

**Paper Title: Two Short Stories Showing the Benefits to Contractors of Collaboration with Surety Claims and Legal Professionals**

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**Session Title:**

Know Your Full Surety Team: The Benefits of Collaboration with Surety Claims and Legal Professionals

**Presented by:**

Stephen Rae, Liberty Mutual Surety and Richard Towle, Head of Chubb Surety Claim (Retired)

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Ed is a Senior Vice President at American Global, working with contractors in the Greater New York region as well as firms with a national and global presence. Prior to joining American Global, Ed was a Senior Vice President and surety leader in Aon's Construction Services Group. He began his surety career at Chubb and spent over 20 years there in various underwriting and legal roles, most recently as Vice President and Regional Surety Manager and prior to that as their first Surety General Counsel.

In thinking about how best to present the topic of why is it important for contractors to know the whole team at their surety, including the professional resources found in the claims and legal departments, we decided to present two stories based on actual events, one for surety claims and the other for surety legal counsel, illustrating how a strong relationship and collaboration is critically important to the contractor achieving their goals. Working together can help the contractor achieve goals that may not have been possible otherwise.

**Surety Claims: One Underwriter's Introduction to the Power of Working Closely with Surety Claims Professionals**

An account file gets dropped on the underwriter's desk. The current underwriter is retiring, and it is being passed on to their replacement. The plan is for the new underwriter to review the financials, job performance and correspondence and then sit down with the former underwriter to go over questions to ensure continuity of approach by the surety with this contractor.

A little background on the contractor. The contractor was led by their dynamic founder and had been bonded by the same surety for 25 years. They had always been growth oriented, but in recent years the approach to achieve growth had shifted from organic growth to acquisitions. Five year prior, the company had merged with and into a public company with almost a century of history and a recent troubling event that had caused the public entity to file for Chapter 11. Buying this entity out of bankruptcy gave the surety's long-time client a publicly traded platform to grow their business. In the five years since that acquisition, the contractor integrated that entity and was looking to add another substantial operation to their portfolio.

Two months before the new underwriter received the file, the company had closed on another deal to acquire all of the construction subsidiaries of another publicly traded company who had decided to exit construction and focus on their other industries. This deal would catapult the contractor into the top ranks in all of the construction segments where they operated. To finance the acquisition, the contractor borrowed several hundred million dollars. All the construction companies involved worked largely in the public construction market and therefore needed surety support to obtain a large portion of their backlog.

The first 10-Q filing for the company since this latest acquisition was due to be filed in about a month and there was a surety meeting planned soon after that to discuss how the integration of this significant acquisition was going in the early months. All parties knew this was a huge move for the contractor and everyone worked hard to maintain open lines of communications. That meant that as soon as the contractor identified an issue with the estimated cost to complete on three large projects being performed by the one of the companies they had just acquired, they sent a team to investigate further and once they had confirmed that

a significant issue did in fact exist, they picked up the phone to their agent who reached out to the surety. At this point the contractor did not know how deep the hole was but they did know it was a problem. The trust the contractor maintained with their surety but not delaying delivering the bad news or worse yet hiding this issue from their surety paid dividends as the facts began to come to light. It is at this point that both the underwriters and the claims professional at the surety began working on this file.

At first the contractor felt that this issue could be dealt with under the purchase and sale agreement since it had a clean-up provision to adjust the purchase price if assumptions made about the projects being completed turned out to be materially different than what was presented at the closing. This was not a bad thought, but the challenge became 1) just how significant the problems were on these projects and 2) what seemed to the contractor as the extreme lengths the seller had gone to keep these issues from coming to light during both due diligence process and prior to closing.

What followed was a period of months where the true problems on this work became clearer. The exposure exceeded the amount that had been paid to acquire these companies. The contractor ended up filing Chapter 11 and suing the seller. The contractor's goals were clear:

- They wanted to emerge from bankruptcy; and
- They wanted the sureties to continue to provide a level of surety support both while they were in Chapter 11 and as they emerged.

The surety had its own primary goal:

- Find the more cost-effective way to honor their obligations to complete their bonded jobs.

How did the surety and contractor work together to achieve these goals?

To start, the contractor already had a long-term close relationship with their surety and had always worked hard to maintain open lines of communication whether the news was good or bad. In this situation, the contractor ultimately came to realize that they were dealing with an enormous problem. They sought advice from their surety and other outside professionals, including lawyers and restructuring experts.

The surety also sought advice from their claim's professionals and other outside professionals. The surety did feel that their client had been the victim in this acquisition but they still needed to know what kind of exposure they might have in the event that the surety had to arrange completion on dozens of bonded projects whose estimated costs to complete was many hundreds of millions of dollars. The surety had some legal protections, most notably a priority position in bonded receivables by operation of law even though the banks had a perfected

security interest in receivables under their loan documents. This is because of the US Supreme court case, *Pearlman v. Reliance Insurance Co.*, 371 U.S. 132 (1962). This case has clarified a surety's rights to equitable subrogation and access to remaining contract balances as against other creditors when they write performance and payments bonds for a contractor. In this situation, this protection made the surety comfortable that if they had needed to complete the contractor's bonded jobs, they would have access to the remaining contract balances and would not end up in a protracted argument what the contractor's lenders about whose interest was superior.

Both the contractor and the surety each had a job to do independent of one another, but they also shared a mutual interest in finding a way for the contractor to complete their work and minimize the cost to the surety. What transpired was a period of months where the surety provided a limited amount of new surety support. This was critical to the contractor. It was important to show the contractor was still in the market to pursue new work. In reality, even more important than the additional backlog, was the perception that the contractor was still able to pursue new work, and this was key as the marketplace started to focus on the issues they faced.

This time, and the work the surety did during this period of time, was also crucial to them. In the end, even with providing new bonds, the surety's remaining bonded exposure was actually lower, and by using this time to complete their investigation, the surety now really knew all of both the good aspects and the problem areas and most troubled contracts of their contractor client. This information made the surety comfortable that the contractor could successfully complete all the bonded work if they emerged from bankruptcy and the surety offered them a surety facility to support them as they emerged.

The keys to success for both the contractor and the surety in this instance included:

- A long-standing strong relationship between the contractor and their surety.
- The underwriting group at the surety working closely with the claims team as both areas were needed to achieve a successful outcome.
- Once the problem was identified, both sides made great effort to communicate the current situation as this changed and to collaborate where possible on determining a path forward that was in the best interest of both parties.
- The time afforded by working together on these challenges pre-bankruptcy, which allowed the surety to complete their investigation and ultimately to offer terms for surety support to emerge from bankruptcy.

The benefits to the contractor from this success story included: 1) their ability to continue to pursue a limited amount of new work as they headed into bankruptcy, 2) a Debtor in Possession (DIP) surety facility while in bankruptcy and 3) bargaining power with their lenders in both instances. This is because the surety pressed to limit the amount of leverage the company would retain post-bankruptcy to make it more likely they could succeed once they did emerge from Chapter 11 and also because the surety could have also provided a DIP lending facility, obtaining a super priority under the bankruptcy laws that the banks certainly wanted to avoid.

The contractor here did emerge from bankruptcy, and the surety was ultimately reimbursed for its entire loss. Closely working together before the contractor entered into bankruptcy gave the surety time to confirm that the projects they had bonded were on balance good work and not the underlying problem. Knowing that allowed the surety to back the contractor and this support made it possible for them to emerge from their Chapter 11 filing, a very uncommon occurrence for a construction company.

### **Surety Legal Counsel Support: Helping a Contractor Obtain a P3 Bond with a Liquidity Component**

A contractor was pursuing a public-private-partnership (P3) project where the owner would require a standard performance bond and where the financing entity was going to require a liquid instrument, almost always a letter of credit in addition to the performance bond. The contractor did not want to pay for both forms of performance security and preferred to see if their surety could work with them to help draft and then sell a surety bond that had both standard performance characteristics and a small percentage of contract value that was liquid in the event the contractor defaulted on this contract.

The challenges this posed were:

- Rating agencies, banks and other financing entities were used to letter of credit being used to satisfy the requirement for a liquid instrument that could be drawn if the contractor defaulted but were not used to seeing a surety issue this type of instrument.
- Sureties can write bonds that are liquid or close to pay on demand, but it is not a commonly written instrument in North America.

The contractor shared their desire for a surety P3 bond when the project very early, was at the Request for Qualifications stage. This time allowed both the contractor and the surety to present their desired approach to the parties in interest. To advance this, there was an initial meeting with contractor, their producer and underwriters and legal representatives from the surety where a game-plan was set. What followed from that meeting were a series of emails, letters, phone calls and ultimately meetings with rating agencies and the owner to

explain their proposed P3 bond offered protection at least as good and likely better than a separate performance bond and letter of credit as performance security. The effort required drafting and negotiating the form of this P3 bond with a liquidity component. This process took months, required some extensive negotiations on the language of the P3 bond and culminated in the surety issuing the bond, one of the first P3 bonds issued. The contractor was very pleased with the outcome, happy to receive support from their surety for this unusual instrument and also quite pleased not to have to utilize their bank credit facility to have a letter of credit issued.

Keys to success in this instance were:

- The contractor coming to the surety very early in the process.
- The surety legal and underwriting team working closely to address the needs of all interested parties, investing a significant amount of time to meet with the ultimate owner, the equity investors, ratings agencies and the outside professionals.
- This close collaboration and relationship building allowed the surety to offer a unique solution which helped the contractor win the project.

The benefits to the contractor were: 1) The chance to use a surety product rather than tying up a portion of their bank facility to issue a letter of credit, 2) the opportunity to partner with a joint venture partner who brought a strong operational advantage but who had made it clear they would post a surety bond but did not want to post a letter of credit, and 3) a chance to advance an alternative type of liquid performance security, showing both industry leadership and securing another type of acceptable security that could be used on future pursuits. For the surety, they got to advance the use of an innovative surety product in a way that helped their contractor client.

## **Conclusion**

These narratives show real life examples of how a close working relationship with your surety's full team, including claims and legal counsel professionals, helped contractors achieve the best outcome possible and how that can help you achieve superior results that impact your business success and your bottom line. Many contractors already invest the time to know their full team at their surety, but we hope this panel and paper provide contractors with an interesting read and provoke some thought about how to develop a deeper relationship with their surety claims and legal professionals.