

**NINETEENTH ANNUAL
SOUTHERN SURETY AND FIDELITY CLAIMS
CONFERENCE**

**Charleston, South Carolina
APRIL 10TH & 11TH, 2008**

**A THREE WAY STREET: THE PERSPECTIVE OF THE
UNDERWRITER, BROKER
AND CLAIMS REPRESENTATIVE**

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A THREE WAY STREET: THE PERSPECTIVE OF THE UNDERWRITER, BROKER AND CLAIMS REPRESENTATIVE

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Introduction

This discussion and the materials provided herein will focus on two large bankruptcy cases involving large construction companies with significant outstanding surety bonds and a need for additional surety credit.⁵ *In re: Washington Group International, Inc.* (Bankr. Nev. BK-N-01-31627) was one of the largest successful reorganizations by a construction company in the United States. Washington Group International was bonded by Federal Insurance Company and other sureties prior to its bankruptcy. Federal's claims representatives, underwriters, and outside counsel were involved in negotiations and discussions with Washington Group prior to Washington Group filing bankruptcy. In fact, Federal's counsel was present at the bankruptcy court on the day of filing. Working with Washington Group's workout team, and its broker, Federal was able to reach agreements and negotiate terms which allowed Washington Group to enter the Chapter 11 bankruptcy proceeding with the possibility of additional surety credit, and Federal obtained certain protections which allowed it to avoid any loss under its bonds.

In *In re: Integrated Electrical Services, Inc.* (Bankr. N.D. Tex. 06-30602-BJH-11), Federal was able to work with Integrated Electrical Services, Inc. and its affiliates (collectively "IES") to prepare what was, essentially, a prepackaged bankruptcy with a surety credit facility. As a result, IES quickly emerged from bankruptcy with surety credit and with no loss to, the Surety.

Both accounts continue to be underwritten by Federal Insurance Company. This discussion will study the issues and challenges of providing surety credit pre-bankruptcy, during bankruptcy, and in a bankruptcy exit facility. The study will also discuss the issues of dealing with large creditors (i.e. the Banks), and the principal's "workout team." Although each case is remarkably different and many surety accounts

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⁵ This is not a bankruptcy paper per se and will not address creditors' options and all the various constituencies in Chapter 11 reorganization.

cannot be salvaged through the use of additional surety credit or other creative means (particularly small accounts), for those few cases which can be salvaged, timely and proactive handling of these cases can make the difference between a significant surety loss and a successfully salvaged account.

A. Identifying Surety Accounts in Trouble Before it's Too Late.

With respect to any surety loss situation, the quicker the surety becomes aware of the potential problem with the account, and the more active the surety is at the early stages of the principal's financial or other problems, the better the surety can control and, hopefully, limit its ultimate loss. This is especially true if there is any opportunity to allow the principal to successfully reorganize. As was remarked on more than one occasion, by the principals' attorneys in the Washington Group and IES cases, a contractor can reorganize without Bank support (although it is more difficult), but can never reorganize without surety support.

1. Broker's Role

It is at this stage of the surety credit relationship that the broker can have a significant impact on the success of the principal. Frequently and historically, principals attempt to minimize financial and other difficulties until disclosure is inevitable. The fear of the impact on the account's credit (both surety credit and bank credit) and the hope of avoiding disaster frequently have the opposite effect. Every contractor believes it can bond its way out of its financial troubles. Very few actually can. If a broker realizes that an account may be in financial trouble, may have trouble with a specific project, or otherwise may be in a situation in which its surety may be called upon under one or more of its bonds, the quicker the broker convinces the principal to disclose this information and bring in the surety and its resources to assist in avoiding loss, the more likely that loss can be significantly mitigated or avoided.

The broker is an advocate for its client, the principal. The broker wants its client to succeed and frequently is looked to by the principal as a source of advice, but often taken for granted. A good broker can be very valuable, while a broker who is just a "premium collector" is rarely part of the solution when the account faces tough challenges. It is important for the broker to avoid the natural tendency to become a "cheerleader" for the account and to be a realistic advisor regarding the account's standing with its surety and the surety market as a whole. The broker enjoys more direct and more frequent contact with the principal and is more likely to begin to see signs of operational, financial, or other deterioration before the surety. The broker may be able to identify problems before the principal is willing to come to terms with its distressed condition. The broker frequently sees developing issues before the surety has independently been advised of problems through payment bond claims or notices of performance defaults. Too frequently, the sureties learn of the principal's troubles through the bond obligee or payment bond claimants. At this point, it is frequently too late to salvage the account, maintain surety credit support, or otherwise take steps to

significantly mitigate the surety's loss. Good brokers can be very valuable to both the surety and the principal.

2. The Underwriter's Role

Behind the principal and its broker, the surety underwriter is the person most likely to see early signs of a principal's troubles. The underwriter will frequently perform periodic reviews of the financial condition of the principal and the status of bonded projects. The underwriter can best serve its customer, the principal, by identifying potential pitfalls for the principal in its business and addressing problems with the principal before the account moves into claims. The underwriter's sole goal is to issue surety credit in a manner which avoids loss to the surety. Increasing bonding capacity for a troubled account or issuing new bonds on a troubled account without addressing problems with respect to management, financial problems, or other deficiency of the account can frequently lead to additional exposure for the surety without providing the principal with any reasonable means of emerging from its operational or financial troubles. **Accounts can rarely, if ever, "bond their way out of problems."** Keep in mind, in many cases, the problems are NOT because of the bonded projects, but from outside sources such as too much debt, too much overhead, and/or problems in unbonded work.

The underwriter's relationship with the broker is also very important. A free flow of information between the broker and the underwriter and between the broker and its principal are very important to a healthy surety credit relationship. The underwriter must also understand the involvement and exposure of the banks and other creditors. If the principal is otherwise a sound surety risk with excellent operations, but is encumbered by overwhelming obligations to its banks or other creditors, the surety's early involvement can be of the utmost importance. Whether it is inter-creditor agreements, out-of-court workouts, or insolvency proceedings, actions can be taken to help alleviate pressure on the principal.

The underwriter should also understand the ramifications of curtailing or cutting off surety credit. As noted above, issuing additional bonds to help an account emerge from troubled circumstances rarely is successful unless the principal's underlying problems have been adequately addressed. However, the impact of canceling bonds, limiting bonding capacity, or discontinuing bonding capacity can potentially have a devastating effect on the account and guarantee the surety immediate defaults and losses. As is the theme throughout much of this paper and related discussion, a "knee-jerk" reaction by any party without the free flow of information frequently results in failure. It may be the proper decision to curtail or discontinue surety credit for the account, but this decision should follow a thorough and careful evaluation. The surety rarely has a "committed surety" credit facility, unlike the bank's lines of credit, and is generally free to cut off surety credit without legal recourse by the principal and indemnitors. The surety can expect the banks, principal and other third parties to quickly become uncooperative at best and more likely combative once surety credit, or the hope of surety credit is cut off.

Underwriters should not hesitate to bring in outside consultants, if necessary to help evaluate an account's financial status, operations, debt structure and the state of its bonded obligations. Underwriters may delay using consultants as claims operations functions until it is too late to be effective. Additionally, underwriters are frequently reluctant to bring in outside professionals as the cost will ultimately be charged back to the principal. However, funds spent on early and independent evaluation of the account and its operations and status of the bonded work can frequently be the difference between a successful workout and a freefall surety loss. Legal representation "pre-bankruptcy" can be and usually is central to the surety's ability to mitigate losses.

Finally, the underwriter must understand how the principal intends to change its operations, business plan, or other procedures to rehabilitate the company. If an account is in financial distress, continuing to operate in the same manner will likely create the same results. With few exceptions, a detailed and thorough plan by the principal is necessary to assure the underwriter that continuing the surety relationship can be beneficial to all parties. Unfortunately, smaller accounts rarely have the resources to develop a successful plan of reorganization

3. Role of the Claims Department

The claims department is frequently the last party to the dance although most successful sureties foster a good relationship between the underwriters and claims departments. Many accounts linger in "no man's land" trying to address problems before ending up in claims. If the principal, the broker and/or the underwriter have attempted to solve the principal's problems without involvement of the claims department, the claims department may be unprepared and unable to avoid significant losses. The quicker the claims department is involved in a potential default, the more it can do to place surety in the best position to prepare for and mitigate the potential loss.

The claims department should as quickly as possible conduct its due diligence and evaluate the various bonded projects, the company, the company's management, and its exposure under the performance and payment bonds. This due diligence is essential for the surety to make an informed decision whether to issue new surety credit. The surety must have a clear understanding of its potential exposure before it can make informed decisions, and the claims department can be a key player in providing the necessary information. The claims department may be asked by the principal to advance payroll, pay bonded subcontractors and suppliers, or make other credit decisions which cannot be made without the necessary information. Whether this is performed by competent in-house accounting and engineering professionals or through outside consultants, the time and expense expended at this stage of the claims process can pay great dividends as the account moves forward.

As discussed above, if the claims department is brought into the matter before surety credit is terminated, it can have a significant and positive impact on the mitigation of surety loss. The claims department can work with the underwriter to evaluate risk

and solutions. The use of mechanisms such as cross-collateralization of bonded receivables, securing and perfecting liens and utilization agreements on the principal's equipment, and cash or other collateralization can enhance the surety's position.

4. The Surety Attorney's Role

The primary role of outside counsel for the surety is to help advise the surety in a manner that will minimize the likelihood and the extent of the surety's loss. The surety attorney should gather all of the information possible regarding the principal, the bonded projects, and the surety's willingness to consider extensions of additional surety credit. While a true workout is a viable option in only a small percentage of cases, counsel provides an independent and fresh evaluation of the surety's legal options. The surety counsel serves a unique role of not only facilitating and implementing the plans and intentions of the surety regarding a workout, affirmative litigation, or representation in bankruptcy or other solvency proceedings, but surety counsel can play a unique and valuable role in advising the surety of all of its potential options and place the surety in the best position in anticipation of bankruptcy, surety default, and other potential exposures.

Unfortunately, the various constituencies, including the principal, the bank, the surety, and the broker, are frequently scurrying to protect their own interests and unwilling to share information or work together to solve the problems. Sometimes the constituencies have fundamental differences of opinion. Sometimes there are turf wars, particularly between the surety and the banks. Sometimes, the constituencies or their counsel do not "play well" together. If surety counsel can broker an exchange of information to allow the parties to engage in pre-bankruptcy planning and discussions, the surety's decisions can be better informed, more sound, and more successful. In both the Washington Group and IES bankruptcies, much of the ultimate success of the bankruptcies and emergence from bankruptcy was fueled by the actions of the parties well before a bankruptcy petition was filed. In also makes "first-day motions" less of a problem for the surety as well as the other constituencies. Some objectives that surety counsel may have in pre-bankruptcy planning include the following:

- _____ Obtain all information and documentation which the surety may need with respect to each of its bonded projects.
- _____ Obtain control of the inventory to be used on bonded projects.
- _____ Obtain cross-collateralization of bonded receivables.
- _____ Obtain equipment utilization agreements regarding the use of equipment necessary to complete the bonded projects.
- _____ Obtain cash collateral, letters of credit, or other security to protect the surety.
- _____ Any agreement regarding future surety credit should be conditioned on and subject to the surety's sole and absolute discretion. **Do not let the surety be in a position where it must bond a project.**
- _____ Get the claims and underwriting departments to work together as long as the surety is still considering issuing surety credit.

_____ Understanding the Bank's and DIP Lender's credit documents.

B. General Considerations When a Large Surety Account is Considering Chapter 11 Bankruptcy

1. Evaluations of the Bonded Projects

Although steps can be taken by the principal, the broker, and the surety before the principal defaults under its bonded contracts, on its financial obligations, or is forced into insolvency proceedings, the surety must also consider steps which unilaterally protect its own interests in anticipation of a potential default or bankruptcy proceeding. The first step which is necessary in order to allow the surety to make any informed decision and to prepare the surety to act promptly and effectively is the evaluation of the bonded projects. As soon as the surety learns that its principal may be having financial trouble or may be encountering problems on bonded contracts, the surety should immediately take action to evaluate both the financial position of the bonded contracts and the status of the surety's remaining obligations under its bonds. Accounting and engineering professionals will potentially be required to effectively conduct this investigation and analysis. Many decisions will likely be made based upon the quality of the work in place, the remaining duration of the project, the outstanding accounts payable, any existing disputes with the obligee, and other factors which will determine whether the principal can successfully prosecute the remainder of the work without financial assistance.

Another step which the surety should immediately take is to evaluate the bonded contracts. Too often the surety makes important decisions or the principal is defaulted on a project before the surety ever gets to read the bonded contracts. While contracts typically contain similar language, each individual contract will have certain nuances that may provide an advantage or disadvantage for the surety under certain circumstances. The amount of liquidated damages assessable on the project, allotments for extensions of time, and other such issues can dramatically impact the surety's exposure and, therefore, the surety's decisions when dealing with an insolvent principal.

The surety should also immediately review and evaluate its bonds. Does the bond provide broad indemnity language, without protections to the surety? Does the bond require the obligee to take certain steps which it has not yet taken to perfect a claim? What tiers of subcontractors are covered under the bond? Can the bond be cancelled, and if so, what are the ramifications? These are all considerations for the surety in evaluating its rights and options.

Finally, the surety must begin to consider what its options would be in the event of a "free fall" by the principal. Are there other contractors in the area (or on the project) who could promptly take over completion? What is the market for construction work and what is the anticipated premium which will be paid in the event of a relet? Will the subcontractors return to the project under a different contractor? Does the surety want

the bonded work to be “assumed” or “rejected,” and why? The surety’s options with respect to financing a principal, extending additional surety credit, attempting to negotiate a termination for a convenience, attempting to negotiate a tender, or attempting to obtain voluntary defaults so that the surety may complete the project are all options which will be weighed against the background of these and other considerations.

2. Evaluation of Other Projects and Obligations

Sureties frequently expend significant time and resources in attempting to evaluate their bonded obligations without consideration of other factors which may be impacting the principal’s business. While the evaluation of the bonded obligations and due diligence in that regard is, perhaps, the most important action taken by the surety, a close second is understanding the other external forces impacting the principal’s business. Are there unbonded projects or projects bonded by other sureties causing either a drain of resources on the principal or negatively impacting cash flow? The debtor’s ability to assume or reject unwanted contracts in bankruptcy can be a valuable resource to the principal and even the surety.

The principal’s debt can frequently push the principal into bankruptcy. IES is a great example. While the bankruptcy code provides many tools and protections to the principal which can be utilized to avoid oppressive terms, the principal and the surety must also carefully consider what security interests are held by the secured creditors or other parties. Whether intercreditor discussions are appropriate or necessary before filing bankruptcy (which they frequently are) will be determined by this analysis. A frequently overlooked need by the surety is the equipment and facilities necessary to complete the bonded project. If the surety can obtain equipment utilization agreements for equipment owned or leased by the principal at limited or reasonable consideration to the lessor or secured lender, that could save the surety a significant amount of money if the project is ultimately relet. It could also help preserve the equipment on the project should the secured lender or lessor declare the principal in default and begin foreclosure proceedings.

3. Other Considerations

Once the surety has a clear picture of the status of the bonded projects, the general status of the unbonded work or projects bonded by other sureties, and the financial obligations of the principal, it is in a much clearer position to evaluate its rights, exposure, and interests. With the assistance of legal counsel, the surety may now begin to discuss with the principal **and ultimately the banks and their counsel**, various options which may be utilized to allow the surety to consider additional surety credit. While sureties frequently fear bankruptcy (as do most creditors), bankruptcy can provide a valuable tool to the surety to allow the principal to discard burdensome and unwanted obligations while preserving the core assets of the principal in hopes of either reorganization or an orderly liquidation. Certain states may have more favorable and flexible insolvency proceedings such as state court receiverships. If the surety can

persuade the principal to understand that the principal and the surety may have aligned interests at this stage, the parties can work closely together to take actions which present the best opportunity to limit the surety's loss and allow the principal to emerge from its financial distress. Unfortunately most principals view the surety as a secondary player to the banks, which is a mistake.

C. After the Bankruptcy is Filed

As is the theme throughout this discussion, the more information the surety learns and the quicker that information is gathered, the more likely the surety can take steps to mitigate or positively impact its overall exposure. Once the bankruptcy petition is filed, time becomes of the essence. Approval of the use of cash collateral, retention of employees, payment of critical vendors, and other similar first day bankruptcy motions can immediately begin to impact bonded projects. As the surety and principal are working together to attempt to preserve the bonded projects and mitigate loss, actions taken at the beginning of the bankruptcy process can pave the road for a successful reorganization or liquidation or set the course for failure. Although sometimes considered by bankruptcy courts as adverse to the purpose of the bankruptcy process, early motions for approval to pay critical vendors can dramatically impact the surety's exposure. Critical subcontractors and suppliers may, under certain circumstances, be paid as a priority in order to maintain and preserve the bankruptcy estate and keep the estate's assets (the contracts) moving forward. While such a motion will likely result in the payment of subcontractors and suppliers on unbonded projects as well, this is a way to significantly reduce the surety's payment bond exposure, keep the subcontractors on the project and suppliers providing materials to the project, and help preserve the status quo. Attached as Appendix A to this paper is a motion and order which resulted (among other things) in the payment of a significant number of critical vendors in *In re: Encompass Services Corp.*, (Bankr. S.D. Tex. 02-43582-H4-11).

1. Determining Whether an Interim Surety Credit Facility is Feasible and Upon What Terms, Conditions, and Collateral

Secured creditors and bankruptcy courts are becoming more willing to acknowledge what sureties and contractors have realized for some time: surety credit is frequently the lifeblood of any contractor. Additionally, a limited surety credit facility created during a pending bankruptcy can provide the debtor-in-possession with "instant credibility." For example in the Washington Group and IES cases, announcement of the surety credit bankruptcy facility proved to be worth significantly more to the debtor than the bonds actually issued. The availability of surety credit calms the principals' subcontractors, suppliers, creditors, customers, and to the outside world and the principals' competitors shows a level of stability and a legitimate hope for a successful reorganization. Therefore, the surety should be viewed as a valued participant in a successful Chapter 11 reorganization as surety credit from other sources will likely be unavailable. Similar to a debtor-in-possession lender, the surety can be provided certain protections, priorities, and interests in exchange for extending additional surety

credit. While the decision to extend additional surety credit is extremely important, the terms, conditions, and protections afforded the surety in exchange for additional surety credit can dramatically impact the result of the surety's decision. As a surety can rarely bond its way out of a loss, any interim surety credit facility given to a debtor in bankruptcy should be carefully drafted both to provide the surety with significant discretion in issuing new bonds and afford the surety significant collateral or other protections which hedge against any potential loss.

If it has not previously been obtained, the surety will want to utilize this process to obtain an agreement and bankruptcy court approval regarding the cross-collateralization of the bonded projects, approval of payment of the bond premiums and fee for the surety to extend the additional credit (which fee should cover the surety's attorneys fees and other expenses incurred in evaluating the surety credit facility), provide for collateral to be posted to the surety which secures all outstanding bonded obligations, and provide for the assumption by the debtor-in-possession of those bonded contracts that the surety wishes the principal to assume. Upon the assumption of the bonded contracts, the bonded obligations become obligations of the estate and obtain administrative priority, ahead of unsecured creditors, in disbursements from the estate's assets. The Motion and Orders attached as Appendix A also sought and obtained the assumption of bonded contracts in the IES case. A similar multi-part Motion was utilized in the WGI case is attached hereto as Appendix B.

2. Whether the Surety Wants its Bonded Projects Assumed

While the benefits of the debtor's assumption of bonded projects is significant if the estate has assets and has a likelihood of either a successful reorganization or liquidation with significant distributions to creditors, a surety must carefully consider this decision as the rejection of bonded contracts can also be used as a tool to quickly extract a problem contract or contract which the principal clearly will be unable to complete to allow the surety to begin to work with the obligee to arrange for completion of the project. Assumption of the bonded projects and an immediate assignment to the surety is also a tool which can be utilized by the surety. In this process, careful consideration should be given to the underlying subcontracts and agreements with suppliers. Options regarding assumption of these obligations and assignment to the surety or other parties may be appropriate or necessary in order to protect the surety's interest and mitigate the cost of completion of the bonded projects.

3. Protecting the Surety's Interests

The Motions and Orders attached in Appendices A and B also provide for an interim surety credit facility. While the terms of each facility may be different and are subject to negotiation with the principal, the secured creditors, and other constituencies in the bankruptcy process, these can provide a guide to the surety practitioner as to terms and conditions which are generally favorable to the surety and allow the surety to move forward to protect its interests while mitigating surety loss. An interim surety credit facility, like an interim debtor-in-possession financing facility, is well advised only

if the surety takes actions to place itself in a better position than it was absent the extension of (additional) surety credit. It cannot be emphasized strongly enough that the surety must have “sole and absolute” discretion when making a determination regarding the issuance of individual bonds. The surety cannot place itself in a position where it has reached an agreement which requires the issuance of a bond which its underwriters determine is an unreasonable risk to the surety. The interim facility (as well as any exit facility and underwriting agreements) should set forth criteria and conditions upon which new bonds will be issued without extracting from the underwriters the discretion to issue new surety credit.

D. Exit Facilities

At the time the surety is considering entering into a surety underwriting agreement extending surety credit beyond confirmation implementation of a plan of reorganization, the surety will likely have the benefit of significant amount of financial and other information to evaluate the necessary precautions which it must take to protect itself from surety loss after the bankruptcy has been concluded. Once the surety has successfully worked its way through the bankruptcy proceeding and is in a position to consider surety credit going forward, it is crucial that the surety protections in the interim facility be made permanent and that the surety properly collateralize and protect itself with respect to the new account. The surety must first determine whether an exit facility is feasible and, if so, what terms are necessary to protect its interests. It must then consider third parties which may impact the success of the reorganization as well as the surety’s position. That would include, primarily, post-bankruptcy lenders. Finally, the surety should work carefully to coordinate with the principal to both protect its interests and assure that the principal is moving forward instead of falling into the same circumstances which resulted in its insolvency.

1. Determining Whether a Surety Credit Exit Facility is Feasible and Upon What Terms, Conditions and Collateral

While extending additional surety credit to a troubled account may be the best course of action in a limited number of cases, extending surety credit to a debtor emerging from bankruptcy is even more infrequently the best course of action. The steps which were taken prior to bankruptcy or during the pendency of the Chapter 11 case will have, necessarily, paved the way for discussions regarding a surety credit facility after confirmation of the bankruptcy plan. First and foremost, the surety must become comfortable that the debtor is going to be able to emerge from bankruptcy and successfully begin to prosecute bonded work. Regardless of the collateral or other protections granted to the surety, if the bonded projects cannot be prosecuted and new bonds are issued without confidence of performance, the surety may be merely delaying a significant loss. However, if the bankruptcy proceeding has afforded the principal the opportunity to shed some of its burdensome obligations, reorganize management, or take other steps which increase the likelihood of success, the surety may consider issuing it surety credit exit facility to the reorganized debtor. The terms, conditions, and collateral required by the surety are very important. The principal is in a position where

it will not be able to obtain surety credit from other sources. Therefore, if the surety is willing to consider taking the chance on the reorganized debtor, it should be rewarded with protections, premiums, and fees commensurate with its additional risk. As discussed above, the surety may want to require cross-collateralization of all bonded project receivables and require agreements regarding the utilization of equipment and materials necessary to complete the bonded projects. In addition, the reorganized debtor and any indemnitors must assume and reaffirm indemnity obligations with respect to pre-bankruptcy bonds. Finally, the additional provision of either a letter of credit, cash collateral, or other collateral which provides the surety a resource from which to offset post-bankruptcy losses can be used. The surety should also require that the principal remain current with respect to any outstanding bond premiums and pay to the surety a surety credit facility fee at a minimum which is sufficient to cover the surety's expenses in evaluating, negotiating, documenting, and monitoring the credit facility.

2. Intercreditor Agreements with Post-Bankruptcy Banks

Unlike the traditional surety credit facility, the bankruptcy process and the post-bankruptcy debtor present the surety with an opportunity to be at the table from the beginning. The secured lender should not be ahead of the surety and both post-bankruptcy financing and post-bankruptcy surety credit must be considered in tandem with one another. The reorganized principal will have little or no chance of success if surety credit is not provided going forward. Similarly, an adequate bank facility will also need to be in place to assure that the debtor will have sufficient working capital. Therefore, the surety and the banks should work together to reach agreements with the principal which allows for protection of both and provides the principal with the best opportunity of success moving forward. The surety should reasonably allow the banks to take priority positions with respect to unbonded contracts and other assets not specifically related to bonded projects. The surety may also want a priority security interest in inventory to be used in bonded projects.⁶ The bank (along with any other secured lender with an interest in equipment) must also consent to and execute equipment utilization agreements whereby the surety agrees to pay a reasonable rental for any equipment utilized in the completion of bonded projects should the principal go into default. This can dramatically decrease the surety's completion costs should the principal's emergence from bankruptcy be unsuccessful.

It is at this stage of the negotiations that the surety should be in a position where it could obtain consideration for "sticking with" the principal through and beyond bankruptcy. The extent to which the surety's present exposure is controlled will impact the surety's leverage at this juncture. If the banks are willing to finance the principal and its completion of bonded projects which present a significant exposure to the surety, the surety may be more willing to compromise on other issues. If, however, the surety has effectively mitigated its loss and isolated its exposure, the surety may be in a better

⁶ For a discussion on how the lender's security interest in inventory may be resolved in a bankruptcy setting, see *Havens Steel Co. v. Commerce Bank, N.A. (In re Havens Steel Co.)*, 317 B.R. 75 (Bankr. W.D. Mo. 2004) (resolving issue of when a lender's security interest in a seller's inventory terminates).

position to negotiate more favorable terms as it relates to the post-bankruptcy lenders and the principal.

3. Coordination with a Merging/Reorganizing/Liquidating Debtor

As the principal emerges from bankruptcy, the broker and the underwriter need to be in clear communication with the principal regarding the surety's requirements and expectations following bankruptcy. The surety should be careful not to make promises which it cannot fulfill or which are highly contingent on future events. However, the post-bankruptcy period can be extremely volatile and require cooperation between the surety and the principal. As the principal attempts to reestablish itself as a legitimate contender in the market, the availability of surety credit from a highly rated surety can provide a very valuable asset to the principal. The broker, the underwriter, claims representative, and the principal can work together to provide the maximum value to the principal while providing the most protection to the surety. With cooperation, creativity, and a proactive plan of action, the surety can, in limited situations, avoid a significant loss and salvage a valuable client.

E. Table of Appendices

- APPENDIX A (IES Case):**
1. **MOTION** Pursuant To Bankruptcy Code Sections 361, 362, 363, 364(c), 364(d) And 365 And Bankruptcy Rule 4001 (I) For Authority To Enter Into A Post-Petition Credit Agreement With Bank Of America, NA; (II) For Authority To Enter Into Post Petition Financing Agreement With Federal Insurance Company And To Assume Surety Contracts; (III) To Obtain Interim Post-Petition Financing; (IV) To Use Cash Collateral And Grant Adequate Protection Pending A Final Hearing; (V) For Limited Relief From The Automatic Stay; And (VI) To Approve Form And Manner Of Notice And Schedule A Final A Hearing Under Bankruptcy Rule 4001(c)
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 2. **FINAL ORDER** (A) Granting Authority to Enter into a Post-Petition Financing Agreement with Federal Insurance Company and Approving Debtors' Assumption of Surety Contracts; (B) Allowing Debtors' Use of Federal Insurance Company's Cash Collateral and Granting of Adequate

Protection Pending Final Hearing; (C) Lifting the Automatic Stay as to Federal Insurance Company

3. **FINAL ORDER** (1) Authorizing the Debtors to Obtain Post-Petition Financing, Granting Senior Security Interest and According Priority Administrative Expense Status Pursuant to Section 364(c) and 364(d) of the Bankruptcy Code, (2) Authorizing the Use of Cash Collateral, (3) Granting Adequate Protection, (4) Modifying the Automatic Stay, and (5) Approving Form and Manner of Notice

**APPENDIX B
(WGI Case):**

1. **MOTION** for (A) Interim and Final Order Under 11 U.S.C. §§ 363, 364 and 105 Authorizing the Debtors to Enter in to Bonding Facility with Federal Insurance Company and (B) Order Under 11 U.S.C. § 365 Authorizing the Debtors to Assume Certain Executory Contacts
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3. **ORDER** under 11 U.S.C. § 365 Authorizing the Debtors to Assume Certain Executory Contracts (July 10)
4. **EMERGENCY MOTION** for Order Approving Payment of a \$500,000 Fee to Cover the Fees and Expenses Incurred by Federal Insurance Company in Connection with Documentation of an Exit Bonding Facility
5. **DECLARATION** of Edwin V. Apel, Jr. in Support of Emergency Motion for Order Approving Payment of a \$500,000 Fee to Cover the Fees and Expenses Incurred by Federal Insurance Company in Connection with Documentation of an Exit Bonding Facility
6. **ORDER** Approving Payment of a \$500,000 Fee to Cover the Fees and Expenses Incurred by Federal Insurance Company in Connection with Documentation of an Exit Bonding Facility\

7. **DECLARATION** of Edward J. Reilly in Support of Debtor's Expedited Motion for Order (I) Authorizing Post-Petition Surety Credit Pursuant to 11 U.S.C. §§ 364 and 105, and (II) Authorizing the Acceptance of Bonded Obligations