

THE STANDING NEUTRAL AND ITS IMPACT ON SURETY CLAIMS

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The Surety industry has, and will continue to be affected by the impact of various dispute resolution alternatives.

Most of us are already aware that Sureties that were not a party to an arbitration. The Sureties have litigated the issue if the Surety should be bound by an arbitration award against their Principal when the Surety was not a party to the arbitration. States, where the case law at one time seemed finally resolved, are now experiencing a whole new set of cases retrying this issue. I have not done research to determine what the final consensus seems to be. I can report to you that there are jurisdictions that bind the Surety to arbitration decisions when Surety was not a party. Sureties need to concern themselves with the cost incurred in attempting to overturn adverse arbitration decisions.

There is a growing trend in the United States to incorporate into bid documents and the contract, a provision establishing a "standing neutral or mediator". The combination and permutations of how the neutral is to operate are endless. We can anticipate that the Surety will not be a party to these alternative dispute resolutions either.

Sureties will be looking very closely at those contracts where the decision making process of the neutral is binding on the owner and the contractor. When the Surety feels that the neutral's binding decision was favorable to their Principal, Surety will remain silent. The Surety, who is being bound by a neutral, without having the opportunity to have the "Surety's day in court", will want to litigate the issue.

The Surety industry would be well advised to take a good hard look at how they will be affected, now, before they write bonds covering contracts that incorporate "standing neutral or mediation provisions". We can expect to see mediation provisions showing up not only in

private construction projects but Municipal and Federal Government projects as well.

The major cost and expense that Sureties face on traditional construction projects has been the cost incurred defending delay claims and consequential damage claims of owners, general contractors, and other affected parties. The expense for consultants and lawyers for the analysis, both technically and legally, of these issues are known to all of us. Perhaps the standing neutral will turn out to be the guardian angel of the Surety industry after all the statistics have been accumulated.

Surety companies will be exposed to costs that a standing neutral has found against the contractor. The Surety will argue that it was never within their contemplation when it underwrote the bond to be responsible for certain costs, cures, means, methods, determined by the neutral. However, the Sureties may have already saved unknown expense as a result of not having to retain consultants and law firms to defend them for traditional damage claims. The Sureties may be causing themselves more harm if the Surety industry attempts to segregate itself from liability in those contracts where mediation is binding. I can only assume that the Surety industry will want its cake and eat it too, which we all know is not the way things ever turn out to be.

The cost of the standing neutral will also become an issue the Surety industry will find itself grappling with. The mediation provision may require the contractor to bill the cost of the neutral as a line item. This may result in a payment bond claim being made against the Surety by the neutral for its fee. Many of the current mediation procedures require the contractor to bill a percentage of the contract on a monthly basis for the cost of the neutral. The contractor, in turn, remits this to the neutral.

A contractor, who is in financial difficulties, will fail to remit this fee to the neutral and a payment bond claim will be made. We all know the traditional argument where payment bond claimants are entitled only to payment for those items which have been incorporated into the

project. We have seen payment bonds which have been rewritten to include workmen's comp. premiums, liability premiums, and other items that historically were not considered covered under a payment bond. We can expect that eventually some of the owners will also become concerned enough to include the neutral's cost as a covered payment bond claim as a provision in their payment bond forms.

We can anticipate the event where a neutral may recommend a settlement that may involve the Surety paying for part of a dispute resolution and waives the Surety's recourse against its Principal or personal indemnitors. The bang of outrage will be heard nationwide when that event occurs. Concepts of common law, demands for due process, taxation without representation, and the imagination of every Surety defense counsel in the country will be heard when the event happens.

The day is coming and it may be wise for executive departments to look at this now and to take the necessary steps to be a part of the associations that will be drafting this language. This is an opportunity for the Surety industry to save those consultant and legal fees that they have been complaining about for years. Will the opportunity be missed or will the industry be entering into a new expense cycle?