TORT TRIAL & INSURANCE PRACTICE
RAISING THE BAR
Spring 2019

COMMITTEE NEWS

Fidelity & Surety Law

Don't Pay the Price: Protect the Penal Sum

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Suretyship, by its nature, is a risk. One of the construction surety's greatest fears when faced with a defaulting contractor is exceeding the penal sum of the surety's performance bond. The surety must and should make considerable effort to protect that penal sum as it navigates the default.

1. Know the Signs of Risk. Is it Possible to Exceed the Penal Sum?

In order for the surety to protect its penal sum, the surety must know the signs of risk, make an assessment based on the information available, and ask whether exceeding the penal sum is a possibility. The simple awareness of the existence of risk associated with the bond's penal sum may determine which performance option the surety selects. Unfortunately, signs of risk often appear in the underwriting phase and are overlooked until a default occurs. For instance, the language of the performance bond itself may increase the risk as discussed later in this article. While bond form concerns may be caught, or at least observed by underwriting,

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In This Issue

Chair Message

Brett D. Divers
Mills Paskert Divers

Chair, ABA TIPS Fidelity and Surety Law Committee

Dear FSLC Members:

Growing up in Florida, I never appreciated the meaning of "Spring Fever" until I went to college where it snowed from November until Tax Day. Winter lasts in Florida for about a month. Instead of buds on trees, it is the convoy of "snow birds" headed north on I-75 and I-95, and six weeks of spring-breakers during March and April, that tell us spring has sprung. Whether it is the thawing climate in the northern states or the migration north that leads to less-congested roads in the southern states, we all seem to eagerly anticipate spring.

The change of seasons also signals the rapidly approaching end of CLE conferences for which the current FSLC Chair is responsible. We closed this Bar year's conference schedule with our Spring Meeting in Austin, Texas. Scott Olson and Chris Ward designed a wonderful program, titled "The Complex Construction Issues Facing the Performing Surety," with a day and a half of programming that was heavier on construction issues than our typical Spring Meeting. The program was well-attended, and we all gained valuable insights on the construction issues presented. In Austin, we hosted a golf tournament Friday afternoon to benefit the Alzheimer's Association. Thank you to everyone who played in the tournament and contributed to this worthy charity. If you would still like to make a donation, please contact me (bdivers@mpdlegal.com).

Though the Spring Meeting was the last of the major programs during my term as Chair, plenty of work continues. Research and writing are already underway for articles in the next edition of this Newsletter. Authors are working on papers and chapters that they will present at upcoming CLE programs. The various subcommittees are working to develop topics for future programs, enhance member benefits, foster camaraderie through inclusive networking events, and continue growing our membership. Our committee remains among the most vibrant and engaged in the entire ABA.

Since this letter is my last as Chair, I offer my sincerest thanks to all of you for your help, support, involvement, and sometimes, patience during this Bar year. Before I officially became the Chair, several Past-Chairs told me if I ever needed help, all I needed to do was ask. I had no idea how right they were. More than 150 people spoke at programs. More than 50 people wrote or edited articles, book chapters, or the annual survey in the TIPS *Law Journal*. More than 130 people served on one or more of our many subcommittees. All of them made serving as Chair easier than I expected. Thanks to them for volunteering so much of their time, and thanks

to you for attending conferences, buying publications, and being members of the FSLC. In addition to making sure the FSLC remains the leading voice in shaping fidelity and surety law, leadership strives to engage members. If you want to be involved, just let Chair-Elect, Darrell Leonard, or Chair-Elect Designee, Chad Schexnayder, or me know.

Last, and most definitely not least, I offer my sincerest thanks to the TIPS staff, particularly Janet Hummons, Jennifer Michel, and Juel Jones, for everything they do to make things run smoothly for all of us. They handle countless details behind the scenes that most of us never see to help us succeed as a committee. On top of that, they have to deal with a new Chair every 12 months, and, as you know, we have different personalities and quirks. They patiently provide their advice and expertise to keep the trains running on time.

To those of you who joined us in Austin for the Spring Meeting, I hope you learned something new and had some fun. To those who could not join us in Austin, best wishes for a pleasant spring, and one more "thank you" for all of your support during the year. It has been a privilege serving you.

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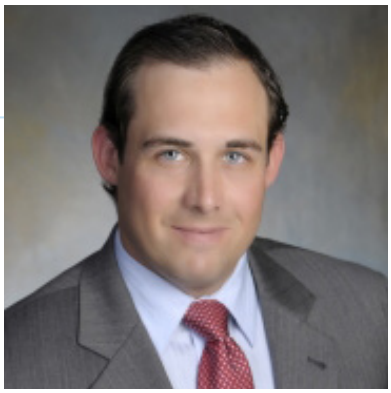
Extra-Contractual Claims and Subdivision Bonds



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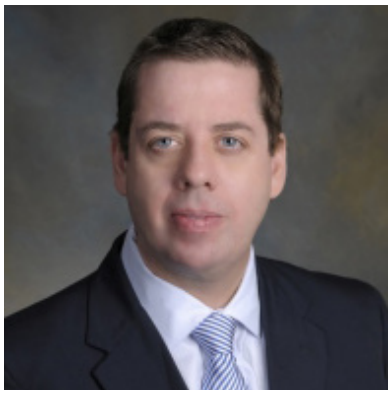

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Subdivision bonds ensure the faithful performance of required subdivision improvements. While writing a form of "suretyship" and not "insurance," subdivision bond sureties have nonetheless been the subject of bad faith claims.[1] This article summarizes cases that provide guidance for sureties faced with extra-contractual and/or bad faith claims against statutory subdivision bonds. These types of claims generally follow the same statutory and/or common law analyses applicable to bad faith claims against contract performance bonds.[2]

In *Upper Pottsgrove Township v. International Fidelity Insurance Co.*, the United States District Court for the Eastern District of Pennsylvania determined that the obligee on a subdivision bond (a municipal corporation) could not maintain a claim for bad faith against the surety.[3] Two weeks after the principal's bankruptcy, the obligee made demand on the subdivision bond, and thereafter sued the surety in state court for, among other things, a claim under Pennsylvania's "bad faith" insurance statute.[4] The surety removed the state court action to federal court and then moved to dismiss the bad faith claim.[5]

In ruling on the surety's dismissal motion, the court initially noted that, in a bad faith action against an insurance policy under § 8371, the court may award fees, interest and punitive damages.[6] The court then considered whether a surety bond fell within the definition of an insurance policy under § 8371. As the term "insurance policy" is not defined by the statute, the court first looked to cases addressing the differences between insurance policies and surety bonds.[7] The court cited the Pennsylvania Supreme Court for the proposition that there "exist fundamental differences between

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1 *See, e.g.*, Upper Pottsgrove Twp. v. Int'l Fid. Ins. Co., 976 F. Supp. 2d 598, 605 (E.D. Pa. 2013) [hereinafter *Upper Pottsgrove*].

2 *Compare* Charlestown Twp. v. United States Sur. Co., No. CV 17-5469, 2018 WL 2045615 (E.D. Pa. May 2, 2018) (finding that an obligee cannot assert a statutory bad faith claim against a surety) (mem.), Cates Constr., Inc. v. Talbot Partners, 21 Cal. 4th 28, 980 P.2d 407 (1999) (finding that an obligee cannot assert tort claims against a surety), *and* Great Am. Ins. Co. v. N. Austin Mun. Util. Dist. No. 1, 908 S.W.2d 415 (Tex. 1995) (finding that an obligee cannot assert statutory and common law extra-contractual claims against a surety), *with* Transamerica Premier Ins. Co. v. Brighton Sch. Dist. 27J, 940 P.2d 348 (Colo. 1997) (holding that an obligee may assert a bad faith tort claim against a surety).

3 *Upper Pottsgrove Twp.*, 976 F. Supp. 2d at 605.

4 *Id.* at 601 (citing 42 Pa. Stat. and Cons. Stat. Ann. § 8371 (West) (1990))

5 *Id.* at 599.

6 *Id.* at 603.

7 *Id.* (quoting Foster v. Mut. Fire, Marine & Inland Ins. Co., 614 A.2d 1086 (Pa. 1992) (quoting Grode v. Mut. Fire, Marine & Inland Ins. Co., 572 A.2d 798 (Pa. Commw. Ct. 1990), *aff'd in part, remanded in part sub nom.* Foster v. Mut. Fire, Marine & Inland Ins. Co., 614 A.2d 1086 (Pa. 1992)); *see also* Intercon Constr., Inc. v. Williamsport Mun. Water Auth., No. CIV.A. 4:07-CV-1360, 2008 WL 239554 (M.D. Pa. Jan. 28, 2008); Superior Precast, Inc. v. Safeco Ins. Co. of Am., 71 F. Supp. 2d 438 (E.D. Pa. 1999); Pullman Power Prod. Corp. v. Fid. & Guar. Ins. Co., No. CIV.A. 96-636, 1997 WL 33425288 (W.D. Pa. Feb. 21, 1997).

Methods Of Analyzing The Critical Path For Proving Delay Damages And Courts' Preferences

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What follows is a common scenario: The plaintiff is a general contractor suing your client, an electrician. The general contractor claims your client delayed the project by 222 days. The general contractor is also claiming other subcontractors have delayed the project. However, the general contractor did not perform a critical path analysis and also failed to adhere to its own schedules. Can the general contractor successfully obtain compensation for delay damages against the electrician without having performed a critical path analysis? This article presents an overview of the different methodologies for conducting critical path analyses for the purpose of quantifying compensable delay damages.

Generally speaking, damages are an attempt by one party to place a monetary value on the harm suffered as a result of another party's action or inaction, and, in the construction industry, damages due to delay are common and remain extensively litigated through the use of scheduling experts. A construction delay is the failure to complete an individual project activity within the time allotted and results from occurrences that affect the critical path, such as weather, owner issues, late or incomplete material deliveries, and labor problems or inefficiencies. Proving that a delay extended the overall project duration, proving that the delay is compensable, and identifying which party bears the sole responsibility for the delay is a complex process, often accomplished through a critical path method analysis.[1]

To ensure a practitioner's ability to competently discuss strategy and tactics with his or her expert or client, it is important to understand the pros and cons of the different CPM methodologies and the level of recognition or preference the courts have given each methodology. This article will provide the practitioner with pointers to discuss with a scheduling expert so a collaborative decision can be made as to which methodology is appropriate for the case at hand.

What is the Critical Path Method?

CPM was developed in the late 1950s as a joint venture between the DuPont Chemical Company and computer firm Remington Rand Univac. DuPont and Remington wanted a way to tackle the correlation of individual activities that make

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1 Critical path method is referred to herein as "CPM."

Forum Selection Clauses and the Surety after *Atlantic Marine*

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Most lawyers would tell you that their civil procedure class in law school, although important, left much to be desired when it came to legal excitement. I suspect few spent their days and nights dreaming of standing before a tribunal in a sweltering courthouse, donned in seersucker, arguing over the finer points of venue before seated skeptical justices and hawkish opposing counsel. Well, at least I never did. However, the reality is that the issue of venue is important to surety professionals and their counsel. We prefer to resolve disputes in our own backyards, or at the very least, not in the backyards of adverse parties. So an early review of the bonds and underlying contracts to identify forum selection clauses, if any, in the wake of the United States Supreme Court's decision in *Atlantic Marine Construction Co. v. United States District Court for the Western District of Texas* will help surety professionals and their counsel prepare to argue for, or against, enforcement of those clauses in relation to venue as their litigation strategy may dictate.[1]

1. *Atlantic Marine*

In 2013, the United States Supreme Court issued its decision in *Atlantic Marine.*[2] The case concerned a project located in Texas.[3] Atlantic Marine, a Virginia corporation, entered into a subcontract with J-Crew Management, a Texas corporation, to perform certain work on the project.[4] The subcontract contained a forum-selection clause which said that all disputes between the parties "*shall* be litigated in the Circuit Court for the City of Norfolk, Virginia or the United States District Court for the Eastern District of Virginia, Norfolk Division."[5] After a dispute arose between the parties, J-Crew commenced suit in the Western District of Texas based upon diversity jurisdiction.[6] Relying upon the subcontract's forum selection clause, Atlantic Marine moved to either dismiss the suit, or in the alternative, transfer it to the Eastern District of Virginia pursuant to 28 U.S.C.A. § 1404(a) (West).[7]

The Supreme Court considered what procedure is available for a party in a civil case who seeks to enforce a forum selection clause.[8] Under normal

1 Atl. Marine Constr. Co. v. U.S. Dist. Court for W. Dist. of Texas, 571 U.S. 49, 2013) [hereinafter *Atlantic Marine*].
2 *Id.* at 52-53.
3 *Id.*
4 *Id.* at 53.
5 *Id.* (emphasis added).
6 *Id.*
7 *Atlantic Marine*, 571 U.S. at 53.
8 *Id.* at 55–60.

circumstances when considering a motion brought under 28 U.S.C.A. § 1404(a), a district court considers the convenience of the parties as well as various public interest considerations.[9] The court weighs the factors and determines, on balance, whether a transfer serves the convenience of the parties and whether it otherwise promotes the interest of justice.[10]

However, the Supreme Court noted that "[t]he calculus changes" when the contract contains a valid forum selection clause, which "represents the parties' agreement as to the proper forum."[11] A forum selection clause is usually "valid and enforceable unless there is fraud or overreaching or unless it can be clearly shown that enforcement of the clause would be unreasonable and unjust."[12]

When a valid forum selection clause exists, a district court adjusts its usual analysis of a 28 U.S.C.A. § 1404(a) motion in three ways: (1) the party defying the forum selection clause bears the burden of establishing that transfer to the forum set out in the contract is unwarranted; (2) a district court should only consider public interest factors because the parties have waived any right to challenge the pre-selected forum as inconvenient; and (3) a district court will not apply the laws of the transferor venue to avoid a choice of law advantage.[13] To that extent, "a valid forum selection clause [should be] given controlling weight in all but the most exceptional cases."[14] This analysis effectively creates a two-part test: (1) whether there is a valid and enforceable forum selection clause; and (2) if so, whether exceptional or extraordinary circumstances exist that would disfavor the transfer of venue.[15] As such, when claim professionals receive claim notices, they should look first at the bond form and underlying contract for forum selection clauses. While the first part of the test deserves some scrutiny, unless it is clear that the forum selection clause exists because of fraud, it will likely be found "valid" as it is an expression of the parties' contract. Focus is better directed on the second test – whether there are extraordinary circumstances that would disfavor the transfer of venue. Analysis of the latter begs the question: What constitutes "extraordinary circumstances?"

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9 *Id.* at 62.

10 *Id.* at 62–63.

11 *Id.* at 63.

12 Michels Corp. v. Rockies Express Pipeline, L.L.C., 34 N.E.3d 160, 167 (Ohio Ct. App.2015) (internal quotations and citations omitted).

13 *Atlantic Marine*, 571 U.S. at 63-65.

14 *Id.* at 63 (alteration in original) (citing Stewart Org., Inc. v. Ricoh Corp., 487 U.S. 22, 33, (1988)).

15 *Id.* at 62.

2. The Miller Act

In *United States ex rel. MDI Services, LLC v. Federal Insurance Co.,* the District Court for the Northern District of Alabama addressed the issue of competing venue requirements found in the Miller Act and the underlying bonded contract as well as the issue of extraordinary circumstances.[16] Sauer, Inc. entered into a subcontract with MDI Services, LLC to provide labor and materials on a construction project located in Alabama.[17] Federal Insurance Company was Sauer's Miller Act surety on the project.[18] The Miller Act provides that a party seeking recovery from the bond must bring its enforcement action in the district court for any district in which the contract was to be performed and executed.[19] However, the subcontract at issue contained a forum selection clause providing that either party could have the dispute resolved in any court having jurisdiction over Sauer's office address.[20] Sauer's business address was located within the Middle District of Florida.[21]

After a dispute arose between Sauer and MDI regarding payment, MDI commenced litigation in federal court in Alabama as required by the Miller Act.[22] Sauer and Federal subsequently brought a motion under §1404(a) seeking transfer of the litigation to the Middle District of Florida based upon the subcontract's forum selection clause.[23] The district court held that the Miller Act language was merely a venue requirement and was not jurisdictional.[24] Therefore, the court determined that "[a] valid forum selection clause could trump the Miller Act's venue provision."[25] The district court then turned to the § 1404(a) analysis under *Atlantic Marine* to conclude that the forum selection clause contained in the subcontract was enforceable and that there were no extraordinary circumstances that would disfavor a transfer of venue.[26]

MDI argued that *Atlantic Marine* did not apply because the forum selection clause at issue was "permissive" whereas the forum selection clause at issue in *Atlantic Marine* was mandatory.[27] A permissive forum selection clause only "authorizes jurisdiction in a designated forum but does not prohibit litigation elsewhere."[28]

16 U.S. ex rel. MDI Servs., LLC v. Fed. Ins. Co., No. 5:13-CV-2355-AKK, 2014 WL 1576975, at *1–2 (N.D. Ala. Apr. 17, 2014) [hereinafter *MDI Services*].

17 *Id.* at *1.

18 *Id.*

19 *Id.*

20 40 U.S.C.A. § 3133(b)(3) (West 2006).

21 *MDI Servs.*, 2014 WL 1576975, at *1.

22 *Id.*

23 *Id.* at *1–2.

24 *Id.* at *2.

25 *Id.*

26 *MDI Servs.*, 2014 WL 1576975, at *2-3.

27 *Id.* at *3.

28 *Id.* (citing Glob. Satellite Commc'n Co. v. Starmill U.K. Ltd., 378 F.3d 1269, 1272 (11th Cir. 2004)).

Conversely, a mandatory forum selection clause dictates that the parties *shall* have their arguments heard in a specific forum.[29] The *MDI Services* court noted that the distinction was important because a mandatory clause confirms the parties' bargained-for agreement concerning forum, but a permissive clause would not necessarily "disrupt the parties' settled expectations."[30] MDI argued that the forum selection clause in the subcontract was permissive because of the use of the word "may."[31] The court rejected MDI's argument and held that the forum selection clause was a "progressive, mandatory dispute resolution process" because only after several attempts to settle the dispute with Sauer did the forum selection clause apply.[32] Sauer was only giving MDI permission to bring suit after its attempts at dispute resolution.[33] The motion to transfer was therefore granted.[34]

MDI Services is problematic for sureties because they cannot rely on the Miller Act language to concretely establish venue when there is a competing forum selection clause in the underlying contract. Attention should be paid, however, to the particular law of the relevant jurisdiction because there is a split in authority among the district courts regarding the "mandatory" versus "permissive" issue. In certain jurisdictions, counsel may be able to attack the forum selection language in the underlying contract as "permissive" and lend weight to the argument that the public interest is served in having the dispute heard in the location of the project.[35]

3. Forum Selection Clause and the Payment Bond

In 2014, the District Court for the Northern District of Texas considered the enforceability of a forum selection clause in a payment bond.[36] Travelers Casualty and Surety Company of America issued a payment bond to Carl E. Woodward, LLC for a project located in Louisiana.[37] The payment bond contained a forum selection clause, which provided that, "[n]o suit or action shall be commenced by a Claimant under this Bond other than in a court of competent jurisdiction in the state in which

29 *Id.*

30 *Id.* (quoting *Atlantic Marine*, 571 U.S. at 66). There is a split between courts as to whether the *Atlantic Marine* § 1404 analysis applies in forum selection cases depending on whether the forum selection language is "mandatory" or "permissive." *See* Fed. Deposit Ins. Corp. v. Paragon Mortg. Servs., Inc., No. 1:15 CV 2485, 2016 WL 2646740, at *3 (N.D. Ohio May 10, 2016) (noting different approaches taken by courts).

31 *MDI Servs.*, 2014 WL 1576975, at *3.

32 *Id.*

33 *Id.*

34 *Id.* at *4.

35 *See Fed. Deposit*, 2016 WL 2646740, at *3 (describing split in authority as to whether *Atlantic Marine* applies to permissive forum selection clauses).

36 Quality Custom Rail & Metal, LLC v. Travelers Cas. & Sur. Co. of Am., No. 3:13-CV-3587-D, 2014 WL 840046, at *1 (N.D. Tex. Mar. 4, 2014).

37 *Id.*

the project that is the subject of the Construction Contract is located."[38] Woodward subcontracted a portion of its work to Quality Custom Rail & Metal, LLC.[39] A dispute arose between the parties, and Quality Custom filed suit against Woodward and Travelers in Texas state court.[40] Travelers removed the action to Texas federal court based upon diversity jurisdiction and then sought a transfer of the case under § 1404(a) to the Eastern District of Louisiana.[41] The district court applied the *Atlantic Marine* test and concluded that Quality Custom had failed to offer any evidence of "extraordinary circumstances" unrelated to the convenience of the parties that would disfavor a transfer.[42] Travelers' forum selection language in the bond was enforced and its motion granted.[43]

While this decision serves as a model for the surety seeking enforcement of its bond's forum selection clause, surety professionals and their counsel should note the inability of Quality Custom to offer *any* evidence of "extraordinary circumstances." For a surety to avoid an undesirable transfer it will need to establish these circumstances. Sureties should focus on identifying the public interest factors for their argument including (1) administrative difficulties and court congestion; (2) local interests in having localized disputes decided at home; (3) familiarity of the forum with the law governing the matter; (4) avoidance of conflict of laws, and (5) judicial economy.[44] While district courts will balance all of these factors, parties that have been the most successful in avoiding transfers have focused on the judicial economy argument.[45] To that extent, the more local parties involved in the action, the stronger the judicial economy argument becomes.

4. Incorporation of Forum Selection Clauses

In *Pioneer Mechanical Services, LLC v. HGC Construction, Co.*, the District Court for the Western District of Pennsylvania addressed the issue of the validity and enforceability of a forum selection clause against a surety.[46] The case concerned a construction project in Pennsylvania. Pioneer Mechanical Services, LLC was

38 *Id.*

39 *Id.*

40 *Id.*

41 *Quality Custom Rail & Metal, LLC*, 2014 WL 840046, at *1.

42 *Id.* at *3–4.

43 *Id.* at *4-5.

44 Bollinger Shipyards Lockport, L.L.C. v. Huntington Ingalls Inc., No. CIV.A. 08-4578, 2015 WL 65298, at *3–4 (E.D. La. Jan. 5, 2015).

45 *Bollinger Shipyards Lockport, L.L.C.*, 2015 WL 65298, at *3–4; Cmty. Voice Line, L.L.C. v. Great Lakes Commc'n Corp., No. C 12-4048-MWB, 2014 WL 3102124, at *3–5 (N.D. Iowa July 7, 2014).

46 Pioneer Mech. Servs., LLC v. HGC Constr., Co., No. 2:18-CV-00507, 2018 WL 6521529, at *1–2 (W.D. Pa. Dec. 12, 2018) [hereinafter *Pioneer Mechanical*].

a subcontractor to HGC Construction Company, and Endurance Assurance was Pioneer's surety.[47] Pioneer entered into a master subcontract agreement and subcontract rider with HGC.[48] The master subcontract contained a forum selection clause, which provided that either Pioneer or HGC "may" file suit in state or federal court in Cincinnati, Hamilton County, Ohio.[49] Endurance's bond incorporated the terms of the subcontract but not expressly the master subcontract agreement.[50] A dispute arose thereafter, and Pioneer commenced suit in Pennsylvania, the location of the project. HGC moved to transfer the action to Ohio per the terms of the forum selection clause in the master subcontract agreement.[51] Included in the various claims and counterclaims were Endurance's unjust enrichment and tort claims against HGC.[52] HGC argued that the transfer to Ohio was consistent with the *Atlantic Marine* decision, and Pioneer did not contest the motion.[53] However, Endurance contested the motion, arguing that since it was not a signatory to the master subcontract agreement between Pioneer and HGC, and because its claims against HGC were based on common law and tort causes of action and not contract, *Atlantic Marine* did not apply.[54]

The district court, following *Atlantic Marine,* first considered whether the forum selection clause was enforceable against Endurance.[55] The district court held that "if the bond places limits on the incorporated agreement, those limits may evidence the intent of the surety not to incorporate all of the terms of the contract."[56] But if there is no mandatory bond forum selection clause, and there is a mandatory forum selection clause in a subcontract, then the forum selection clause in the subcontract controls, including suits related to the bond.[57] Since the bond in *Pioneer Mechanical* did not limit the terms of the subcontract, the forum selection clause was incorporated by reference and enforceable against Endurance.[58]

The court then turned to Endurance's argument that the forum selection clause did not apply because its claims sounded in common law and tort and not in contract.[59] The court rejected the argument, citing the language of the forum selection clause

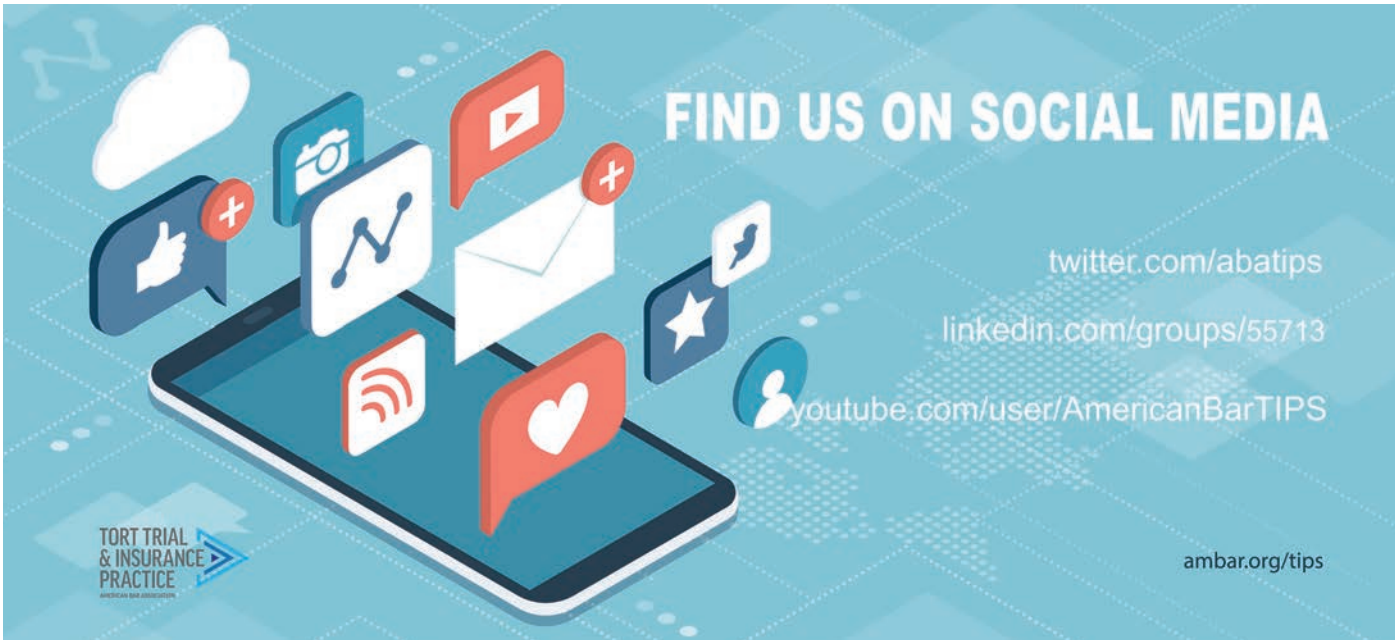
47 *Id.* at *1.
48 *Id.*
49 *Id.*
50 *Id.*
51 *Pioneer Mech.*, 2018 WL 6521529, at *1.
52 *Id.* at *2.
53 *Id.*
54 *Id.*
55 *Id.* at *3-*4.
56 *Id.* at 4 (citing Kan. City S. Ry. Co. v. Hanover Ins. Co., 159 F. Supp. 3d 729 (S.D. Miss. 2015)).
57 *Pioneer Mechanical Services, LLC*, 2018 WL 6521529, at *4.
58 *Id.*
59 *Id.* at *5.

which included all disputes that arose out of or were related to the subcontract or its breach.[60] The breadth of the language meant Endurance's claims were within the reach of the forum selection clause.[61] Rounding out the *Atlantic Marine* analysis, the court concluded that no extraordinary circumstances existed disfavoring the application of the forum selection clause.[62]

The important lesson here is that a strong defense to a transfer of venue motion is a strong forum selection clause in the bond. If a surety includes mandatory forum language in its bond forms, then the district courts are more likely to give weight to that clause because it expresses the surety's intent *not* to consent to any forum selection clause language in the underlying contract.

Atlantic Marine has raised the bar for parties wishing to avoid contractual forum selection clauses. If a surety wishes to give itself the best chance of having a dispute heard in its chosen forum, then professionals and counsel need to include a forum selection clause in its bonds, craft the language carefully so that its clause cannot be considered anything other than "mandatory", and, if necessary, be prepared to provide good evidence that the public interest factors support the surety's preferred forum.

60 *Id.*
61 *Id.*
62 *Id.* at *5-6.



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Don't Pay... continued from page 1

they may be a risk the surety is willing to accept or one that is simply overlooked until it is too late.

Beware of a principal's practice of routinely underbidding jobs. Consider, for instance, the poor bidding practices of contractors during and following the 2008 financial crisis. After a weakened economy resulted in less funding for capital improvement, contractors found themselves fighting for the little work that remained. Some contractors engaged in the practice of grossly underbidding projects in order to continue to perform and to keep cash flowing. These contractors assumed that the loss felt on one project could be "made up" by reaping profits on a later project. This practice continues today and may result in a risk to the penal sum when all options for a replacement contractor are unwilling or unable to complete the job at the same discount as the principal.

One risk to the penal sum that is not apparent during the underwriting phase is the construction project that, upon a default, has defects or deficiencies that require demolition and rebuilding. In fact, this risk may be latent, i.e., not apparent to anyone until a replacement contractor begins performing work. The conditions place the surety at a risk of a penal sum loss because of the costs associated with both tearing down and reconstructing some or all of its bonded obligation. The surety's exposure to loss may be doubled by the addition of demolition, testing, and remedial protocol costs. These costs are in addition to rebuilding an original scope of work. Depending on the size of the defect, the surety runs the risk that reprocurement costs will exceed the penal sum of the performance bond. Certain types of construction, such as apartment complexes, hotels, and other projects with a residential component, seem to run a greater risk of having latent defects. Evidence that the principal failed to perform required or suggested tests should also serve as a red flag to the surety. If the surety has any concern that its principal may have performed defective work, the surety may benefit from retaining a construction consultant in the early phases of its investigation to perform a cost-to-complete analysis, including repair contingencies. Consultants are not free, however, and the surety cannot usually credit their expense against the performance bond's penal sum, as discussed in greater detail below.

2. What *is* the Penal Sum of the Bond?

Sureties commonly set the penal sum of the performance bond for the amount of the original bonded contract price. Even so, many bonded contract prices are subsequently increased by change order or modification. While the surety prefers that the penal sum not exceed the original price of the contract, manuscript or owner-drafted bonds may contain a provision whereby the penal sum of the performance

bond increases automatically upon the increase in the contract price, regardless of notice to the surety. Some bond terms vaguely state that the surety accepts all changes and modifications to the bonded contract, but do not specifically mention the impact to the penal sum. If the amount of the penal sum of the performance bond is at issue, the first step is, as always, RTB: read the bond. In most states, a bond is interpreted "using the general rules of contract construction . . . and in light of both the statute requiring it and the contract with which it was executed."[1]

Companion cases in the adversary proceeding *Public Service Electric & Gas Co. v. Technology for Energy Corp.* (*In re Technology for Energy Corp.)* from the United States Bankruptcy Court for the Eastern District of Tennessee rejected the argument that a performance bond's penal sum automatically increased as the bonded contract's price increased.[2] In the first opinion, the bankruptcy court held that the surety's liability could not exceed the penal sum of the performance bond at issue, which provided, in part: "the Surety shall . . . fully indemnify and hold harmless the OWNER and [the obligee], from all costs, damages and expenses. . . ."[3] The performance bond further stated that "in no event shall the Principal or Surety be liable to both Obligees for more than the penalty of this bond. . . ."[4] The court held that the surety's liability was capped at the bond's penal sum, even if the surety did not remedy the principal's default or perform the bonded obligation:

> [The obligee]'s argument is based on a misreading of the bond. It assumes that "all" damages means "unlimited" damages. . . . "All" defines the kind of damages allowable against [the surety], not the amount. . . . In any event, [the obligee]'s argument also misses an obvious point about the penal sum limit. The penal sum is always a limit on the surety's liability for its own refusal to perform the contract.[5]

In the subsequent *In re Technology for Energy Corp.* companion case, the bankruptcy court fully considered and rejected the obligee's argument that the performance bond's penal sum automatically increased as the bonded contract's price increased.[6] The performance bond's stated penal sum equaled the bonded contract's initial price of approximately $3,900,000, but the bonded contract's price was ultimately increased to approximately $6,950,000. The performance bond expressly waived

1 BIF, a Div. of Gen. Signals Controls, Inc. v. Serv. Constr. Co., No. 87-136-II, 1988 WL 72409, at *4 (Tenn. Ct. App. July 13, 1988) (internal citations omitted).

2 123 B.R. 979 (Bankr. E.D. Tenn. 1991); 140 B.R. 214 (Bankr. E.D. Ten. 1992).

3 *In re Tech. for Energy Corp.*, 123 B.R. at 981.

4 *Id.*

5 *Id.* at 983 (internal citations omitted) (emphasis added).

notice of changes to the bonded contract and stated that such changes would not release the surety from liability under the performance bond. The obligee proffered expert testimony "that there is a custom of the trade under which the penal sum automatically increased from the original contract price to the much larger contract price that resulted from the changes."[7] The surety offered expert testimony to the contrary, including one witness who testified that he had "never heard of a custom of the trade that the penal sum automatically increases with the contract price" and that "[t]he normal practice in the surety industry is that the penal sum does not automatically increase with the contract price."[8] The court rejected the "custom of the trade" argument offered by the obligee, recognizing that a performance bond that expressly consents to changes to the bonded contract does not necessarily reflect the surety's "consent to an increase in the penal sum unless there is some connection between them."[9]

The court then considered the following questions in assessing the possible connection between a surety's consent to changes to the bonded contract and consent to the increase of a performance bond's penal sum: (1) Did the surety follow the practice of consenting to an increase in the penal sum whenever it consented to a contract change that increased the contract price?; and (2) Did the surety follow the practice of charging the additional premium only when it consented to both the contract change and a corresponding increase in the penal sum? According to the court, "[i]f sureties followed either of these practices or some equivalent practice, then a surety's consent to a contract change might carry with it consent to an increase in the penal sum, without regard to the method of giving consent."[10] However, the obligee had not proffered any such evidence. Consequently, the court held that, notwithstanding the increase in the bonded contract's price, the surety's liability was capped at the subcontract performance bond's penal sum.

Accordingly, while the *In re Technology for Energy Corp.* cases refused to acknowledge that it was a "custom of the trade" for an increase in the bonded contract price to result in a commensurate and automatic increase in the penal sum of the performance bond, the bankruptcy court implicitly acknowledged that a commensurate increase in the penal sum may be found if the surety followed the practice of (1) consenting to an increase in the penal sum at the same time that it provided consent to an increase in the contract price; or (2) charging an additional

6 *In re Tech. for Energy Corp.*, 140 B.R. 214 (Bankr. E.D. Tenn. 1992).

7 *Id.* at 215.

8 *Id.* at 222.

9 *Id.* at 228.

10 *Id.*

premium only when it consented to both the contract change and corresponding increase in the penal sum.

Of course, there are always exceptions. In *Centex Construction v. ACSTAR Ins. Co.*, the United States District Court for the Eastern District of Virginia considered a subcontract performance bond that contained an "escalation provision."[11] The court rejected the surety's argument that its liability was limited to the subcontract performance bond's original, stated penal sum where the bond at issue expressly stated that "any increase in the Subcontract amount shall automatically result in a corresponding increase in the penal amount of the bond without notice to or consent from the Surety, such notice and consent hereby being waived."[12] The *Centex* court found "nothing ambiguous" about the language of the bond and that the surety "clearly waived [] notice and consent" in relation to automatic increases to the penal sum of the bond.[13]

3. The Penal Sum is Routinely Enforced as the Surety's Limit of Liability.

Once the surety establishes the penal sum of the bond, the next question is whether the surety may be liable to the obligee in an amount greater than the penal sum. The clear majority rule in courts throughout the United States appears to be that the non-breaching surety's liability is limited to the performance bond's penal sum.[14]

In an anomalous decision, the United States District Court for the Western District of Tennessee held that the surety's liability for breach of a performance bond could exceed the face amount of the bond in *Clark Construction Group, Inc. v. Eagle Amalgamated Service, Inc.*[15] The bond expressly obligated the surety to "indemnify and save harmless [the obligee] of and from any and all loss, damage, and expense" arising from the principal's failure to perform and apparently did not expressly state that the surety's liability could not exceed the bond's penal sum.[16] The bonded subcontract imposed on the principal fairly broad indemnity

11 448 F. Supp. 2d 697, 709 (E.D. Va. 2006).

12 *Id.* at 708.

13 *Id.* at 708-09.

14 *See, e.g.,* Trainor Co. v. AETNA Cas. & Sur. Co., 290 U.S. 47, 55-56 (1933) (noting that the surety's liability could not exceed "the amount of the bond"); Morrison Knudsen Corp. v. Ground Improvement Techniques, Inc., 532 F.3d 1063, 1072 (10th Cir. 2008) (stating that the obligee's argument "ignores one of the most fundamental rules of suretyship: except in limited circumstances, a surety's liability cannot extend beyond the penal sum announced in the bond"); Hall v. Consol. Freightways Corp. of Del., 142 F.. App'x. 875, 878-879 (6th Cir. 2005) (recognizing "the general rule that a surety's liability is limited to the penal sum stated in the bond"); Ins. Co. of N. Am. v. United States, 951 F.2d 1244, 1246 (Fed. Cir. 1991) (holding that a defaulting surety's liability is capped at the penal sum plus interest from the date of the surety's default); Hous. Fire & Cas. Ins. Co. v. E.E. Cloer Gen. Contractor, Inc., 217 F.2d 906, 912 (5th Cir. 1954) (stating that "[t]he surety's obligation is of course limited to the penal sum named in the bond").

15 190 F. Supp. 2d 1077, 1082 (W.D. Tenn. 2002).

16 *Id.*

obligations. The surety relied "solely on the pleadings" to dispute the obligee's assertion that the surety's liability could exceed the penal sum, i.e., the surety did not offer any affidavits or supporting evidence for its position. The court found that, based on the indemnity language in the performance bond, the surety was liable to the same extent as the principal and must indemnify the obligee accordingly. The holding in this case has not been consistently adopted, even in Tennessee, and it is considered an outlier. However, the surety should be cognizant that this ruling is often relied upon by obligees in erroneously asserting that an indemnity bond is not limited by its penal sum.

4. Be Aware of the Hidden Risks of a Takeover.

As mentioned previously, the potential for reaching the penal sum may drive the surety's ultimate selection of a performance option under its bond. The AIA A312 Performance Bond, for instance, generally gives the surety the following options upon default: finance the principal's completion, takeover, tender, buy back the bond, or deny liability in whole or in part. When it comes to protecting the penal sum of the bond, the takeover option has hidden risks. For starters, Section 8 of the AIA A312 Performance Bond – 2010 only protects the penal limit if the surety elects to act under Section 5.1, 5.3 or 5.4. Section 8 makes no mention of Section 5.2, generally understood to be the surety's takeover option, leaving the surety vulnerable to waiving the penal sum of the bond if it selects the takeover option. This change was possibly made to reflect that courts have frequently held that a surety that elects to takeover completion of a bonded contract waives the penal sum of its bond unless otherwise agreed upon by the obligee.[17]

Furthermore, the surety often incurs "hidden" costs in taking over completion of a bonded contract that further drive up its total losses and expenses. Those hidden costs include sums paid to consultants and construction managers to oversee the performance of work by a replacement contractor. Because the surety assumes the role of arranging for completion of the contract, the surety generally prefers to have a steady onsite presence in order to "mind the shop." While the onsite presence gives the surety greater control in mitigating its exposure, these administration costs are often viewed as expenses that are not credited against the penal sum of the performance bond.

17 *See, e.g.,* McWaters and Bartlett v. United States *ex rel.* Wilson, 272 F.2d 291 (10th Cir. 1959); Int'l Fid. Co. v. Cty. of Rockland, 98 F. Supp. 2d 400 (S.D.N.Y. 2000). *But see* People *ex rel.* Ryan v. Envtl. Waste Res., Inc., 782 N.E.2d 291 (Ill. App. Ct. 2002).

18 *See, e.g., Int'l Fid. Co.,* 98 F. Supp. 2d at 429-30; *see also* Allegheny Cas. Co. v. Archer-Western/Demaria Joint Venture III, No. 8:13-cv-128, 2014 WL 4162787 (M.D. Fla. Aug. 21, 2014).

The takeover option often also comes with the risk of the unknown. The surety may be assuming liability for defective work or for unforeseen delays, as the takeover scenario contemplates a surety receiving a discharge of its performance bond obligations only after the work is complete. This is not to say that a surety should never consider taking over completion of a bonded contract. Certainly, takeover gives the surety a great measure of control. Instead, it is crucial that a surety that elects to takeover a contract insist on a provision in its takeover agreement that limits its exposure to the penal sum of the performance bond. Such provisions are routinely enforced by courts.[18]

To further account for the risk of the unknown, a surety should craft language into the takeover agreement that defines exactly what completion costs and other loss and expenses incurred by the surety are offset against the penal sum. More specifically, and if agreed upon by the obligee, the surety can clarify that, for instance, (a) its own consultant, management and administration expenses, (b) any delay damages, and (c) prejudgment interest and attorneys' fees are all considered payments by the surety for completion of the project that erode the penal sum of the performance bond. Such provisions must be clear and consistent throughout the takeover agreement and in light of the terms of the performance bond.

Likewise, the surety may consider including provisions in a takeover agreement setting forth the process to follow in the event the surety expends the penal sum of the bond before completion of the contract. Takeover sureties have found themselves in the uncommon scenario of nearing a penal sum loss prior to completion. If the surety is not armed with clear language in the takeover agreement, the surety may give into the threats of the obligee and continue work, despite having completely eroded the penal sum. By including steps in the takeover agreement to navigate these circumstances, the surety can further protect its exposure.

While the request to include such provisions may inflame an obligee, do not let the obligee be a bully. The surety is entitled to, and should endeavor to, protect its penal sum. If the obligee refuses to agree to cap the surety's losses at the penal sum, the surety should examine other alternatives to a takeover.

Extra Contractual... continued from page 8

bilateral contracts of insurance and tripartite surety bond agreements."[8]

The court rejected the obligee's reliance on a payment bond case in which the claimant was a subcontractor, rather than a party in direct contractual privity with the surety, such as an obligee on the bond.[9] The court reasoned that the relationship between the litigants "reflects the garden variety relationship" between the surety and an obligee, and that "[u]nder this approach a surety bond is not an insurance contract, and the bad faith provision of § 8371 would thus not apply to sureties."[10]

The court was also not persuaded by the obligee's reliance on the definition of an insurance policy contained in the Unfair Insurance Practices Act, which provides that "any contract of insurance, indemnity, health care, suretyship, title insurance, or annuity issued, proposed for issuance or intended for issuance by any person" constitutes an insurance policy.[11] The court explained that the UIPA "does not create a private right of action, but instead allows the Insurance Commissioner to regulate bad faith claims."[12] The court reasoned that:

> [i]f it were the legislature's intent to create a private cause of action for bad faith claims encompassing all of the instruments covered by the UIPA, it could have amended the UIPA or included in § 8371 a definition of insurance policy as expansive as that in the UIPA.[13]

Accordingly, the court granted the surety's motion to dismiss the bad faith claim.[14]

In *Board of Supervisors of Stafford County v. Safeco Insurance Co. of America,* the Virginia Supreme Court similarly found that an obligee could not maintain a bad faith claim against a subdivision bond surety.[15] The court held that a surety's refusal to issue payment under a subdivision bond was not in bad faith even though the surety's primary defense was rejected on appeal, and the surety was ultimately held liable under the bond.[16] In *Stafford County*, the surety issued four performance bonds on behalf of a developer who had planned to construct a multi-phased

8 *Upper Pottsgrove,* 976 F. Supp. 2d at 604 (citing *Foster*, 614 A.2d at 1099).

9 *Id.*

10 *Id.*

11 *Id.* at 604–05 (citing 40 Pa. Stat. Ann. § 1171.3 (West) (2014)). The Unfair Insurance Practices Act is referred to herein as "UIPA."

12 *Upper Pottsgrove,* 976 F. Supp. 2d at 604.

13 *Id.* at 605 (quoting *Pullman Power Products Corp.*, 1997 WL 33425288, at *4).

14 *Id.*

15 Bd. of Sup'rs of Stafford Cty. v. Safeco Ins. Co. of Am., 310 S.E.2d 445, 450 (Va. 1983) [hereinafter *Stafford County*].

16 *Id.*

residential development with 346 individual lots.[17] Shortly after receiving the relevant approvals, the developer abandoned the project and filed for bankruptcy protection.[18] The obligee thereafter filed claims under the performance bonds seeking the cost to complete the outstanding improvements allegedly covered by the bonds.[19]

The surety denied the obligee's claim on the basis that it had become infeasible to complete the public improvements and, therefore, recovery against the surety was unnecessary.[20] Specifically, the surety took the position that the public improvements were no longer practicable because Stafford County, the obligee, had determined that the land was not suitable for a 346 residential home development and re-zoned the property as "rural-residential."[21]

Ultimately, after the obligee filed suit against the surety, the trial court dismissed the obligee's claim, finding that the rezoning of the property constituted an "abandonment" of the project and frustrated the purpose of the bond.[22] On appeal, the Virginia Supreme Court overturned the trial court's decision and found that the surety was liable.[23] In doing so, the court reasoned that the rezoning occurred after the claim was made and that the obligee had complied with all of the terms of the bond.[24]

Despite finding the surety liable, the Virginia Supreme Court rejected the obligee's argument that the surety's refusal to pay under the subdivision performance bond was evidence of bad faith.[25] The court first looked to the language in the subdivision bonds, which "expressly limited recovery to their face amounts."[26] The court also referred to a 1950 Virginia Code section which required that a "judgment against a surety could not be obtained for more than the amount to which his liability was limited on the bond."[27] The court then referenced a 1977 Virginia Code provision, which deleted the 1950 Code provision language on the basis that "it merely declared what were 'longstanding and clear principles of substantive law.'"[28] Based upon its

17 *Id.* at 447.
18 *Id.* at 447–48.
19 *Id.* at 448.
20 *Id.* at 449.
21 *Id.*
22 *Id.* at 447.
23 *Id.* at 448–50.
24 *Id.*
25 *Id.* at 450–51.
26 *Id.* at 450.
27 *Id.* (citing Va. Code Ann. § 8-353 (1950)).
28 *Id.* at 451 (citing Va. Code Ann. § 8.01-430 (West 1977)).

analysis of the bond and statutory history – both of which limited the bond liability to its face amount – the court determined that the "trial court correctly ruled that the [obligee] could not properly claim consequential damages other than interest."[29]

In *Republic Insurance Co. v. Board of County Commissioners of St. Mary's County*, the Maryland Court of Special Appeals also held that the liability of the subdivision bond surety was limited to the penal sum of the bond and that a breach of contract does not give rise to a tort claim for bad faith damages.[30] In *St. Mary's County*, the surety posted a subdivision bond to secure the construction of certain roadways in a subdivision.[31] After the developer informed the obligee that a roadway and related improvements would not be completed, the obligee made a demand on the bond.[32] Ultimately, the obligee filed suit against the surety under the subdivision performance bond to recover its costs to complete the roadway.[33] The obligee alleged that the surety was liable in an amount exceeding the penal sum of the bond and for bad faith damages in connection with the surety's failure to complete outstanding improvements or to pay under the bond.[34]

The surety consented to judgment in an amount certain but objected to any attempt by the obligee to recover damages in excess of the penal sum in connection with a bad faith claim.[35] At trial, the jury resolved the bad faith claim in favor of the obligee.[36]

The surety appealed both the jury award of damages in excess of the value of the bonds and the trial court's jury instructions on the issue of bad faith.[37] The appellate court agreed with the surety that it could not be liable for damages that "exceed the sum" of the bond.[38] In reaching this conclusion, the appellate court found that the language of the bond unequivocally limited the surety's liability to the face amount of the bond.[39] The appellate court further explained that "[i]n accepting the bond with its condition of limited liability unambiguously stated thereon, the [obligee] passively consented to the liability limitation on the face value of the bonds."[40] Moreover, the court noted that Maryland law "does not recognize failure to perform a contract as giving rise to a tort action for 'bad

29 *Id.* at 450.

30 Republic Ins. Co. v. Bd. of Cty. Comm'rs of St. Mary's Cty., 68 Md. App. 428, 511 A.2d 1136, 1138 (1986) [hereinafter *St. Mary's County*].

31 *Id.*

32 *Id.* at 1137.

33 *Id.*

34 *Id.* at 1137–38.

35 *Id.*

36 *Id.*

37 *Id.*

38 *Id.*

39 *Id.* at 1137–38 (quoting the following language from the bond: "the aggregate liability of the Surety on the bond obligation shall not exceed the sum thereof for any cause or reason whatsoever").

40 *Id.* at 1138.

faith,'" and that, if it did, "[e]very breach of contract could, and probably would, result in claims in both contract and tort."[41] The court concluded that "a breach of contract does not, under the circumstances of this case, give rise to a tort claim for 'bad faith'." As such, the bad faith claim should not have been submitted to the jury.[42]

The United States Court of Appeals for the Eleventh Circuit in *Hall County, Georgia v. Selective Insurance Co. of America* applied Georgia law and addressed the possibility that a subdivision bond surety may be held liable for bad faith.[43] In *Hall County*, the surety issued three separate subdivision performance bonds in connection with the construction of three sidewalk system projects.[44] After it became clear that construction of the sidewalks would extend beyond the stated time periods within the bonds, the obligee requested that the developer obtain new bonds from the surety in an aggregate amount that was more than the initial bonds.[45] Before the surety could issue new bonds, the obligee made claims against the original subdivision bonds, and, thereafter, filed suit seeking the costs to complete each of the sidewalk system projects and for damages arising from the surety's alleged bad faith.[46]

On competing motions for summary judgment, the surety argued that the obligee's claims were untimely because the obligee did not file its claim before the bonds had expired.[47] The trial court rejected the surety's argument, finding that the bond expiration dates "in no way form[ed] a statute of limitations" because "[t]he bond periods, and particularly their extensions, served functionally as time limits for [the developer] to complete its work."[48] The court reasoned that the obligee "would not know if a default had truly occurred until the bond periods had lapsed."[49] The trial court granted the obligee's motion for summary judgment and found that the surety was liable in the aggregate amount of the subdivision bond limits.[50]

On appeal, the Eleventh Circuit upheld the trial court's decision, finding that the surety was liable for the full amount of the bonds.[51] In its holding, however, the

41 *Id.*

42 *Id.*; *see also* Collier Dev. Co. v. Jeffco Constr. Co., 25 Pa. D. & C.4th 193, 199–201 (Ct. Comm. Pl. 1995) (relying upon the decision in *St. Mary's County* to support its holding that performance bond surety was not liable for bad faith damages).

43 Hall Cty., Georgia v. Selective Ins. Co. of Am., Inc., 679 F. App'x 815, 816 (11th Cir. 2017) (per curiam).

44 Hall Cty., Georgia v. Selective Ins., Co. of Am., Inc., No. 2:15-CV-00073-WCO, 2016 WL 9024813, at *1 (N.D. Ga. Apr. 19, 2016), *aff'd in part, vacated in part, remanded,* 679 F. App'x 815 (11th Cir. 2017)[hereinafter *Hall County*].

45 *Id.* at *2.

46 *Id.*

47 *Id.* at *2–3.

48 *Id.* at *4.

49 *Id.*

50 *Id.* at *5.

51 *Hall County, Georgia*, 679 F. App'x at 816.

appellate court noted that the trial court did not explicitly address the obligee's bad faith claim when it awarded summary judgment in favor of the obligee.[52] As a result, the Eleventh Circuit remanded to the trial court the question of whether the subdivision bond surety was liable for bad faith damages under Section 10-7-30 of the Georgia Code.[53] The matter ultimately settled on remand.[54]

In sum, extra-contractual and/or bad faith claims against statutory subdivision bonds require consideration of the relevant "bad faith" statutes and/or applicable common law governing tort actions claiming bad faith damages. Regardless of whether a bad faith claim against a subdivision bond alleges a statutory or common law basis, a court will likely factor the same considerations applicable to bad faith claims against contract surety performance bonds into its determination of a bad faith claim against a subdivision bond.

52 *Id.*

53 *Id.* at 816–17; *see also* Ga. Code Ann. § 10-7-30 (West 2019) (providing, in part, as follows: "[i]n the event of the refusal of a corporate surety to commence the remedy of a default covered by, to make payment to an obligee under, or otherwise to commence performance in accordance with the terms of a contract of suretyship within 60 days after receipt from the obligee of a notice of default or demand for payment, and upon a finding that such refusal was in bad faith, the surety shall be liable to pay such obligee, in addition to the loss, not more than 25 percent of the liability of the surety for the loss and all reasonable attorney's fees for the prosecution of the case against the surety").

54 Satisfaction of Judgment, Hall Cty., Ga. v. Selective Ins. Co. of Am., Inc., No. 2:15-CV-73-WCO (N.D. Ga. April 17, 2017).

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up a project schedule.[2] Over the last sixty years, CPM methodologies have been developed to aid in determining the cause and extent of delay to assist in resolving construction disputes. In all the methodologies, the critical path is defined as the longest sequence of required construction activities to complete the project, and, as such, any delay to an activity on the critical path will extend the overall duration of the project.[3] Delay to items that are not on the critical path are said to contain "float" or "slack;" they do not affect the overall project duration and cannot be the basis for delay damages. However, float can be used up, and, once a non-critical path activity is delayed by more than its available float time, it becomes a critical path delay.

CPM analysis is used in pre-construction and post-construction scheduling analyses. In the pre-construction phase, CPM is used to plan project sequencing. In the post-construction phase, CPM analysis is used forensically to determine not only what activity caused the delay but also the amount of compensable delay to support financial damages calculations.

One of the first cases to rely on CPM as evidence in a construction dispute was *Haney v. United States*.[4] The court described CPM analysis as follows:

> Essentially, the critical path method is an efficient way of organizing and scheduling a complex project which consists of numerous interrelated separate small projects. Each subproject is identified and classified as to the duration and precedence of the work. (E.g., one could not carpet an area until the flooring is down and the flooring cannot be completed until the underlying electrical and telephone conduits are installed.) The data is then analyzed, usually by computer, to determine the most efficient schedule for the entire project. Many subprojects may be performed at any time within a given period without any effect on the completion of the entire project. However, some items of work are given no leeway and must be performed on schedule; otherwise, the entire project will be delayed. These latter items of work are on the "critical path." A delay, or acceleration, of work along the critical path will affect the entire project.[5]

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2 Maria Kielmas, *History of the Critical Path Method,* Chron.com, https://smallbusiness.chron.com/history-critical-path-method-55917.html (last visited March 31, 2019).

3 Ass'n for Advancement of Cost Eng'g Int'l, AACE International Recommended Practice No. 49R-06, Identifying the Critical Path 2 (2010), https://web.aacei.org/docs/default-source/toc/toc_49r-06.pdf [hereinafter the AACEI]. This citation is to a publicly available sample from the document. This publication is copyrighted and must be purchased through the AACEI website at https://web.aacei.org/resources/publications.

4 676 F.2d 584 (Ct. Cl. 1982).

5 *Id.* at 595.

What is Considered a Delay?

As stated above, delay in the construction context is the inability to complete a scheduled activity or the need to extend the completion of the activity due to some unanticipated circumstance. Therefore, to understand CPM, one must first understand the different types of delay. While the contract between the parties will usually define categories of delay and should be the first point of review, delays can generally be grouped into three categories: (1) excusable; (2) nonexcusable; and (3) concurrent.

Excusable delays are those which were caused by some unforeseeable event outside of the contractor's control, such as an act of God or the fault of the owner, which entitle the contractor to an extension of time. Excusable delays can be further subcategorized as compensable and noncompensable. Noncompensable excusable delays entitle the contractor to a time extension, but not to compensation. Compensable excusable delays are those that entitle the contractor to a time extension and compensation, usually in the form of a contract price adjustment in the amount of added costs for the delay, i.e., delay damages. Nonexcusable delays are those for which the contractor is responsible, requiring the contractor to complete the project without additional time or compensation. These delays often entitle the owner to delay damages, usually in the form of liquidated damages. Again, the applicable contract will typically define how these types of delays are defined and handled.

Concurrent delays are delays caused by both the contractor and the owner simultaneously and tend to be technically and legally intricate. With a concurrent delay, it is clear the project was delayed, but there are two or more explanations for the underlying cause of the delay. Courts have treated compensability of concurrent delays differently: (1) awarding no recovery where the other party was at fault;[6] (2) awarding a time extension but no monetary compensation;[7] and (3) allocating the cost of the delay between the two parties at fault.[8]

Necessity of a CPM Analysis

To recover on a delay claim, a contractor must prove "by a preponderance of the evidence: (1) the number of days of delay attributable to the defendant's wrongful actions; and (2) that these delays were on the project's critical path."[9] Essentially, the

6 Broward Cty. v. Russell, Inc., 589 So. 2d 983, 984 (Fla. Dist. Ct. App. 1991).

7 Morganti Nat'l, Inc. v. United States, 49 Fed. Cl. 110, 132 (2001).

8 Tyger Constr. Co. v. United States, 31 Fed. Cl. 177, 259 (1994).

9 Jackson Constr. Co. v. United States, 62 Fed. Cl. 84, 97 (2004).

goal is to determine what was supposed to happen, what actually happened, what the variances were, and how they affected the project schedule.

While there are non-CPM methodologies that might answer these questions, the courts have become, and will likely continue to become, more critical of the adequacy of these proffered analyses. Courts have allowed expert testimony regarding a non-CPM technique, but usually make their preference for CPM known.[10] Additionally, unless the delay is obvious or well-known via common sense,[11] it is more likely than not that a non-CPM analysis will be rejected as an unreliable and untested methodology under *Daubert* and *Kumho Tire*.[12] The courts have a critical "gatekeeping" function and must "conduct an exacting analysis of the foundations of expert opinions to ensure they meet the standards for admissibility."[13]

CPM analysis has become widely accepted because it is viewed as the most accurate methodology available for proving construction delays.[14] In fact, in one case where the project utilized a CPM schedule to plan the work, the court found the lack of a CPM analysis fatal to the delay damage claims. The court reasoned as follows:

> A critical path method analysis is an efficient way of organizing and scheduling a complex project which consists of numerous interrelated separate small projects. The reason that the determination of the critical path is crucial to the calculation of delay damages is that only construction work on the critical path had an impact upon the time in which the project was completed. If work on the critical path was delayed, then the eventual completion date of the project was delayed. Delay involving work not on the critical path generally had no impact on the eventual completion date of the project. Thus, the court cannot rely on assertions of a contractor, not supported by a critical path analysis of the project, to award critical path delay costs.[15]

10 United States *ex rel.* CMC Steel Fabricators v. Harrop Constr. Co., 131 F. Supp. 2d 882, 891-92 (S.D. Tex. 2000).

11 Richmond Am. Homes of Colo., Inc. v. United States, 80 Fed. Cl. 656, 678 (2008).

12 Kumho Tire Co. v. Carmichael, 526 U.S. 137 (1999); Daubert v. Merrell Dow Pharm., Inc., 509 U.S. 579 (1993); *see also Morganti Nat'l*, 49 Fed. Cl. at 134 (finding the non-CPM methodology called the "total time approach" of "virtually no value" especially as compared to an as-built versus an as-planned analysis).

13 United States v. Frazier, 387 F.3d 1244, 1260 (11th Cir. 2004).

14 MACTEC, Inc. v. Bechtel Jacobs Co., 346 F. App'x 59, 74 (6th Cir. 2009). ("[The consultant's] analysis applied the CPM approach, which has been accepted by the United States Court of Federal Claims as the most accurate way to calculate delay damages in complex construction projects.")

15 Catel, Inc. v. United States, No. 05-1113 C, 2012 U.S. Claims LEXIS 927, at *111 (Fed. Cl. July 31, 2012) (internal citations omitted); *see also* Commercial Contractors v. United States, 29 Fed. Cl. 654, 662 (1993). ("The mere allegation that delays caused work to be disrupted or performed out of sequence, or caused costs to be increased, will not satisfy plaintiff's burden of proof.")

CPM Delay Analysis Methodologies

In 2011, the AACEI issued its *Recommended Practice 29R-03, Forensic Schedule Analysis*, which sets out basic technical principles and guidelines for use in CPM scheduling and forensic schedule analysis.[16] Additionally, it lists nine CPM methodologies for analyzing delay but notes that schedule analysis is both a science and an art that involves professional judgment, so there could be as many analysis methods as there are analysts. Some of the more frequently utilized methods include (1) as-planned versus as-built; (2) impacted as-planned; (3) collapsed as-built; (4) windows; and (5) time impact.

Each method will likely produce different results, even if applied to the same set of facts, and each has its own strengths and weaknesses, which makes understanding and selecting a method all that more critical. However, each methodology will either refer to the as-planned schedule or the as-built schedule, or both. The as-planned schedule is the baseline schedule, which sequences the contractor's intended activity at the outset of the project. It depicts the critical path and the contractor's initial plan for timely completion of the project. The as-built schedule is how the project activities ultimately played out.

As-Planned versus As-Built

In the as-planned versus as-built method, all delaying events, whether excusable or inexcusable, are depicted on the as-built schedule, noting start dates, finish dates, and durations. The analyst compares the planned start and finish dates with the as-built start and finish dates. The difference between the two will be the amount of time for which damages are sought. While this method is the simplest and the least costly to prepare, it has drawbacks. This method is most often utilized when accurate or thorough scheduled updates are not available, but it thus fails to account for the dynamic nature of the critical path and changes in schedule logic. Therefore, this method is generally not a good choice for complex delay scenarios.

Impacted As-Planned

In the impacted as-planned method, all owner caused delays are inserted into the as-planned schedule, generating an impacted as-planned schedule, which is supposed to indicate the net effect of the owner's delays. Since this method uses only the as-planned schedule, it requires only limited progress-related records.

16 Ass'n for Advancement of Cost Eng'g Int'l, AACE International Recommended Practice No. 29R-03, Forensic Schedule Analysis (2010), https://web.aacei.org/docs/default-source/toc/toc_29r-03.pdf. This citation is to a publicly available sample from the document. This publication is copyrighted and must be purchased through the AACEI website at https://web.aacei.org/resources/publications.

However, the major drawback to this method is that it treats the as-planned schedule as fixed in time, ignoring the dynamic nature of construction projects. Similarly, by ignoring other categories of delay, such as excusable delays and delays caused by the contractor, it fails to consider the fact that a contractor typically revises its schedule to mitigate the effects of delay. Ultimately, this method will result in an analysis based on a schedule far from the realities of what occurred on site, leaving the delay damages subject to a likely successful attack based on adequacy and plausibility.[17]

Collapsed As-Built

The collapsed as-built method starts with the as-built schedule and removes the delays, either chronologically or in a single effort, to collapse the schedule to show how the project would have progressed without the delays. The delay damages will be based on the difference between the completion date of the collapsed schedule and the as-built completion date. The perceived advantages of this method are that it is based on actual events lending to higher credibility and that it requires only limited progress-related records. However, the use of as-built information to prepare the critical path is subjective and easily manipulated. Additionally, in collapsing the schedule, the analyst usually must make numerous assumptions about what hypothetically should have been planned, which may not reflect the thinking of the executor of the schedule during actual performance. While courts have generally accepted the collapsed as-built method, it is not a preferred methodology.[18]

Windows & Time Impact

To perform a windows analysis, the analyst divides the as-planned project duration into windows or time periods that are usually based on major milestones, periods of change to the critical path, or events of delay. The analyst then updates the as-planned schedule within the window or time period with the as-built information to determine gains or losses to the critical path during that window or time period. The analyst then determines the new critical path and new completion date. This revised date is used as the baseline for measuring impact to the critical path in the next as-planned window or period. The difference between the completion date as determined from the analysis to the window or time periods and the original as-planned completion date determines the amount of delay incurred.

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17 MW Builders, Inc. v. United States, 134 Fed. Cl. 469, 526 (2017).

18 Fru-Con Corp. v. State, 50 Ill. Ct. Cl. 50, 96-97 (1996) ("In a construction job of this magnitude where there are a number of items being constructed simultaneously, there are inevitable interdependencies or restraints. A job such as this which is incredibly complex from the outset contains numerous changes, delays and problems which have a ripple effect on the entire project. For this reason, the [collapsed as-built] schedules as prepared by the consultants hired by the Joint Venture contain a large number of errors which affect the weight of that evidence.").

The time impact methodology is just a variant of the windows analysis. In time impact, the analyst focuses on a specific delaying event, rather than a window or time period containing delays, as the starting point for analysis. The analyst determines the impact of each delaying event chronologically to determine a new completion date. The biggest issue with this methodology is that it may not be realistic to use if there are time or cost constraints, especially if there are a large number of delaying events to analyze. Still, this methodology is the most reliable and the most widely accepted by courts.[19]

Windows analysis, and similarly, the time impact analysis, are considered the more sophisticated methods and, not surprisingly, also the most time-consuming and costly. The obvious benefit to these methods is that they divide complex schedules into manageable parts, taking into account the dynamic nature of the critical path. Accordingly, to be prepared accurately, complete project documentation must be available, and, more importantly, the project schedules must have been accurately maintained and updated regularly or the accuracy of the analysis will be substantially affected.[20] If the schedule was maintained and updated, then presumably the schedule being used to measure delay should already reflect all prior events of delay. Thus, the analysis is of the current and ongoing planned performance, rather than the original as-planned schedule, avoiding the highly criticized static analysis of the impacted as-planned methodology.

Conclusion

One thing is clear – a CPM analysis should, and probably must, be presented if you are seeking an award of delay damages. Accordingly, hiring an expert as soon as possible is advisable for two reasons: the expert can 1) assist the practitioner with drafting discovery requests to ensure the key records are identified and produced in the appropriate format (e.g., PDF, native, etc.); and 2) assist with methodology selection. Given the myriad results the different methodologies produce, once a practitioner is aware of what project-related documents are available, the various methodologies should be discussed and a determination made as to what will produce the most advantageous and defensible analysis for the client. Of course, the required turnaround time and financial resources of the client must be considered as well.

19 *E.g.,* Bell BCI Co. v. United States, 81 Fed. Cl. 617, 540 (2008), *rev'd in part on other grounds*, 570 F.3d 1337 (Fed. Cir. 2009).

20 Blinderman Constr. Co. v. United States, 39 Fed. Cl. 529, 585 (1997).

It would be a mistake for a practitioner to retain an expert and then allow the expert to develop the strategy to prove the client's delay damages without further input from the attorney. CPM methodologies are not one-size-fits all, so a practitioner should ask the expert questions to ensure the expert can readily and clearly explain why a particular methodology has been selected. Each method has its own advantages and disadvantages, and some are more fitting to specific issues than others. Discussing with the expert his or her chosen methodology for proving delay damages will help avoid wasting time and the client's money on a method that a particular court may not recognize or prefer. How simple or technical the CPM analysis must be to meet the burden of proof often is a big unknown, but utilizing the criteria described here to assess the appropriate methodology may be the key to prevailing on a delay damages claim.

Calendar

August 8-11, 2019	**ABA Annual Meeting** Contact: Juel Jones – 312/988-5597 Speaker Contact: Arthena Little – 312/988-5672	San Francisco, CA
October 16-19, 2019	**TIPS Fall Leadership Meeting** Contact: Janet Hummons – 312/988-5656 Juel Jones – 312/988-5596	Grand Wailea Hotel Wailea, HI
October 24-25, 2019	**Aviation Litigation** Contact: Danielle Daly – 312/988-5708	Ritz-Carlton Washington, DC
November 6-8, 2019	**Fidelity & Surety Law Fall Conference** Contact: Janet Hummons – 312/988-5656 Danielle Daly – 312/988-5708	Hilton Boston Back Bay Boston, MA
January 29-31, 2020	**Fidelity & Surety Law Midwinter Conference** Contact: Janet Hummons – 312/988-5656 Speaker Contact: Juel Jones – 312/988-5597	Grand Hyatt New York New York, NY
February 12-16, 2020	**ABA Midyear Meeting** Contact: Arthena Little – 312/988-567	Austin, TX
February 20-22, 2020	**Insurance Coverage Litigation Midyear Conference** Contact: Janet Hummons – 312/988-5656 Danielle Daly – 312/988-5708	Arizona Biltmore Resort Phoenix, AZ
April 2-3, 2020	**Motor Vehicle Products Liability Conference** Contact: Janet Hummons – 312/988-5597 Danielle Daly – 312/988-5708	Hotel Del Coronado Coronado, CA
April 3-4, 2020	**Toxic Torts & Environmental Law Conference** Contact: Juel Jones – 312/988-5597 Arthena Little – 312/988-5672	Hotel Del Coronado Coronado, CA
April 29-May 3, 2020	**TIPS Section Conference** Contact: Janet Hummons – 312/988-5656 Juel Jones – 312/988-5597 Speaker Contact: Arthena Little – 312/988-5672	JW Marriott Nashville Nashville, TN