SURETY TODAY PRESENTATION
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<u>Surety Case Law Update – What We Found Interesting Over the Past Six Months</u>

(MIKE)

This will be the third time we have done a surety case law update on Surety Today since we began in 2016. The last time was February 2017. George and I have gone back to June 2017 and looked at the case summaries prepared by the SFAA from June through mid-January 2018 and have selected cases of interest to discuss with you today. Of course, we are limited by time in the number of cases we can talk about and there were some very interesting cases that came out since June that we will not talk about today because they have been discussed in previous Surety Today presentations, such as the decisions on the False Claims Act. We also weed out cases that are more procedural in nature or that turn on trial or burden of proof issues, as those are more germane to outside counsel. Instead, we try to focus on cases that have some practical use and/or application for the claims handler.

I am always surprised by the number of cases that are generated in the 7 – 8 months' time period we look at, just getting through them all is a chore. George and I each go through the entire list separately, then we sit down and go through which ones we thought were interesting and decide which one's we will discuss. Today we are going to discuss cases dealing with non-dischargeability in bankruptcy, waiver of Miller Act rights, surety vs. a bank and surety rights to contract funds in bankruptcy.

(GEORGE)

The three cases that I will present today all relate back to prior presentations that Mike and I have given over the last year addressing a number of issues and concepts. I will quickly summarize those presentations during my discussion today of the three cases, putting those issues and concepts into a factual and practical context based upon the circumstances of each case. The first case concerns:

<u>The Surety's Subrogation Rights and Claims Against the Principal/Debtor</u>

***American Southern Insurance Company v. DLM. LLC*, 2017 U.S. Dist. LEXIS 105716 (D.Md. July 10, 2017)**

<u>Narrative</u>:

Last month, on January 8, 2018, Mike and I presented a Surety Today program entitled Bankruptcy: The Surety's Proof of Claim. While this case is not a proof of claim case, it does show the strength of the surety's subrogation rights to the post-petition assumption of executory contract rights of an obligee and how the surety may seek reimbursement for its surety bond losses from a debtor who previously discharged the surety's indemnity agreement reimbursement rights.

Mike and I have not discussed executory contracts under the Bankruptcy Code in a presentation yet *per se*. However, we have discussed the surety's subrogation rights to another entity's post-petition claim for administrative expenses. Under the debtor's business judgment rule and in the best interests of the debtor's bankruptcy estate, a debtor may assume its rights and obligations under a pre-petition contract, such as a bonded contract and the surety bond required by the bonded contract, if the debtor believes that the profits from that pre-petition contract are a benefit to the debtor's estate.

Those assumed rights and obligations become both the debtor's and the other contracting entity's, or the obligee's, post-petition rights and obligations. They also create an obligee's administrative expense claim against the debtor for the "the actual, necessary costs and expenses of preserving the [debtor's] estate."[1] If the debtor defaults post-petition in its obligations to perform the assumed bonded contract and the surety is called upon to make payments under the assumed surety bonds, the surety may assert its subrogation rights to the obligee's rights to a post-petition claim, and an administrative expense claim, against the reorganized debtor.

That is what happened in ***American Southern Insurance Company v. DLM. LLC***, 2017 U.S. Dist. LEXIS 105716 (D.Md. July 10, 2017). The surety sought to recover losses that it incurred from the principal and other indemnitors resulting from the principal's defaults under two pre-petition subdivision bonds executed in July of 2005. In November of 2009, the principal filed for Chapter 11 bankruptcy and became a debtor. In the September of 2010 confirmed reorganization plan, the debtor agreed to assume liability under the public works agreements secured by the subdivision bonds, and the subdivisions bonds themselves, but the debtor did not assume liability under the indemnity agreement. The bankruptcy court discharged the debtor's liability to the surety under the indemnity agreement.[2]

In November of 2014, four years after the confirmation of the debtor's plan, the obligee on the bonds notified the surety that the principal had defaulted under the public works agreements, and the surety paid the obligee over $500,000 under the subdivision bonds. The surety's initial complaint brought one claim against the principal and other indemnitors for

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1 Section 503(b)(1)(A) of the Bankruptcy Code.

2 As an aside, I take the position that the indemnity agreement is not an executory contract that can be assumed or rejected because while the principal/debtor has obligations to the surety under the indemnity agreement, the surety has no obligations back to the principal/debtor. However, as we said last month, a debtor may discharge its contingent, unmatured and unliquidated financial obligations to indemnify and reimburse the surety for its losses even if the debtor's other indemnity agreement obligations remain. As you will see, in this case, the surety's obligations under the bonds did not even arise until long after the debtor's plan was confirmed. The important point here is that the surety no longer had indemnity agreement rights of reimbursement against the debtor upon confirmation of the plan.

contractual indemnity. The surety then amended its complaint by removing the principal from the indemnity claim due to the principal's discharge from its indemnity agreement reimbursement obligations, and adding a claim against the principal for breach of the public works agreements. The surety asserted that it was subrogated to the rights of the obligee to assert the breach of the public works agreement claims.

The principal moved to dismiss the complaint, arguing that the broad language in the indemnity agreement would include any claims that the surety had pursuant to its subrogation rights to the obligee's breach of contract rights. The court disagreed and held that when a bankruptcy court does not discharge the obligations that a principal owes to the obligee because of the debtor's assumption of the bonded contracts and the bonds, the surety retains its subrogation right enforce the obligee's rights under the bonded contracts.

There are two takeaways from this case. First, when a debtor assumes an executory contract, it become a post-petition obligation of the reorganized debtor. If the debtor subsequently defaults, and the surety pays under the bond securing that post-petition contractual obligations, the surety, as usual, is subrogated to the rights of the obligee it paid and may assert the obligee's rights against the now reorganized debtor.

Second, when the surety's indemnity rights are discharged, the surety may maintain its subrogation rights. As Mike said during last month's presentation, the surety can't enforce both its indemnity agreement reimbursement rights and its subrogation rights to the obligee's rights in order to obtain a double recovery. However, when one of those rights disappears, as in this case with the indemnity agreement reimbursement rights, the surety that pays the obligee's claims under the bonds may fall back on its subrogation rights and assert the obligee's contractual claims against the reorganized debtor.

(MIKE)

I am going to discuss a series of cases that came out in August, October and December of 2017, which all dealt with the issue of impairing a payment bond claimant's Miller Act rights. Of course, we are all familiar with the Miller Act. The Act was intended to provide an alternative remedy to protect laborers and suppliers on federal projects because such parties would not have traditional mechanics lien rights. The Act has been characterized as a "highly remedial" statute, which should be liberally construed to effectuate its purpose.

In 1999, Congress amended the Miller Act to add a new provision which stated that a waiver of the rights under the Miller Act to bring a claim against the payment bond is *void* unless: (1) the waiver is in writing, (2) the waiver is signed by the person whose right is waived and (3) the waiver is executed *after* the person whose right is waived has furnished labor or materials. 40 USC §3133(c). Courts have recognized that the purpose of the new provision is to prevent prime contractors from requiring subcontractors to waive their Miller Act rights as a precondition to obtaining work on federal projects. It has also been held that any waiver of Miller Act rights must be clear and explicit and cannot be implied.

I have three cases to discuss and what I will do is briefly go over the facts and holding of each case and then talk about the basis for the holdings all together as they were all very similar.

In ***U.S. f/u/b/o of Aarow Electrical Solutions v. Continental Casualty Company***, 2017 WL 3642957 (D.Md 8/24/17), Aarow Electrical Solutions was a subcontractor to Grunley Construction Co., the prime contractor, on a project at the Social Security Administration complex in Maryland. Aarow contended that it was not paid in full for certain costs and expenses related to delays on the project. Accordingly, Aarow filed suit against the Miller Act surety. Grunley moved to intervene and to stay the case. Grunley acknowledged that there were delays on the project and indeed had submitted a delay claim to the government, which included Aarow's alleged delay damages. The government had not rendered a final decision on the claim when the suit was filed by Aarow. Accordingly, the motion to stay asked the court to stay the case pending the outcome of the claims process under the Contract Disputes Act ("CDA"). The court granted Grunley's motion to intervene, but denied the motion to stay.

In ***U.S. f/u/b/o Kitchens to Go v. Grimberg***, 2017 WL 46978217 (E.D. Va. 10/19/17), the subcontractor, Kitchens to Go, provided temporary kitchen facilities to the prime contractor, John C. Grimberg Co., on a project at the FBI Academy in Quantico, Virginia. The project was delayed and Kitchens to Go was required to maintain the temporary facilities at the project for almost an additional year beyond the time period in the subcontract. Kitchens to Go asserted a claim for delay damages and Grimberg included that claim in its own claim to the government. Eventually, Kitchens to Go filed suit against Grimberg and the surety under the Miller Act.

Kitchens to Go moved for partial summary judgment as to the claim against the surety. The surety opposed the motion and moved to stay the case pending the outcome of the claim submitted to the government. The motion to stay was denied and the motion for partial summary judgment against the surety was granted in part, holding that the surety may not rely on the no-damage-for-delay clause and that the claimant need not wait for completion of the disputes process, and denied in part on the grounds that additional discovery was needed as to damages.

In ***U.S. f/u/b/o American Combustion Industries, Inc. v. Hartford Accident and Indemnity Co.***, 2017 WL 5971833 (M.D. Pa. 12/1/17), the subcontractor, American Combustion Industries ("ACI"), was hired by John C. Grimberg, Co., the prime contractor, to install new boilers and related equipment at a new central heating plant in a federal government project in Pennsylvania. ACI filed suit against the surety under the Miller Act seeking payment for certain change orders and extra work performed. The parties jointly agreed to a stay of the case and that stay was subsequently extended multiple times by consent for almost 4 years. The stay was agreed to while the parties were waiting for a decision from the government on a claim which included the subcontractor's change and extra work. The government ultimately denied the claim and Grimberg appealed the denial to the Armed Services Board of Contract Appeals with respect to a portion of the ACI change work. The surety wanted to continue the stay, but ACI refused, so the surety filed a motion to stay. The court denied the motion for stay.

In each of these cases, similar arguments were made by the surety or prime contractor in support of staying the case or in opposition to summary judgment. In each of the cases, the underlying subcontracts had similar contractual provisions such as: no-damage-for-delay clauses and clauses that bound the subcontractor to the dispute resolution provisions of the prime contract and bound the subcontractor to the outcome of those dispute resolution processes. The position was taken in these cases by the surety or prime contractor that the subcontractor's suit was premature because unless the claims process was completed and the government paid the prime contractor, the subcontractor was owed nothing – there were no "sums justly due" under the Miller Act.

In each of these cases, the courts made the same conclusions of law. The Courts held that the surety is not entitled to enforce the subcontract's no-damage-for-delay clause, because the clause contravenes the Miller Act. Under their view, the Act conditions the right to assert a claim only on the passage of 90 days after the last labor or materials was provided, not after payment by the owner. In these Court's view, the 90 day provision can be the only condition to filing suit. It was noted that in Miller Act cases courts "must look beyond the principal's contractual liability, to the Miller Act itself, in defining the limits of coextensive liability between surety and its principal." In this regard, the Supreme Court has recognized that "[t]he surety's liability on a Miller Act bond must be at least coextensive with the obligations imposed by the Act if the bond is to have its intended effect." *United States ex rel. Sherman v. Carter*, 353 U.S. 210, 215–16 (1957). The *Kitchens to Go* court noted further that the Miller Act trumps conflicting suretyship principles such that a surety can only enforce contract terms to limit its Miller Act liability if those terms are consistent with the Act. The *Kitchens to Go* court rejected the surety's argument that Congress did not intend to extend the liability of the surety beyond that of the principal.

The three Courts also noted that the no-damage-for-delay clause was not a valid waiver of the Miller Act rights because the "waiver" occurred in the subcontract before any work was provided. The Courts stated that enforcement of the no-damage-for-delay clause would frustrate the purpose of the Miller Act, which is to ensure that claimants who perform work are paid in the event the principal does not pay. The *Kitchens to Go* court noted a split among the lower courts that have addressed the no-damage-for-delay clause issue. But stated that courts are uniform in finding analogous clauses like pay-when-paid or pay-if-paid to be unenforceable under the Miller Act. The Courts agreed that the Miller Act conditions payment only on the passage of time, clauses that condition payment on factors other than the passage of time i.e.: payment by the owner, conflict with the Miller Act and are unenforceable. The Courts rejected the surety's arguments that the no-damage-for-delay clause did not affect the timing or right of recovery, but only the measure of recovery. It should be noted that this argument has been upheld by other courts.

For the same reasons, the Courts rejected the sureties' arguments that the subcontractor cannot assert a claim under the Miller Act until the dispute process between the prime and owner has been concluded. The Courts stated that the dispute resolution provision would insert an additional condition to payment under the Miller Act and the dispute process is not a valid waiver. In addition, the court noted that the subcontractor did not have rights under the prime contract or the CDA. In *Kitchens to Go* the surety pointed to legislative history that stated that Congress did not intend to "void subcontract provisions requiring arbitration or other alternative methods of resolving disputes . . . The bill respects the freedom of the parties to the subcontract to specify means to resolve their disputes." The Court dismissed the legislative history as applying only to dispute provisions in the subcontract and not dispute provisions between the prime contractor and the owner. Apparently, ignoring the whole incorporation by reference issue.

(GEORGE)

My next case will address:

<u>The Surety's Subrogation Rights to Earned Progress Payments Paid to the Bank</u>

***Berkley Insurance Company v. Hawthorn Bank*, 2017 U.S. Dist. LEXIS 16069 (September 29, 2017)**

<u>Narrative</u>:

On March 13, 2017, Mike and I presented a Surety Today program entitled The Limitations on the Surety's Subrogation Rights. One of those limitations may occur when the surety is competing with the principal's bank for earned progress payments that have been paid by an obligee or the principal directly to the bank. The question becomes whether the surety may assert any rights against the bank and get back the progress payments to reimburse the surety for its present or subsequent performance and/or payment bond losses.

The ultimate issue in these such cases is whether the principal is in default under the bonded contract and whether, at the time the bank receives the payment of the earned progress payment, the bank was aware of the principal's default. Remember – the bank has provided the principal with a loan or line of credit. The principal draws on the line of credit to pay its bills, whether on bonded contracts, non-bonded contracts, or for overhead and other administrative expenses. The balance on the line of credit is reduced by the bank's receipt of payments of contract funds deposited with the bank from bonded and non-bonded contracts. This is a normal course of business activity.

In ***Berkley Insurance Company v. Hawthorn Bank***, 2017 U.S. Dist. LEXIS 16069 (September 29, 2017), the bank had a perfected security interest in the principal's receivables, including bonded and non-bonded contract funds. The surety had not perfected its UCC security interest against the principal under the indemnity agreement. The surety incurred losses in excess of $2,500,000 in paying for the completion of the work and resolving claims under performance and payment bonds. Prior to that time, to satisfy some of the principal's unpaid loan debts due to the bank, the bank applied funds from the principal's accounts, including some progress payments received by the principal for its work on the bonded contracts. The surety sued the bank under six counts: conversion, tortious interference with business expectancy, equitable lien, constructive trust, implied indemnity, and unjust enrichment. The surety alleged that it was entitled to recover from the bank the amount of the bonded contract progress payments deposited into the principal's bank account and applied by the bank to the principal's loan debts.

The critical timing was as follows. The bank received and then applied the last bonded contract progress payments to the principal's loan debt on January 16, 2015. The bank only learned about the surety's indemnity agreement unperfected assignment rights and trust fund rights and the principal's defaults under the bonded contracts when it received a notice from the surety on January 20, 2015. The surety paid its first bond loss on February 10, 2015.

The court granted summary judgment in favor of the bank on all six counts.

These kinds of cases show the dilemma faced by a surety when the principal is in default and yet the obligees under the bonded contracts continue to pay the principal. The surety wants the obligees to pay, but only so long as the bonded contract funds are used to reduce the surety's exposure to loss under the bonds. The surety would like the bank to lend more money under the line of credit to the principal to keep the principal afloat. However, once the surety notifies the bank that the principal is in default under one or more of the bonded contracts, two results may occur:

1. The bank will most likely cut off the principal's access to the line of credit; but
2. The bank may now be on notice that any subsequent payments it receives of the bonded contract funds – whether directly from an obligee or through the principal – are subject to the surety's subrogation rights.

The court made a big deal out of the fact that the surety's subrogation rights only arise "upon total satisfaction of the underlying obligation" under the bonds, citing Section 27 of the RESTATEMENT OF SURETYSHIP as requiring the surety's performance before the surety's subrogation rights become effective. The court ignored Section 31 of the RESTATEMENT OF SURETYSHIP that defines the surety's right to return performance from the obligee upon the principal's default under the bonded contract, namely the payment of the bonded contract funds from the obligee to the surety. Section 31 also makes the bank, claiming its rights through the principal, subordinate to the surety's subrogation rights in the bonded contract funds.

Whether the obligees overpaid the principal by paying the progress payments when the principal was in default under the bonded contracts may be a surety's issue, but it is not the surety's issue with respect to the bank. If, as in this case, the bank had no actual knowledge of the principal's bonded contract defaults, and received and then applied the last bonded contract progress payments to the principal's debts to the bank on January 16, 2015, prior to such knowledge of the principal's defaults on January 20, 2015, the surety is highly unlikely to get those bonded contract progress payments back from the bank under any legal or equitable theory, including the six alleged in this case by the surety.

(MIKE)

My next case to discuss is ***In re Ward***, 578 B.R. 541 (Bankr. E.D. Va. 2017). In this case, the Court held a debtor's debt to the surety under an indemnity agreement was non-dischargeable in the debtor's bankruptcy under 11 U.S.C. §523(a)(4) of the Code. This provision provides that a debtor is not discharged from any debt "for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny." *Id.* I chose this case because in 2013 the

Supreme Court in *Bullock v. BankChampaign, N.A.*, 569 U.S. 267 (2013), issued an opinion that resolved a three-way split among the Circuits and adopted a very restrictive standard for establishing non-dischargeability in fiduciary defalcation cases. The Court's ruling in *Bullock* upset the long-standing standards that were applied in the vast majority of jurisdictions.

Non-dischargeability in fiduciary defalcation cases is important to sureties because often the principals and indemnitors have fiduciary obligations under probate or fiduciary bonds and as trustees of bonded contract funds that have become trust funds under the underlying contract, the GAI or trust fund statute. Denying a debtor a discharge for such debts can help with salvage. Ever since *Bullock*, the surety world has been struggling to define the parameters of the Court's ruling so that we can know when to challenge dischargeability in a given case. Consequently, every decision that comes out in this area is another step on the road to coming to grips with the new standard.

In *Ward*, the surety issued bonds for its principal, an attorney that was an administrator and guardian of three separate estates. As the administrator and guardian the principal owed a fiduciary duty to the estates. The principal failed to file the proper accountings for the estates, failed to file tax returns for the estates, failed to respond to notices from the courts, moved offices several times and failed to notify his clients or the courts and failed to leave a forwarding address. As a result, the principal was removed as administrator and guardian for the estates and ultimately his license to practice law was suspended. Needless to say, the surety incurred losses on its bonds. The principal filed bankruptcy. The surety commenced an adversary proceeding against the principal, now debtor, seeking a determination that the debtor's debt to the surety was non-dischargeable because of defalcation while acting in a fiduciary capacity under Section 523 of the Code.

The Bankruptcy Code does not define the term "defalcation." The 4th, 8th and 11th Circuits held that defalcation under Section 523 could occur from a mere failure to meet a fiduciary obligation, whether through negligence or innocent mistake. The 5th, 6th and 7th Circuits developed a rule that defalcation under Section 523 required more than just negligence. There had to be some sort of willful conduct or neglect of duty, something short of fraud. The third position was established by the 1st and 2nd Circuits, which held that defalcation required an intent to deceive, the scienter element of fraud, or extreme recklessness in order to satisfy the requirements of Section 523.

In the *Bullock* case the Supreme Court held that defalcation under Section 523 requires conduct including bad faith, moral turpitude or other immoral conduct or intentional wrongdoing, which includes not only conduct that the fiduciary knows is improper, but also reckless conduct. The *Bullock* Court defined reckless conduct as a conscious disregard of a substantial and unjustifiable risk that the conduct will turn out to violate the fiduciary duty. The Court stated that the reckless conduct must be a gross deviation from the standard of conduct that a law abiding person would observe.

In *Ward,* after a bench trial, the court found that the surety established, by a preponderance of the evidence, that "the Debtor consciously disregarded the risk that his failures to act would breach his fiduciary duties." The court held the debt owed to the surety to be non-dischargeable. This was not the typical case where the fiduciary stole the money or misused the funds, it was a case of reckless disregard of the fiduciary duty. So, the Court found that the debtor had a known duty and utterly failed to satisfy that duty sufficiently to constitute gross recklessness standard under *Bullock*.

One of the interesting factors in the case, which the Court mentioned in its ruling, was the fact that in one of the estates, the principal, prior to issuance of the bonds and accepting his role as a fiduciary, executed a "Fiduciary Acknowledgment Form" which stated that he had various fiduciary duties to the estate and that he understood that he could be held liable for violating those duties.

When Jason Potter and I discussed non-dischargeability in the September 2016 Surety Today presentation we noted that to meet the new *Bullock* standard you have to establish the intent, willfulness and/or recklessness, which means you will need to establish that the debtor knew what his or her obligations were as a fiduciary, whether as an administrator, guardian or trustee of trust funds. In the underwriting process sureties should require principals and indemnitors to acknowledge that they have fiduciary obligations, etc., such as what occurred in this case with the Acknowledgement form. Then, when those duties are grossly and recklessly breached, non-dischargeability can more readily be established. In this case, the guy was an attorney, so I think issue of knowledge of the fiduciary duty was fairly clear, but in cases where the fiduciary is not an attorney some effort is going to be required.

(GEORGE)

My final case will address:

<u>The Bonded Contract Funds as Property of the Debtor's Bankruptcy Estate</u>

***In re Kappa Development and General Contracting, Inc*., 2017 Bankr. LEXIS 3785 (Bankr. S.D. Miss. October 31, 2107)**

<u>Narrative</u>:

On December 11, 2017, Mike and I presented a Surety Today program entitled Bankruptcy: The Debtor's and the Surety's Rights to the Bonded Contract Funds. We discussed the interests that the debtor and the surety have in the bonded contract funds, who gets possession of them, and who has the better rights to determine the use of the bonded contract funds. The surety frequently asserts that the debtor has no rights to the bonded contract funds under various theories, that they are not property of the debtor's estate, and that the surety is the owner of and should receive the bonded contract funds.

In the following case, the bankruptcy court found that the bonded contract funds were property of the debtor's bankruptcy estate.

In ***In re Kappa Development and General Contracting, Inc*.**, 2017 Bankr. LEXIS 3785 (Bankr. S.D. Miss. October 31, 2107), the debtor bonded principal and surety disputed the ownership of the bonded contract funds that the government paid the principal on a federal project. The surety had paid a payment bond claim on the project. The principal subsequently filed for Chapter 11. Two months prior to the bankruptcy filing, the government made a payment of $67,516 to the principal and, with the surety's consent, the funds were first deposited into a trust account of the attorney who represented the principal on contractual matters, then transferred to the debtor's attorney's trust account, and ultimately ended up in a restricted-access debtor-in-possession account. The principal and surety filed cross motions for summary judgment. The surety sought a judgment that the funds were not property of the bankruptcy estate and an order to pay the funds to the surety. The principal argued that the funds were property of the debtor's estate and the principal was free to use the funds as they were not subject to any subrogation claims of the surety.

The principal argued that *Pearlman v. Reliance*, 371 U.S. 132 (1962), was no longer precedential as the Bankruptcy Code was revised after *Pearlman* with an expanded definition of "property of the estate." The court took no position on *Pearlman*'s continuing validity. It held that, under the present facts, *Pearlman* did not conflict with the conclusion that the funds were property of the estate. The court held that the "consensus across jurisdictions" was that property held in the attorney's client trust account is property of the client. It distinguished *Pearlman* from this case, noting that in *Pearlman*, the funds were not in possession of the debtor.

Nevertheless, the court also held that whether the funds were property of the estate had no bearing on whether the surety was entitled to the funds. The court granted summary judgment in favor of the principal on the issue of whether the funds were property of the estate. It denied the principal's summary judgment on the issue of the surety's rights to the funds or whether the principal could use the funds. The court stated, "It is for the bankruptcy court to sort out competing property interests," and that the surety would have its day in court to argue its rights to the funds.

There are three takeaways from this case. First, unless the principal has been effectively terminated from its performance of a bonded contract, most bankruptcy courts will find that the debtor may have some kind of an interest in the bonded contract funds regardless of the surety's rights.

Second, as we discussed on December 11, most bankruptcy courts will, at some point, provide the surety with some adequate protection and control over the debtor's use of the bonded contract funds to ensure that the bonded contract funds are applied to the payment of obligations for which the surety would otherwise become liable under its bonds. The transcript for the December 11 program sets out examples of such adequate protection and control.

Third, the facts of the *Kappa* case merely state that the contract funds were being held in various attorney trust accounts with the surety's permission and that no escrow agreement was signed. Later the funds were placed in a restricted-access debtor-in-possession account. The lack of paperwork describing why and under what circumstances the funds were held in those various accounts and the rights of the principal and the surety to use those funds is very common, unfortunately, but some documentation describing the circumstances and rights – a formal escrow agreement, a letter agreement, or even an email – would help.