NASBP Attorney Advisory Council Participants Opine on Current Risk Management Challenges and Business Opportunities

NASBP IS PLEASED to announce an exciting new initiative — the Attorney Advisory Council (AAC). The AAC is comprised of eight lawyers with broad and deep knowledge and experience in various relevant sectors of the industry, including contract surety, commercial surety, construction, and/or government contracts.

The mission statement for the AAC states as follows:

> The NASBP Attorney Advisory Council is constituted for the purpose of serving as a resource team to NASBP and providing substantive content to NASBP for articles, programs, and presentations on surety, government contracts, and construction law topics for the betterment of the surety industry.

The distinguished attorneys who serve on the Attorney Advisory Council comprise a valuable NASBP "resource team." These lawyers will provide articles for the various NASBP publications, including *Pipeline* and *Surety Bond Quarterly*; participate in NASBP Virtual Seminars; develop articles for SuretyLearn.org; assist with the development of various online courses; and provide in-person presentations on various topics at the Annual Meeting, Regional Meetings, and special conferences and seminars.

As a brief introduction to the attorneys serving on the AAC, each attorney responds below to a question posed on a current, compelling topic of interest to surety professionals and their contractors and subcontractors.

Barron Avery
Baker & Hostetler LLP
Washington, DC

Q What should federal construction contractors be most concerned about in the coming year?

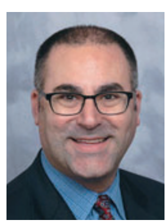
Answer: Compliance plans. Federal construction contracts require contractors to maintain numerous compliance plans, such as business and ethics compliance plans, anti-human trafficking compliance plans, and government property management plans. A federal contractor's failure to maintain adequate compliance plans could place the contractor at risk for a civil False Claims Act (FCA) suit and other negative consequences. With the noticeable uptick in FCA enforcement over the past few years, adequate compliance plans are more important than ever. Federal construction contractors should therefore ensure that their compliance plans meet contractual requirements, and a regularly scheduled "check-up" of those compliance plans will go a long way to mitigating contractors' FCA risk.

Adrian Bastianelli
Peckar & Abramson, PC
Washington, DC

Q How will increased fraud enforcement impact sureties?

Answer: The government has dramatically increased the vigor with which it pursues fraud and false claims in construction contracting. Generally, a surety will not be responsible for its principal's fraud or false claims unless the surety participated in the fraud or conspired with the principal. The mere fact that the surety issued bonds for a principal that submitted a false claim should not trigger liability.

A completing surety, however, is not in the same situation. The surety will be responsible for false or fraudulent claims it submits. Some sureties do not understand their obligations and might be ill equipped to avoid the pitfalls in pursuing payment from the government. As a result, the completing surety needs to carefully review its claims and payment demands to ensure that there is a factual and legal basis and that the claimed costs are allowable, allocable, and reasonable. It cannot blindly rely on its principal. Failure to perform such a review can expose the surety to significant liability.



Jeff Frank
Alber Crafton, PSC
Troy, MI

Q What can we expect in the world of commercial surety in the next few years?

Answer: According to the Wells Fargo 2015 Insurance Market Outlook, fierce underwriting competition, too many carriers, and insufficient client need will result in continued softening of rates.

Premium is down in construction surety. As a result, a number of new carriers have entered the commercial surety market. Because there is already excess capacity in that market, the new carriers may only stay in this market for the next one to two years. In addition, it is questionable if there is sufficient need in the commercial surety marketplace to generate sufficient revenue for these carriers. They may choose to return to the contract surety market as the need there increases. There is also currently more market capacity available than there is client demand for commercial surety.

As a result of the increased competition, underwriting has softened. There is some concern that the looser underwriting will ultimately lead to an increase in claims. Finally, pricing has continued to soften as competition increases.

Keith Langley
Langley LLP
Dallas, TX

Q Can a surety that justifiably relies on an audit bring a cause of action against the CPA for negligent misrepresentation?

Answer: In some jurisdictions, such as Texas, an intended third party, such as a surety, justifiably relying on an audit, can bring a cause of action against a certified public accountant (CPA) for negligent misrepresentation. The CPA auditing a construction company holds herself or himself out to have a particular knowledge and expertise with construction accounting. The surety relies on the CPA to be independent; maintain professional skepticism; understand and test the internal controls of the contractor; and to evaluate, analyze, and test key issues.

The applicable accounting standards require an auditor to ensure the validity of the numbers in a company's financial statements. The failure of the auditor to do so can negatively impact an underwriting surety that relies on the audit. Whether a surety has the right to rely on the audit and the right to sue if an audit is negligently performed is jurisdiction specific.

Mike Pipkin
Weinstein Radcliff Pipkin LLP
Dallas, TX

Q In the current economic environment, how can a contractor's banking relationship help it grow into different markets?

Answer: A principal should have a wide range of financial and credit facilities in place, in addition to its bonding capacity, including an operational line of credit with its primary bank, plus equipment and inventory financing, with such lending secured in a variety of ways. While intercreditor agreements are often used by sureties when financing of the principal is determined to be the best approach to mitigate a loss, they can also be used during the underwriting process, when a principal is evaluating new opportunities. In those situations, carefully negotiated and drafted intercreditor agreements, with the surety and lenders acknowledging and consenting to each other's rights in specific collateral, can enable a principal to approach new business opportunities with confidence in its lending and credit relationships. At the same time both the surety and the financial institution can remain secure in their rights and collateral in the event of a claim.

Steve Reed
Smith, Currie & Hancock LLP
Atlanta, GA

Q What is the greatest risk today for federal contractors?

Answer: By far, the greatest risk is claims made against contractors pursuant to the False Claims Act. Such claims can be filed by private parties, known as qui tam relators, on behalf of the government. The cases are filed under seal (that is, secret and unknown to the target defendant contractor). The government (Department of Justice) has a relatively brief time to decide whether to join the case; however, the time limit is routinely extended, again in secret (that is, under sealed court orders) for up to months and years. False claims can be something as straightforward as misclassification of workers under prevailing wage requirements and then filing wage reports that are incorrect (false statement) or submitting an equipment lease cost for equipment owned by an affiliated company in support of a change order proposal (false claim). The intent requirement is general in nature, and the line between an honest mistake and a false claim/statement is fuzzy.

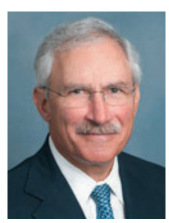
Todd Regan
Robinson & Cole LLP
Hartford, CT

Q What are the three most important risk-shifting contract terms a contractor and its surety should be concerned about?

Answer: "No damages for delay" clauses shift the financial risks of project delays to the contractor. These clauses preclude recovery of increased costs resulting from extended project duration, even when such costs result from owner caused delays. Although there are exceptions to enforcement of these clauses, they are routinely enforced by courts to defeat otherwise meritorious claims.

Although mutual waivers of consequential damages can limit damages a contractor can recover from an owner, they protect the contractor and surety from claims for the owner's lost revenue and other speculative losses due to delayed project completion.

Although many states have "anti-indemnity" statutes that invalidate clauses requiring contractors to indemnify owners for damages caused by the owner's own negligence, contractors are often required to provide broad indemnification to owners from damages arising from their work. Contractors must ensure that their insurance covers the scope of their indemnity obligations.



Armen Shahinian
Chiesa Shahinian & Giantomasi PC
West Orange, NJ

Q Is it sufficient to protect the surety's interests if only the parent company of an account signs the indemnity agreement, where bonds will be issued with its subsidiaries or affiliates as the bond principals?

Answer: The best practice is to require each company on behalf of which bonds are to be issued to sign the indemnity agreement. Some, but not all, indemnity agreements state that each signatory intends to bind its affiliates, but that might not be sufficient to bind the non-signatory companies to the terms of the indemnity agreement. The surety may face interpretational, legal and evidentiary challenges in seeking to establish that the parent company was authorized as an agent to bind its subsidiary. In such a case, a surety's assignment rights, right to settle, access to books and records, collateral deposit, and other rights spelled out in common forms of indemnity agreements may be found to be unenforceable against a bond principal that did not itself sign the indemnity agreement.