Mediation for the Performance Bond Surety

2016 SOUTHERN SURETY & FIDELITY CONFERENCE
Charleston, South Carolina

Presented by:
Christina Craddock (Liberty Mutual Surety)
Duane A. Daiker, Esq. (Shumaker, Loop & Kendrick, LLP)

I. Introduction

The concept of Alternative Dispute Resolution (ADR) is certainly not new to the construction litigation arena. Mediation first appeared with regularity in the construction industry in 1980. By the mid-1980s, construction mediation was endorsed by the Design Professionals Insurance Company (DPIC), and other insurance companies. However, it was not until 1997 that the American Institute of Architects (AIA) finally included a mediation clause in its standard form construction contacts. Since that time, use of the mediation process has increased exponentially, and has spawned a cottage industry of private ADR firms around the country.

Mediation has become an integral part of both the federal and state court systems. The majority of cases in all jurisdictions are referred to mandatory court ordered mediation, regardless of the preferences of the parties. This is particularly true with complex construction cases, which are generally avoided by trial judges, and become prime candidates for court-ordered mediation and other alternative dispute resolution procedures. Mediation, whether voluntary or mandatory, is one of the most common means of resolving construction disputes.

Sureties face particular challenges with the mediation process in the context of performance bond claims. Such claims are often very large in scale, with many parties, many issues (including insurance coverage issues), and huge potential exposure to the surety. When utilized properly, however, mediation can be a valuable tool for the performance bond surety.

II. Mediation Benefits for the Surety

The advantages of mediation over litigation are well-known. Mediation is frequently touted as being quicker, less expensive, more private, and more confidential.[1] In light of those benefits, the question of *whether* to engage in mediation is becoming largely a moot point—especially in complex litigation. Most jurisdictions employ the inherent authority of the

[1] *See, e.g.,* What are the Advantages to Mediation?, How Courts Work (2016), *http://www.americanbar.org/groups/public_education/resources/law_related_education_network/how_courts_work/mediation_advantages.html.*

court to require mediation prior to trial.[2] The better questions for the surety, perhaps, are *when* to engage in mediation, and *how* to maximize the benefits in complex performance bond cases. There are a number of potential benefits particular to the surety that should be considered—in addition to the obvious benefits of mediation and the ADR process as a whole.

Maintain control. Mediation, at its core, is a voluntary process. By reaching a resolution at mediation, the surety avoids the inherent risk in trusting its fate to a judge, a jury, or even an arbitration panel.[3] Studies have shown that most jurors are biased against insurance companies, even before the first shred of evidence is introduced.[4] Even experienced judges and arbitrators may not fully appreciate the subtleties of the surety relationship, which is often not the focus of commercial litigation. By reaching a mediated settlement, even if somewhat in excess of the surety's "calculated" exposure, the surety avoids the risk of an unexpected judgment—along with the accompanying attorney fees and possible pre-judgment interest. As the well-known English idiom expresses, "better the devil you know than the devil you don't." Reaching an impasse at mediation may sometimes be the right choice strategically, but also opens the door to uncertainty.

Increase participation of other parties. Performance bond litigation often involves a morass of potentially liable parties beyond the typical surety triad of owner, contractor and surety. Parties to a performance bond case can include subcontractors, design professionals, and commercial general liability insurance carriers. Managing a large volume of parties in this type of case can be challenging, and mediation is often a catalyst for serious discussions with the other parties and their carriers. Preparation for a mediation conference tends to focus other parties on their risk, and dangles the carrot of an exit strategy for the litigation, if they will participate.

Communicate with the decision makers. By definition, mediation is about having an opportunity to communicate directly with the decision makers for the performance bond claimant. In this type of litigation, the claimants are often sophisticated business people, who may be hard to reach through the filter provided by aggressive plaintiff's counsel. Even more problematic are the cases where the decision-maker is a group—like a homeowner's association board, or a body politic, like a municipality. Maneuvering the mediation process to ensure direct communication with the decision makers can be a benefit that is unavailable at any other time in the litigation or settlement process.

Reduce attorney fees. Undoubtedly, the mediation of a complex performance bond claim can be extremely expensive, especially if undertaken with adequate advance

---

[2] *See In re Atl. Pipe Corp.*, 304 F. 3d 135, 148 (1st Cir. 2002). *But see*, *Jeld-Wen, Inc. v. Superior Court*, 53 Cal. Rptr. 3d 115, 120 (Ct. App. 2007) (holding trial court was not authorized to order cross-defendant to attend and pay for private mediation over its objection).

[3] Kenneth P. Kelsey, Mediation: The Sensible Means for Resolving Contract Disputes (2016), *http://www.mediate.com/articles/kelsey.cfm*

[4] Mark E. Ruquet, Survey: Insurers Face Bias Among Potential Jurors (2016), *http://www.propertycasualty360.com/2013/01/11/survey-insurers-face-bias-among-potential-jurors?slreturn=1457040558.*

preparation and discovery. Nevertheless, the time spent in mediation is a fraction of the time likely to be spent in the preparation for trial and presentation of evidence at trial.[5] A successful mediation cuts off the bulk of attorney fees at its conclusion—without the additional expense of the post-trial motions and appeals that inevitably follow a judgment in a complex civil matter. Post-trial maneuvering and appeals are almost a certainty if the surety obtains a favorable judgment at trial, and the costs of an appeal, together with the risk of a reversal and remand, can be difficult to justify.

The potential for cost savings, of course, is much greater if the surety can position the matter for an early mediation, before the expenditure of all the time and effort required to prepare the case for trial. This requires the surety to carefully balance the timing—so as to have enough information to make an informed settlement, but still mediate early enough to obtain significant savings. The ability to engage in an early mediation will depend upon the type and nature of the claims asserted, and the surety's ability to accurately assess its risk without the need for extensive discovery.

III. Best Practices for the Performance Bond Surety in Mediation

Although general "best practices" for mediation success are well-known, the specific context of performance bond litigation raises specific recommendations for sureties in these often complex scenarios.

1. **Mediate early and often**. First, the timing of mediation can be crucial. Generally speaking, early mediations are often beneficial. By scheduling the mediation early, the amount of attorney fees incurred by both sides is reduced—including fees incurred in the discovery process, which is often very expensive in complex and document intensive performance bond cases.

Time is often running against the surety in these situations. The longer the owner and its attorneys and experts have to investigate, the more "defects" tend to surface. Items that are truly in the nature of maintenance items are often viewed by owners as defects for which the surety is responsible. Furthermore, depending upon the law of the jurisdiction in question, pre-judgment interest may be running at a potentially exorbitant rate.[6]

On the other hand, sureties need enough time to get a handle on the state of the project and the potential range of liability. Consultants engaged by the surety will need to determine the potential timeframes for mediation, based upon the time required for their investigation and determination of a realistic assessment of bond exposure.

---

[5] Michael Kasperzak, Jr., Using Mediation to Reduce Litigation Costs (2016), *http://www.mediates.com/drsusingmed.html.*

[6] Florida courts, in particular, may apply older, and therefore higher, prejudgment interest rates for the entirety of the prejudgment time period, resulting in artificially high awards that are out of sync with current interest rates. *See, e.g., Regions Bank v. Maroone Chevrolet, L.L.C.*, 118 So. 3d 251, 258 (Fla. 3d DCA 2013) ("[t]he interest rate established at the time a judgment is obtained shall remain the same until the judgment is paid."). This issue is not yet fully resolved in Florida.

If in the course of mediation the parties determine it is too early for a global resolution, an early mediation can still help resolve any issues that are ripe—even if other issues are left open for a later date. An early mediation, if nothing else, can be used to agree upon various pre-trial and discovery issues, paving the way for a subsequent mediation at a more appropriate time. Performance bond cases can often require more than one mediation session to reach a conclusion of all issues.

2. **Choose an appropriate mediator**. Mediators for performance bond cases don't have to be experts in surety law, but complex construction experience is almost essential. The volume of parties to a large performance bond case can be overwhelming. Furthermore, an understanding the intricacies of the relationships between the parties—including sureties, principals, owners, sub-contractors, design professionals, and insurers—is important to crafting a complex mediated settlement. And since these cases often don't settle in a single session, a mediator who is willing to help the parties advance the case, and drive the process even outside the mediation sessions, can be very valuable. An experienced mediator can essentially serve the role of a case manager or magistrate of sorts—to shepherd the case through the mediation process and toward a conclusion. Referrals from other experienced surety claims handlers and claims attorneys are often the best way to find an appropriate mediator for performance bond cases.

3. **Ensure the proper parties attend**. As an initial matter, ensure that all the proper parties are represented at the mediation. This can be difficult to accomplish until the pleadings are closed and all the necessary parties have been brought into the case, including: subcontractors, suppliers, design professionals, and insurers. Performance bond cases tend to have many parties, and a variety of claims, counterclaims, and third party claims. It can be difficult to unravel any portion of these claims without all parties present.

Of course you must be certain, to the extent possible, that the proper individuals for each party attend mediation. This is being made easier by changing procedures in various jurisdictions that require parties to confirm the settlement authority of mediation participants in advance of the mediation.[7] This is particularly true in performance bond litigation, which often involves several levels of insurance, and requires the right adjusters to be present. Furthermore, since these cases often develop over long periods of time in a turbulent industry, extra care must be taken to ensure the representatives of the principal and the subs at mediation have personal knowledge of the particular project in question. One way to avoid surprises is to have a pre-mediation meeting with counsel and the mediator to discuss exactly who will be attending mediation on behalf of each party. Most experienced construction mediators are willing to examine these issues with the parties in a pre-mediation telephone conference.

4. **Document all agreements, no matter how small.** Documenting the results of any mediation, or even pre-mediation conference, is always important—but even more important in complex multi-party cases. The time required to fully document mediated

[7] For example, Florida courts have recently implemented a rule required the advance filing of a certificate of authority for the party representative attending mediation. Rule 1.720(e), FLA. R. CIV. P.; *In re Amendments to Florida Rule of Civil Procedure 1.720*, 75 So. 3d 264, 265 (Fla. 2011). Similar rules are being considered in other states, and various federal districts.

agreements in complex cases can be daunting, but is well worth the time and effort. Agreements not documented contemporaneously—*i.e.*, the day of the mediation, before the parties leave the room—are often lost in the mire of ongoing complex litigation.

IV. Conclusion

When utilized properly in the context of complex performance bond litigation, mediation can be a valuable tool. There is little point in evaluating the overall benefits of mediation since most courts will require pre-trial mediation. However, sureties who embrace the process early may be far more successful in achieving an efficient resolution of the performance bond dispute.

The only significant risk in the mediation process, since the surety never loses control over the settlement process (as happens in arbitration), is the risk of introducing inefficiency.[8] The additional time and attorney fees associated with extensive ADR processes can be costly, if results are not achieved. Ultimately this risk can be minimized by following the strategies outlined in this paper, and using the process strategically, with an eye toward early resolution. Undoubtedly, some cases, either because of the particular facts, or perhaps because of the parties involved, are not appropriate for a collaborative settlement environment. Such cases must be evaluated and identified, and treated accordingly.

[8] An interesting case in Florida has introduced another potential risk in unusual circumstances. A federal court in the Southern District of Florida found the mediation confidentiality privilege did not apply to communications made in a private mediation caucus by the surety that potentially reflected on the surety's bad faith. *Carles Const., Inc. v. Travelers Cas. & Sur. Co. of Am.*, 56 F. Supp. 3d 1259 (S.D. Fla. 2014).

About the Authors

Christina Craddock is Senior Surety Counsel with Liberty Mutual Surety and handles contract surety claims in the Southeast Region. Ms. Craddock has over 25 years' experience handling surety claims, with over 23 years as outside counsel at Bovis, Kyle & Burch, LLC, prior to moving in-house with Liberty Mutual Surety in 2013. She is a member of the State Bar of Georgia and the American Bar Association, including a Co-Chair of the Women's Involvement Subcommittee of the ABA TIPS Fidelity and Surety Law Committee, and she is a licensed adjuster in Georgia. Email: *christina.craddock@libertymutual.com.*

Duane A. Daiker is a partner in the Surety & Fidelity Practice Group at Shumaker, Loop & Kendrick, LLP, in Tampa, Florida. Mr. Daiker practices extensively in the area of surety and fidelity claims, commercial litigation, and appeals. He is Board Certified by the Florida Bar as an appellate specialist, and A/V rated by Martindale Hubble. Email: *ddaiker@slk-law.com*.