondence that coincide with those monthly submissions. It may also be helpful to review how much time the contractor spends on these activities, and whether or not they actually have the capability to produce the level of work product or submission that is required or specified in the contract documents.

Estimating and Tracking Costs:

Contractors often underestimate the amount of management time and money that needs to be allocated to administering their contracts in their bids. This is often compounded by the fact that the contractor needs to assist and manage its subcontractor's compliance with the administrative requirements on the project.

If the Surety needs to get involved in a re-let and completion contractor scenario, some of the increase in completion costs or "re-let premium" can often be attributed to the need to increase staffing and management of the administrative and project controls requirements of the contract documents by the completing contractor. In some cases, this may be related to the efforts required to "Catch-up" and get fully integrated into the project.

Concerns regarding LEED:

LEED stands for Leadership in Energy and Environmental Design and is a green building rating system administered by the US Green Building Council. Consultants need to pay attention to LEED requirements that are expressly included in the bonded contract or incorporated by reference therein. LEED Requirements have resulted in many claims and disputes and require the Surety's attention.

California has some of the more aggressive LEED requirements, but many other states as well as Federal projects are implementing more stringent LEED or Green Building requirements into specifications. Some of which includes a number of guidelines as to acceptable materials, pre-fabrication certifications and the process of getting those certifications, inspections throughout the manufacturing process of key components, tracking and documenting the materials that come on, or off the project. This includes the disposal of any materials from the site, or the re-use and repurposing of materials from the project.

In the event of claim or default, the Surety generally does not know if these critical requirements have been met. After reading the specifications and determining what is required, consultants should determine whether the Principal has complied. If they have, it is critical to secure compliance documents. If they have not, it is important to account for the added cost of compliance in any estimate of the potential loss on the project.

Unique Requirements on Specialty Projects:

Certain project types or owners also present unique, specific, restrictive, or extraordinary contractual requirements. Projects involving NAVFAC, Army Corp of Engineers, Department of Defense, Aerospace, or Airport projects often include unique challenges. Typical issues in these types of projects involve limited site access, security clearance/background checks for all laborers, daily security protocols, odd or limited work hours, challenging working conditions, use of preapproved subcontractors, material and delivery limitations.

Additionally, these projects often require more detailed QA/QC guidelines and may require that a certified QA/QC consultant or project team member be on site at all times to monitor work, and

or sign off and submit the necessary QA/QC documents. Some project specifications dictate the certifications required of QA/QC personnel, and often this certified individual is not an existing member of the contractor project management team and needs to be retained for the particular project.

For Federal projects in particular, getting a response, answer, direction, or approval of Change Orders may take significant amount of time. In many of these Federal or Military projects, delays are common, and in many cases the impacts of these delays are not adequately compensated. The contractor will be granted time, but in most cases not granted additional funds for extended overhead without a lengthy dispute resolution process. These are all manageable issues that need to be considered on certain types of specialty projects.

Getting Ahead of the Issues:

Consultants need to review the bonded contract to determine what was required of the Principal and determine if that work has been performed. Often, these issues are not raised by the defaulted Principal, and rear their head months or years later during completion of the work.

For example, has the Principal received approved submittals for critical work elements or equipment? Submittal requirements and submittal tracking logs can be voluminous and is worthy of careful attention, the details matter. Has the Principal obtained the necessary permits required to perform the project successfully? The time to identify and resolve these types of issues is at the outset of the Surety's involvement – not months later when the issues may cause critical delays to project completion.

Other key areas to identify as early as possible in the review process involve claim and dispute resolution requirements. Knowing what is required is step one. Determining if those requirements have been met is step two. Making sure the Surety/completion contractor follow these requirements during completion is step three.

Though it may not be on the top of the list of immediate issues or concerns, the status of closeout documents, and in particular status of As-Built drawings can be a significant issue. The As-Builts in particular are incredibly challenging to re-create accurately, if not impossible. Forensically re-creating As-builts is an expensive and time-consuming effort fraught with issues. Often the people that are responsible for updating the As-Builts (the PM, or PE) throughout the project, may not be available to you in the event of a default or termination. Understanding how complete the As-builts are, and where they are, should be high on the priority list.

Often, initial books and records review focus a great deal on the financial status of the project or the company as it stands at that moment in time. However, some of these details will have a significant financial impact down the road if not understood or addressed up front. Construction claims or defaults can be messy and complicated. There are a countless number of issues that could arise, but experience has shown that in many cases issues can be more successfully managed or impacts mitigated if identified and addressed as early as is possible.

Conclusion:

Surety professional, claims managers, or their Engineering consultants need to identify, understand and confirm compliance with a myriad of management and administrative issues on construction projects in order to successfully assist the Surety in mitigating its loss. Over time, these issues have continued to expand in volume, detail, and in some cases complexity. However, the issues almost always involve at least some element of an initial failure by the Principal or other contractors to adequately estimate, plan for, manage and or pay for compliance with the variety of administrative, management, or project control requirements.

PANEL 11

A PRIMER TO ENTITLEMENT AND QUANTIFICATION OF COVID IMPACT CLAIMS

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A PRIMER TO ENTITLEMENT AND QUANTIFICATION OF COVID IMPACT CLAIMS

Jarrod Stone
Chris Simmelink
Richard Tasker

I. INTRODUCTION

Whether it be directly or indirectly, nearly every facet of American life, including the construction industry, has been impacted by the COVID-19 Pandemic. In fact, one of the authors of this paper is drafting it while on quarantine because to members of his household have contracted COVID-19. Frankly, the true nature and extent of the COVID-19 Pandemic's impact upon the construction industry may not be known for years, if not decades. In the meantime, owners, contractors, and sureties are proverbially making their way through uncharted territories where most construction activities have been deemed "essential" but the COVID-19 Pandemic has directly or indirectly impacted the timing and cost of nearly every construction project. Each of the authors of this paper has dealt with and/or is currently dealing with construction projects involving impact claims arising from the COVID-19 Pandemic, some of which have/may be resolved amicably and some of which will be resolved judicially once the judicial backlog eventually subsides and some of the issues addressed in this paper are litigated.

Against that background, this paper is intended to provide a very high-level primer of some of the issues owners, contractors, and sureties may face when disputed issues arise in relation to the entitlement to and quantification of impact claims arising from the COVID-19 Pandemic, with a focus on impacts on the timing and price of construction projects. This paper briefly outlines the provisions of manuscripted contracts, modern AIA contracts, and Federal contracts governed by the Federal Acquisition Regulations (the "FAR"). This paper also briefly outlines the types of evidence that may be necessary to establish the COVID-19 Pandemic's impact on timing/price, as well as methods of quantifying those impacts.

II. CONTRACTUAL RIGHTS ARISING FROM COVID-19 IMPACTS

A. Manuscripted Contracts

Force majeure clauses and price escalation clauses are two of the most common types of clauses that may entitle contractors (or the sureties) to relief in relation to impacts on the timing and costs on construction projects arising from the COVID-19 pandemic. Both types of clauses are briefly discussed below.

1. Force Majeure Clauses

Black's Law Dictionary defines a force majeure clause as "[a] contractual provision allocating the risk of loss if performance becomes impossible or impracticable, esp. as a result of

an event or effect that the parties could not have anticipated or controlled."[1] A leading treatise has described force majeure clauses as follows:

> Parties to commercial contracts use provisions called force majeure clauses to reduce uncertainty when an extreme event (such as a natural disaster or a public health emergency) they may not foresee or control (a force majeure event) makes performance impossible, illegal, or commercially impracticable. Force majeure clauses:
>
> - Allocate the risk of a negotiated list of force majeure events.
> - Excuse the impacted party's performance during the force majeure event.
> - Impose notice and mitigation obligations on the impacted party.
> - Set out the other party's rights (including the right to terminate the contract) if the force majeure event continues for an extended time.
> - Reduce the probability that a court applies a common law or Uniform Commercial Code (UCC) doctrine to allocate force majeure risk. These may include the doctrines of:
>   - frustration of purpose;
>   - impossibility;
>   - impracticability; and
>   - commercial impracticability under UCC Section 2-615.[2]

Generally speaking, there are two common types of force majeure clauses, which the authors will describe as "broad/open ended" versus "specifically defined." The former type will generally set forth an unrestricted list of force majeure events, whereas the latter will generally set forth a finite list of force majeure events. An example of a "broad/open ended" force majeure clause may read as follows:

> No party shall be liable or responsible to the other party, or be deemed to have defaulted under or breached this Agreement, for any failure or delay in fulfilling or performing any term of this Agreement [(except for any obligations to make payments to the other party hereunder)], when and to the extent such party's (the "Impacted Party") failure or delay is caused by or results from the following force majeure events ("Force Majeure Event(s)"): (a) acts of God; (b) flood, fire, earthquake, [OTHER POTENTIAL DISASTER(S) OR CATASTROPHE(S), SUCH AS EPIDEMICS,] or explosion; (c) war, invasion, hostilities (whether war is declared or not), terrorist threats or acts, riot or other civil unrest; (d)

[1] FORCE-MAJEURE CLAUSE, Black's Law Dictionary (11th ed. 2019).
[2] Force Majeure Toolkit, Practical Law Toolkit w-026-1791.

> government order, law, or action; (e) embargoes or blockades in effect on or after the date of this Agreement; [and] (f) national or regional emergency; [and] [(g) strikes, labor stoppages or slowdowns, or other industrial disturbances;] [and] [(h) telecommunication breakdowns, power outages or shortages, lack of warehouse or storage space, inadequate transportation services, or inability or delay in obtaining supplies of adequate or suitable materials;] **[and] [(i) other similar events beyond the [reasonable] control of the Impacted Party**].][3]

In the authors' experience, almost every force majeure clause, whether it be classified as "broad/open ended" or "specifically defined," will include epidemics and/or pandemics as force majeure events. Generally speaking, an epidemic is the occurrence of more cases of a disease than would be expected in a community or region, whereas a pandemic is an epidemic that becomes widespread and may affect larger regions. In other words, all pandemics are epidemics, but not all epidemics are pandemics. In any event, if a manuscripted contract contains a force majeure clause, then the force majeure clause will likely govern the contracting parties' rights and remedies in relation to any impacts the COVID-19 pandemic may have on the timing and cost of the construction project at issue.

2. Price Escalation Clauses

Though such clauses were less common before the COVID-19 pandemic, a manuscripted contract may contain a price escalation clause, which may allocate the risks associated with the increase of the cost of labor or material during the life of the construction project. For example, as a result of the skyrocketing price of lumber arising from the COVID-19 pandemic, the North Carolina Home Builders Association recommended that builders include the following "Escalation Clause for Specified Building Materials" to their contracts:

> The contract price for this residential construction project has been calculated based on the current prices for the component building materials. However, the market for the building materials that are hereafter specified is considered to be volatile, and sudden price increases could occur. The Builder agrees to use his best efforts to obtain the lowest possible prices from available building material suppliers, but should there be an increase in the prices of these specified materials that are purchased after execution of contract for use in this residential construction project, the Owner agrees to pay that cost increase to the Builder. Any claim by theBuilder for payment of a cost increase, as provided above, shall require written notice deliveredby the Builder to the Owner stating the increased cost, the building material or materials in question, and the source of supply, supported by invoices or bills of sale.
>
> **Specified Building Material/ Current Price per (Unit of Measurement)/ Date /Supplier**
>
> **SPECIAL CIRCUMSTANCES – RIGHT OF TERMINATION**
>
> Should there be a rise in the cost of any specified building material or materials,

[3] General Contract Clauses: Force Majeure, Practical Law Standard Clauses 3-518-4224 (emphasis added).

> exclusive of any other price changes, that would cause the total contract price to increase by more than (%), the Builder shall, before making any additional purchases of specified material or materials, provide to the Owner a written statement expressing the percentage increase of the contract price, the building material or materials in question, and the dollar amount of the price increase to be incurred. The Owner may then, at his option, terminate the contract by providing within _________ business days both written notice of termination to the Builder, and payment to the Builder for all costs expended in performance of the contract to the date of termination, plus payment of a prorated percentage of the Builder's profits based on the percent of completion. Should both notice of termination and full payment not be forthcoming within ________ business days, as provided herein, the Builder shall have the option to terminate the contract, or to proceed with the contract and purchase the specified building materials at the increased price. If termination is elected, the Builder shall provide to the Owner a written notice of termination, andthe Owner shall be required to pay the Builder for all his costs expended in performance of the contract to the date of termination, plus payment of a prorated percentage of the Builder's profits based on the percent of completion. If the Builder elects to proceed on the contract, he may then purchase the specified material or materials at the increased price, and the Owner shall be required to pay the increased cost incurred.[4]

If included in a manuscripted contract, a price escalation clause would likely govern (1) the particular types of labor or material encompassed by the clause, (2) the events/conditions that may trigger the clause, (3) and the contracting parties' rights and remedies once a triggering event/condition has occurred.

B. AIA Contracts

Notably, despite the fact that they are commonly used in the construction industry on both public and private projects, neither the A101-2017 Standard Form Agreement Between Owner and Contractor (the "AIA Contract") nor the A201-2017 General Conditions of the Contract for Construction (the "AIA General Conditions") contains a price escalation clause or a provision that is specifically designated as a force majeure clause. Nonetheless, both the AIA Contract and the AIA General Conditions contain provisions that may entitle contractors (and their sureties) to "adjustments" to the "Contract Time" and/or the "Contract Sum" arising from the COVID-19 Pandemic, which are outlined below.

1. "Contract Time"

In a nutshell, the "Contract Time" under the AIA Contract is the time period during which "Substantial Completion" must be reached. Section 8.1.1 of the AIA General Conditions states that, "[u]nless otherwise provided, Contract Time is the period of time, **including authorized adjustments**, allotted in the Contract Documents for Substantial Completion of the Work." (Emphasis added). Section 9.8.1 of AIA General Conditions states that "Substantial

[4] https://www.nahb.org/-/media/NAHB/advocacy/docs/legal-issues/construction-liability/trending-now/escalation-clause-specified-building-materials-2018.pdf

Completion is the stage in the progress of the Work when the Work or designated portion thereof is sufficiently complete in accordance with the Contract Documents so that the Owner can occupy or utilize the Work for its intended use." Section 8.1.3 of AIA General Conditions further states that the date of Substantial Completion of the Work or a designated portion of the Work is the date certified by the architect under the procedure set forth in Section 9.8.

The Substantial Completion date is often fixed in one of two ways: (1) by granting the contractor a set number of days from the date of commencement of the Work to achieve Substantial Completion; or (2) by simply picking a particular calendar date by which Substantial Completion must be achieved. More specifically, Section 3.1 of the AIA Contract states:

> The date of commencement of the Work shall be (*Check one of the following boxes*):
>
> [ ] The date of this Agreement.
>
> [ ] A date set forth in a notice to proceed issued by the Owner.
>
> [ ] Established as follows:
>
> (*Insert a date or a means to determine the date of commencement of the work.*)
>
> If a date of commencement of the Work is not selected, then the date of commencement shall be the date of this Agreement.

Section 3.2 of the AIA Contract further clarifies that "the Contract Time shall be measured from the date of commencement of the Work." Section 3.3.1 of the AIA General Conditions further states:

> **Subject to adjustments of the Contract Time as provided in the Contract Documents**, the Contractor shall achieve Substantial Completion of the entire Work:
>
> *(Check one of the following boxes and complete the necessary information.)*
>
> [ ] Not later than ( ) calendar days from the date of commencement of the Work.
>
> [ ] By the following date:

(Emphasis added). Thus, the concepts of "Contract Time" and "Substantial Completion" are inherently intertwined. However, the AIA Contract expressly acknowledges that the "Contract

Time" is subject to "adjustments," and the entitlement to such "adjustments" arising from the COVID 19 Pandemic are discussed below.[5]

i. Section 8.3 of the AIA General Conditions — Delays and Extensions of Time

Section 8.3 of the AIA General Conditions, which is entitled "Delays and Extensions of Time," entitles contractors (and their sureties) to "adjustments" to the "Contract Time" arising from impacts of the COVID-19 pandemic. Section 8.2.1 of the AIA General Conditions clarifies that the "[t]ime limits stated in the Contract Documents are of the essence of the Contract" and that "the Contract Time is a reasonable period for performing the Work." Section 8.2.3 of the AIA General Conditions also requires the contractor to "proceed expeditiously with adequate forces and shall achieve Substantial Completion within the Contract Time." However, Section 8.3 of the AIA General Conditions entitles contractors (and their sureties) to "adjustments" to the Contract Time" arising from the COVID-19 Pandemic as follows:

> **§ 8.3.1 If the Contractor is delayed at any time in the commencement or progress of the Work by** (1) an act or neglect of the Owner or Architect, of an employee of either, or of a Separate Contractor; (2) by changes ordered in the Work; (3) by labor disputes, fire, **unusual delay in deliveries**, unavoidable casualties, adverse weather conditions documented in accordance with Section 15.1.6.2, **or other causes beyond the Contractor's control**; (4) by delay authorized by the Owner pending mediation and binding dispute resolution; or (5) by other causes that the Contractor asserts, and the Architect determines, justify delay, **then the Contract Time shall be extended for such reasonable time as the Architect may determine**.
>
> **§ 8.3.2** Claims relating to time shall be made in accordance with applicable provisions of Article 15.
>
> **§ 8.3.3** This Section 8.3 does not preclude recovery of damages for delay by either party under other provisions of the Contract Documents.

(Emphasis added). While there may be disputes as to the extent of the impact arising therefrom, there is no question that the COVID 19 Pandemic has disrupted deliveries and delayed construction on many projects in ways that were beyond contractors' control. On its face, however, Section 8.3 of the AIA General Conditions only relates to "adjustments" of the "Contract Time," as opposed to adjustments to the "Contract Sum."

ii. Article 10 of the AIA General Conditions — Protection of Persons and Property

[5] Like any other "adjustment" to the "Contract Time," an "adjustment" to the "Contract Time" may be made by the agreement of the parties by virtue of a "modification" arising from a change order or a construction change directive. This paper focuses on the instances in which no agreement is reached.

Article 10 of the AIA General Conditions, which is entitled "Protection of Persons and Property," entitles contractors (and their sureties) to "adjustments" to the "Contract Time" (and the "Contract Sum") associated with exigent actions taken to protect the safety of workers and others on projects as a result of the COVID 19 Pandemic. As a preliminary matter, Section 10.1 of the AIA General Conditions places responsibility upon the contractor "for initiating, maintaining and supervising all safety precautions and programs in connection with the performance of the Contract." Section 10.2.1.1 of the AIA General Conditions also requires "take reasonable precautions for safety of, and shall provide reasonable protection to prevent damage, injury or loss to . . . employees on the Work and other persons who may be affected thereby . . . ." Section 10.2.2 of the AIA General Conditions further obligates contractors to comply with "applicable laws, statutes, ordinances, codes, rules and regulations, and lawful orders of public authorities bearing on safety of persons or property or their protection from damage, injury or loss," which would include the various "stay at home orders" that have been issued and/or the "social distancing requirements" imposed during the COVID 19 Pandemic. More importantly for purposes of this paper, Section 10.4 of the General Conditions grants the contractor the discretion to take action to prevent the threat of injury to workers and others in connection with COVID 19 Pandemic as follows:

> **In an emergency affecting safety of persons or property, the Contractor shall act, at the Contractor's discretion, to prevent threatened damage, injury or loss. <u>Additional compensation or extension of time claimed by the Contractor on account of an emergency shall be determined as provided in Article 15 and Article 7</u>.**

(Emphasis added).

iii. Section 15.1.6 of the AIA General Conditions — Claims for Additional Time

As noted above, "Claims" for "adjustments" to the "Contract Time" under both Section 8.3 of the AIA General Conditions and Article 10 of the AIA General Conditions are subject to the procedure for "Claims" set forth in Article 15 of the AIA General Conditions, which is entitled "Claims and Disputes." Section 15.1.1 defines a "Claim" as follows:

> A Claim is a demand or assertion by one of the parties seeking, as a matter of right, payment of money, a change in the Contract Time, or other relief with respect to the terms of the Contract. The term "Claim" also includes other disputes and matters in question between the Owner and Contractor arising out of or relating to the Contract. The responsibility to substantiate Claims shall rest with the party making the Claim. This Section 15.1.1 does not require the Owner to file a Claim in order to impose liquidated damages in accordance with the Contract Documents.

The time limits and notice requirements for "Claims" are set forth in Articles 15.1.2 and 15.1.3 of the AIA General Conditions, respectively. With respect to "Claims" for increases in the "Contract Time," Section 15.1.6.1 of the AIA General Conditions states:

> If the Contractor wishes to make a Claim for an increase in the Contract Time, notice as provided in Section 15.1.3 shall be given. The Contractor's Claim shall include an estimate of cost and of probable effect of delay on progress of the Work. In the case of a continuing delay, only one Claim is necessary.

The methods of estimating the "probable effect of delay on progress of the Work" arising from the COVID-19 Pandemic are discussed below.

2. "Contract Sum"

The terms "Contract Sum" and "Contract Price" are often used interchangeably, and they are both tied to the total amount payable to the contractor, including authorized adjustments, for performance of the "Work." Specifically, Section 9.1.1 of the AIA General Conditions states, "The Contract Sum is stated in the Agreement and, **including authorized adjustments**, **is the total amount payable by the Owner to the Contractor for performance of the Work under the Contract Documents**." (Emphasis added). Article 4.1 of the AIA Contract requires to Owner to "pay the Contractor the Contract Sum in current funds for the Contractor's performance of the Contract," but notes that the "Contract Sum" is "subject to **additions and deductions** as provided in the Contract Documents." A "Claim" for an adjustment to the "Contract Sum" arising from emergency action taken to protect workers and others from harm may entitle a contractor to an increase in the "Contract Sum" as detailed below.

i. Article 10 of the AIA General Conditions — Protection of Persons and Property

As discussed more fully above, Article 10 of the AIA General Conditions, entitles contractors (and their sureties) to "adjustments" to the "Contract Sum" associated with exigent actions taken to protect the safety of workers and others on projects as a result of the COVID 19 Pandemic. The authors reiterate that Section 10.4 of the General Conditions grants the contractor the discretion to take action to prevent the threat of injury to workers and others in connection with COVID 19 Pandemic as follows:

> **In an emergency affecting safety of persons or property, the Contractor shall act, at the Contractor's discretion, to prevent threatened damage, injury or loss. Additional compensation or extension of time claimed by the Contractor on account of an emergency shall be determined as provided in Article 15 and Article 7.**

(Emphasis added). Thus, contractors may be entitled to an increase in the "Contract Sum" in relation to emergency actions taken to protect the safety of workers and others on construction projects.

ii. Section 15.1.6 of the AIA General Conditions — Claims for Additional Costs

As noted above, "Claims" for "adjustments" to the "Contract Sum" under Article 10 of the AIA General Conditions are subject to the procedure for "Claims" set forth in Article 15 of the AIA General Conditions. With respect to "Claims" for increases in the "Contract Sum," Section 15.1.5 of the AIA General Conditions states:

> If the Contractor wishes to make a Claim for an increase in the Contract Sum, notice as provided in Section 15.1.3 shall be given before proceeding to execute the portion of the Work that is the subject of the Claim. **Prior notice is not required for Claims relating to an emergency endangering life or property arising under Section 10.**

(Emphasis added).

C. Federal Contracts Governed by the FAR

Like the AIA Contract and the AIA General Conditions, federal construction contracts governed by the FAR generally do not contain a price escalation clause or a provision that is specifically designated as a force majeure clause. Nonetheless, the Office of Management and Budget issued Memorandum No. M-20-18 on March 20 2020, which noted that federal "agencies should be flexible in providing extension of performance dates if telework or other flexible work solutions, such as virtual work environments, are not possible, **or if a contractor is unable to perform in a timely manner due to quarantining, social distancing, or other COVID-19 related interruptions**." Furthermore, various provisions of the FAR may entitle contractors (and their sureties) to additional time or money as a result of COVID 19 impacts on federal projects, which provisions are discussed below.

1. Excusable Delays

Delays arising from the COVID-19 Pandemic should be excusable and should not provide a basis for termination of a federal construction contract pursuant to the FAR. By definition, delays beyond contractors' or subcontractors' control arising from pandemics are excusable under the "Excusable Delay Clause" set forth in FAR 52.249-14, which states:

> (a) Except for defaults of subcontractors at any tier, **the Contractor shall not be in default because of any failure to perform this contract under its terms if the failure arises from causes beyond the control and without the fault or negligence of the Contractor**. Examples of these causes are (1) acts of God or of the public enemy, (2) acts of the Government in either its sovereign or contractual capacity, (3) fires, (4) floods, (5) **epidemics**, (6) **quarantine restrictions**, (7) strikes, (8) freight embargoes, and (9) unusually severe weather. In each instance, the failure to perform must be beyond the control and without the fault or negligence of the Contractor. Default includes failure to make progress in the work so as to endanger performance.
>
> (b) If the failure to perform is caused by the failure of a subcontractor at any tier to perform or make progress, and if the cause of the failure was beyond the

control of both the Contractor and subcontractor, and without the fault or negligence of either, the Contractor shall not be deemed to be in default, unless—

(1) The subcontracted supplies or services were obtainable from other sources;

(2) The Contracting Officer ordered the Contractor in writing to purchase these supplies or services from the other source; and

(3) The Contractor failed to comply reasonably with this order.

(c) Upon request of the Contractor, the Contracting Officer shall ascertain the facts and extent of the failure. **If the Contracting Officer determines that any failure to perform results from one or more of the causes above, the delivery schedule shall be revised, subject to the rights of the Government under the termination clause of this contrac**t.

(Emphasis added). The authors reiterate that all pandemics are epidemics, but not all epidemics are pandemics.

The fact that uncontrollable delays arising from COVID 19 are excusable because delay is the primary basis upon which a federal construction contract can be terminated for default under Section A of the “Default Clause” set forth at FAR 52-249-10, which states, in relevant part:

> **If the Contractor . . . fails to prosecute the work . . . with the diligence that will insure its completion within the time specified in this contract including any extension, or fails to complete the work within this time**, the Government may, by written notice to the Contractor, terminate the right to proceed with the work (or the separable part of the work) that has been delayed . . . **The Contractor and its sureties shall be liable for any damage to the Government resulting from the Contractor's refusal or failure to complete the work within the specified time, whether or not the Contractor's right to proceed with the work is terminated.** This liability includes any increased costs incurred by the Government in completing the work.

(Emphasis added). However, Section B of the “Default Clause” explains that such excusable delays shall not be grounds for a termination for default as follows:

> The Contractor's right to proceed shall not be terminated nor the Contractor charged with damages under this clause, if—
>
> (1) The delay in completing the work arises from unforeseeable causes beyond the control and without the fault or negligence of the Contractor. Examples of such causes include . . . epidemics . . . quarantine restrictions . . . [or] delays of subcontractors or suppliers at any tier arising from unforeseeable

causes beyond the control and without the fault or negligence of both the Contractor and the subcontractors or suppliers; and

(2) The Contractor, within 10 days from the beginning of any delay (unless extended by the Contracting Officer), notifies the Contracting Officer in writing of the causes of delay. The Contracting Officer shall ascertain the facts and the extent of delay. If, in the judgment of the Contracting Officer, the findings of fact warrant such action, the time for completing the work shall be extended. The findings of the Contracting Officer shall be final and conclusive on the parties, but subject to appeal under the Disputes clause.

Excusable delays arising from the COVID 19 Pandemic may give contractors grounds for converting a termination for default into a termination for convenience under Section C of the "Default Clause," which states:

> If, after termination of the Contractor's right to proceed, it is determined that the Contractor was not in default, **or that the delay was excusable, the rights and obligations of the parties will be the same as if the termination had been issued for the convenience of the Government**.

(Emphasis added).

2. Government's Suspension of Work

To the extent the government suspends works on federal construction contracts as a result of the COVID 19 Pandemic, federal contractors may be entitled to additional time and money under the "Suspension of Work Clause" set forth at FAR 52.242-14. Section A of the "Suspension of Work Clause" authorizes the federal government to suspend work as follows, "The Contracting Officer may order the Contractor, in writing, to suspend, delay, or interrupt all or any part of the work of this contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government." With respect to contractors' entitlement to additional time or money relative to such suspensions of work, Sections B and C of the "Suspension of Work Clause" provides:

(b) **If the performance of all or any part of the work is, for an unreasonable period of time, suspended, delayed, or interrupted (1) by an act of the Contracting Officer in the administration of this contract, or (2) by the Contracting Officer's failure to act within the time specified in this contract (or within a reasonable time if not specified), an adjustment shall be made for any increase in the cost of performance of this contract (excluding profit) necessarily caused by the unreasonable suspension, delay, or interruption, and the contract modified in writing accordingly**. However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent that performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or

negligence of the Contractor, or for which an equitable adjustment is provided for or excluded under any other term or condition of this contract.

(c) A claim under this clause shall not be allowed (1) for any costs incurred more than 20 days before the Contractor shall have notified the Contracting Officer in writing of the act or failure to act involved (but this requirement shall not apply as to a claim resulting from a suspension order), and (2) unless the claim, in an amount stated, is asserted in writing as soon as practicable after the termination of the suspension, delay, or interruption, but not later than the date of final payment under the contract.

(Emphasis added).

III. PREPARING, PROVING, PRICING, AND EVALUATING COVID-19 IMPACTS

Impacts of the pandemic on construction are highly variable. They include direct impacts to the work site and the work force, actions of parties responding to the pandemic (both private and public), and less apparent impacts on material pricing, supply chains, etc.

Unfortunately, the onset of a dangerous, contagious, airborne pathogen was unanticipated by the construction world. Performance of U.S. construction at December 31, 2020 was extremely strong, prices were increasing but at a manageable rate, work opportunities were broad, and the largest concern of many players within the construction community, margins were strong. The largest forecasted concern for Architects and Engineers, General Contractors large and small and trade contractors was labor shortages.

Three months later, the entire construction community was in extreme defensive mode. The workforce was scared. Government leadership was inconsistent, in some locations all shut down by governmental directive. New contract formation ceased almost entirely. Design contracts and even some ongoing work were suspended. The industry was in survival mode.

The construction community responded brilliantly. Competing firms began cooperative relationships to share best practices and respond consistently and comprehensively. The construction work force stepped up and returned to work (some out of economic necessity, some out of commitment, etc.). The Government correctly identified most construction as essential services and the Federal Government responded quickly (very quickly in comparison to "business as usual") with significant loans and direct funding to keep construction open for business.

Measuring the start of COVID-19 impacts on a construction project is often very easy, often there is a day, a specific directive, or event. It will be much more difficult to evaluate the end of COVID-19 impacts on construction projects. We can't know when that will be – or if it will be. COVID-19 overall impacts may have altered the construction environment permanently. Hence, COVID-19 impacts to projects in process in Q1 2020 will end when the project is complete.

However, the implications/nature of the impacts arising from COVID-19 will be significantly different from project-to-project, in trade categories, and over various time frames. As example, labor productivity as measured in the initial stages of the reaction to the virus and in the initial responses, policies, and procedures, will likely be lower than measured with the same work a year later.

Generally, COVID-19 impacts have been negative to productivity and profitability and sometimes to schedule. However, even that is not universal. Construction occurring concurrent to occupancy began much less problematic. In the early months of the pandemic traffic control on road and bridge work was less of a problem.

Measuring and evaluating the impacts of COVID-19 can be very difficult, in part because the impacts may be so broad. Calculating the reduced efficiency of face masks/shields and social distancing can be tricky. It is generally accepted that such requirements will have some impact on productivity, but quantification is difficult. Lumber prices in fall 2020 soared largely due to reduced supply because of severe reductions at the mills (coupled with continued strong demand by a booming residential construction sector). Is the increase in material prices solely attributable to the virus? Numerous manufacturers experienced, and continue to experience, delays in deliveries. This in turn is impacting construction schedules.

From the contractor's/surety's perspective the impacts of complex interactions require a reduction to something much more specific….money.

- Is the aggregate impact of COVID-19 on the project a recoverable cost or avoidable cost (i.e. delay damages)?
- Recoverable/avoidable: what is the evidence and quantification of the impact(s)?
- What costs are properly allocated to the quantified impacts of COVID-19?

In overview, traditional contractual provisions apply.

- If any activity, sequence of activities, or the entire Project schedule was delayed, what is the evidence and magnitude of the delay?
- If actions were taken to mitigate delay, what is the evidence those actions and what delay was mitigated?
- If labor was less productive, how much less productive and how is this calculated?
- If things material or equipment costs increased, how much?

And with each of these, there is the question: Were there other factors occurring concurrently?

It will be years before there is a significant history of construction settlements and judicial findings related to COVID-19 to draw conclusions on both the state of the law and range of outcomes on COVID-19 related Change Order Requests and Claims.

Following are general observations and/or considerations regarding COVID-19 related claims:

A. Quantifying Time Impacts

1. Schedules matter – how accurate, current, detailed, and reliable are they?
2. Status of work at time of initial impact is the starting point.
3. What non COVID-19 related time impacts were pending (i.e., RFIs, etc.) at the “occurrence”?
4. What other changes, not directly linked to the virus, occurred after the pandemic began?
5. What occurred with other related trade performance as well as related performance, such as inspections, response times to RFIs, payments, etc.?
6. What happened with manpower, including quantity, turnover, and absenteeism, etc.?

COVID-19 remained an issue on balance of performance throughout the completion, but the severity of impacts may have varied.

B. Quantifying Cost Impacts

1. Often, productivity of craft labor is the largest element of a COVID-19 claim. Traditional methods of quantifying/proving productivity remain:

    a. Measured mile
    b. Industry standards
    c. Comparisons to similar work/projects
    d. Published cost estimating data which include labor detail
    e. Trade specific productivity surveys
    f. Expert opinion

2. Some trade groups have begun publishing their own COVID-19 productivity analysis and surveys.

3. Project-specific variables that may impact productivity (include, but not limited to):

    a. Craft labor availability and composition
    b. Management and supervision availability and composition
    c. Access to both project site and work area/inter-project flow
    d. Availability of material and equipment
    e. PPE protocols and enforcement
    f. Means and methods of performance
    g. Training
    h. Interface with other trades

PANEL 12

THE LAST FRONTIER:
SALVAGE BY ENCUMBRANCE

Charles Evans | Jermain Dunnagan & Owens, PC | Anchorage, AK

Nick Bajwa | Jermain Dunnagan & Owens, PC | Anchorage, AK

Gerry Carozza | Selective Insurance Company | Branchville, NJ

PEARLMAN 2021

September 9-10, 2021

Columbia Winery | Woodinville, WA

The Last Frontier: Salvage by Encumbrance

Charles G. Evans and Nicholas I. Bajwa

An interesting bit of Surety history:

> "He was a high-class magistrate, and presided at the making of covenants, and saw them carried out, in which capacity he was termed Mac-Nascaire (Mac Neskera), i.e. 'Surety-Man'; and he had 100 armed men to attend him on all state occasions." A Social History of Ancient Ireland by P.W. Joyce Vol.1, p.156 M.H. Gill & Son Ltd (1920).

As Mac-Nascaire, women and men, we occasionally confront difficult large losses with more pending claims caused by an uncooperative principal/indemnitor who has real property assets. So uncooperative in fact, she moves and sells assets preferring other creditors. Time is of the essence. We show how Mac- Nascaire can quickly and unilaterally encumber real property assets by recording a lis pendens or, without filing suit, a deed of trust or mortgage lien. Extension of the common law remedy of quia timet underlies the development of the more extensive contractual rights and remedies found in modern, or current, versions in use of the General Agreement of Indemnity. In particular two clauses, place in funds (collateral demands) and powers of attorney, in the modern indemnity agreement permit unilateral encumbrance of real property assets of the uncooperative principal/indemnitor. Finally, benefits and costs (including risks) are considered.

Black's law dictionary defines encumbrance:

> **Encumbrance** *n.* (16c) A claim or liability that is attached to property or some other right and that may lessen its value, such as a lien or mortgage; any property right that is not an ownership interest. • An encumbrance cannot defeat the transfer of possession, but it remains after the property or right is transferred. — Also spelled *incumbrance.* — **encumber,** *vb.*

Quia timet

Excellent resources from our recent surety treatises[1] address the common law equitable bill of quia timet[2] and the modern general indemnity agreement,[3] and its clauses, including place in funds (collateral demands) and powers of attorney, relevant to the frontier step of the surety's unilateral encumbrance of real property.[4]

"To start, the doctrine is pronounced "kwee-e tim-et…"[5] Jay Mann wrote extensively to chronicle the common law history and to promote the use of quia timet, "the technical name of an equitable remedy which can be extremely valuable to the surety practitioner."[6]

"Quia timet (literal translation, "because he fears') is an action for equitable relief against an anticipated injury."[7] In short, when a surety fears a loss, the equitable powers of a court can require the principal to secure the surety with collateral. Relief under the common law writ of

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[1] Weinstein & Zanotta, eds., The Law of Performance Bonds, 3d ed., ABA, (2018); Lybeck, Lambert, and Sebastian, eds, The Law of Payment Bonds, 2d ed., ABA (2011); Klinger, Bachrach, Haley eds. The Surety's Indemnity Agreement: *Law and Practice*, 2d ed., ABA, (2008); Clore et al. eds. Bond Default Manual, 3d ed. ABA 2005

[2] Weinstein & Zanotta, eds., The Law of Performance Bonds, 3d ed., ABA, (2018) pp 151-154; Lybeck, Lambert, and Sebastian, eds, The Law of Payment Bonds, 2d ed., ABA (2008) pp 723; Klinger, Bachrach, Haley eds. The Surety's Indemnity Agreement: *Law and Practice*, 2d ed., ABA, (2008) p 278; Clore et al. eds. Bond Default Manual, 3d ed. ABA (2005) p 472; See also, Charles Howell, Exoneration of Surety, 22 INS. COUNS. J. 49 (1955): Jay M. Mann, Exoneration and Quia timet, in the LAW OF SURETYSHIP 455-85 (Edward G. Gallagher ed., 2d ed. 2000); Jay M. Mann & Curtis A. Jennings, Quia timet; A Remedy for the Fearful Surety, 20 FORUM 685 (1985); George J. Bachrach, The Surety's Right to Obtain Salvage, Exoneration, Reimbursement, Subrogation and Contribution, in SALVAGE BY THE SURETY 1 (George J. Bachrach ed., 1998).

[3] Provisions from the Model General Agreement of Indemnity may be found in Project Update 1975: Guide for the Draft of Provisions of the Indemnity Agreement, 42 Insurance Counsel Journal 291 (1975), Illustrative Provision of Indemnity Agreement by Surety on Construction Contract Bond Project update 1985, 52 Insurance Counsel Journal 118 (1985), and Project Update 1995: Illustrative Provision of a General Indemnity Agreement taken in Connection with Contract Surety Bonds, 62 Defense Counsel Journal 259 (1995)

[4] Weinstein & Zanotta, eds., The Law of Performance Bonds, 3d ed., ABA, (2018) pp 167, 180-188, 198-200; Lybeck, Lambert, and Sebastian, eds, The Law of Payment Bonds, 2d ed., ABA (2011) pp 739-744, 752-753,781-782; Klinger, Bachrach, Haley eds. The Surety's Indemnity Agreement: *Law and Practice*, 2d ed., ABA, (2008) pp 107, 130, 134,139, 284-289, 315; Clore et al. eds. Bond Default Manual, 3d ed. ABA (2005) pp 37-40. See also Getz, Collateral: What to take, How to take it, and What to do with it once you have it, 28 SPG Brief 25 (ABA 1999)

[5] *Fidelity and Deposit Company of Maryland v Edward E Gillen*, 926 F.3d 318. 321 (7 Cir. 2019) citing Black's Law Dictionary (10th ed. 2014).

[6] The Law of Suretyship 2nd ed. (2000), p 454

[7] *Escrow Agents' Fidelity Corp. v Superior Court*, 4 Cal App. 4th 491.493 (1992).

quia timet has included the requirement to post cash and real property as collateral.[8] While quia timet is available to reach all assets, here we address only real property.

Immediate relief to freeze or secure assets by court order requires not only a lawsuit and service of process, but also a successful motion for prejudgment relief. Prejudgment relief depends upon persuading a court to issue an injunction after the balancing the four pillars: the likelihood of success, hardships to otherwise obtain the relief requested, the balance of the equities, and the public interest. There may also be a requirement to post a prejudgment bond as security.

Courts may decline to grant complete prejudgment relief. *Transamerica Premium Ins. Co. v Calvary Const., Inc.,* 552 So.2d 225 (Fla App. 5 Dist. 1989). The opinion in *Transamerica* prompted one commentator to criticize, "… the willingness of many courts to scrutinize and reduce a surety's demand for collateral irrespective of the language in the collateral security clause".[9] Further, review of Westlaw published cases, where sureties have moved for prejudgment injunctive relief, shows courts more often than not curb or deny the relief requested.

However, filing suit opens the door to the right and privilege of a surety to record a lis pendens encumbering specific real property. The lis pendens gives notice of the lawsuit and establishes the point in time after which later conveyances, liens or mortgages follow the outcome of the lawsuit. To the extent the indemnitor has equity in the real property, a lis

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[8] Weinstein and Zanotta, supra 1, Chapter 5, Price Jones, Daniel Pentecost and Patricia Wagner, "Surety's Rights of Recovery Against Principals and Indemnitors Under the Common Law and the Indemnity Agreement", pp 151-155

[9] Solan, The General Indemnity Agreement Revisited & Traps for the Unwary, 27 Tort & Ins. Law Journal 127, 130 (1991)

pendens preserves that equity until a final court decision. When the complaint alleges specific real property constitutes collateral security, the recording of a lis pendens requires no imprimatur of an order of a court. This unilateral action of the surety may significantly advance its salvage recoveries.

Lis Pendens

In the last frontier of Alaska, as in most states, a statute authorizes the recordation of a lis pendens.

AS 09.45.940[10] specifies:

> Lis pendens. In an action affecting the title to or the right of possession of real property, the plaintiff at the time of filing the complaint, or afterwards, and the defendant, when affirmative relief is claimed, at the time of filing the answer, or afterwards, may record in the office of the recorder of the recording district in which the property is situated a notice of the pendency of the action, containing the names of the parties, and the object of the action or defense, and a description of the property affected in that district. From the time of filing the notice for record, a purchaser, holder of a contract or option to purchase, or encumbrancer of the property affected has constructive notice of the pendency of the action and of its pendency against parties designated by their real names.

In *Zamarello v Yale*, 514 P.2d 228 (Alaska 1973), the Alaska Supreme Court held an absolute judicial privilege barred claims for slander of title arising from the recordation of a lis pendens, so long as the recording reasonably related to real property involved in the lawsuit:

> We agree that the filing of the lis pendens was absolutely privileged and could not be made the basis of a claim for slander or disparagement of title. In a closely analogous case, Justice Traynor held for the California Supreme Court:
>
> > Since 'the effect of a lis pendens is to give constructive notice

[10] Previously AS 09.45.790

> of all the facts apparent upon the face of the pleadings, and of those other facts of which the facts so stated necessarily put a purchaser on inquiry * * *.' *Harris v. Whittier Building & Loan Association*, 18 Cal.App.2d 260, 266, 63 P.2d 840, 842, the recordation of a notice of lis pendens is in effect a republication of the pleadings. The disparagement of title arises, therefore, from the recordation of the notice of lis pendens as well as from the pleadings. The publication of the pleadings is unquestionably clothed with absolute privilege, and we have concluded that the republication thereof by recording a notice of lis pendens is similarly privileged. (Footnote omitted.)[11]

Thus, the recordation of a lis pendens against real property cannot slander or disparage it's title. However, the lis pendens must reasonably relate to the subject of the lawsuit.

In *Asher v Alcan*, 212 P. 3d 772 (Alaska 2009), the Alaska Supreme Court stated at footnote 34, the reasonable relationship required by the lis pendens statute, i.e. cases "disputing title or physical possession of real property":

> We strictly construe this statute. Blake v. Gilbert, 702 P.2d 631, 643 (Alaska 1985) overruled on other grounds in Bibo v. Jeffrey's Rest., 770 P.2d 290 (Alaska 1989). A lis pendens is only appropriate in cases disputing title or physical possession of real property. Id. We have previously found lis pendens inappropriate where the litigation sought damages for breach of fiduciary duty and breach of contract, even though the complaint demanded an accounting of all defendant's ill-gotten gains that might be traced to the property on which the plaintiff filed a lis pendens. Id. In that case we held that "a lien which results merely from an ultimate entry of a judgment provides no basis for filing of a lis pendens notice." Id. We also cited with approval a California case holding a lis pendens inappropriate where the plaintiff alleged fraudulent misrepresentation and sought a constructive trust in property in which defendant allegedly invested the profits from the tort. Id. (citing Brownlee v. Vang, 206 Cal.App.2d 814, 24 Cal.Rptr. 158 (1962)).[12]

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[11] *Zamarello* at 230.
[12] *Asher* at fn. 34.

Collateral Demands

Place in funds, or collateral demands, are clauses in the general indemnity agreement inspired by the relief sought by the common law bill of quia timet. In the modern general indemnity agreement, when claims have been made, paid or not, reserves set or liability reasonably feared, the indemnitors agree, upon demand by the surety, to immediately deposit cash or other acceptable collateral to protect the surety from loss. A form of the place in funds clause in 1995 read:

> The Undersigned will deposit with the Company as collateral security, immediately upon demand, a sum of money, at the option of the Company, equal to (I) 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 indemnify the Company under the terms of this Agreement.
>
> The Company shall have the right to use the deposit, or any part thereof, in payment or settlement of any liability, loss or expense for which the Undersigned is or would be obligated to indemnify the Company under the terms of this Agreement. The Company shall have no obligation to invest, or to provide a return on, the deposit. The Undersigned shall be entitled to the refund of any unused portion of the deposit upon termination of the liability of the Company on all Bonds and the performance by the Undersigned of all obligations to the Company under the terms of this Agreement. The Company's demand shall be sufficient if sent by registered or certified mail, by facsimile transmission, or by personal service to the Undersigned at the addresses stated herein, or at the addresses of the Undersigned last known to the Company, regardless of whether actually received.
>
> The Undersigned acknowledge that the failure of the Undersigned to deposit with the Company, immediately upon demand, the sum demanded by the Company as collateral security shall cause irreparable harm to the Company for which the Company has no adequate remedy at law. The Undersigned agree that the Company shall be entitled to injunctive relief for specific performance of the obligation of Undersigned to deposit with the

> Company the sum demanded as collateral security and hereby waive any claims or defenses to the contrary.[13]

Other later modern forms provide more expansive powers to simply demand immediate cash or acceptable collateral, and may state the following:

> If Surety in its sole discretion determines that the Collateral is not sufficient to protect Surety's interests or if Surety deems itself insecure, Surety may call for additional collateral, ("Additional Collateral") satisfactory to Surety and the Undersigned shall furnish Additional Collateral immediately upon demand by Surety.

Our surety treatises provide citations to cases enforcing the right of the surety pursuant to the general indemnity agreement or under common law quia timet to compel place in funds or collateral deposits demanded by the surety,[14] but none cite cases discussing the contractual right of the surety to unilaterally record a lien against the real property of the principal indemnitor.

Before filing suit the surety should issue a collateral demand including specifically identified real property. Upon filing suit in common law for quia timet and for the contractual failure to post immediate collateral, the title to that specifically identified real property is disputed and this is the subject of the lawsuit permitting the unilateral encumbrance by recording a lis pendens.

Irrevocable Powers of Attorney Coupled with an Interest.

The modern indemnity agreement includes a clause where the principal and indemnitors irrevocably appoint the surety as its power of attorney to sign for and in the name of the

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[13] Supra 3, Project Update 1995, 62 Defense Counsel Journal 261

[14] Weinstein & Zanotta, eds., The Law of Performance Bonds, 3d ed., ABA, (2018) pp 180-188, 196-200; Lybeck, Lambert, and Sebastian, eds, The Law of Payment Bonds, 2d ed., ABA (2011) pp 742-745; Klinger, Bachrach, Haley eds. The Surety's Indemnity Agreement: *Law and Practice*, 2d ed., ABA, (2008) pp 289-290; Duncan Clore et al. eds. Bond Default Manual, 3d ed. ABA 2005 pp 37-40

principal and indemnitors. An irrevocable power of attorney appears to qualify as an oxymoron because usually a power of attorney, like a will, can be revoked at any time before death but unlike a will, the power of attorney terminates at death. Durable powers of attorney lasting beyond competence but before death are widely permitted by legislative enactments. Durable powers of attorney also terminate at death. However an irrevocable power of attorney coupled with an interest in fact is a different species, a security instrument, from the ordinary power of attorney. The irrevocable power of attorney removes the maker's ability to terminate and lodges the power to act in the holder after a default has occurred.

The Restatement (Third) of Agency, Section 3.12(1) provides:

> **(1) A power given as security is a power to affect the legal relations of its creator that is created in the form of a manifestation of actual authority and held for the benefit of the holder or a third person. This power is given to protect a legal or equitable title or to secure the performance of a duty apart from any duties owed the holder of the power by its creator that are incident to a relationship of agency under § 1.01. It is given upon the creation of the duty or title or for consideration. It is distinct from actual authority that the holder may exercise if the holder is an agent of the creator of the power.**

Comment b explains:

> *b. Distinguished from agency and actual authority.* A power given as security creates neither a relationship of agency as defined in § 1.01 nor actual authority as defined in § 2.01, although the power enables its holder to affect the legal relations of the creator of the power. The power arises from a manifestation of assent by its creator that the holder of the power may properly create liability against the creator, or dispose of property or other interests of the creator, or perfect or otherwise protect a title already held by the holder of the power or the person for whose benefit the holder is to act. If the power is given as security for the performance of a duty, it must be supported by consideration, but consideration is not necessary if

> the power is given to facilitate transfers of title to the power holder.
>
> The rights created by a power given as security, or by an irrevocable proxy, entitle the holder to take specific actions. If the creator of a validly created power given as security purports to revoke the holder's authority contrary to the agreement pursuant to which the creator granted the power, specific enforcement of the holder's rights is an appropriate remedy, subject to the court's discretion in granting an equitable remedy. Likewise, specific enforcement may be warranted to protect the rights of the holder of a validly created irrevocable proxy. In both cases, it will often be difficult or impossible for the holder to prove quantifiable damages or to obtain a substitute performance. See Restatement Second, Contracts § 360, Comments *b* and *c*.

The Restatement (Third) of Agency Section 3.12(1) sets forth a majority view which is broader than the law in some states which limit the irrevocable power of attorney to situations where the holder of the power also possesses a proprietary interest in the subject matter of the power. Comment c states:

> Some jurisdictions follow a test narrower than that stated in this section, under which it is necessary that a power holder possess a proprietary interest in the "subject matter of the agency itself."

Irrevocable powers of attorney, coupled with an interest, are common in many commercial agreements other than surety agreements of indemnity, such as an irrevocable proxy in the sale of businesses, real estate developments, especially condominiums, and commercial loan extensions of credit, (closely analogous to the surety's extension of credit.) Specific identification of real property in collateral demands disputes the title of the property. By the place in funds clause, the surety has a right to immediate cash or other collateral acceptable to

the surety. Once the surety identifies and demands specific real property as collateral, the title to that property is and becomes the, "subject matter of the agency itself."

A modern irrevocable power of attorney clause states:

> The Undersigned hereby irrevocably nominate, appoint, and designate the Company or any person or persons designated by the Company as their attorney-in-fact with the right to exercise all the rights assigned, transferred or conveyed to the Company by this agreement, and in their name to execute and deliver any and all additional or other assignments, instruments or documents deemed necessary or desirable by the Company to vest in the Company absolute title to any and all monies, property and rights hereby assigned, and to provide the protection and rights to the Company contemplated by the provisions of this Agreement.[15]

Another form may include specific authority to record or file this Agreement or any other document executed by any of the indemnitors or by the surety under the power of attorney herein granted.[16]

Another form may specifically include the power to record the indemnity agreement as a consensual lien on all real property owned by the principal indemnitor at the time of recording. This Agreement shall, if recorded, constitute a consensual lien upon any and all real estate owned by the undersigned at the time of such recording.

Sureties most frequently use the irrevocable power of attorney to sign and deposit checks, close out documents, and releases of claims of the principal when the principal/indemnitors

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[15] Supra 3, Project Update 1995, 62 Defense Counsel Journal 271

[16] Weinstein & Zanotta, eds., The Law of Performance Bonds, 3d ed., ABA, (2018) p 196

refuse to sign, or are absent by choice or death. The frontier extension of this use to unilateral recording of an encumbering lien of a deed of trust or mortgage is a logical step.

Once a place in funds or collateral demand identifies specific real property owned by the principal/indemnitor required as security, the surety can use the irrevocable power of attorney to execute in the name of the principal/indemnitor and record mortgage or deeds of trust liens to encumber the real property. Although commentators have suggested sureties have the unilateral right to record liens and mortgages[17], none have found (and neither have we) case law applying or discussing the place in funds and the irrevocable power of attorney clauses supporting unilateral recording of a lien or mortgage against real property.

Benefits and Costs (Risks)

The chief benefit is speed to act unilaterally to freeze by encumbrance real property of the principal/indemnitor. No prior court order is required to encumber specific real property and any then existing equity in that property. Recording a lien pursuant to the irrevocable power of attorney may take less time, but filing a lawsuit along with recording a lis pendens provides protection and immunity from slander of title or disparagement. Recording a deed of trust or mortgage lien without prior notice to the principal indemnitor has great shock value when later discovered, and if discovered more than ninety days after recording avoids potential bankruptcy preference claw backs. Once real property with equity has been encumbered, the surety

[17] Shannon Briglia, Mike Pipkin, and David Olsen stated in 2008: "Although rare, some Indemnity Agreements contain provisions that allow a surety to obtain mortgages and/or deeds of trusts on the principal and indemntiors' real property. Essentially, the assignment provision includes real property and the attorney-in-fact provision is expansive enough to allow the surety to execute and record a mortgage or deed of trust". Klinger, Bachrach, Haley eds. The Surety's Indemnity Agreement: *Law and Practice*, 2d ed., ABA, (2008) p 315

achieves significant leverage to negotiate a favorable outcome. Other benefits include, in appropriate diversity jurisdiction situations, the ability to file in federal court in one state and to record a lis pendens against real property in another state.

But unusual or rare is the case worthy of the costs and risks.

Costs include a commitment to the end result, if not settled, of a trial or court decision confirming by judicial lien the right of the surety to specific real property collateral and judicial foreclosure and sale of that property. The loss or exposure of the surety must be large enough to support aggressive representation and identification of real property assets. Sorting out ownership, encumbrances prior to the lis pendens or unilateral lien, equity, if any, in multiple real properties, is expensive and takes time.

The lack of any court decisions discussing, applying and upholding the proposed unilateral recording of liens against real property by a surety exercising its collateral demand and irrevocable power of attorney clauses entails the risk of adverse court decisions, especially where poor facts advised caution. In some states statutes with respect to powers of attorney or by analogy to a similar clause authorizing a confession of judgment may prohibit unilateral recording of mortgage or deed of trust liens. For example, in Alaska the procedures in Alaska Civil Rule 57 for Confession of Judgment bar use of a contractual clause to enter a judgment on confession.[18]

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[18] AK Civil Rule 57; see also, Gentsch and Keller, The Use of Confession of Judgment Clauses within Indemnity Agreements, 2015-FALL, Fidelity & Surety L. Committee News 1 (ABA 2015)

Another likely risk is that the principal/indemnitor will defend typically with claims of bad faith, overreaching, domination, breach of trust or breach of fiduciary duties, among others, limited only by the creativity and resources of counsel.

Other risks may include environmentally compromised real property which should be excluded from acceptable collateral.

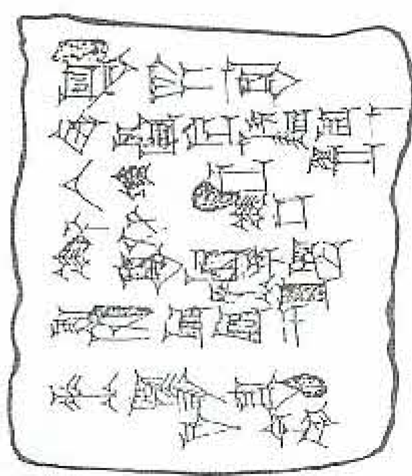
CONCLUSION, a bit of surety history, (as we began)

"In case, Ur-Enlil does not pay the grain on his account, Ur-Da-mu shall do it". Somewhere about the year 2400 B. C.

The following documents the discovery of the oldest record of a surety agreement:

Bond

In case *Ur-Enlil* does not pay the grain on his account, *Ur-Da-mu* shall do it.



In case
on account of *Ur-Enlil*,
10 *gar* corn,
are not forthcoming,
it's corn *Ur-Da-mu*
shall bring in.
By the name of his king
he has sworn.
Ur-Su-mah,
Ad-da-kal-la,
Kalam-ae-mu,
Utu-sugga,
witnesses.
Year *Simurum*
devastated.

The stone tablet reproduced above was discovered during the second Babylonian expedition of the University of Pennsylvania in the years 1889-1890. It was uncovered at the temple Archives of Nippur, a city of Babylon and dates back to the 35th year of the reign of King Dungi which dates it somewhere about the year 2400 B.C.

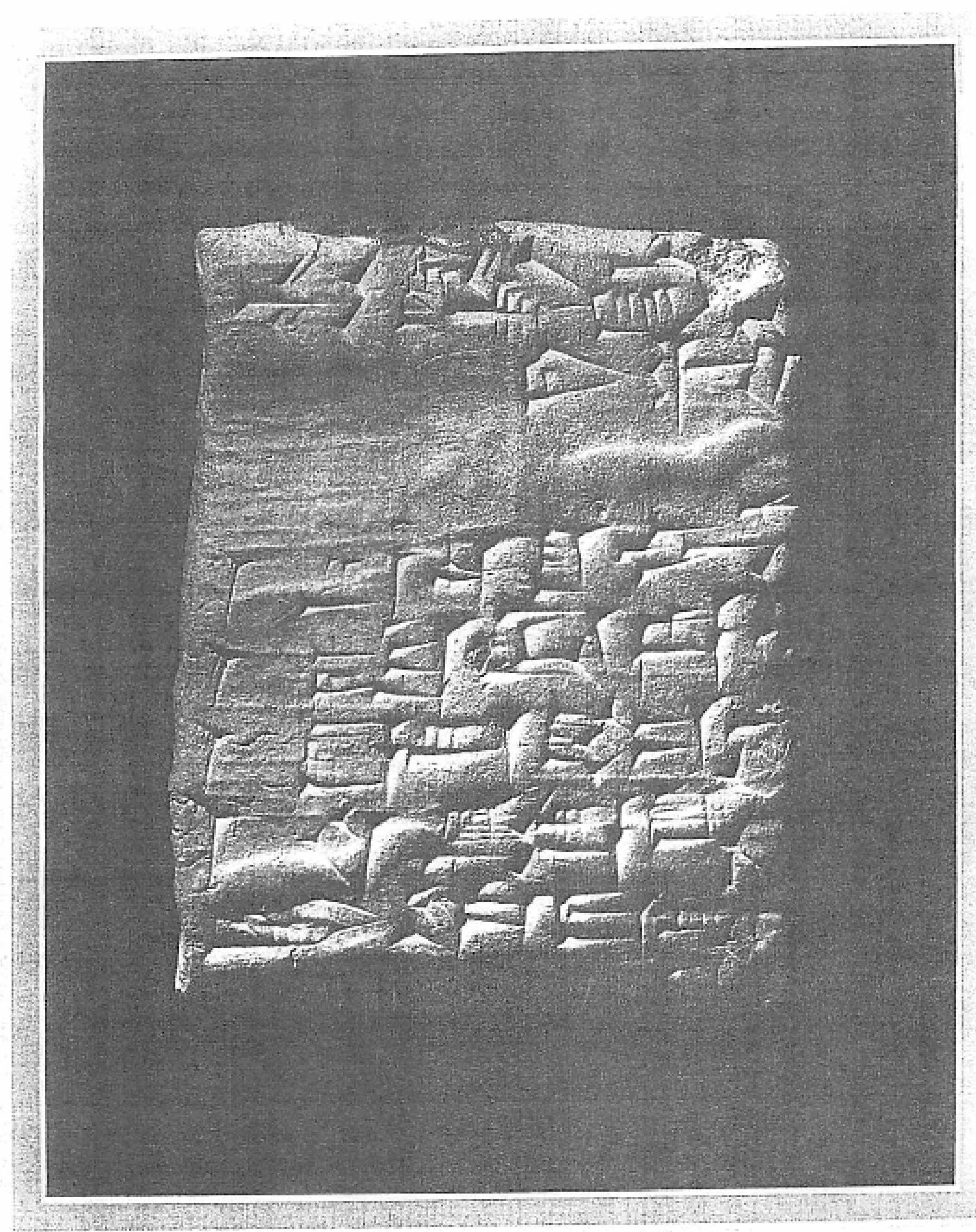
It is a dark brown, baked tablet which is well preserved and contains 15 lines of cuneiform which are translated above. The tablet is of the approximate size shown above. It is covered with seal impressions which were common at that time.

The tablets of that period of time were binding legal agreements and were drawn up by professional scribes, for a fee, who wrote the whole of the document, even the names of the witnesses. The seals were impressed by the parties to the document. It appeared to be the rule that the documents were executed in duplicate and in some cases in triplicate. The scribe may have retained a copy or a copy was placed in the public archives.

The bond guarantees the payment of grain by the principal and the personal surety guaranteed payment if the principal should fail to do so. Corn at that time was used as a medium of exchange as is money today.

Reference

Myhrman, David W.
"Summerian Administrative Documents from the Temple of Nippur" Department of Archaeology, University of Pennsylvania 1910



PANEL 13

TO ARBITRATE OR NOT TO ARBITRATE – THAT IS THE QUESTION

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Christopher R. Ward | Clark Hill PLC | Frisco, TX

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TO ARBITRATE OR NOT TO ARBITRATE—THAT IS THE QUESTION

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Robert D. Riggs, The Hanover Insurance Company
Christopher R. Ward, Clark Hill PLC
Tyler M. Frankel, Clark Hill PLC

I. INTRODUCTION

Arbitration has become a hot topic in legal and political circles. The United States Supreme Court has issued arbitration-related decisions almost every term for several years and legislators at both national and state levels have publicly questioned whether to limit the right to arbitrate in consumer or employment disputes. The purpose of this paper, however, is not to address public policy arguments concerning arbitration of consumer or employment claims. Instead, the authors offer their perspectives on whether—and if so, why—a well-managed arbitration may be a better forum than litigation for resolution of construction disputes.

The decision of whether to arbitrate or litigate a given construction dispute should be made like any business decision: after weighing costs, risks, benefits, and return on investment and based on reliable data about the dispute resolution options available in arbitration. Such an important decision should not be made based on misinformation, personal intuition, limited experience, or reflexive habit. The goal of this paper is to assist with making such a decision by substituting facts for fiction as to the merits and limitations of arbitrating construction disputes.

II. REMINDER: THERE IS NO ONE TYPE OF ARBITRATION

It is important to begin any discussion of the merits or challenges of arbitration by noting that there is no archetypal arbitration model that holds true in every case. As Professor Thomas J. Stipanowich observed: "When people ask you about your perspectives on arbitration, I tell them, always ask, 'What kind of arbitration?'"[1] Arbitration proceedings can, and should, vary greatly depending on the nature of the issues and remedies to be addressed as well as differences in controlling law, arbitral rules, party decisions, arbitrator philosophy, and contract terms. In fact, parties have considerable freedom to customize almost every aspect of their dispute resolution process, including deciding who will judge their case, what arbitral rules to follow, what hearings to allow, what discovery to allow, how to structure and when to schedule any hearings, and many other important decisions over which litigating parties have little to no control.[2]

In short, parties in arbitration can fit the process to the problem by avoiding those aspects of litigation they do not like, need, or can afford, and by selecting decision maker(s) of their choice.

III. THE RIGHT TO APPEAL AN ARBITRATION AWARD ON THE MERITS

While most attorneys and their construction clients believe they are familiar with the tools available to them in the theoretical arbitration tool box, formal and informal surveys reveal that one important component is widely unknown or misunderstood: the parties' ability to contract for the right to appeal the final award "on the merits" to a panel of seasoned and

[1] Thomas J. Stipanowich, *Living the Dream of ADR: Reflections on Four Decades of the Quiet Revolution in Dispute Resolution,* 18 CARDOZO J. CONFLICT RESOL. 513, 533 (Spring 2017).
[2] *See, e.g., Lamps Plus, Inc. v. Varela,* 139 S. Ct. 1407, 1416 (2019).

knowledgeable appellate arbitrators.[3] The widespread, but mistaken, belief that there is no appellate remedy for erroneous arbitration awards is often cited as one of the chief negatives of arbitration.[4] This misunderstanding likely stems from the fact that the Federal Arbitration Act (the "FAA") and many state arbitration statutes provide few grounds for judicial relief from a final arbitration award.[5]

A. Contracting for the private right of appeal

The FAA does not allow for any *judicial* appellate review of an award, even by agreement of the parties.[6] Nevertheless, neither the FAA nor state arbitration codes prohibit parties from contracting for the right to appellate review of an arbitration award via a *private panel of appellate arbitrators*.[7] Parties may agree to this option in their original arbitration agreement or by written stipulation at any time after a dispute arises.[8] For example, JAMS suggests the following model contract provision: "The Parties adopt and agree to implement the JAMS Optional Arbitration Appeal Procedure" with respect to any arbitration award "arising out of or related to this [arbitration] agreement."[9] JAMS arbitration rules also allow parties to "agree at any time" during an arbitration to adopt the JAMS optional appellate procedures as an optional remedy in that proceeding.[10] Including such an option in an arbitration does not mean that it will be used.[11] But, given humankind's undeniable proclivity to err, parties approaching an arbitration hearing may be comforted by the existence of a contractual backstop against the risk of arbitrator mistakes.

Additionally, as explained below, such contractual appellate arbitration is a fast, fair, final, and cost-effective dispute resolution option that provides parties with the reassurance of

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[3] One such survey was conducted of corporate counsel, advocates, arbitrators and academics by Bryan Cave Leighton Paisner LLP, in 2020, concerning arbitration appeals. *See Annual Arbitration Survey 2020,* BRYAN CAVE LEIGHTON PAISNER (2020) https://www.bclplaw.com/images/content/1/8/v2/186066/BCLP-Annual-Arbitration-Survey-2020.pdf [*hereinafter* "BCLP Survey]. The survey participants admitted they were concerned about the risk of erroneous arbitration awards, but they also believed that appellate relief was either unavailable or would impair finality and increase delay or cost of arbitration. *See id.* They also raised concerns about the fairness of possible review processes. *See id.*

[4] *See* BCLP Survey, *supra* note3. According to the BCLP Survey, "Some believe that the finality of arbitration undermines the legitimacy of the process, as there is no relief from error." *See id.*

[5] *See, e.g., Patton v. Signature Ins. Agency, Inc.,* 441 F.3d 230, 234 (4th Cir. 2006); *Hall Street Assocs., LLC. v. Mattel Inc.,* 552 U.S. 576 (2008) (U. S. Supreme Court limited vacation of an award to statutory grounds such as "evident impartiality", "fraud", "corruption", refusing to hear "pertinent and material" evidence, and acts exceeding the powers of the arbitrator).

[6] *See Hall Street Associates,* 552 U.S. at 576.

[7] *See Chicago Typographical Union No. 16 v. Chicago Sun-Times, Inc.*, 935 S.W.2d 1501, 1505 (7th Cir. 1991); *see also* Christian A. Garza and Christopher D. Kratovil, *Contracting for Private Appellate Review of Arbitration Awards*, 19 APP. ADVOC. 17, 20 (Winter 2007).

[8] For a scholarly discussion of the legal bases for contractual, legislative, and other ways of overcoming concerns about the limited standards of review allowed for most arbitration awards, *see* Philip L. Bruner, *The Appeal of Appellate Arbitration,* in 35 INT'L L. REV., Pt. 4, 436, 444 *et seq.* (2018) [*hereinafter* "Bruner"].

[9] The International Institute for Conflict Prevention & Resolution (the "CPR") and the American Arbitration Association (the "AAA") have their own, slightly different model contract language and rules.

[10] *See, e.g.,* JAMS COMPREHENSIVE R. ARB. P. 34.

[11] *See id.*

knowing they may, if they wish, have another set of eyes and ears review their arbitration awards.[12]

B. A fast and final appellate process

Some speculate that allowing appellate scrutiny of arbitration awards would "frustrate the purpose of having an arbitration at all – the quick resolution of disputes and the avoidance of the expense and delay associated with litigation."[13] The experience of the JAMS appellate arbitrators interviewed for this paper proves otherwise—parties may enjoy the peace of mind provided by appellate review and also receive a quick and final arbitral award, free of the delays caused by the lengthy appeals and retrials that plague litigation. In an arbitral appeal, there are no crowded appellate dockets, motion practice, or many months of delay for briefing, oral argument, and waiting for an appellate decision. Brevity is baked into the JAMS Appeals Procedure. An appeal must be filed within fourteen (14) days of a final award and any cross-appeal seven (7) days thereafter.[14] The arbitrators are selected promptly and the parties are required to provide the record on appeal.[15] They either agree on or JAMS will establish a reasonably abbreviated schedule for briefing and, possibly, oral argument.[16] Finally, the panel must issue its decision twenty-one (21) days after the later of receipt of the record and all briefs or oral argument, unless the parties agree otherwise.[17]

In addition, the finality of JAMS appellate review may surprise those used to remand as the reward for reversal of judgment on appeal or who lament that statutory award vacatur may result in an arbitration rehearing or referral to *de novo* litigation.[18] Instead, JAMS procedures prohibit remand for further hearing or "retrial" and limit the appellate panel's authority to affirming, reversing, or modifying an award.[19] Even if a panel re-opens the record to receive any evidence excluded in error, at most, the panel will issue a new, final award.[20]

C. Appellate cost savings

Parties may believe they should avoid arbitration appellate review to save expense.[21] However, parties can preserve their appellate option in arbitration and still achieve significant cost savings—especially compared to litigation appeals. First, time is money, especially in an industry like construction where the costs of dispute delay may escalate the cost of the project. So, correcting error on the expedited timetable of a JAMS appeal may save money directly and

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[12] Indeed, the ability to appeal an arbitration award may enhance the fairness of the arbitral process, providing an answer, among others, to concerns that a particular contractual arbitration clause appears unjust.
[13] *Apex Plumbing Supply, Inc. v. U. S. Supply Co.,* 142 F.3d 188, 193 (4th Cir. 1998). Finality of an arbitration award is cited in the BCLP survey an important reason parties favor arbitration. *See* BCLP Survey, *supra* note 3.
[14] *See JAMS Optional Arbitration Appeal Procedure*, JAMS (2003), https://www.jamsadr.com/files/Uploads/Documents/JAMS-Rules/JAMS_Optional_Appeal_Procedures-2003.pdf [*hereinafter* "JAMS Appeal Procedure"].
[15] *See id.*
[16] *See id.*
[17] *See id.*
[18] *See Enforcement of the Arbitration Award and Limited Rights of Appeal*, *in* ARBITRATION AND THE SURETY 79-80 (Ashley L. Belleau et al. eds., 2020) (after vacatur of an arbitration award, the remedy is often no better than a costly "do over").
[19] *See* JAMS Appeal Procedure, *supra* note 14.
[20] *See id.*
[21] *See, e.g., MACTEC, Inc., v. Gorelick*, 427 F.3d 821, 829-30 (10th Cir. 2005).

indirectly.[22] Second, the activities necessary for this appellate process can be abbreviated by agreement of the parties or at the direction of the panel, with limited briefing and waiver of oral argument.[23] Third, in the right kind of case, the parties can agree to an interlocutory appeal of a key issue, such as insurance coverage or whether the parties have liability to one another, before incurring the—possibly unnecessary—additional expense of proving the amount of loss or damages.

Finally, even more cost savings can be realized before the parties reach the point of appeal, as their knowledge that any award will be reviewed by highly experienced appellate arbitrators may be reason to justify using one arbitrator—rather than the three called for by contract—to decide the underlying case.[24] Obviously, using one arbitrator to manage and hear the dispute will significantly reduce the cost of the underlying arbitration, which savings should exceed the lesser expense of the appellate panel, which meets for much less time for a limited purpose. And, as appeals are optional, it is very possible the parties will not appeal and, thus, not incur any additional cost.

D. A fair and just review

The standard of review is an important issue to consider when contracting for the right of appeal. While it is possible for parties to contractually define the standard of review, absent such a stipulation, JAMS appellate procedures provide: "The Appeal Panel will apply the same standard of review that the first-level appellate court in the jurisdiction would apply to an appeal from the trial court decision."[25] JAMS appellate panels are comprised of highly experienced former jurists and appellate practitioners. Thus, the parties can have the assurance that their appeal will be accorded the same standard of review and quality of scrutiny as a judicial appeal.

In addition, the parties may participate in selecting each member of their appellate panel and may require neutrals who "speak the language" and have the legal and substantive knowledge best suited to their dispute.[26] This advantage over litigation is particularly important in complex or technical arbitrations.

The right to customize the appellate process itself is another plus; arbitration appeals need not follow any hard and fast rules.[27] If the parties and panel need several hours of oral argument, they may so agree. If the panel needs additional information after initial briefing or argument, they may request it. If the panel needs clarifying evidence to supplement the record, they may obtain it. If the parties want the results of the appeal to be confidential outside the confines of the arbitration, that usually can be agreed to as well.

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[22] For example, as JAMS neutral Philip L. Bruner explained, "Having served as chair of a JAMS appellate arbitration tribunal reviewing an award issued by a non-JAMS arbitrator, my tribunal was able to correct an important error of law on the record and issue the Final Award within three weeks after receiving the record and counsel briefs." BRUNER, *supra* note 8, at p. 447-48.

[23] *See* Patricia H. Thompson et al., *Effective Use of Arbitration*, 54 TORT TRIAL & INS. PRAC. L. J. 211, 243-46 (2019).

[24] *See id.* at 236.

[25] *See* JAMS Appeal Procedures, *supra* note 14; Conna A. Weiner, *Getting the Arbitration that You Want: Appeals? Really?*, 2018 A.B.A. SEC. LIT. COMM. & BUS. 1. Note: JAMS, CPR, and AAA have slightly different standards of review.

[26] Per interview with J. Ronald E. Cox. *See also* THOMPSON, *supra* note 23, at 233; J. Ronald E. Cox, JAMS, JAMS Washington State Virtual Round Table: Appellate Analysis Options (Nov. 2019).

[27] *See* THOMPSON, *supra* note 23, at 222-23.

Fairness is more than procedural flexibility or a broad standard of review. Fairness requires consideration of underlying award free from constraint or prejudice, regardless that an award was issued by a colleague arbitrator. In the first place, the parties can ensure in the selection process that the members of an appellate panel do not know the underlying arbitrator. Moreover, former appellate court judges, such as those affiliated with JAMS, have been trained to be ready and able to reverse or otherwise honestly disagree with the decisions under review, even those by neutrals they know and respect, when the evidence and law so requires. As one stated, it is their ethical obligation and ingrained into their character to "never be afraid to do what is right."

E. Some disputes are too important not to have a right of appeal

One of the most important arbitral tools is the optional remedy of a prompt, private right of appeal to experienced, personally selected appellate specialists. Parties may rightly decide that arbitration of certain disputes would be too risky to undertake without such an option. In summary, by assuring review of awards finally, quickly, inexpensively and fairly, "appellate arbitration enhances the benefits of arbitration itself."[28]

IV. IS ARBITRATION SHORTER AND LESS EXPENSIVE THAN LITIGATION?

Arbitration critics sometimes argue that arbitration takes as long and or is as expensive as litigation, especially when the cost of the arbitrator's fees is included in the expense analysis. There are several points raised by these criticisms.

A. Survey says . . .

First, there are numerous studies as to the relative costs and length of arbitrations versus litigation. A recent five-year, ten-state study found that federal court lawsuits lasted over a year longer than arbitrations decided during the same period, excluding appellate time.[29] The same study supports the conclusion that the longer a dispute takes to resolve, the more expensive it will be, not just because the parties are paying attorneys to do more, and do it for a longer time. That survey found that such cumulative federal litigation *delays* caused *direct* business losses exceeding $10 billion, *excluding* the increased costs and fees associated with greater attorneys' fees or expense. Such business losses resulted from the cost of management's involvement in and attention to the litigation; the effect of prolonged litigation uncertainty on management decision-making; the cost of having resources tied up by litigation unavailable for use or investment; and impacts on creditworthiness and investor concerns due to the risks presented by pending litigation.[30] These are real costs of protracted litigation in comparison to arbitration; simply said, "saving time saves money."

B. Expedited rules, contract provisions, and bond provisions

Parties seeking the quickest possible resolution of a dispute should consider contracting for or opting to use the newly promulgated rules issued by JAMS and the AAA that allow for expedited resolution—literally within months of filing of the proceeding. For example, JAMS Comprehensive Rule 16.2 provides for limited discovery and depositions as to number and time-

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[28] *See* BRUNER, *supra* note 8, at p. 448.
[29] *See* Roy Weinstein et al., *Efficiency and Economic Benefits of Dispute Resolution through Arbitration Compared with U.S. District Court Proceedings,* MICRONOMICS ECON. RSCH. & CONSULTING (March 2017).
[30] *Id.* at 16-21.

frame and empowers the arbitrator to enforce discovery limits beyond those requested by the parties, prohibits dispositive motions absent agreement of the parties or a showing of good cause as defined by the JAMS protocols, and provides for the final hearing within sixty (60) days of the close of discovery.[31]

Another expedited arbitration option, designed for resolution of performance bond disputes, has been developed by Travelers in conjunction with another, specially tailored set of expedited construction dispute resolution rules drafted by JAMS.[32] Since Travelers introduced its Early Dispute Resolution ("EDR") bond to the market in early 2015, the bond has started to take hold. The EDR bond defines only three issues to be addressed in the proceeding: (1) is the contractor in default; (2) has the obligee performed its obligations under the contract; and, consequently, (3) is the surety liable under the bond? The bond also ensures the participation of only three parties: the surety, the obligee, and the principal, which are the only parties necessary to resolve the key questions of whether the surety's performance obligations have been triggered. The bond's adjudicative process is crafted to resolve this issue: (a) quickly enough to allow the project to proceed with as little impact on the schedule as possible; (b) based on the decisions of an impartial decision maker knowledgeable about construction and its processes, surety and dispute resolution law, and the facts specific to the project at issue (the Travelers EDR bond provides that the decision-maker must be from the JAMS Global Engineering and Construction panel pursuant to JAMS Rules); and (c) with a decision that is binding and obligates the parties to perform, while also preserving the parties' rights to later seek a *de novo* review if warranted. Judicial review is the bond's default option, but the parties can agree on appellate arbitration.

C. Arbitration expense is largely under the control of the parties and their counsel

The tendency of parties or their counsel to treat an arbitration like litigation is one of the main reasons why that arbitration may look a lot like and cost as much as litigation. For example, one primary cause of litigation expense is motion practice. Few motions are expressly allowed by the rules of any arbitration organization, because such practice is considered unnecessary and inconsistent with the purposes of arbitration by the ADR professionals who have drafted those rules. Yet, repeatedly, counsel seek permission in arbitration to file motions to dismiss, discovery motions, dispositive motions, and motions *in limine*, all supported by extensive and expensive briefs. The second major cause of expense is discovery, which is also limited by most arbitration rules. Here too, parties seek permission to conduct broad discovery, the cost of which may far outweigh the benefit.

There are at least two ways to ensure that an arbitration is as efficient and economical as possible and as anticipated by the parties who drafted the contracts that required arbitration. First, the parties and their counsel must go on a metaphorical diet. One cannot lose weight unless one intentionally exercises more and eats less. So too, parties must choose to intelligently, efficiently, and cost effectively prepare their cases and defenses, cooperating with opposing counsel rather than fighting about everything and using the more limited discovery tools that the arbitration rules allow, rather than resorting to scorched earth tactics.

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[31] *See* JAMS Comprehensive R. Arb. P. 16.2.

[32] A detailed description of the EDR bond's speedy decision process and a prototype copy of the bond language can be found in the A.B.A Fidelity and Surety Law Committee's publication, *see in* Patricia H. Thompson et al., *Effective Use of Arbitration*, ARBITRATION AND THE SURETY 151, 154-157, and app. A (Lee Brewer et al., eds, 2020)

The second means of ensuring efficient and cost-effective dispute resolution is finding experienced arbitrators who will manage the arbitration consistent with the reasonable limiting provisions of the rules governing discovery and motions as promulgated by JAMS or the AAA. Thus, selection of the right arbitrators is important. The parties to a dispute should and can interview potential arbitrators before selecting them to ask about their philosophy of arbitration management. They should check out their references, to confirm whether they are "muscular" in their control of the proceedings, or will they let the parties manage the process to the point it no longer looks like an arbitration?

D. Reluctance to incur arbitrator fees—judges are free

A second, parallel financial criticism concerns arbitrator fees and arbitration filing expenses, which costs obviously are not present in litigation.

Like any business decision, it is important to consider whether parties receive sufficient value for the fees they pay in arbitration to justify the cost, in comparison with litigation. In such an analysis, the following factors might be relevant.

First, given the time and money analysis above, to the extent an arbitration is quicker to resolve a dispute than litigation, then, the parties will likely save enough in direct and indirect costs to set off some or all of the arbitration fees.

Second, having a case manager as provided by JAMS means parties can get quicker hearings or other access to the arbitrators, answers to procedural and logistics questions, and other administrative assistance not afforded by court clerks. Plus, JAMS provides hearing rooms, side conference rooms, technical support, food and beverages, and coordination of party access to a hearing site not afforded by public courts.

Third, it is difficult to quantify the undeniable benefit of the parties' right and flexibility to choose the arbitrator[33] who, by training and experience is best able to manage the process and understand and decide the factual and legal issues. As noted above, a good managerial arbitrator can act as an experienced guide to help the parties navigate the rules applicable to the proceeding and, when necessary, will need to make decisions concerning management of a workable discovery plan and hearing schedule, that best achieve the parties' desires for efficient and effective resolution of their dispute. Such an arbitrator should know how to conduct efficient hearings, assist the parties in how best to provide their proof, and make rulings as needed to actively strike a balance between efficiency and fairness. "An effective arbitrator creates a professional atmosphere and insists that counsel cooperate with each other and the arbitrator in all procedural aspects of the arbitration."[34] Experienced construction arbitrators can assist the parties in saving time and money at the evidentiary hearing in numerous ways. For example, the arbitrator can encourage the parties to submit direct fact testimony through written witness statements, exchanged prior to the hearing, in order to reduce the need for depositions to discover what a party's witnesses will say, shorten the time needed for the hearing, and enable the parties to better prepare for the hearing. Cost and time for expert testimony can also be reduced if arbitrators accept the expert reports in advance, limiting the need for and purposes of their live presentations, and allowing for effective "hot-tubbing" of the experts.

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[33] For simplicity, unless otherwise indicated in this discussion, the term "arbitrator" is referred to in the singular.
[34] *See* Richard Chernick & Zela Claiborne, *Reimaging Arbitration*, 37 LITIG 32 (A.B.A. 2011).

Fourth, there may be cultural, racial, gender or other reasons why the parties may find it beneficial to incur the cost of having diversity in their dispute decision maker(s). JAMS and other arbitral organizations have the ability to offer the type of diverse panels that will best address the specifics of any dispute.

Finally, parties concerned about the expense of having three arbitrators may agree to the cost saving measure of having only the chair decide most of the issues in the case prior to the hearing. Or they may use the option cited above of agreeing to the safety valve of a contractual right of appeal, in exchange for having only one arbitrator decide the underlying case.

V. BUT CAN YOU "INTERPLEAD" THIRD PARTIES?

Another criticism of arbitration is the potential inability to join third parties who are non-parties to the arbitration agreement, such as sureties, subcontractors, vendors, design professionals, etc., who may be necessary to efficiently and effectively resolve the construction dispute. Arbitration is a matter of contract, and, generally, a party cannot be required to arbitrate absent its consent.[35] As a general rule, third parties who are non-signatories to an arbitration agreement cannot be bound by the agreement or by any resulting reward.[36] However, arbitration agreements *can* be enforced by or against non-signatories under ordinary principles of contract or other vehicles such as: (1) incorporation by reference; (2) assumption; (3) agency; (4) piercing the corporate veil and/or alter ego; (5) third-party beneficiary; and (6) equitable estoppel.[37]

Sureties are frequently joined to an arbitration under the "incorporation by reference doctrine."[38] Under this doctrine, "[a] nonsignatory may compel arbitration against a party to an arbitration agreement when that party has entered into a separate contractual relationship with the nonsignatory which incorporates the existing arbitration clause."[39] While the performance bond generally does not contain an arbitration provision, it typically incorporates by reference

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[35] For a detailed description on joinder of surety into arbitration, *see* Andrew Carter, Douglas J. Wills, and Kelly Perry, *Arbitration Provisions and the Surety*, *in* THE LAW OF PERFORMANCE BONDS. *See also AT&T Tech., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 648 (1986) (quoting *United Steelworkers v. Warrior & Gulf Navigation Co.,* 363 U.S. 574, 582 (1960)).

[36] *See, e.g., AT&T Tech., Inc. v. Commc'ns Workers of Am.*, 475 U.S. 643, 648 (1986) (quoting *United Steelworkers v. Warrior & Gulf Navigation Co.,* 363 U.S. 574, 582 (1960)); *Bel-Ray Co. v. Chemrite (Pty) Ltd.*, 181 F.3d 435 (3d Cir. 1999); *Interocean Shipping Co. v. Nat'l Shipping & Trading Corp.*, 462 F.2d 673 (2d Cir. 1972); *Beacon Constr. Co. of Mass. v. Prepakt Concrete Co.,* 375 F.2d 977 (1st Cir. 1967); *Orion Shipping & Trading Co. v. E. States Petroleum Corp. of Panama, S.A.,* 312 F.2d 299 (2d Cir. 1963); *SSC Mont. Cedar Crest Operating Co. v. Bolding*, 130 So. 3d 1194 (Ala. 2013); *Cone v. Dunham*, 20 A. 311 (Conn. 1890); *Karlen v. Gulf & Western Indus., Inc.*, 336 So. 2d 461 (Fla. Ct. App. 1976); *Brescia Constr. Co. v. Walart Constr. Co.*, 190 N.E. 484 (N.Y. 1934).

[37] *See GE Energy Power Conversion France SAS, Corp. v. Outokumpu Stainless USA, LLC,* 140 S. Ct. 1637, 1643-44 (U.S. 2020); *Thomson-CSF v. AAA*, 64 F.3d 773, 776-77 (2d Cir. 1995).

[38] *See* CARTER, *supra* note 36.

[39] *Thomson-CSF v. AAA,* 64 F.3d 773, 776-77 (2d Cir. 1995); *see also Cont'l U.K. Ltd. v. Anagel Confidence Compania Naviera, S.A.,* 658 F. Supp. 809, 813 (S.D.N.Y. 1987) (if a "party's arbitration clause is expressly incorporated into a bill of lading, nonsignatories . . . who are linked to that bill through general principles of contract law or agency law may be bound"); *Northrop Grumman Info. Tech., Inc. v. United States*, 535 F.3d 1339, 1345 (Fed. Cir. 2008); *Standard Bent Glass Corp. v. Glassrobots Oy,* 333 F.3d 440, 447 (3d Cir. 2003); *PaineWebber, Inc. v. Bybyk*, 81 F.3d 1193, 1201 (2d Cir. 1996); *Hertz Corp. v. Zurich Am. Ins. Co.*, 496 F. Supp. 2d 668, 675 (E.D. Va. 2007); *Ingersoll-Rand Co. v. El Dorado Chem. Co.,* 283 S.W.3d 191, 196-97 (Ark. 2008); *Estate of Kokjohn v. Harrington*, 531 N.W.2d 99 (Iowa 1995).*Comput. Controls, Inc. v. Charles Perry Constr., Inc.*, 743 So. 2d 627, 631 (Fla. Dist. Ct. App. 1999).

the bonded contract, which does.[40] Courts have frequently determined that the performance bond incorporates the bonded contract's arbitration provision, binding it to arbitration. The majority of courts broadly apply this doctrine to any dispute arising in connection with the bond.[41] A minority of courts, however, have held that the specific terms of the arbitration provision itself control.[42] If the arbitration limits itself to disputes between the principal and obligee only, then the surety is not obligated to arbitrate.[43] Sureties have also been compelled to arbitrate under the theory of assumption of contract in situations where they take over a project for the defaulted principal.[44] By stepping into the shoes of its principal, it might be concluded that the surety has essentially assumed all of the principal's obligations under the bonded contract, including the requirement to arbitrate as originally agreed to by the principal.[45]

Subcontractors, vendors, design professionals, and other third parties to a construction contract likewise can be compelled to join an arbitration under the theories of assumption and incorporation by reference. For example, similar to a surety's bond, a subcontractor's or vendor's subcontract typically incorporates the prime contract by reference, binding the subcontractor to arbitration.[46] Even when the subcontract does not contain incorporation or "flow down" provisions, the subcontractor or vendor, or other third party, might be joined into arbitration under an agency theory:

> A nonsignatory to an agreement to arbitrate may be required to arbitrate, and may invoke arbitration against a party, if a preexisting confidential relationship, such as an agency relationship between the nonsignatory and one of the parties to

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[40] *See* CARTER, *supra* note 36.

[41] *See, e.g., U.S. Fid. & Guar. Co. v. W. Point Const. Co.*, 837 F.2d 1507, 1508 (11th Cir. 1988) (citing *J.S. & H. Constr. Co. v. Richmond Cnty Hosp. Auth.*, 473 F.2d 212, 215 (5th Cir.1973) and *Exch. Mut. Ins. Co. v. Haskell Co.*, 742 F.2d 274 (6th Cir.1984)); Comm. Union Ins. Co. v. Gilbane Bldg. Co., 992 F.2d 386, 389 (1st Cir. 1993*); Compania Espanola de Petreoles v. Nereus Shipping*, 527 F.2d 966, 973 (2d Cir. 1975), *overruled on other grounds by United Kingdom of Great Britain and N. Ireland v. Boeing Co.,* 998 F.2d 68 (2d Cir. 1993); *Cost Bros., Inc. v. Travelers Indem. Co.*, 760 F.2d 58 (3d Cir. 1985); *Drews Distrib., Inc. v. Silicon Gaming, Inc.*, 245 F.3d 347 (4th Cir. 2001); *Kvaerner ASA v. Bank of Tokyo-Mitsubishi Ltd., N.Y. Branch,* 201 F.3d 262 (4th Cir. 2000); *Encompass Power Servs. v. Eng'g & Constr. Co.,* 224 F. App'x 329 (5th Cir. 2007); *Jewish Fed'n of Greater New Orleans v. Fid. & Deposit Co. of Md.,* 273 F.3d 1094 (5th Cir. 2001*); J.S. & H. Constr. Co. v. Richmond Cty. Hosp. Auth.*, 473 F.2d 212 (5th Cir. 1973); *Exch. Mut. Ins. Co. v. Haskell Co.*, 742 F.2d 274, 276 (6th Cir. 1984); *Grundstad v. Ritt*, 106 F.3d 201, 204-05 (7th Cir. 1997); *Gingiss Int'l, Inc. v. Bormet*, 58 F.3d 331-32 (7th Cir. 1995); *Nat'l Am. Ins. Co. v. SCOR Reinsurance Co.,* 362 F.3d 1288 (10th Cir. 2004).

[42] *See, e.g., Schneider Elec. Bldgs. Cricitcal Sys. v. W. Sur. Co.,* 165 A.3d 485, 490 (Md. 2017); *Developers Sur. & Indem. Co. v. Carothers Constr., Inc.,* No. 17-2292-JWL, 2017 U.S. Dist. LEXIS 135949, at *18-19 (D. Kan. Aug. 24, 2017); *Hartford Accident & Indem. Co. v. Scarlett Harbor Assocs*., 695 A.2d 153, 155 (Md. 1997).

[43] *See, e.g., Schneider Elec*., 165 A.3d at 490; *Carothers Constr.*, 2017 U.S. Dist. LEXIS 135949, at *18-19; *Scarlett Harbor Assocs.,* 695 A.2d at 155.

[44] *See, e.g., Tower Ins. Co. v. Davis/Gilford, A JV*, 967 F. Supp. 2d 72 (D.D.C. 2013); *Fid. & Guar. Ins. Co. v. West Point Realty, Inc.*, No. 02 Civ. 1951 (LMM), 2002 U.S. Dist. LEXIS 15405, at *13-14 (S.D.N.Y. Aug. 20, 2002); *Compania Espanola de Petroleos, S.A. v. Nereus Shipping, S.A.*, 527 F.2d 966, 973 (2d Cir. 1975).

[45] *See* CARTER, *supra* note 36.

[46] *See, e.g., Slaught v. Bencomo Roofing Co.,* 25 Cal. App. 4th 744, 30 Cal. Rptr. 2d 618 (2d Dist. 1994); *Saturn Constr. Co., Inc. v. Landis & Gyr Powers, Inc.,* 238 A.D.2d 428 (N.Y. Ct. App. 1997); *Wonder Works Constr. Corp. v. R.C. Dolner, Inc.,* 73 A.D.3d 511 (N.Y. Ct. App. 2010); *Bartley, Inc. v. Jefferson Parish Sch. Bd.,* 302 So. 2d 280 (La. 1974).

the arbitration agreement, makes it equitable to impose the duty to arbitrate upon the nonsignatory.[47]

Non-signatories have also been compelled to arbitrate under the estoppel doctrine when the claims asserted by or against a contracting party are related to nonperformance of the construction contract requiring arbitration or the non-signatory receives direct benefits under such contract, especially when the claims are closely intertwined with the underlying contractual obligations.[48] In addition, under certain circumstances, non-signatories may use estoppel as a defense in order to compel arbitration and stay pending litigation.[49] Specifically, when: (1) the signatory to a contract with an arbitration provision asserts claims against a non-signatory that arise out of and are directly related to such contract; and (2) "the signatory raises allegations of . . . substantially interdependent and concerted misconduct by both the non-signatories and one or more of the signatories to the contract."[50] Lastly, non-signatories may also be force into arbitration under alter ego or piercing the corporate veil and third-party beneficiary theories.[51] An "alter ego" or "third party beneficiary" should be bound by an arbitration provision to the same extent as a signing party.[52]

In short, while it is not as simple as in litigation, there are various ways in which a party may be able to force another potentially responsible third party, such as a subcontractor or vendor, to arbitrate claims.

VI. CONCLUSION

While there may be some valid criticisms against arbitration, particularly when the parties do not structure the proceeding properly, there are also many reasons why arbitration might be a better forum for resolving construction disputes amongst all players – whether a contracting party such as an owner or general contractor, or third-party surety, subcontractor, vendor, and/or architect. Again, the decision whether to arbitrate or litigate must not be taken lightly. It is important, however, to fully consider the pros and cons as to both in order to make sure the claims are in the best suited forum, taking account of creative ways that may be available to efficiently structure an arbitration to fit the needs of the parties.

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[47] *Westra v. Marcus & Millichap Real Estate Inv. Brokerage Co., Inc.,* 28 Cal. Rptr. 3d 752, 10 A.L.R.6th 821 (Cal. App. 2005). *See Leighton v. Chesapeake Appalachia, LLC,* 2013 WL 6191739 (M.D. Pa. Nov. 26, 2013); *Provenzano v. Ohio Valley Gen. Hosp.,* 121 A.3d 1085, 1097 (Pa. Super. 2014); *see also* Carl F. Ingwalson, Jr., Adam T. Mow, and Elysian Kurnik, *Arbitration and Nonsignatories: Bound or Not Bound?* 6 NO. 1 THE AM. COLL. OF CONSTR. LAW. J. 3 (2012).

[48] *See, e.g., McBro Plan. and Dev. Co. v. Triangle Elec. Constr. Co.,* 741 F.2d 342 (11th Cir. 1984); *Hughes Masonry Co., Inc. v. Greater Clark County Sch. Bldg. Corp.*, 659 F.2d 836 (7th Cir. 1981); *Grinham v. Fielder,* 121 Cal. Rptr. 2d 468 (Cal. App. 2002); *Lovret v. Seyfarth*, 101 Cal. Rptr. 143 (Cal. App. 1972); *DCK World Wide, LLC v. Pacifica Riverplace*, Cause No. A-6-CV-00666-SS, 2018 WL 934898 (W.D. Tex. Feb. 16, 2018); *In re Weekely Homes, L.P.*, 180 S.W.3d 127, 131-32 (Tex. 2005).

[49] *See* Philip L. Bruner, *Streamlining Construction Arbitration: Reducing the Peril of "Double Jeopardy" in Dual-Track Proceedings*, 38-FALL CONSTR. LAW. 7, 11 (A.B.A. 2018).

[50] *See MS Dealer Servs. Corp. v. Franklin*, 177 F.3d 942, 947 (11th Cir. 1999).

[51] *See Hall, Goodhue, Haisley & Barker, Inc. v. Marconi Conf. Center Bd.,* 49 Cal. Rptr. 2d 286 (Call. App. 1996) (alter ego); *MS Dealer Serv. Corp. v. Franklin,* 177 F.3d 942 (11th Cir. 1999) (third-party beneficiary); *In re Merrill Lynch Trust Co. FSB,* 235 S.W.3d 185 (Tex. 2007) (third-party beneficiary).

[52] *See id.*

PANEL 14

LEGAL EFFECTS OF ELECTRONIC SIGNATURES

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PEARLMAN 2021

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PEARLMAN CONFERENCE
September 2021

LEGAL EFFECTS OF ELECTRONIC SIGNATURES

1. INTRODUCTION

The first signatures appeared thousands of years ago in the form of pictographs, and eventually evolved into signing paper documents that we are all familiar with. But as computers have improved and provided easier technology, customers have demanded quicker and easier options to enter into agreements and finalize transactions. These transactions take many forms now, including clicking on boxes on a computer or your cell phone. Laws were initially created over 20 years ago to provide the framework to cover these electronic transactions, but the last year and a half seems to have accelerated the surety industry's involvement in this field. Unfortunately not all public agencies and owners are ready, as many do not accept electronically signed documents. We hope this paper will provide some background on the laws covering this fast-moving field, as well as some cases that might help you navigate possible problems.

2. FEDERAL LAW – ESIGN (Electronic Signatures in Global and National Commerce) Act – 15 USC §7001, *et seq*)

E-Sign does not amend any laws specifically but provides that a signature, contract or other record relating to a transaction may not be denied validity solely because it is in electronic form. 15 U.S.C. §7001. Therefore, if a state statute requires a "writing", the simple fact that the record or signature is in electronic form would not affect the validity of the record or signature.

E-Sign defines the term "electronic signature" as "an electronic sound, symbol or process, attached to or logically associated with a contract or other record and executed or adopted by a person with the intent to sign the record." *Id.* at §7006(5). Under E-Sign, the use of a PIN number, a digital signature (usually defined as one using public key infrastructure technology), or any number of things, including a typed name, might be considered an electronic signature. From a contracting standpoint, what is relevant is whether the signature can be attached to the record, and whether it can be attributed to the person against whom enforcement is sought. The law does not require any person or entity to agree nor does it endorse any particular technology.

E-Sign also states that a contract or other record may not be denied legal effect solely because it involved the action of an electronic agent, provided the action of any such electronic agent is legally attributable to the person to be bound. *Id.* at 7001(h). "Electronic agent" is defined as "a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performance in whole or in part without review or action by an individual at the time of the action or response." *Id.* at §7006(3).

E-Sign specifically provides that it does not apply to, among other things, wills, family law matters, court orders or matters governed by the Uniform Commercial Code, other than §§ 1-107 and 1-206, and Articles 2 and 2A. *Id.* at §7003. E-Sign also does not apply to notice of the cancellation of utilities, or default, acceleration, or foreclosure. *Id.*

E-Sign contains consumer protections regarding mandatory disclosures. Where statute, regulation, or other rules of law require that information relating to a transaction be provided to a consumer in writing, the disclosure may be made in electronic form only if the consumer consents electronically in advance, and certain other conditions are met. *Id.* at §101(c).

E-Sign also contains records retention standards. It states that if law or regulation requires the retention of records for a particular transaction, the retention requirement may be met by retaining an electronic record, provided certain conditions are met. *Id.* at §101(d). One requirement is that the record remain capable of being reproduced for later reference. *Id.* Therefore, it is important to ensure that the document remains retrievable despite changing technology.

E-Sign provides that if notarization or acknowledgment of a signature or record is required, that requirement is satisfied if the electronic signature of the person notarizing the record is "attached to or logically associated with the signature or record." *Id.* at §7001(g).

E-Sign addresses the electronic creation and execution of notes secured by real estate by creating a category of electronic documents known as "transferable records." E-Sign defines a "transferable record" as an electronic record that

(A) would be a note under Article 3 of the Uniform Commercial Code if the electronic record were in writing;

(B) the issuer of the electronic record expressly has agreed is a transferable record; and

(C) relates to a loan secured by real property.

Id. at §7021.

E-Sign states specifically that a transferable record may be executed with an electronic signature and sets forth conditions for determining who is a holder in due course of the transferable record. Among other things, E-Sign requires that there be only a single authoritative copy of the transferable record which is unique, identifiable and unalterable. *Id.* at §7021(c). This is a requirement that is dependent on technology that will be able to ensure that only one authoritative copy exists. For example, DocuSign Asset Vaulting by eOriginal manages the document's authoritative copy. This requirement does not preclude making other copies of the transferable record, provided it is clear which copy is for informational purposes and which copy is the "authoritative" copy.

A. Required Elements

For an electronic signature to be legally binding under the ESIGN Act, Adobe Sign recommends that all electronic signature workflows include the following elements:

1. Intent to sign.

As with a handwritten signature, a signer must show clear intent to sign an agreement electronically. For example, signers can show intention by using a mouse to draw their signature, typing their name, or clicking an "Accept" button that is clearly labeled.

2. Consent to do business electronically

Most electronic signature laws also require some form of consent to do business electronically. Many enterprise electronic signature solutions ask signers to "click to accept" a standard consent clause or provide an option to customize a consent clause such as:

> The parties agree that this agreement may be electronically signed. The parties agree that the electronic signatures appearing on this agreement are the same handwritten signatures for the purposes of validity, enforceability, and admissibility.

3. Opt-out clause

If a signer elects to opt out of signing an agreement electronically, clear instructions on how to sign an agreement manually should be easily accessible as part of the signature workflow.

4. Signed copies

All signers should receive a fully executed copy of the agreement. Many electronic signature solutions automatically provide executed copies of agreements to signers as part of the approval workflow.

5. Record retention

Record retention requirements are addressed via the ESIGN Act which legitimizes the validity of electronic records as long as they accurately reflect the agreement and can be reproduced as required. Often this requirement is met by providing a fully executed copy to the signer or permitting the signer to download a copy of the agreement.

3. STATE LAW – Uniform Electronic Transactions Act (UETA)

The ESIGN Act has been adopted by 49 states in the form of the UETA which essentially codifies the ESIGN Act verbatim. UETA was initially proposed in 1999 by a non-profit group called the National Conference of Commissioners on Uniform State Laws in order to provide a

consistent framework of state law allowing easier use of electronic commerce by the validation of electronic signatures and methods of retaining those records. UETA, like ESIGN, covers electronic contracts that relate to business, commercial and governmental matters. Each state had the choice to adopt or reject these rules, and while 23 states adopted UETA within the first year, others were not so quick. Some states have also adopted their own specific changes and have not passed UETA verbatim, although the main points are all very similar.

A. California – Civil Code §1633.1, *et seq.*

California was the first state to adopt UETA, which it did on September 16, 1999. California's version adopted the UETA in almost all respects. However, it does add a number of specifically excluded transactions including several in the Insurance Code. None of those appear to relate to indemnity agreements, bond applications, forms, or settlement contracts. California's amount of exemptions appear to lead the country, so particular attention should be paid to California Civil Code §1633.3 (b) and (c):

> (b) This title does not apply to transactions subject to the following laws:
>
> (1) A law governing the creation and execution of wills, codicils, or testamentary trusts.
>
> (2) Division 1 (commencing with Section 1101) of the Uniform Commercial Code, except Sections 1206 and 1306.
>
> (3) Divisions 3 (commencing with Section 3101), 4 (commencing with Section 4101), 5 (commencing with Section 5101), 8 (commencing with Section 8101), 9 (commencing with Section 9101), and 11 (commencing with Section 11101) of the Uniform Commercial Code.
>
> (c) This title does not apply to any specific transaction described in Section 17511.5 of the Business and Professions Code, Section 56.11, 56.17, 798.14, 1133, or 1134 of, Sections 1350 to 1376, inclusive, of, Section 1689.6, 1689.7, or 1689.13 of, Chapter 2.5 (commencing with Section 1695) of Title 5 of Part 2 of Division 3 of, Section 1720, 1785.15, 1789.14, 1789.16, 1789.33, or 1793.23 of, Chapter 1 (commencing with Section 1801) of Title 2 of Part 4 of Division 3 of, Section 1861.24, 1862.5, 1917.712, 1917.713, 1950.5, 1950.6, 1983, 2924b, 2924c, 2924f, 2924i, 2924j, 2924.3, or 2937 of, Article 1.5 (commencing with Section 2945) of Chapter 2 of Title 14 of Part 4 of Division 3 of, Section 2954.5 or 2963 of, Chapter 2b (commencing with Section 2981) or 2d (commencing with Section 2985.7) of Title 14 of Part 4 of Division 3 of, or Section 3071.5 of, the Civil Code, subdivision (b) of Section 18608 or Section 22328 of the Financial Code, Section 1358.15, 1365, 1368.01, 1368.1, 1371, or 18035.5 of the Health and Safety Code, Section 658, 662, 663, 664, 666, 667.5, 673, 677, 678, 678.1, 786, 10083, 10086, 10087, 10102, 10113.7, 10127.7, 10127.9, 10127.10, 10197, 10199.44, 10199.46, 10235.16, 10235.40, 10509.4, 10509.7, 11624.09, or 11624.1 of the Insurance Code, Section 779.1, 10010.1, or 16482 of the Public Utilities Code, or Section 9975 or 11738 of the Vehicle Code. An electronic record may not be substituted for any notice that is required to be sent pursuant to Section 1162 of the Code of Civil Procedure. Nothing in this subdivision shall be construed to prohibit the

recordation of any document with a county recorder by electronic means.

B. Outlier #1 – New York

New York decided not to pass UETA, but instead enacted their own version last amended in 2014, passing the Electronic Signatures and Records Act (ESRA) (NY State Tech L 301-309) (STT – State Technology, Article 3 (301 – 309). This Act is very brief compared to UETA, an unexpected bonus when reading these laws. “Electronic signature” is defined exactly as it is under UETA.

Section 304.2 states, “…an electronic signature may be used by a person in lieu of a signature affixed by hand. The use of an electronic signature shall have the same validity and effect as the use of a signature affixed by hand.”

This article does not apply to “any negotiable instruments and other instruments of title wherein possession of the instrument is deemed to confer title, unless an electronic version of such record is created, stored or transferred pursuant to this article in a manner that allows for the existence of only one unique, identifiable and unalterable version which cannot be copied except in a form that is readily identifiable as a copy.” *Id.* at § 307.2.

C. Outlier #2 – Illinois

Illinois initially enacted the Electronic Commerce Security Act instead of passing UETA, which they also modeled after the ESIGN Act. However, on June 25, 2021 Illinois approved SB 2176 to become the 49th state to enact UETA. They adopted UETA in full, making it easier to understand that state’s rules. They are no longer an outlier.

4. CASE LAW INTERPRETING ESIGN/UETA

Both California state and federal courts have addressed the use of a password in the context of a person's "act" related to an electronic signature. Courts have found that evidence of use of a unique, secure username and password may sufficiently authenticate a signature when that signature is a typed name inputted by the user. Similarly, the use of a checkbox to show acknowledgment and agreement with a specific policy document also has been found sufficient where a unique, secure username and password was used to access the website containing the policy document. *Tanis v. Southwest Airlines, Co., et al*, No. 18-CV-2333-BAS-BGS, 2019 U.S. Dist. LEXIS 38876, 2019 WL 1111240, at *5-7 (S.D. Cal. March 11, 2019). Likewise, the act of inputting a username and password, itself, has been found sufficient to constitute an electronic signature. *Hose v. Washington Inventory Services, Inc.,* No. 14-CV-2869-WQH-WVG, 2016 U.S. Dist. LEXIS 188368, 2016 WL 6427810, at *6-7 (S.D. Cal. August 30, 2016); *Taft v. Henley Enterprises, Inc.,* No. SACV 15-1658-JLS (JCGx), 2016 U.S. Dist. LEXIS 193641, 2016 WL 9448485, at *1-4 (C.D. Cal. March 2, 2016).

In all these cases, authentication of the electronic signatures turned on the indicia of reliability demonstrated in the processes associated with use of the username and password. These processes, and attendant explanations, are fact-specific and contextual. They may take many forms yet still satisfy the burden of authentication.

Courts in other jurisdictions that have adopted a version of UETA have concluded that names typed at the end of e-mails *can* be electronic signatures. *Preston Law Firm, L.L.C. v. Mariner Health Care Management Co.,* 622 F.3d 384, 391 (5th Cir. 2010) [affirming that "[e]mails can qualify as the signed writings needed to form contracts" under Louisiana's UETA]; *Cloud Corp. v. Hasbro, Inc.,* 314 F.3d 289, 295–296 (7th Cir. 2002) [holding that "the sender's name on an e-mail satisfies the signature requirement of the [Illinois] statute of frauds" and noting that it would be a valid signature under the federal Electronic Signatures in Global and National Commerce Act (15 U.S.C. § 7001 et seq.) as well]; *Lamle v. Mattel,* 394 F.3d 1355, 1362 [e-mail was written prior to the enactment of California's UETA but court opined that inclusion of individual's name on e-mail would be valid signature under California's UETA]; *Gillis v. Wells Fargo Bank,* 875 F.Supp.2d 728, 734–735 (E.D.Mich. 2012) [signed letter and e-mail messages that included the sender's salutation were sufficient to satisfy statute of frauds].)

Even if a printed name can satisfy the signature requirements of California Code of Civil Procedure §664.6, a printed name is not a signature under contract law simply because the person deliberately printed his or her name. "[I]t is a universal requirement that the statute of frauds is not satisfied unless it is proved that the name relied upon as a signature was placed on the document or adopted by the party to be charged with the intention of authenticating the writing." *Marks v. Walter G. McCarty Corp.,* 33 Cal.2d 817, 820 (1949). The evidence must also demonstrate that the person printing his or her name intended to execute the document. *J.B.B. Inv. Partners, Ltd. v. Fair,* 232 Cal. App.4th 974, 987-93, 182 Cal. Rptr.3d 154, 164-68 (2014)

An email "settlement agreement" must contain a statement indicating that the parties agreed to enter into a final settlement by electronic means. If the plain language of the email offer made it clear that no signature was being requested as the offer and included no signature line or signature block, contained no signature by any of the other parties, and if it advised that future paperwork was forthcoming it cannot be considered a signed settlement agreement [a party's signature added "to a document that does not call for it" is not a signed writing under California Code Civ. Proc., § 664.6 because "[a] party's signature fails to convey" knowledge and express consent "unless it is contained in a document that was clearly intended by that party to be a binding settlement agreement"]; *Powell v. City of Newton,* 364 N.C. 562 [703 S.E.2d 723, 727–728] (2010) [applying North Carolina's UETA and concluding that the parties did not agree to the use of electronic signatures "[i]n light of the express indication by [one party] that [the other party] should sign and forward the [agreements]"].)

The following are specific examples of court decisions that have upheld electronic signatures and those that have not.

A. Decisions upholding electronic signatures

1. <u>Dustin Barwick v. Government Employee Insurance Co., Inc. (GEICO), 2011 Ark. 128 (2011)</u>. In this case, Geico had issued an auto policy to a person (Barwick) who applied for a policy online. The applicant elected to waive medical benefits coverage and electronically signed a statement rejecting it. Arkansas insurance law requires that medical benefits coverage can only be rejected by signature in writing. However, Arkansas has also adopted UETA. Later, the applicant's husband was injured when struck by another vehicle. He submitted the bills for payment under their insurance policy, however, the medical bills were denied. Barwick filed a suit against Geico, claiming that the waiver was not valid because it was not signed "in writing". However, the Arkansas Supreme Court held that UETA allowed the use of electronic signatures to satisfy the writing requirement of the statute. The Court granted Geico's motion for summary judgment.

2. <u>Mustafa Fteja v. Facebook, Inc., 841 F. Supp.2d 829 S.D.N.Y. (2012)</u>. In this case, Fteja was an active user of Facebook. At some point, Facebook disabled his account. Fteja, a Muslim, filed suit against Facebook in a NY federal trial court. Facebook moved to transfer the case to the United States District Court for the Northern District of California, due to language contained in its Terms of Use, which contained a forum-selection clause stating that any dispute with Facebook was required to be pursued in Santa Clara County, California. Fjeta argued that he did not agree to this clause. However, in order to use Facebook, one must acknowledge an agreement to Facebook's Terms of use. Specifically, as part of signing up for an account, one is taken to a webpage that displays a "Sign Up" button. A sentence below states that by clicking the button, the consumer indicates they have read and agree to the Terms of Service. The phrase "Terms of Service" was a hyperlink that sent the consumer to the document. Facebook argued that by clicking the "Sign up" button, Fteja acknowledged his agreement to the policy and terms, including the forum-selection clause. The N.Y. Court rejected Fteja's claims and ruled in favor of Facebook because the user "signed" the contract by clicking "I agree".

3. <u>Loretta and Leonard Traynum v. Cynthia Scavens and Progressive Direct Insurance Co. (2016)</u> South Carolina Supreme Court, Opinion No. 27629. Leonard Traynum was injured in an auto accident, and filed suit against Progressive, seeking to reform the insurance policy to include UIM coverage. The Supreme Court held that the insurer made the statutorily compliant offer of UIM coverage to the driver who purchased the policy online, through the insurer's website. Traynum contested the method by which the offer was communicated and rejected by him through the website. Because the transaction occurred online, it is governed by SC's version of UETA. Under UETA, an electronic signature satisfies a law requiring a signature. UETA also allows offers to be communicated online. Moreover, the UETA endorses automated transaction between an "electronic agent" of a company and a consumer. Traynum argued that the website communicated the offer in a confusing and misleading way. However, the Court held that pursuant to UETA, Progressive effectively communicated the offer form to Traynum, who effectively signed it.

4. *Vergara Hermosilla v. Coca-Cola Co*., 717 F. Supp.2d 1287 (S.D.F.L. 2010)

A court held that the Copyright Act's requirement that an agreement to convey copyright ownership must be "in writing and signed by the owner of the rights conveyed" was satisfied by an agreement reached via e-mail. The Southern District of Florida held that the songwriter plaintiff assigned his rights to a copyrighted work when he and the defendant agreed to the assignment via e-mail. Citing prior case law and ESIGN, the court stated that "emails [] constitute signed writings."

5. *Metropolitan Regional Info Systems v. American Home Realty Network, Inc*., 722 F.3d 591 4th Cir. (2013)

The Court of Appeals for the Fourth Circuit held that electronically transferring copyright ownership of photographs on a real estate website - by clicking "yes" to the terms of use of the website prior to uploading the photographs - satisfied the requirement that such an agreement must be "in writing and signed by the owner of the rights conveyed." The court stated that failing to recognize "copyright transfer agreements solely because they were made electronically would thwart the clear congressional intent embodied in [ESIGN]."

6. *Campbell v. General Dynamics Government Systems Corp,* 407 F.3d 546 (1st Cir. 2005)

The Court of Appeal for the First Circuit held that the Federal Arbitration Act's "written provision" requirement was satisfied by a mass e-mail notice sent out to employees. ESIGN "prohibits any interpretation of the [Federal Arbitration Act's] "written provision' requirement that would preclude giving legal effect to an agreement solely on the basis that it was in electronic form."

7. *Klein v. Delbert Servs. Corp.,* No. 15-cv-00432-MEJ, 2015 U.S. Dist. LEXIS 43505, at 1 (N.D. Cal. Apr. 1, 2015)

The Northern District of California echoed the holding of *Campbell v. General Dynamics* and held that checkmarks in a web form "are sufficient to establish [defendant's] acceptance of the terms of the Note and the arbitration provision."

8. *Espejo v. S. Cal. Permanente Med. Grp.,* (2016) 246 Cal.App.4th 1047, 1047, 201 Cal. Rptr.3d 318, 320 (2016)

A former employee sued his employer for wrongful termination and whistleblower retaliation, but the employer petitioned to compel arbitration pursuant to an electronically signed arbitration agreement. The trial court denied the petition, holding that the employer had not met its burden to establish the signature's authenticity. The California Court of Appeal reversed and remanded, holding that the employer adequately addressed all of the concerns raised by the court in *Ruiz v. Moss* - specifically by showing that a combination of a unique username and password were required in order for employees to sign the arbitration agreement.

9. *Newton v. American Debt Services*, 75 F.Supp.3d 1048 (, N.D. Cal. 2014)

The plaintiff tried to avoid an arbitration clause based on the assertion the defendant lacked proof that plaintiff was the one who signed the relevant contract. The plaintiff did not actually dispute that she signed the contract, but merely challenged the defendant based on an alleged lack of evidence. In response, the defendant corporation substantiated that it had used the

DocuSign electronic signature product to send the relevant contract to the plaintiff for her signature, she had opened the document for review, created a signature, and clicked a button confirming her signature once she had completed all form fields and signed in all required places. The court considered this sufficient evidence and upheld the electronic signature created with DocuSign.

10. *Smith v. Rent-A-Center, Inc.,* No. 1:18-CV-0135, 2019 U.S. Dist. LEXIS 47369, (E.D. Cal. 2019)

The complaint alleged wrongful termination and whistleblower retaliation. The trial court denied the employer's petition to compel arbitration pursuant to the employment agreement and associated documents, finding that the employer had failed to establish the existence of an enforceable arbitration agreement.

The Court of Appeal reversed and remanded, holding that the employers satisfied the initial burden of establishing the existence of the agreement by attaching a copy to their petition and were not required to establish the authenticity of the former employee's electronic signature until the employee challenged it; thus, their supplemental declaration did not have to be filed by the deadline for a party's moving papers (The supplemental declaration sufficiently authenticated the signature (Evid. Code, § 1401; Civ. Code, § 1633.9, subd. (a)) as an electronic signature with legal effect (Civ. Code, § 1633.7) by describing the employers' secure procedures for signing documents and concluding that the employee must have signed the agreement. *Smith v. Rent-A-Center, Inc.* No. 19-15742, 2019 U.S. App. LEXIS 31046 (9th Cir. July 23, 2019)

B. Decisions invalidating the electronic signatures

1. *Fabian v. Renovate America, Inc.,* 42 Cal.App.5th 1062 (2019)

The plaintiff expressly stated that she did not sign the relevant contract. Defendant referred summarily to an electronic signature created with DocuSign's technology, but did not substantiate how this signature was created, by whom, and following what process. The court sided with plaintiff and noted that Renovate's reliance on *Newton v. American Debt Services* is misplaced because, unlike here, the declarant in that case proved that the "docusigned" electronic signature was the plaintiff's by explaining the process used to verify the signature. There, the defendant submitted a declaration stating that it sent a contract to the plaintiff using DocuSign, and that the plaintiff signed the Client Signature portion of the contract. Once signed, the signature was assigned an identifying code, such as the one that appeared above the plaintiff's signature on the subject contract.

Renovate did not provide any evidence from or about DocuSign in its petition, reply, or supplemental declaration. The word "DocuSign" does not appear in any of Renovate's moving papers. Renovate offered no evidence about the process used to verify plaintiff Fabian's electronic signature via DocuSign, including who sent Fabian the contract, how the contract was sent to her, how Fabian's electronic signature was placed on the contract, who received the signed the contract, how the signed contract was returned to Renovate, and how Fabian's identification was verified as the person who actually signed the contract. The Fourth District

Court of Appeal found Renovate's DocuSign authentication argument unsupported and unpersuasive.

2. *Ruiz v. Moss Bros. Auto Grp., Inc.,* 232 Cal. App. 4th 836, 838, 181 Cal. Rptr. 3d 781, 783 (2014)

An employee sued his employer for various wage and hour violations and his employer petitioned to compel arbitration based on an agreement to arbitrate all employment-related disputes. The trial court denied the employer's petition, holding that the employer had not met its burden under California's version of UETA to establish that the employee was actually the one who executed his electronic signature, and the California Court of Appeal affirmed. The employer's personnel records custodian summarily asserted that Ruiz electronically signed the agreement and that the same agreement was presented to all persons who seek or seek to maintain employment with the employer, and she did not explain how she verified that the employee electronically signed the agreement. She explained that "each employee is required to log into the Company's HR system - each with his or her unique login ID and password - to review and electronically execute the Employee Acknowledgement form, which includes the arbitration agreement." However, because the employee did not recall signing the agreement and stated that she would not have done so, she needed to explain how the electronic signature came to appear on the agreement, and thus, how it was the act of the employee. The court stated that "this was not a difficult evidentiary burden to meet, but it was not met here."

3. *In re Vee Vinhnee* 336 B.R.437 (B.A.P. 9th Cir. (2005)

A bankruptcy court in the Central District of California examined the process for authenticating electronic documents under the Federal Rules of Evidence and elected to use an eleven-step test for computer records developed by Professor Edward Imwinkelried. Based on the Imwinkelried method, the trial court refused to admit electronic records of monthly billing statements submitted by the plaintiff. Though the plaintiff attempted to cure its defective evidentiary foundation by submitting a declaration from a qualified witness, the court still refused to admit the electronic records because (a) the declaration failed to establish that the witness was qualified to testify as to the authenticity of the records, and (b) "the declaration did not contain information sufficient to warrant a conclusion that the "[plaintiff's] computers are sufficiently accurate in the retention and retrieval of the information contained in the documents.'" The Court of Appeals for the Ninth Circuit affirmed the trial court's judgment, noting "the cursory nature of the declaration and the lack of basic information that would provide assurance that the record reproduced from the electronic media is identical to the record that was originally stored." *In re Vee Vinhnee* has been cited sparingly and does not appear to have established the Imwinkelried method as a standard test for determining the admissibility of electronic documents.

It is worth noting that the court did not find any fault with DocuSign's product specifically or electronic signatures more generally, but merely noted that defendant failed to allege the necessary facts to substantiate that plaintiff signed the relevant contract. The court would presumably have come to the same conclusion if plaintiff had stated that a handwritten signature was not hers and defendant failed to allege any facts or present any evidence to the contrary.

5. ELECTRONIC/DIGITAL SIGNATURES IN SURETYSHIP

The most obvious use of electronic signatures is in obtaining the signature of indemnitors on the indemnity agreement. Sureties also may obtain electronic signatures on commercial surety applications, certain bond forms (that sureties know will be accepted by the obligee), riders, agency agreements and vendor contracts. Suretybonds.com is one of the largest producers of surety bonds, and they use a one DocuSign document authorized by 19 sureties for purposes of obtaining a binding indemnity agreement. DocuSign is not the only vendor that provides electronic signature services, but they appear to be the largest and most commonly used service.

Sureties writing accounts with a program of contract bonds use a lengthier, more detailed indemnity agreement. DocuSign can provide template forms for these agreements that can be sent out to obtain the signatures, or a surety can tailor the agreement on a pdf and upload it to DocuSign to be sent. This indemnity agreement is the document that exposes the surety to the greatest exposure to loss, so it is imperative that a thorough, verifiable process be created. It is equally important to document every step in this process. Legal decisions in appellate proceedings can help determine how to appropriately navigate this as the *Ruiz* and *Fabian* cases in particular explain.

This may not become an issue until years later, but if the surety sustains a loss and sues an indemnitor who denies liability and states, “that’s not my signature”, someone will need to testify about the set up process and document details.

Who created the document, and when?
Where and when was it sent? To the agent, or to the indemnitor directly?
When was the document viewed? When was it signed?
Once signed, where did it go from there? To other indemnitors, or the agent?
When was it returned to the surety? Who viewed it after that?

These document details and how the document was stored from its receipt until the indemnity action are key pieces of evidence that the court will review. Date & time stamps of who did what and when are critical. But possibly more important is showing that the form created is identical through every step of the process, and it remains the same, unaltered document today. Having a system that can show any changes, or that no changes were made, is imperative.

The other key piece needed is the identification and authentication of the signer. It is not enough to just show the IP address of the computer the document was sent to. For example, an indemnitor can claim a co-worker sat down and clicked/signed the document, my spouse did it because they know my personal information, etc. This is where 2-factor authentication methods can be used: sending a code to a previously registered cellphone number; secret questions that must be answered correctly; signing while on camera, possibly even holding up a drivers license; or using an online or remote notary. These are all potential ways to prove the person signing the document is who they say they are. Use caution if you choose to use electronic notarization as many states have specific differing rules relating to this, including many that require the notary

to be physically present in that state. Designing or ensuring that your process covers all of these factors can ensure a valid and enforceable signature and document.

6. ELECTRONIC SIGNATURES IN THE PRACTICE OF LAW

1. Federal Law

As every licensed attorney in the USA knows, the PACER comprehensive electronic filing system is used by all Federal Courts. FRCP 5(d)(3) *electronic filing and signing* (A) specifically states that "a person represented by an attorney *must* file electronically, unless non-electronic filing is allowed by the court for good cause or is allowed or required by local rule (emphasis added).

(C) *signing* states that "a filing made through a person's electronic-filing account and authorized by that person, together with that person's name on a signature block, constitutes the person's signature."

(D) *same as a written paper* states that "a paper filed electronically is a written paper for purposes of these rules."

Each United States District Court then promulgates their own Local Rules. For example, the United States District Court – Northern District has Rule 5-1 *electronic case filing*. Subsection (C)(1) obliges each attorney of record to become an ECF user and obtain a user ID and password for access to the system upon filing a case in the district. (I) *signatures* asserts in general under subpart (1) provides that a document electronically filed with the court shall be deemed to be signed by the person ("signatory") when the document identifies the person as a signatory and the filing complies with either subsection (2) or (3). Subsection (2) provides that a signatory that is an ECF user regardless of the existence of a physical signature on the document is deemed signed provided it is filed using the user ID and password of a signatory. Subsection (3) referencing *others* requires that the filer of the document attests that in concurrence with the filing of the document, consent has been obtained from all of the other signatories, such as in cases in which the filing contains multiple signatures.

And as many of us have learned the hard way, "courtesy copies" are required for the judge's chambers in paper form and must conform to the particular requirements of the assigned judge's standing orders as per L.R. 5-1 (e)(7). Apparently being nominated and confirmed as a Federal Judge automatically entitles one to issue "standing orders" that must be complied with or an attorney may find themselves subject to monetary sanctions or worse.

2. State Law

This portion of the paper pertains to which court filings and evidence are mandatory and/or permitted in electronic form. Each state is different and only California is presented as it is where one of the authors practice law.

1. California Supreme Court

The rules governing electronic filing in the California Supreme Court are found at California Rules of Court (CRC) 8.70 – 8.79. The Court's electronic filing system (EFS) is operated by ImageSoft TrueFiling (True Filing). CRC 8.71 requires all attorneys representing a party to file documents through the court's EFS. Pursuant to Rule 8.71(b) and (c), electronic filing is voluntary for self-represented litigants and trial courts. Use of a registered true filers user's name and password to electronically file a document is the equivalent of placing the registered user's electronic signature on the document.

2. Trial Courts

The pandemic and lockdowns of 2020 accelerated the use of electronic filing and service of documents in the California Superior Courts. Each of the 58 counties has its own Superior Court which issues its own Local Rules. The Los Angeles Superior Court is the largest trial court in the USA with 494 Judges. In contrast, Alpine County Superior Court has two (2).

Most if not all California Superior Courts have issued local rules mandating electronic filing of documents. For example, Santa Cruz Superior Court Local Rule 1.3.01 effective July 1, 2021 has made electronic filing mandatory by attorneys for all civil, family, and probate proceedings. Certain exceptions are made for appellate filings, criminal, juvenile justice, and dependency cases. The electronically filed documents must comply with Code of Civil Procedure 1010.6 and CRC 2.250 through 2.261. CRC 8.75 provides the specific procedures for documents filed electronically with signatures under penalty of perjury, not under penalty of perjury, or of multiple parties.

The process of electronically filing documents with electronic signatures is done through the court portal. Not surprisingly, there are an enormous amount of e-filing Service Providers (EFSP) that act as an intermediary between the attorney and the court's case management system. Odyssey e-File CA identifies 105 certified EFSPs on their website.

7. CONCLUSION

We have attempted to provide some insight into a newer area of the law that is constantly changing and adapting. As this is fairly new, many detailed aspects of electronic signatures and electronic documents have not been tried often or at all yet, so there is not a great deal of case law to rely on compared to most issues. This will likely change in the very near future given the pandemic and the lockdowns in 2020. What is important to know as you work with this subject are the specific rules of the jurisdiction governing the transaction and/or dispute, and how those rules may differ for different forms or agreements. As such, you should refer to the latest laws in your jurisdiction when these issues arise.

8. RESOURCES

Lothar Determann, *Electronic Form Over Substance: eSignature Laws Need Upgrades,* 72 Hastings L.J. 1385 (2021)

Stephen Mason, Electronic Signatures in Law (4th edition, Cambridge University Press, 2016)

Stephen Errol Blythe, Ph.D., J.D., Ph.D., *E-Commerce Law Around the World: A concise Handbook* (Xlibris, Corp. February 24, 2011) available on Amazon and Google Books

Electronic Signature & Records Association (ESRA) (www.esignrecords.org)

Digital Evidence and Electronic Signature Law Review

Armen Shahinian, Electronic Surety Bonds, NASBP Annual Meeting (April 24, 2017)