Surety Today's Presentation on May 9, 2016
Conducted by
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Hello everyone. Welcome to this inaugural edition of the Surety Today Program. My name is Mike Stover. I'm a partner with Wright, Constable & Skeen here in Baltimore, Md. I have been practicing surety construction law for over 25 years. I am joined today by George Bachrach, who is also a partner at Wright Constable. George has been practicing, I think, since the Magna Carta, if I'm not mistaken. Is that correct George? George : that's correct. Mike: He admits it.

Mike: Surety Today is the brain child of our marketing director, Miss Jeanne Hyatt. We owe a big thanks to Jeanne. The program is going to be held the second Monday of each month, and it's designed to keep the busy surety claims professional up to date and informed with no fuss and no muss. If you have a phone, you can call in from wherever you are, on the road, at the airport or wherever to join in on the call. The program is only offered to in-house surety claims handlers and managers. It's been very well received so far. We have gotten about 90 company people signed up, so I think that's a pretty good turnout for something new like this. Our topic today is Surety Case Law Update. We wanted to have a topic that would have the broadest appeal to everybody, so that's what we're starting off with. George and I combed through the surety cases from October, 2015 through April 2016 to find what we hope are interesting cases for the claims handler. Now, we're going to provide a list of the cases that we talk about with citations after the call by email. We didn't want to waste a lot of time trying to go through the citations. So, if you have any issues with the call, get in touch with Jeanne. Her contact information was in that reminder email that came out on Friday. Her email address is jhyatt@wcslaw.com. We're going to go ahead and mute the line now to avoid any background noises that may interfere. We now have the mute on. Hopefully, we have muted your lines and not our line. We are also going to be recording the call so that hopefully technology will be on our side and we can post on our website these recordings of the call so you can refer back to it later. We also intend to have the recordings transcribed so there will be a written version, as well. So, at the end there's going to be a question and answer session and we will unmute the line at that time so that everyone can participate. So at this point, I will turn over to George, who will talk about the first case.

George: First case we're going to talk about is called EC Power Systems and Insurance Company of the State of Pennsylvania. We tried to choose some cases that would be helpful to surety claims handlers who are facing the kinds of problems we're going to be addressing on a daily basis. In the EC Power case, the question came up as to whether the surety's actions or the actions of the surety's consultant somehow led the subcontractor claimant to miss the one-year statute of limitations under a Miller Act payment bond. Put another way, did the surety and/or its consultant's actions create an equitable tolling of the Miller Act Payment Bond Statute of Limitations or equitably estop the surety from raising the statute of limitations to the subcontractor's claim? Namely loose lips can sink ships and they can also sink the defenses of the surety. Now in the EC Power case, the court ruled in favor of the surety and its statute of

limitations defense based upon the facts of the case. That's the important issue here, the facts of the case. The take away from this case when you think about it is that both the surety and its consultant must document their discussions and not unintentionally waive the surety's rights and defenses. So the facts are the key and there are really two sets of facts. There are the overall facts that you and I face every single day and then there are the facts specific to the case. With respect to the overall facts, and we have all seen this case before, the surety's principal was a general contractor on a federal project with the Navy. The principal voluntarily terminated its contract because it was financially unable to complete. Three days later, it filed a chapter 7, so the principal is gone. The surety and the consultant contacted the subcontractor on the job, EC Power because it wanted EC power to complete its work under a subcontract ratification agreement. As usual in these situations, there are many issues. The sub was owed contract funds under the contract with the principal, the job had been delayed for years and so the sub had a delay claim that it wanted to resolve, it had performed its last day of work before May 1, 2014, and over the next year there were negotiations and discussions and options and everything discussed with the subcontractor about completion of the work, the payment of the contract balances owed, which were finally paid, pending change orders and the delay claim. So the surety was investigating how to best perform the contract with the federal government, but in doing so was dealing with its subcontractor that it wanted to complete some of the work. But finally in May of 2015, the surety and its consultant began getting bids from other contractors to complete the sub's work, which was an indication that the sub was not going to complete the work. The sub then filed suit and the sub filed suit more than one year after the statute of limitations. So you have something that got extended out and out and out, and then the sub filed suit after the statute of limitations had run and everybody agreed that was the case. So the sub decided that it would keep its suit in place, despite missing the statute of limitations by claiming that the actions of the surety and its consultant equitably estopped the surety from raising the statute of limitations defense or that the tolling of the limitations had not begun to run and that there was an excusable delay on the part of the sub in filing the suit. The case goes on to discuss a number of the legal and equitable standards, at least in the 9th circuit but somewhere in other circuits for proving equitable estoppel and equitable tolling. The court went through many specific facts and emails and documents, conversations and affidavits concerning the discussions that the surety and its consultant had with the subcontractor. Notwithstanding all of that, the court found for the surety, said the statute had run and that was no equitable estoppel or equitable tolling of limitations. Now again, the surety won based upon the facts, but there are many other cases or at least a number of situation where the factual are such that the surety doesn't win, that there is an equitable tolling, an equitable estoppel. EC Power case is not necessarily, when you look at it, a roadmap on how to handle such a case and what needs to be done, rather it's a reminder to all of us, and that includes outside counsel, consultants and inside people that they have to do whatever they have to do, whether it's the consultant, the lawyer, the in-house person to avoid these kind of cases and making statements that equitably stop you from raising whatever defense whether it's a statute of limitation defense or otherwise. For that reason alone, that case is worth reading and we will provide you a citation. Mike, you may have other comments.

Mike: A couple of things, looking at that case. One, was that the court noted the fact that in many of the communications between the surety and the claimant, there was a reservation of rights and the court said there shouldn't have been any reliance by the claimant because the surety was continuously reserving its rights in the communications. I know that most claims

folks are really good about that, and that's one reason why you should be. The other thing that was interesting was they went into the internal emails of the consultants to see what was going on behind the curtain to see if there was any kind of intent to pull the wool over the eyes of the claimant and so be aware of that, that those internal communications could come into play in a situation such as this. The other thing was that this case really was turning on the issue of the communications of the consultant with the claimant, so not only does the surety's claim handler come into play but the consultant as well and there's a case out of, I believe, the 4th Circuit, the *Humble Oil* case, it's an older case on equitable tolling. In that situation, the surety was financing the principal and the court even attributed the financed principal's statement to the surety for the purposes of equitable tolling or equitable estoppel. So, you have to be really mindful of what communications on going on there with claimants and make sure you are reserving your rights.

So, I am taking on the next case, which is *Chessney & Co., Inc. v. Hartford*. This is a United States District Court case out of Maryland from March of this year. Basically, it is a dispute that arose out of a construction project to build an Army Reserve Center. The owner was the Corps of Engineers, the bond principal was the general contractor and the claimant was the subcontractor. The claimant eventually asserted that it had a delay claim. The problem was that all along throughout the two-year project history of this case, the claimant was signing lien releases and waiver forms and in fact, the subcontract required that lien release and waiver forms be provided as a condition precedent to get payment, and so 24 of these lien releases were executed by the subcontractor along the way. These lien releases had some very broad language waiving and releasing all claims and demands, not only against the contractor, but the sureties as well. There were parts of it where the claimant affirmed it was aware of no claim or any circumstances that could give rise to future claims. There was an area of the release where you could write in exceptions to the release and those were left blank when the claimant filled out the lien release and waiver form. So, they really got themselves in a hole with this. The court looked it and looked at some of the general principles of surety law and said the surety stands in the shoes of the principal, the liability on a payment bond is defined by the liability in the underlying contract and the surety is only liable to the extent that the principal is liable. The court found that the surety can also assert the defenses of its principal; it's all basic surety law. So the court looked at these releases and said you've released all of your claims that arose during the period covered by these releases and so the court granted a partial summary judgment to the surety in that case. You have to be mindful of the fact that there are restrictions on releases in bond situations and the court talked about the one in the Miller Act which is applicable in this case and under 40 USC 3133C, any waiver of a claim on a bond is void unless it's in writing, signed the party who is making the waiver and executed after the party waiving has provided labor and/or materials. So, in this case the restriction didn't apply because these lien releases were all signed, they were in writing, signed by the party waiving and was signed after the work had been done. There are other restrictions. I know in Maryland we have a limitation on releasing and waiving bond claims as well, so you have to be careful with that. I think that one of the takeaways here is when you get a claim and you're doing your initial response letter , typically what claims handler would do is ask for various documentation to support the claim and I think it would be a good practice to start asking for these lien releases and waiver forms because you might be able to put together a history of waivers and releases that might get you summary judgment like it did in this *Chessney* case for Hartford. As George said, we will

provide the citation at the end. In this case, we may actually send it to you. It's a District Court opinion. George, the next case.

George: The next case is called *Erection Co. v. Archer Western* and we chose this one because it brings forth an issue that pops up occasionally and you always cringe when it does and that's a situation where the surety executes two sets of bonds on the same project. It executes the general performance and payment bonds to the owner and then it decides to bond one or more subcontractors to the general. So XYZ surety company has now got bonds from the sub to the general and from the general to the owner. What happens when disputes arise between the general contractor and the subcontractor; the general says to the sub you messed up this job, you owe me money. The sub says I've done the work and you owe me this much money, also claims for delay and whatever. Not all of you out there will bond the same job twice but some of you do and I've been involved in these and they can become messy. In this *Erection Co. v. Archer Western* case the bond from the general to the owner was $40 million and the bond from the sub to the general is $1.6 million. What is interesting about this case is it really isn't a court opinion; it really is a stipulation and consent order because it appears but is not stated that in this case both the general and the sub are solvent and capable of paying in the adverse judgment without requiring the surety in either instance to suffer a loss under either set of bonds, and it appears that both the subcontractor and general are represented by competent counsel. So you have a situation where the surety doesn't think it's going to have a loss because it has two solvent parties with competent counsel. What the surety wants to do is not sit at the trial table at a long protracted litigation case, so what they did is the surety entered into a stipulation with both claimants, and here are the issues that the stipulation addressed: the indemnity agreement rights because the surety wanted in the case where there was a loss to reserve its rights to go against either the general contractor and the indemnitors under the GC's indemnity agreement or if the sub lost and the surety ended up with a loss to go against the subcontractor under the subcontract indemnity agreement and the indemnitors. So that issue was addressed in the stipulation. The stipulation said that the surety did not have to attend the trial; it could but it did not have to attend the trial but the surety agreed to be bound by the court's rulings, whether those rulings were for or against the general contractor or for or against the sub. Apparently one of the issues was that the surety didn't want to be liable for loss profits and that was part of the stipulation. The stipulation agreed that both sets of bonds were limited to their respective penal sums so that the surety wasn't looking at extra damages beyond the penal sum, and the bonds were admitted into evidence. So the surety got what it wanted which is to get out of the case until a decision was made, really, under the auspicion that they didn't think they were ever going to have a loss because their principals were going to take care of it. So the surety did not anticipate a loss from either side but that's not the way that such a case always happens. I have been mostly in the opposite situation where one of the principals is not solvent and the case does not address, of course the stipulation does not address the much more difficult issues when that happens, namely when either or both the general and sub are insolvent and can't protect the surety from the loss. Normally I've seen it where the general happens to have money and the sub does not and you have a situation where the surety would like to have one side win and not the other, but that's not case. There is also the issue of when there are disputes, who pays for the prosecution of the claims or the defense of the claims. That can be a very expensive chore if your sub has good claims. Can the surety settle off at the expense of one of the parties; can the surety make a policy payment; and how does that affect them when the surety makes that kind of a payment?

The case doesn't answer those questions. We all know that a surety has to act in good faith with respect to all parties and usually when that happens there are separate claims people involved and separate counsel involved. What makes this case worthwhile is it addresses the issues that may arise, and if you actually do have a case where you have two solvent principals, this is a good case to look at for an agreement if you want to reach such an agreement. Mike?

The next case is *Granger Construction Co. v TJ LLC* and Liberty Mutual was the surety involved. It's a New York Supreme Court appellant division case December, 2015. The case arose from the construction of a hotel. The hotel was substantially completed and open for business before all of the work was actually done. Then a problem arose with respect to a fire alarm system so the hotel had to close down. The owner made demand upon the principal to repair the alarm system, but the principal refused because the owner hadn't been timely paid. So the owner hired another contractor to fix the alarm issue and in the course of doing that it found other issues of defective work and then the owner hired other contractors to fix the other defective work. After the repairs were completed, the owner then sent its notice of intent to declare a default to the surety. They got that one a little backwards. Later, the contractor ended up suing the owner for failure to pay and the owner filed a third-party claim against the surety making a claim on the performance bond. The surety then, promptly and correctly, moved for summary judgment, asserting that the owner had violated several conditions precedent in the bond, failed to provide the notices required by the bond, failed to allow the surety options to perform, failed to give additional notice before filing suit and basically just ignored all of the conditions of the bond as near as could be dealt. So the court granted summary judgment for the surety and on appeal, the appellant court affirmed finding that the language of the bond provided clear, unambiguous conditions precedent and that the surety's obligation did not arise until those conditions precedent were satisfied, and since they weren't satisfied here, the court affirmed the summary judgment and the surety was out of the case. Now the opinion doesn't reference what bond form this was. I assume, based on the language that they quoted, it was an A312. It doesn't talk about what version of the A312 it was either. It could have been a 2010 or a it could have been 1984. As most folks know, that change in 2010 of the A312 bond form, there were lots of things put in the performance bond form and one of the provisions that would come into play on this issue of conditions precedent is that they added a new paragraph 4 to the 2010 which said that failure on the part of the owner to comply with the notice requirements in section 3.1 shall not constitute a failure to comply with a condition precedent to the surety's obligation or relieve the surety from its obligations, except to the extent the surety demonstrates actual prejudice. So when you're looking at these situations, you have to RTFB (read the friendly bond). In any event, you've got to look at the language to see whether you're dealing with 1984 or 2010 to make sure you can assert the conditions precedent as a defense. The other thing the opinion doesn't talk about is that the principal claimed it wasn't paid timely and in fact filed suit because of lack of payment. The bond is also conditioned, both the 1984 and 2010, it says it requires that there be no owner default, so it says in paragraph 3 on the 1984 version, if there is no owner default, the surety's obligation under this bond shall arise after. Then it goes into the discussion of that. The same is on the 2010 bond. It says if there is no owner default under the construction contract. An owner default is defined in the A312 as failing to timely pay in accordance with the terms of the contract. So, that's another potential condition precedent to defense. So, the takeaway is look at the terms of the bond and see if you have a condition precedent to defense. Be careful because conditions precedent can be waived or excused. So your conduct might come

into play there. So those are the cases that we've been able to talk about today. Unfortunately, with a 30 minute format we don't have a lot of time to go into more, but we've got a couple of issues here. Before we go into our question and answer session, we want to remind everybody that the next edition of the Surety Today will be Monday, June 13 at 12:30. It will be the same time, the second Monday of the month. You use your same call in number, participation code and pin and that will remain the same for all future calls. Our next topic will be the Surety's Use of Collateral Demand. In looking at these cases from October through April of this year, we noted that there must have been 15 cases that dealt with the issue of collateral demand and whether the surety can enforce that provision of its GAI. So, we're going to delve into that a little bit. I wanted to give everybody a quick rundown of some upcoming surety events. The Philadelphia Claims Surety Association is having its meeting on May 18 at Maggianos in Philly, and then the Philadelphia Surety Claims Association will have its golf outing on June 6. The Chicago Surety Claims Association will have its golf outing on June 9, and of course, the Surety Claims Institute will be held from June 22 to the 24th in New Port, Rhode Island. Thank you so much for tuning in and we hope that you will join us again on the 13th.