

**ELEVENTH ANNUAL
NORTHEAST SURETY AND FIDELITY CLAIMS
CONFERENCE**

RECOVERY CONSIDERATIONS

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The handling and resolution of performance and payment bond claims consumes the majority of time among surety claims practitioners. However, it is often the recovery generated from the salvage and subrogation effort that creates a bottom line profit for the surety. Although recovery efforts may seem easy, one of the toughest aspects of the surety claims professional's job involves the decision on recovery of the loss. Initially, the professional must decide whether to commence recovery efforts. He must then closely monitor the case and decide if continuation of the case justifies the resources that are required to produce the hoped for result. After all, no one benefits when a surety loss of \$50,000.00 costs an additional \$35,000.00 in recovery fees, and the end result is a default judgment against a bankrupt indemnitor.

Prior to commencement of the recovery effort, the surety claims professional needs to initially perform a basic review to determine if the case should even be pursued. No one can be faulted for trying to recover a loss, but the experienced claims professional is paid to decide when to commence the effort and when the situation appears hopeless. Each claim loss is unique and the following checklist is a composite of some issues to consider:

- 1) Size of the loss - Usually, large losses require at least an initial effort to try to recover something. After all, corporate management will always ask what is being done to recover on the large losses. The larger the loss, the more the claims person should exert effort, since it is usually those claims with the largest losses that produce the largest recoveries.
- 2) Type of loss - Is the loss derived from a surety default, or did the president steal the contract funds and fail to pay various vendors? Sureties can often make large recoveries from contract balances on performance losses, but they have a tougher time collecting when the job is near completion and the payment bond claims are voluminous. This is where timing is crucial. The surety needs to act promptly in notifying the obligee of its right to contract balances when reserves are first established and there are pending payment and performance bond losses.
- 3) Type of business - Is the contractor a large sophisticated corporate entity or is the principal solely a mom and pop operation? Again, each case is unique but the surety claims professional has to examine the corporate size and form to determine if the responsible parties will cooperate in assisting in recovery. Powerful corporations may resist the surety's recovery efforts while a smaller principal may not have the resources to fight.
- 4) Date of loss - If the loss occurred several years ago, and the surety is just now beginning the recovery operation, it may prove more difficult than a more timely effort. Witnesses may be missing, key documents may be lost and memories may have faded. The chances of recovery are usually enhanced if the surety acts promptly in commencing the effort.
- 5) Corporate principal and corporate indemnitors - It is helpful to carefully review the underwriting file that usually contains the indemnitors financial statements. Although these statements may be dated, especially if the account is no longer underwritten by the surety, they serve as a starting point in the recovery effort. Review of the underwriting information doesn't cost the surety anything (other than the time of the in-house claims professional) and the file may provide invaluable information. Dun and Bradstreet credit reports also provide a good summary of the corporate balance sheet.

- 6) Personal indemnitors - The surety claims professional needs to look at several factors
- a) Is the General Indemnity Agreement ("GIA") valid or will the spouse or other personal indemnitors claim a forgery? Litigating the validity of GIAs can be time consuming and expensive. You need to carefully weigh the effort of fighting this particular battle against the potential for recovery. Protracted GIA litigation can be a Pyrrhic victory. We had a case where the performance bond loss was \$100,000.00 yet the GIA litigation ended up costing \$50,000.00 in legal fees. The ultimate recovery was \$10,000.00. No one benefits in such a scenario.
 - b) Can you produce the original GIA for examination by opposing counsel and forgery experts? It is not wise for the surety to commence its indemnity action if it cannot produce the original necessary documents. We had a case where there were three GIAs executed over the course of several years, all pertaining to the same corporate principal. Unfortunately, the original copy of the one GIA that contained the signatures of the wealthy additional indemnitors could never be found. We had a photocopy of this GIA but could not produce the original. Consequently, our summary judgment efforts were reduced into a nominal settlement.
 - c) Did the indemnitors cooperate in the claims handling? Indemnitors who help the surety reduce the overall loss through cooperative efforts may be able to strike a better deal from the surety when the time comes for reimbursement to the surety. The surety may be more lenient if the indemnitors really tried to facilitate the resolution of the claim and assisted the surety.
 - d) Individual assets - It is often beneficial to use the services of a private agency to conduct a location search for individual indemnitors (if needed) or to conduct an asset investigation. The fees charged by these agencies vary and are based upon the type of report requested. A large loss with a recalcitrant indemnitor who is suspected of hiding assets may justify the expenditure of several thousand dollars to search out assets. There are several nationwide credit and search agencies who can assist the surety industry in this effort. The work product of these agencies can prove very beneficial in the surety's recovery efforts.
 - e) Homestead exemption - Florida and Texas are notorious as debtors' havens and the surety cannot take the indemnitors' homes in those states. Other jurisdictions make it difficult to garnish wages or attach bank accounts. You need to carefully consider the state where the indemnitors' assets are located to determine if further pursuit is justified. Although sureties usually do not take homes as salvage, the threat of doing so often works as leverage in extracting recovery in those states where there is no homestead exemption.
 - f) Attorney fees - Is outside counsel pursuing salvage/subrogation for the surety on a contingency fee basis, or is the meter running on an hourly basis? It can get very expensive very quickly if the legal effort is on an hourly basis and the surety is unsure if the defendant has any assets. The surety claims professional must closely monitor the legal fees and must be prepared, if necessary, to "pull the plug" on the litigation. In some cases, outside counsel may agree to handle the recovery file on a reduced hourly rate.

- g) Choice of counsel - Sureties are used to being defendants in litigation, after all, that is the unfortunate nature of the business, at least for those of us on the company side. In the salvage/subrogation arena, the surety is usually in the position as plaintiff. Defense counsel may approach cases differently than plaintiffs' counsel, so in selecting counsel for the recovery effort, the surety claims professional must be cognizant of this fact. Effective plaintiffs' counsel are used to taking the proactive lead in moving cases, and the surety is usually well served by an aggressive collection effort. If recovery counsel is not comfortable in the role of representing a plaintiff, or is not accustomed to pushing cases, the surety is well advised to hire new counsel. Overworked attorneys or attorneys who are not comfortable in their role as collection counsel may cost the surety a fortune in legal fees without accomplishing anything beneficial for the client. Therefore, it is vital that the surety claims professional carefully select the recovery counsel and closely monitor the file to ensure that there is movement. Cases can get lost in the system and with crowded dockets, salvage/Subrogation cases can be overlooked.

There is no guarantee that every recovery effort will be productive. Unfortunately, we all have seen cases where the recovery cost is significant but the outcome is negligible. This result may not be from lack of effort. Nonetheless, the surety professional best serves her employer by close evaluation of the recovery possibility before the effort begins and then continued monitoring of the case until conclusion.