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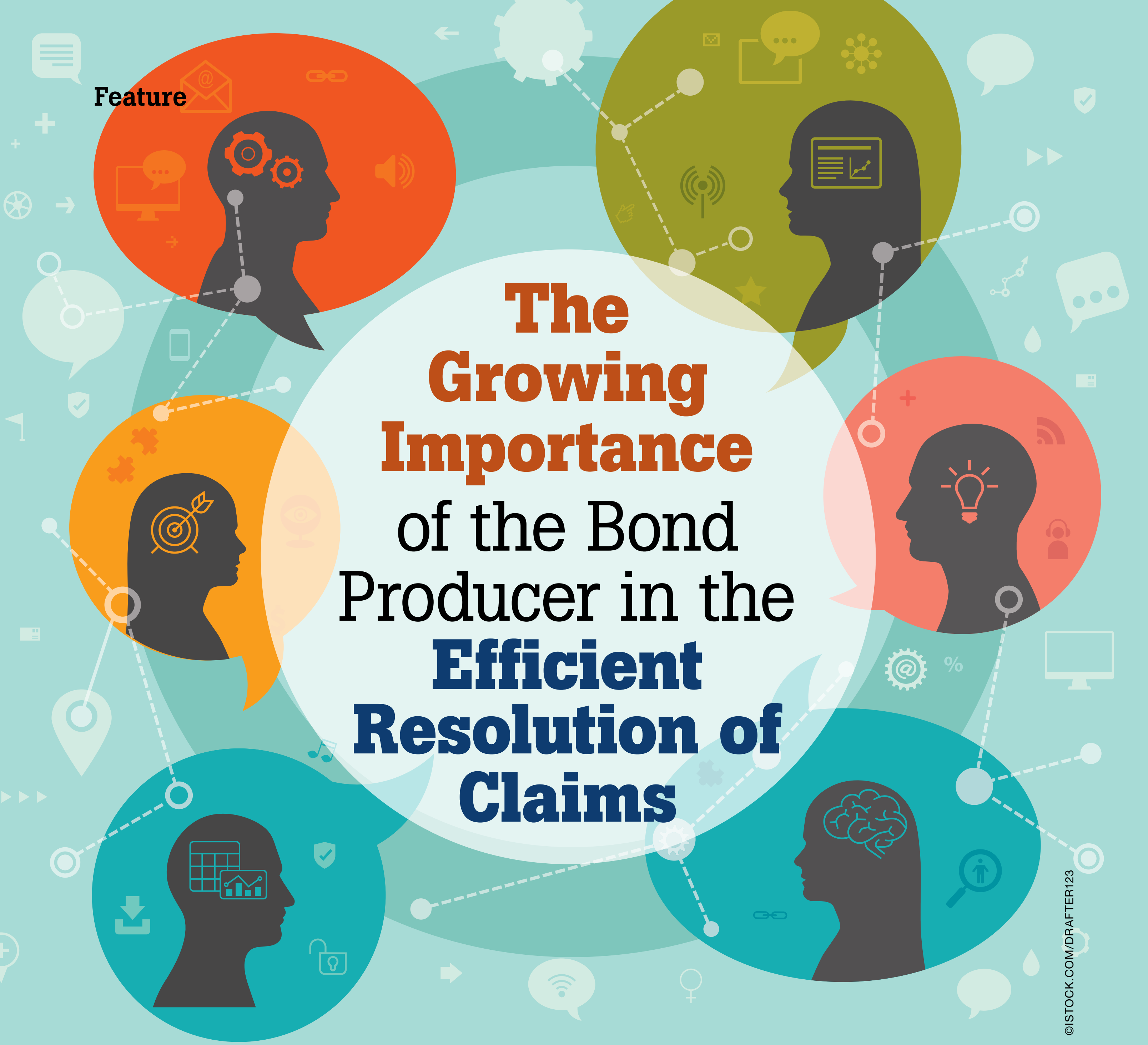

The Growing Importance of the Bond Producer in the Efficient Resolution of Claims

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BY ALEC M. TAYLOR AND BRYAN BADEAUX

"THE BIGGEST PROBLEM in the world could have been solved when it was small." – Witter Bynner, American poet and writer. A federal magistrate cited this quotation to me in a settlement conference six or seven years ago, and it now has a permanent place on my desk. I chose to begin this article with this quotation because this article focuses on the impact that a bond producer can have on the claims process. As we discuss instances when a producer's involvement has aided in the resolution of a claim and others where their involvement has done the exact opposite, it is important to note that, in almost every case, the course of action chosen by the producer was done in an attempt to solve the problem before it became "the biggest problem in the world." Some producers, however, may lack knowledge of the inner workings of a performance bond claim, which can complicate matters. This article will examine some general instances in which a producer's relationship with the principal and knowledge of basic suretyship can aid the surety as a claim arises, and then we will examine specific instances when a producer's relative level of knowledge has been beneficial and detrimental, respectively, to the surety.

General Instances of the Producer's Ability to Aid the Surety

Oftentimes, well before a surety receives a performance bond claim, the producer has knowledge of the circumstances that led to the claim(s) being made on the bond. Thus, a producer can be of great importance to the surety as it endeavors to resolve the performance bond claim in the most efficient manner. Furthermore, a good producer is intimately familiar with his or her accounts, often being friends with the individual indemnitors. This can be advantageous to the surety because, if this is a principal's first time being faced with a performance issue on one of its projects, the producer's ability to be the friendly face in the room will ease the principal's anxiety as the surety takes a more active role in the project. This is important because, during the claims process, the ease with which a resolution is reached is often directly proportional to the cooperation of the principal in the process. Stated another way, the more cooperation the surety has from its principal, the more efficiently the claim is able to be handled, which is generally better for both the principal and the surety.

In the payment bond context, we have seen instances where the producer's relationship with the principal allows the producer to explain to the principal the practical effects of a claim being filed on the bond (loss of bonding capacity, indemnity, etc.). Knowing the consequences of a claim arising, the principal was able to put aside the differences it had with the claimant(s) and resolve the claim prior to the surety's involvement. This would not have occurred had it not been for the producer's relationship with the principal.

Lastly, the producer's relationship with the principal can be helpful after the proverbial smoke has cleared and the surety is looking to the principal for indemnity. During this time, the principal's relationship with the underwriter and producer can aid in an efficient resolution of the matter. For instance, if the producer is able to correctly explain the principal's obligations to the surety pursuant to the indemnity agreement, the principal may not see the need to litigate the dispute with the surety, which it may have otherwise done. In another example, if the producer is able to, in a sense, informally mediate the indemnity dispute, the surety may be willing to discount the indemnity or enter into a payment plan with the principal, which would not have been an option if the principal had not cooperated with the surety.

Specific Examples of the Effect of the Producer's Role in the Claims Process

The above examples illustrate the general effect that a producer may have when it becomes necessary for the surety to intervene in its principal's business, but specific examples of how the producer's actions proved both beneficial and detrimental to the surety are useful in showing how important the relationship between the producer and the principal can be during the claims process.

This first example evidences how a good producer can prove invaluable in minimizing a surety's damages on a multi-project default. After incurring substantial losses on various bonded and unbonded construction projects, a large "union shop" electrical subcontractor made a request to the surety for financial assistance, as it was no longer able to manage losses being incurred and cash flow continued operations using their line of credit. At the time the surety became aware of the account's financial concerns, the subcontractor had eleven active bonded contracts with a corresponding bonded liability of approximately $42 million. Initial estimates indicated a shortfall of approximately $5 million on the bonded work, of which approximately $1.4 million represented ongoing completion costs in excess of remaining contract balance receivables. In an effort to minimize its exposure, the surety entered into a comprehensive Underwriting, Loan and Continuing Indemnity Agreement whereby all of the subcontractor's business and personal assets of relative value were pledged to the surety. In total the surety was able to secure approximately $4.5 million in collateral security comprised of deeds of trust in an array of real properties, brokerage accounts, and equipment. Accordingly, the surety projected that it was under-collateralized by approximately $500,000.

During the course of the wind-down of the bonded scope of work, the producer was instrumental in assisting the subcontractor's efforts to convince the surety to go against conventional thinking and issue an additional $1.8 million in bonds for two upcoming projects that involved a narrow scope of work that was the principal's expertise. As we all know, in the midst of a performance bond claim, it is almost unheard of for a surety to issue bonds to the principal for subsequent projects. However, because of the producer's years of experience in handling the account, he was able to advise the surety and its counsel as to the historical profitability of the subcontractor's prior projects involving the same scope of work with the same owner that was seeking the subcontractor's bid on the two proposed projects. Ultimately, the producer's efforts were successful, and the surety was convinced to issue the additional bonding. The results were highly beneficial to both the subcontractor and the surety, as the two projects followed the profitability trends of prior jobs as presented by the producer and produced pure profit in excess of $600,000, bridging the gap between the funds advanced by the surety and the collateral security previously obtained. The result left the surety in an over-collateralized position, which allowed the subcontractor to complete all of the remaining bonded work and continue to make its quarterly payments under the financing agreements as it continued to pick up and perform non-bonded work.

However, to the same degree the above producer was beneficial in positioning the surety and principal in order to obtain a favorable outcome, a producer who does not understand the industry can prove detrimental. In this example, after the obligee declared its principal in default on a large private project for delayed performance, the surety, by imbedding a construction consultant on site, took action to assist the principal in improving its project controls to enhance its ability to capture delays and disruptions caused by the obligee. Ultimately, the effort proved successful, and the obligee rescinded its default of the principal. However, shortly thereafter the principal's producer, presumably at the principal's request, demanded that the surety's claims team retract its involvement and oversight of the project since the project was no longer in default. The resulting retreat of the surety's claims team eventually proved disastrous for the bonded principal, which could not itself adequately maintain project controls to capture and assert financial harm caused by ongoing obligee inefficiencies. This course of action resulted in the principal sustaining substantial losses on the project. The resulting deterioration of the principal's financial condition ultimately rendered it unbondable, as the surety would not extend further surety credit to the principal on subsequent jobs. Had the producer communicated with the surety about the value of the consultant's services and then communicated this import to the principal, it could have saved the principal from suffering such a substantial loss and assisted both itself and the surety in retaining a premium producing account.

In a final example, one of the surety's large premium producers also represented an obligee on the bonded project. The obligee asserted facially improper claims against the surety's performance bond for damages allegedly resulting from the defective work of the surety's then-insolvent principal. While the producer could have been a conduit for bridging the gap between the surety's and his client's respective positions, the producer elected to apply pressure on the underwriting arm of the surety in an unsuccessful attempt to force a settlement that was clearly unjust. The result of this pressure by the producer was lengthy and costly litigation that cost the obligee more than it was able to recover from the surety through settlement. Inevitably, if the producer had chosen to act impartially, he would have been able to reset his client's expectations on the front end and save both his client and the surety a great deal of time and money.

Practical Ways for a Surety to Engage the Producer

So what can the surety do to better position itself for the day when the producer's help is needed? The most important action is not waiting until that day before reaching out to the producer. Many sureties are making a deliberate push to reach out to producers and begin developing relationships with them before their principal defaults and the claims begin cascading in. The underwriters have somewhat paved the way as they have cultivated relationships with the producers over time. Some sureties have started using these existing relationships to introduce claims representatives to producers once or twice a year to discuss issues commonly arising in the industry and how these issues can be handled on the front end to minimize loss to the principal and surety. This is a smart idea, as it is beneficial to the producer in advising its client, the principal, but also opens the lines of communication between the surety and the producer before a default occurs. Ultimately, the more the producer knows about the surety industry and the better the relationships develop between producers and surety professionals, the greater success both the surety and the principal/indemnitors will have in minimizing loss. Hopefully, the above anecdotal examples of the effect of the producer on the surety as it navigates claims arising from troubled projects will spur more discussion between sureties and bond producers, whose value is often overlooked. ●

Alec M. Taylor is a partner in the Jackson, MS office of the law firm of Krebs Farley, PLLC. He has a broad litigation background, including complex commercial litigation, insurance defense, and construction litigation. Taylor primarily focuses his practice on the representation of sureties in the handling of payment and performance bond claims, the interpretation of the bond rights of laborers and materialmen under the Miller Act and various state public and private works acts, and the institution of indemnity actions against defaulting principals. He also has extensive experience representing financial institution, public official, and conservatorship/guardianship bond carriers on disputes involving their principals and insureds. He can be reached at ataylor@kfplaw.com or 601.968.6710.

Bryan Badeaux, an associate in the Plano, TX office of Krebs Farley, PLLC, is a co-author of this article. His practice focuses primarily on the representation of sureties in the handling of payment and performance bond claims, the interpretation of the bond rights of laborers and materialmen under the Miller Act and various state public and private works acts, and the institution of indemnity actions against defaulting principals. Prior to joining Krebs Farley, Badeaux worked for five years at International Fidelity Insurance Company as Senior Claims Counsel for the Southern Claims Division. He can be reached at bbadeax@kfplaw.com or 214.945.3026.