AMERICAN BAR ASSOCIATION
Tort Trial and Insurance Practice Section

Winter 2023

COMMITTEE NEWS

Fidelity & Surety Law

Tender Agreements With The Federal Government: Yes, You Can—And Should

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Watt, Tieder, Hoffar & Fitzgerald

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I. Introduction

As surety practitioners are aware, a tender agreement between a surety and an obligee can be particularly advantageous to both parties in the proper circumstances. The surety tenders a completing contractor to the obligee, remits the difference in price between the remaining contract funds and the completion price to the obligee, and obtains a release of its performance bond. The obligee, for its part, is able to contract directly with the completing contractor without the burden of having the surety as an intermediary during the construction process.[1]

Over the years, the Federal Government has been less than receptive to tender agreements. This lack of interest can be attributed to many factors, such as an ingrained institutional bias against tenders, as well as to the fact that within the Federal Government, construction projects are administered by a wide variety

Read more on page 12

1 Many useful articles have been written on the topic over the years. *See, e.g.*, E.A. "Seth" Mills, Jr. & Bradford R. Carver, Bond Default Manual, Chapter VI: Tender, 461 (Mike F. Pipkin et al. eds., 4th ed. 2015).

In This Issue

Chair Message

I am delighted that we have been able to hold two in-person conferences as scheduled. We continue to have incredible company support at the meetings and hope to see more attorneys attend our future events.

In November, we met in Philadelphia for the traditional joint meeting with the Fidelity Law Association chaired by Bob Flowers and the FSLC Fall Fidelity Program, *Pushing the Limits of Traditional Fidelity Coverage* co-chaired by Theresa Biedermann, Katherine Musbach and Andy Chambers. Congratulations to Bob, Theresa, Katherine and Andy for the terrific programs.

The FSLC Midwinter meeting was held in January in Washington DC. It was standing room only for the construction program, *Reimagining the Claims Process: From Contract to Courthouse,* co-chaired by Doug Wills, Vivian Katsantonis, and Emory Allen. There was a day and a half of fidelity programming, *The Next Frontier of Fidelity Coverage,* co-chaired by Amy Malish and Joel Wiegert. Of particular note, Amy and Joel arranged for Eric Goldstein of the Cybersecurity & Infrastructure Security Agency (CISA) to speak on the topic of cybersecurity. Mr. Goldstein provided his thoughts on strategies for defeating cyber criminal activity and practical steps that we can take to protect ourselves and our businesses. Mike Pipkin spearheaded the effort to publish the third edition of *The Surety's Indemnity Agreement: Law and Practice,* edited by Mike Pipkin, Marilyn Klinger, George Bachrach, and Tracey Haley. This book anchored the surety program, *At the Other End of the Telescope: The Evolution of Indemnity*, co-chaired by Shana Rothman and Patrick Hustead. The programs were excellent. Thank you to the many presenters. Their knowledge, expertise and originality in presenting the materials shined through. And no one was injured—if you were there, you know what I mean.

In what was personally very meaningful for me, we honored Scott Leo with the Martin J. Andrew award. It is very important to recognize the individuals who have contributed so much to the intellectual body of work that has been produced by the FSLC. Thank you to David Krebs and Bruce Shreves for introducing Scott. It was wonderful to hear their comments about Scott and his contributions as well as Scott's thoughts about what this committee and its members have meant to him.

For those who missed the Midwinter Meeting, *The Surety's Indemnity Agreement: Law and Practice, 3d,* is available for purchase for a discount at this link. Be sure to add this book to your library along with our committee's other recent publications, *Surety Aspects of Bankruptcy Law and Practice* and *The Law of Commercial Surety and Miscellaneous Bonds, 3d*.

Carol Z. Smith
Chair, Fidelity & Surety Law Committee
Dysart Taylor Cotter McMonigle & Brumitt, P.C.

We are looking forward to the Spring Conference at the Hyatt Lake Tahoe on May 10-12, 2023. There will be a leadership meeting on Wednesday, May 10 at 4:00 p.m. so plan to come early enough to attend that meeting. Alana Porrazzo and Ryan Springer are co-chairing the program, *For Future Reference: Emerging Issues in Payment Bond Law*. The program will include a panel discussion of fundamental surety concepts essential to the industry in litigating claims as well as presentations on current payment bond issues and case law trends. The course materials will be an "all-electronic" guide to federal, state, and U.S. territory payment bond law—a compilation that explains and hyperlinks relevant cases and statutes, jurisdiction by jurisdiction. This is a resource you can only obtain by attending the conference. Lake Tahoe is a beautiful venue and we are working on events to get all of us outside!

Continuing the efforts of my predecessors, we have reinvigorated our leadership committees. There are many opportunities to become involved in committee activities, including becoming a member of a subject matter subcommittee of the Law Division (contact Drew Gentsch at Gentsch@whitfieldlaw.com), contributing to publications (contact Shane Mecham at smecham@levycraig.com), and providing video presentations for fellow members (VLOGs) (contact Melissa Lee at mlee@manierherod.com). We also hope you take advantage of our membership groups in which you have an interest: new members/mentorship (contact Mark Gamell at mgamell@tlggr.com), young professional (contact Heather Jonczak at HJonczak@carltonfields.com) women's involvement (contact Grace Cranley at Grace.Cranley@Dismore.com), diversity and inclusion (contact David Bresel at david.bresel@zurichna.com). I encourage you to become more involved in the FSLC.

There is a lot more to look forward to during the 2022-2023 year. I hope you can join us in Lake Tahoe for the Spring Meeting on May 10-12, 2023!

Thank you so much for your continued support.

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AMERICAN BAR ASSOCIATION

Tort Trial and Insurance Practice Section

FSLC MidWinter Meeting 23

Congratulations to the 2023 Martin J. Andrew Award Recipient

T. Scott Leo

Whether The Court Or The Arbitrator Determines The Existence Of An Arbitration Agreement

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In 2019, the United States Supreme Court concluded that the "wholly groundless" exception employed by the Fifth Circuit and some other Courts of Appeals was inconsistent with the text of the Federal Arbitration Act and with Supreme Court precedent.[1] The "wholly groundless" exception allowed the court, rather than an arbitrator, to decide the threshold question of whether the parties' arbitration agreement applied to a particular dispute, if the argument that the arbitration agreement applied to the particular dispute was "wholly groundless."[2] The *Schein* decision stands for the proposition that:

> We must interpret the Act as written, and the Act in turn requires that we interpret the contract as written. When the parties' contract delegates the arbitrability question to the arbitrator, a court may not override the contract. In those circumstances, a court possesses no power to decide the arbitrability issue. That is true even if the court thinks that the argument that the arbitration agreement applies to a particular dispute is wholly groundless.[3]

Since the Supreme Court decided *Schein*, the issue of whether the arbitrator or the court should decide the arbitrability of a dispute involving a bonding company has been examined on a number of occasions.[4] In the *Federal Insurance Co. v. Metropolitan Transportation Authority* matter, the underlying bonded contract contained arbitration provisions that assigned jurisdiction to the arbitrator under the AAA Construction Industry Arbitration Rules.[5] Additionally, the performance bond incorporated the construction contract "without exclusion."[6] While the surety did not challenge the facial validity of the arbitration clause in the construction contract, the surety asserted that the arbitration clause did not apply to its claims because the surety was not a "party" to the construction contract.[7]

Read more on page 22

1 Henry Schein, Inc. v. Archer and White Sales, Inc., 139 S.Ct. 524, 529 (2019).

2 *Id.* at 528-529.

3 *Id.*

4 *See* Great Am. Ins. Co. v. Johnson Controls, Inc., No. 1:20-CV-96, 2020 WL 4569126 (S.D. Ohio August 7, 2020); *see also* FCCI Ins. Co. v. Nicholas Cty. Lib., No. 5:18-CV-038-JMH, 2019 WL 1234319 (E.D. Kentucky March 15, 2019); *see also* Fed. Ins. Co. v. Metro. Transp. Auth., 785 Fed.Appx. 890 (2d Cir. 2019)(although a post-*Schein* decision, this decision does not mention or cite to *Schein* but notes that the operative contract uses "any and all" language and states that the parties to that contract authorize and agree to the resolution of all disputes arising out of, under, or in connection with the contract, through arbitration, which language "clearly and unmistakably" required the issue of arbitrability to be decided by the arbitrator, not the court).

5 2019 WL 1234319 at *6.

6 *Id.*

7 *Id.*

Case Note: Northwest Arkansas Conservation Authority v. Crossland Heavy Contractors, Inc[1]

John F. Fatino
Whitfield & Eddy, P.L.C.

***John F. Fatino** is a Member of Whitfield & Eddy, P.L.C. at the Firm's Des Moines, Iowa office.*

On August 30, 2022, a panel of the United States Court of Appeals for the Eighth Circuit issued a unanimous 3-0 decision in Northwest Arkansas Conservation Authority v. Crossland Heavy Contractors, Inc.[2] The court held that statutes of limitations and repose apply when a municipality sues a contractor and its surety for a breach of contract. The court predicted the Arkansas Supreme Court would make the same holding. Sovereign immunity and related theories do not defeat such claims.

Background

In 2002, a group of Arkansas municipalities joined together to create a sanitation authority, the Northwest Arkansas Conservation Authority (the "Authority").[3] The Authority uses the joint resources of the municipalities to engage in public sanitation projects, such as the disposal of "bio-solids." In 2007, the Authority contracted with Crossland Heavy Contractors, Inc. ("Crossland") to construct a 47,000-foot sewer pipeline. Crossland's surety, Fidelity & Deposit Company of Maryland ("F&D"), issued a performance bond for the pipeline construction project. In June 2010, Crossland completed the pipeline. However, on multiple occasions between 2016 and 2020, the pipeline overflowed, spilling onto nearby property.

Generally, the diameter of a sewage pipeline can safely deviate by five percent without causing an overflow. The opinion noted that a 2018 report found that ninety-six percent of the sections of the pipeline had diameters that deviated by more than five percent.[4] The deviations were attributed to Crossland surrounding the pipe with bedding—soil meant to prevent deviations in the diameter of the pipe—improperly.

In January 2020, the Authority sued Crossland, in Arkansas state court, for breach of contract, negligence, breach of express and implied warranties, and products liability, and against F&D for breach of contract. Crossland and F&D then removed the case to federal court (the United States District Court for the Western District of Arkansas).

Read more on page 26

1 The author would like to acknowledge Holden C. Sinnard, J.D. Candidate at the University of Iowa Law School, for his assistance in the preparation of these materials.

2 47 F.4th 705 (8th Cir. 2022).

3 *Northwest Arkansas Conservation Authority*, Springdale, https://www.springdalear.gov/609/Northwest-Arkansas-Conservation-Authority (last visited Oct. 13, 2022).

4 *Northwest Arkansas*, 47 F.4th at 707.

Member Profile – Meet The Youth And Future Of The FSLC

Emory G. Allen
Clark Hill, PLC

Emory Allen is a senior attorney at Clark Hill, PLC in its Frisco, Texas office. Emory is licensed in Alabama, Colorado, and Texas. He represents clients in litigation and contract matters with an emphasis on surety, construction, and contract claims. After graduating with honors with a BBA from Mississippi State University, Emory completed his Juris Doctorate from the University of Mississippi School of Law.

Emory is currently a co-chair of the Young Professionals subcommittee, and at the 2023 FSLC Midwinter Meeting in Washington DC, he co-chaired the Construction Program, *Reimagining the Claims Process: From Contract to Courthouse.* Given his work on that program, Emory was asked by the Past Chairs Committee to assist in preparing a guideline for future program chairs to be included in the Chairs Handbook.

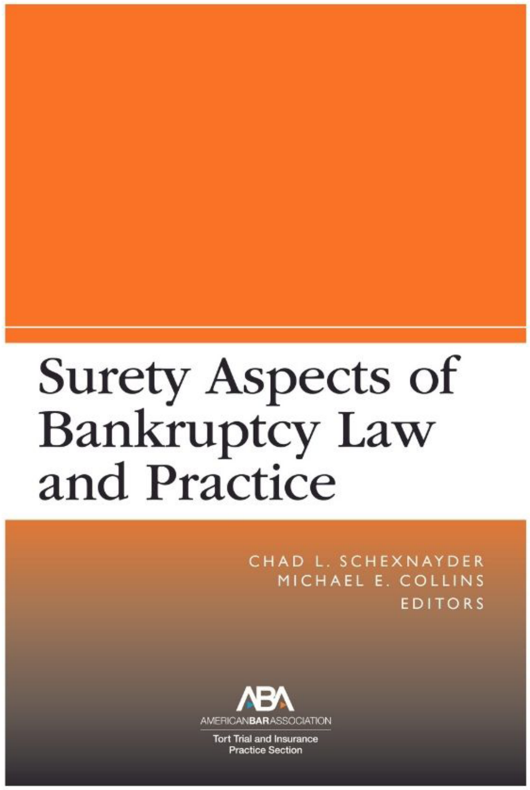
FUN FACTS: Emory was a sponsored competitive water skier/wakeboarder prior to attending law school and he can jump really, really high.

AMERICAN BAR ASSOCIATION

ABA Publishing

Surety Aspects of Bankruptcy Law and Practice

From the Tort Trial and Insurance Practice Section



In a bankruptcy case, both judges and attorneys may lack experience with surety law. This compendium provides a practical resource to help bankruptcy counsel and the courts understand the critical and often misunderstood implications of surety principles and claims in bankruptcy cases, especially in chapter 11 cases.

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of departments and services such as the Army Corps of Engineers, the various branches of the armed services, the Veterans Administration, and the National Park Service. Each of these departments and branches of government often approach defaulted contractors and sureties differently, or in many instances, they have little experience with contractor defaults.[2]

In recent years, however, there has been a greater willingness on the part of the Federal Government to accept tenders. This trend should be strongly encouraged. First, as indicated, a tender can be advantageous to both the surety and the Federal Government. Second, within the unique parameters of Federal Government projects, there is a risk that if the surety enters into a traditional takeover agreement with the Federal Government, the completing surety may be considered a "contractor" and potentially exposed to a myriad of unanticipated and unwelcomed Federal Government regulations and unwanted liability.

The purpose of this article is to discuss the use of tenders, specifically in the context of the Federal Government, and to highlight the potential risks to the surety if a tender agreement is not utilized with the Federal Government.

II. Tender Agreements—The Basics

A tender agreement is one of several options that a surety typically employs upon the default or termination of its principal. With a tender, the surety locates a completion contractor willing to complete the defaulted construction contract and then "tenders" that contractor to the obligee with the understanding that the obligee will enter into a contract directly with the completing contractor to complete the unfinished scope of work. The contractual arrangements can be a three-party agreement between the surety, obligee, and completing contractor, or it can be a two-party agreement between the surety and obligee. Under either iteration of the contractual arrangement, the surety remits a check to the obligee representing the difference between the remaining contract balances and the completion contractor's price. In return, and in the ideal situation, the surety's performance bond is released.

Whether an obligee will consider or accept a tender begins with an examination of the performance bond. For example, the AIA A312 bond form expressly permits the use of tender agreements. Many performance bonds, however, are

2 Practical Guide to Construction Contract Surety Claims, § 14.08(B) (W. Schwartzkopf ed., 3d ed. 2022). ("Tenders are not prohibited by the Federal Acquisition Regulations (FAR)…In practice, however, many federal agencies, including many contracting officers within the Department of Defense and the Department of Transportation, which account for many federal construction contracts, strongly prefer takeover to tender").

silent on the completion options that the surety can employ. In those situations, the successful use of a tender agreement is the result of the surety educating the obligee as to the advantages of a tender agreement and skillful negotiation by the surety with the obligee. As will be discussed in further detail below, a tender is a permissible option to complete under a Miller Act performance bond issued to a Federal obligee.

A. Advantages of a Tender

Compared with other completion options, tendering a completion contractor has distinct advantages. One of the primary advantages of a tender is that the surety is able to "fix" or "cap" its loss and obtain a discharge of its performance bond. Given unexpected and potentially costly contingencies that arise in virtually any construction project, the ability of the surety to cap its performance bond exposure is a benefit that cannot be overstated. Moreover, a cardinal principle in the handling of any surety claim is that the penal sum of the bond must be protected. By negotiating a tender agreement with a discharge of the performance bond, the goal of protecting the penal sum of the bond is achieved.

Another advantage is that a tender allows for a "fresh start" on a troubled project. By the time that the principal is defaulted or terminated, there is often a hostile atmosphere between the principal and the obligee. The surety steps into this hostile environment. Despite a surety's best efforts to improve this atmosphere by arranging for completion, the ill will and hard feelings harbored by the obligee may linger and impact the project going forward. By tendering a completion contractor and extricating itself from the construction project, the surety insulates itself from a potentially hostile future work environment and the obligee can proceed with a new contractor.

By contrast, when the surety utilizes takeover and completion agreements, it remains involved in the day-to-day construction operations. This involvement invariably requires considerable time commitments by the in-house surety personnel as well as ongoing expenses of outside counsel and consultants. By tendering a completion contractor, all of these attendant expenses and time obligations are eliminated, which can amount to considerable savings for the surety. Moreover, and from the obligee's perspective, eliminating the surety as the "middle man" also has distinct advantages. By having the direct contract with the completion contractor, communications and day-to-day dealings are streamlined, likely resulting in a more expeditious completion of the project. A significant advantage to the obligee occurs by virtue of the completing contractor's own surety issuing new performance and payment bonds to the obligee, including a new penal sum that restarts the coverage for the obligee and in an amount that likely exceeds even the tendering surety's penal sum.

Another important advantage to a tender involves potential damages. In virtually any construction project involving a defaulted or terminated principal, the specter of liquidated damages or actual damages for delay are present. In negotiating a tender agreement, liquidated damages or delay damages are typically resolved at the time of the agreement, thereby relieving the surety of potential future exposure for those damages. As most tenders can be achieved far quicker than a competitive procurement process, both the surety and obligee benefit from earlier contract completion.

Similarly, because a tender agreement results in a release of the surety's obligations under its performance bond, this means that the surety is released from post-default risks and maybe even any warranty or latent defect claims. The dollar value of this exposure is often unknown, but can be substantial, and a tender agreement often eliminates some or all of this exposure. It should be noted, however, that–not infrequently–either the obligee or the completion contractor in a tender situation will refuse to assume responsibility for warranty or latent defect claims related to the original contractor's work, and tender agreements on occasion must contain a "carve out" for such latent defect claims.

Finally, in most tender situations the selection of the completion contractor is the result of the surety obtaining competitive bids and/or an independent consultant's estimate to complete. By maintaining control of the selection of the completion contractor, the surety obtains assurances as to the quality of the completion contractor and the competitiveness of its completion price.

B. Disadvantages of a Tender

Despite the many advantages of a tender, it may not be the appropriate option in all cases. In certain instances, these disadvantages can outweigh the advantages, and the determination as to the correct completion option involves the weighing of all of these factors.

Typically, tenders are most appropriate when little work has been completed on the bonded project. If substantial work has been completed, as noted above, a completion contractor may be reluctant to assume responsibility for work in place or latent defects, or if those liabilities are assumed, it will invariably be accompanied by a substantial cost to the surety. Resolving this issue can become complicated and can result in certain "carve outs" for latent defects that, at some point, can militate against utilizing a tender. Such exceptions or "carve outs" could largely eliminate the advantage of the surety obtaining a release of its performance bond. In that same vein, if a project is nearing completion, it may not be cost effective or expedient to locate a contractor to complete a rather limited scope of work.

On a different level, at the time of a default or termination, the principal may have substantial claims against the obligee. If those claims cannot be reserved for the principal, those claims must be "liquidated" as part of the tender agreement. To achieve a comprehensive release, the surety may need to negotiate a monetary settlement of those claims, which is an additional cost above and beyond the pure completion cost.

A tender may be challenging in large design-build contracts, especially where the default termination involves a design dispute. If a completing contractor is not provided sufficient design parameters to estimate its construction price, the contingency that must be carried in the completing contractor's quote may render a fixed-price tender impracticable. When there is considerable work to be performed, proceeding under a cost-reimbursable tender is often problematic to both the surety and obligee, especially if the penal sum is potentially in play.

Finally, soliciting bids and negotiating a tender agreement can be time consuming. When a project has significant time constraints, the process of obtaining bids and negotiating a tender can result in further delays and costs to the surety. These additional costs must be weighed against the advantages of obtaining a discharge of the performance bond.

III. Tender Agreements And The Federal Government

The Federal Standard Form 25 Performance Bond does not contain an express option whereby the surety can tender a completion contractor to the obligee. In a contractor termination situation, the Government contracting officer will look to the Code of Federal Regulations (C.F.R.) for guidance, specifically Title 48, commonly referred to as the Federal Acquisition Regulation (FAR). 48 C.F.R. § 49.404 (2000) is titled "Surety-takeover agreements," and many Government contracting officers mistakenly point to the title of this section to assert that the agency is prohibited from utilizing a tender agreement. However, when § 49.404 is read in context, and in conjunction with 48 C.F.R. § 49.405 (1985) (titled "Completion by another contractor"), it is clear that a surety has three options: (i) it may pursue a tender, (ii) include a "takeover" by the surety in its completion proposal, or (iii) do nothing and let the Government complete the contract on its own.

There is nothing within the body of § 49.404 that restricts or limits a contracting officer to the use of a takeover agreement. In fact, several provisions of § 49.404 provide a contracting officer with considerable leeway in choosing the most appropriate completion option for any particular situation. For example, § 49.404(b) states, in full:

> (b) Since the surety is liable for damages resulting from the contractor's default, the surety has certain rights and interests in the completion of the contract work and application of any undisbursed funds. Therefore, the contracting officer must consider carefully the surety's proposals for completing the contract. The contracting officer must take action on the basis of the Government's interest, including the possible effect upon the Government's rights against the surety.[3]

Note that this section does not mention a takeover agreement, but it does expressly direct the Government to "carefully consider the surety's proposals…" Given the usage of the plural "proposals", a plain reading of the section reveals that the Government must be open to more than just a takeover agreement proposal from the surety.

Similarly, § 49.404(c) states, in full:

> (c) The contracting officer should permit surety offers to complete the contract, unless the contracting officer believes that the persons or firms proposed by the surety to complete the work are not competent and qualified or the proposal is not in the best interest of the Government.[4]

Note, again, that nothing in this subsection limits the Government to the use of a takeover agreement. In fact, the section specifically instructs the contracting officer to "permit surety offers to complete the contract", without dictating the form of those proposals.

Finally, section (d) of the clause recognizes that the surety may or may not decide to include a "takeover" agreement in its proposal. § 49.404(d) states, in full:

> (d) There *may* be conflicting demands for the defaulting contractor's assets, including unpaid prior earnings (retained percentages and unpaid progress estimates). Therefore, the *surety may* include a 'takeover' agreement in its proposal, fixing the *surety*'s rights to payment from those funds. The *contracting officer may* (but not before the *effective date of termination*) enter into a written agreement with the *surety*. The *contracting officer should* consider using a tripartite agreement among the Government, the *surety*, and the defaulting contractor to resolve the defaulting contractor's residual rights, including assertions to unpaid prior earnings.[5]

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3 48 C.F.R. § 49.404(b) (Emphasis added).

4 48 C.F.R. § 49.404(c) (Emphasis added).

5 48 C.F.R. § 49.404(d) (Emphasis added).

The following section, § 49.405, titled "Completion by Another Contractor," states:

> If the surety does not arrange for completion of the contract, the contracting officer normally will arrange for completion of the work by awarding a new contract based on the same plans and specifications. The new contract may be the result of sealed bidding or any other appropriate contracting method or procedure. The contracting officer shall exercise reasonable diligence to obtain the lowest price available for completion.[6]

Once again, there is nothing in the FAR that, in any way, limits a contracting officer to the use of a takeover agreement. When all of these sections are read together, it is quite clear that a contracting officer is not only permitted to entertain, but must carefully consider, a tender proposal by a surety.

As a practice pointer, a useful strategy to employ if confronted with a contracting officer that is reluctant to consider a tender is to provide that contracting officer examples of tender agreements that the surety has utilized with the Federal Government on other projects in the past. Ideally, one can provide an example of an executed tender agreement from the particular branch or service agency that is involved in the current contractor termination. Experience indicates that a contracting officer's reluctance to consider a tender agreement will be significantly reduced if that contracting officer knows that he or she is not "going out on a limb" in considering such a proposal.

The bottom line is that tender agreements are permitted on Federal Government contracts. If a tender agreement is the best option to pursue in a given situation, there is no prohibition in advancing that option. In fact, the Government is required to consider any reasonable tender proposal.

IV. Unique Reasons Exist For Using Tender Agreements On Federal Government Projects

Aside from the usual reasons why a tender agreement may be appropriate on a Federal Government project, there are several reasons that are unique to Federal Government contracting that strongly militate in favor of tender agreements.

Sureties that enter into takeover and completion agreements are, on occasion, referred to by the obligee as the "completing contractor." Surety practitioners know that this is a misnomer. In fact, most takeover agreements contain express

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6 48 C.F.R. § 49.405 (Emphasis added).

representations that the obligee acknowledges that the surety is not a "contractor" but rather is a surety arranging for completion of the work. Stated simply, a completing surety is not a "contractor." The surety is—as stated—a surety. The distinction is not semantic.

In any particular jurisdiction, there are any number of regulations and laws that apply directly to construction contractors but not to sureties. It is important that the surety practitioner be familiar with the laws, regulations, and industry standards in any particular jurisdiction so that a determination can be made as to what laws do and do not apply to a completing surety.

In the Federal Government contracting arena, there are a plethora of laws and regulations that apply to construction contractors. Given the sheer size of the Federal Government and its many branches and departments, the number of laws and regulations that impact a contractor are enormous. It is beyond the scope of this article to detail all of these laws and regulations, but they can involve health and safety issues, employee compliance issues, financial reporting, or disclosure requirements. Construction contractors, if they choose to work on Federal construction contracts, must be familiar with these laws and regulations and must implement internal controls and procedures to insure compliance with such laws and regulations.

Now consider the "typical" surety that is often part of a larger insurance company. These larger insurance companies may employ tens of thousands of employees and operate in most states and many foreign countries. These insurance companies are not structured or equipped to comply with Federal Government laws and regulations that apply to construction contractors. A recent example dramatically illustrates this point. During the height of the COVID epidemic, the Federal Government issued a directive that all employees of a construction contractor on Federal projects were required to provide verification that he or she had received the COVID vaccination. The mandate applied to the entire construction contractor organization and not just to those construction workers on the involved Federal project. Although the mandate was ultimately never enforced and was later rescinded, consider the impact of that mandate if a surety on a takeover agreement was deemed a "contractor." If applicable, the mandate would have required the insurance company to provide verification that all of its thousands of employees were vaccinated. Needless to say, such compliance would have been daunting, if not impossible.

The specter of a surety being considered a "contractor" in a Miller Act takeover situation is not far-fetched. In *Lumbermens Mutual Casualty Co. v. United States*,[7]

7 654 F.3d 1305 (Fed. Cir. 2011).

the surety and the Federal Government entered into a takeover agreement. After completion of the project, the surety sued the government claiming that the government made improper progress payments to the defaulted contractor and the surety sought to recover those payments under the theories of equitable subrogation and impairment of suretyship claims.[8] The surety also challenged the assessment of liquidated damages against the completing contractor, and therefore the surety, as well.[9]

The Federal Government claimed that the surety, as a completing contractor, failed to comply with the jurisdictional requirements of the Contract Disputes Act ("CDA")[10] in asserting its challenge to the assessment of the liquidated damages.[11] The trial court disagreed and held that the CDA did not apply to the surety because the CDA applies to "contractors that enter contracts for the procurement of materials or services," whereas the surety entered into the takeover agreement "in its capacity as surety."[12] The trial court stated: "Lumbermens signed the takeover agreement as a surety fulfilling its performance bond obligation, not as a contractor completing a construction project."[13] The Federal Government appealed.[14] The United States Court of Appeals for the Federal Circuit overturned the Court of Federal Claims decision.[15]

The language used by the Federal Circuit in its decision is potentially troubling and should give sureties reason to pause. The appellate court first noted:

> [W]e find that the Claims Court erred in concluding that Lumbermens did not enter the takeover agreement as a "contractor" within the meaning of the CDA. The Act defines "contractor" as "a party to a Government contract other than the Government." 41 U.S.C. § 601(4). Lumbermens argues that the takeover agreement in this case is somehow outside the scope of the CDA because it is a three-party agreement between Atherton (referred to as the "Completing Contractor"), Lumbermens (referred to as the "Surety"), and the United States, rather than a two-party agreement between a surety and the government. *See* J.A. 314. Lumbermens contends this takeover agreement "merely memorialized

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8 *Id.* at 1309.

9 *Id.*

10 41 U.S.C § 601.

11 *Lumbermens*, 654 F.3d at 1311.

12 *Id.*

13 Lumbermens Mut. Cas. Co. v. United States, 90 Fed. Cl. 558, 560 (2009) (referred to in the Federal Circuit decision as "*Lumbermens II*").

14 *Lumbermens*, 654 F.3d at 1309.

15 *Id.*

> and reaffirmed [its] pre-existing obligations as [a] performance bond surety" and that "Atherton—and not Lumbermens—is clearly and expressly considered the 'contractor' " under the agreement.[16]

The Federal Circuit then stated:

> We have previously recognized that where, as here, a surety enters a takeover agreement with the government under which the surety agrees to complete the performance of a defaulted contract, the surety assumes the role of a prime contractor and becomes "a party to a Government contract" in direct privity with the United States. 41 U.S.C. § 601(4).[17]

It must be noted that in *Lumbermens*, the sole issue before the court was whether the Court of Federal Claims had jurisdiction to hear the surety's claim under a theory of equitable subrogation, an impairment of surety claim, or the administrative requirements of the CDA. Thus, it can be correctly asserted that the *Lumbermens* decision should be limited solely to a jurisdictional analysis under the Contract Disputes Act – it did not address a surety's obligations under any other law.

On the other hand, the Court's language could be more expansively applied in the future to assert that a surety that employs a takeover agreement to arrange for completion of a terminated contractor's work is, in fact, a "contractor" for purposes of other Federal laws and regulations. Although a more expansive application of the court's holding in *Lumbermens* would be improper and unwarranted, experience dictates that the Federal Government, or another court, might attempt to apply *Lumbermens* in that fashion.

As noted at the outset, the use of a tender agreement can be particularly beneficial to both the surety and the obligee. When dealing with a termination on a Federal Government project, there are additional, and compelling, reasons why the use of a tender agreement should be singularly pursued.

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16 *Id.* at 1319.

17 *Id.* at 1320. To support its finding that the surety was a "contractor," the court relied on two previous rulings: Travelers Indem. Co. v. United States, 16 Cl. Ct. 142, 153 (1988) ("[W]here a surety has executed a takeover agreement, as here, upon the default of the prime contractor in order to complete the work under the construction contract, it becomes a 'party to a Government contract' and thus, logically, a 'contractor' within the meaning of § 601(4) of the CDA."); Universal Sur. Co. v. United States, 10 Cl. Ct. 794, 800 (1986) ("[Where a] separate takeover agreement [ ] [is entered] between the government and the surety after default by the contractor.... the surety in effect becomes the contractor, subject to the terms of the new agreement.").

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The court followed the *Schein* court and stated "[w]hen the parties' contract delegates the arbitrability question to an arbitrator, the courts must respect the parties' decision as embodied in the contract."[8] The court ultimately held that, "the parties agreed to let the arbitrator rule on his or her own jurisdiction, any other threshold questions about arbitrability must be submitted to the arbitrator, not this Court" because the arbitration provision provided that "[t]he arbitrator shall have the power to rule on his or her own jurisdiction, including any objections with respect to the existence, scope, or validity of the arbitration agreement."[9]

Another post-*Schein* decision involving a bonding company presented a similar scenario.[10] In that case, the surety issued a payment and performance bond in connection with the bond principal's subcontract to perform certain construction work at a hospital.[11] The bond incorporated the subcontract by reference. The subcontract contained an arbitration provision requiring that "[a]ll disputes not settled by negotiation or mediation shall be reserved until the final completion or termination of the Work and negotiation or mediation, at which time they shall be submitted to arbitration in accordance with the prevailing Construction Industry Rules of the American Arbitration Association…"[12] The bonding company argued against arbitration in favor of litigation, relying on, among other arguments, that the operative bond uses the term "suit" when referring to disputes and that the "plain and ordinary meaning" of the term "suit" is a court action, such that the bond "clearly contemplates the use of litigation to resolve claims arising under the [b]ond."[13] The obligee argued that the bonding company "did not contest the argument that incorporation of the AAA Rules 'clearly' delegates the question of arbitrability to an arbitrator."[14] The court determined that the bonding company's argument presented an issue concerning the scope of the arbitration agreement, as it was arguably the case that the issues among the bonding company and the obligee were not subject to arbitration, while the claims among the subcontractor and the contractor/obligee arguably were subject to arbitration.[15] However, following *Schein,* "the Court need not reach that issue, as the Court concludes that the arbitration provision at issue assigns the determination of such matters to the arbitrator, rather than the Court."[16]

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8 *Id.* At *8-9 (*citing Schein,* 139 S.Ct. at 531).

9 *FCCI,* 2019 WL 1234319 at *9.

10 *See Great Am. Ins. Co.,* 2020 WL 4569126.

11 *Great Am. Ins. Co.,* 2020 WL 4569126 at *1-2.

12 *Id.* at *1-2.

13 *Id.* at *4.

14 *Id.*

15 *Id.* at *7.

16 *Id.*

While courts have found that the question of arbitrability is for the arbitrator, other recent decisions stand for the proposition that the threshold issue of whether an arbitration clause reflects the enforceable agreement of the parties continues to be for the court.[17] The Third Circuit, in a decision that does not involve a bonding company or any surety-specific issues, focused on supersession and whether the court or the arbitrator must determine whether a second contract that sent disputes to litigation superseded a first contract that required arbitration to resolve any disputes.[18] In that matter, the parties entered into two agreements.[19] The first agreement was a "Non-Disclosure Agreement" that contained an arbitration provision requiring that any "dispute, controversy or claim arising out of or in connection with this Agreement, or the breach, termination or invalidity thereof" be "settled by arbitration in accordance with the Rules of the American Arbitration Association."[20] The second agreement was a "Software Subscription Service Agreement" that contained an integration/merger clause stating that "[t]his Agreement constitutes the entire agreement between the parties with respect to its subject matter, and supersedes any and all prior or contemporaneous understanding or agreements whether written or oral."[21] The second agreement did not contain an arbitration provision, instead requiring any "action under or concerning" that contract to be litigated in a state or federal court in New Jersey.[22]

Field Intelligence Inc. ("Field") sued Xylem Dewatering Solutions Inc. ("Xylem") in the United States District Court for the District of New Jersey, alleging a breach of the second contract.[23] Field's lawsuit made no mention of the first contract.[24] For the first time, within an interrogatory response, Field alleged that Xylem also breached the first agreement.[25] One month after receiving Field's interrogatory response, Xylem filed an arbitration demand with the American Arbitration Association and moved to stay the federal litigation pending resolution of the arbitration.[26] Field opposed Xylem's motion and cross-moved to enjoin the arbitration.[27]

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17 Field Intelligence Inc. v. Xylem Dewatering Solutions Inc., 49 F.4th 351 (3d Cir. 2022).

18 *Id.*

19 *Id.* at 354.

20 *Id.*

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.*

25 *Field Intelligence Inc.*, 49 F.4th at 354-355.

26 *Id.* at 355.

27 *Id.*

The District Court determined that the question of arbitrability belongs to the court and not the arbitrator.[28] Additionally, the District Court decided that the second contract replaced the first contract, such that there was no arbitration obligation and all matters would be decided by the District Court.[29] Xylem appealed the decision to the Third Circuit Court of Appeals.[30]

The Third Circuit reviewed the matter *de novo*.[31] Reciting the general proposition that the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* places arbitration agreements "on the same footing as other contracts," the court held that the interpretation of whether the second contract superseded/replaced the first contract is for the court to decide, and not for an arbitrator.[32] The logic behind this determination is the court's recognition that "an arbitrator's authority is limited to those claims that 'the parties have agreed to submit to arbitration.'"[33] The Third Circuit agreed with the District Court's interpretation that the court, and not the arbitrator, is required to determine the parties' supersession dispute because the substance of the dispute is "whether there is an agreement to arbitrate."[34] The Third Circuit indicated that if the second contract superseded the first contract, there would be no arbitration agreement for the court to enforce.[35]

The "guiding principle" in the arbitration context is that "no arbitration may be compelled in the absence of an agreement to arbitrate."[36] "[I]t can hardly be said that contracting parties clearly and unmistakably agreed to have an arbitrator decide the existence of an arbitration agreement when one of the parties has put the existence of that very agreement in dispute."[37] In declining Xylem's request "to enforce the arbitration provision contained in the parties' 2013 contract despite the assertion [by Field Intelligence] that it [the 2013 contract] was extinguished and that the parties instead redefined their relationship in the 2017 agreement not to include an arbitration obligation," the Third Circuit indicated that rather than "reach such an odd outcome [the court would] instead conclude that the District Court was right to resolve the supersession issue itself rather than send it to an arbitrator."[38]

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28 *Id.*

29 *Id.*

30 *Id.*

31 *Id.*

32 *Id.* at 355-356 (*citing* Spinelli v. Serv. Corp. Int'l, 324 F.3d 212, 218 (3d Cir. 2003) and *quoting* Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 24, (1991)).

33 *Field Intelligence Inc., 49 F.4th* at 356 (*citing* First Options of Chi., Inc. v. Kaplan, 514 U.S. 938, 943, (1995); AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 648-49, (1986)).

34 *Id.* at 356 (*citing* Jaludi v. Citigroup, 933 F.3d 246, 255 (3d Cir. 2019)).

35 *Id.* at 356.

36 *Id.* at 358 (*citing* Sandvik AB v. Advent Int'l Corp., 220 F.3d 99, 107-08 (3d Cir. 2000)).

37 *Field Intelligence Inc., 49 F.4th* at 356 (*citing* MZM Constr. Co. v. N.J. Bldg. Laborers Statewide Benefits Funds, 974 F.3d 386, 401 (3d Cir. 2020)).

38 *Id.* at 358.

In reaching its decision in *Field Intelligence Inc.*, the Third Circuit held that courts, rather than arbitrators, must "decide questions about the formation or existence of an arbitration agreement, namely the element of mutual assent."[39] Although *Field Intelligence Inc.* did not involve a surety-related matter, this decision demonstrates that a careful analysis should be performed to determine whether a fact-based challenge concerning the formation or existence of an arbitration agreement may be presented to the court in support of a demand for the court, rather than an arbitrator, to determine as a matter of law the threshold issue of whether the parties reached an enforceable agreement to arbitrate.

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39 *Id.* at 356-357 (*citing MZM Constr. Co.*, 974 F. 3d at 397-98).

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Under Arkansas law, lawsuits based on construction contracts are barred by a five-year statute of repose. Further, under the statute in place at the time, lawsuits based on payment and performance bonds were controlled by a six-month statute of limitations.[5] Therefore, because the lawsuit was initiated nine-and-a-half years after the completion of the pipeline, both Crossland and F&D moved to dismiss the Authority's claims.

The Authority defended their claims by arguing that the statutes of repose and limitations did not apply because of the doctrine of *nullum tempus occurrit regi*, Latin for "time does not run against the king." The district court disagreed with the Authority's assertion that the *nullum tempus* doctrine applied and granted Crossland's and F&D's dismissal of the Authority's claims. The Authority appealed the district court's decision to the United States Court of Appeals for the Eighth Circuit.

Analysis

Although the *nullum tempus* doctrine originally applied to the English king, some states have applied the doctrine to their state governments. The doctrine presupposed that the king was too busy to timely file suits before they are barred by a statute of limitations or repose; therefore, the king could file a lawsuit at any time, regardless of a statute of limitations or repose. The *nullum tempus* doctrine was originally conceived as a mirror image to sovereign immunity, a doctrine that protected the king from lawsuits and which has also been adopted by various states and the federal government.

The various states differ in their application of the *nullum tempus* doctrine—adopting, rejecting, or expanding the doctrine. Those states that have expanded the doctrine differ as to which governmental entities are covered by it. Some states hold that the doctrine applies if the government entity serves a public—rather than proprietary—function.[6] Other states hold that the doctrine applies if the government entity is seeking to enforce a public—rather than proprietary—*right*.[7]

Although the Arkansas Supreme Court has previously held[8] that the *nullum tempus* doctrine generally only applies to the state government—not county or municipal

5 Note that the statute, A.C.A. § 18-44-508, was revised in 2021, and now sets forth a one-year limitations period for actions on payment bonds and a two-year statute of limitations for performance bond lawsuits.

6 *See, e.g.*, Town of Littleton v. Layne Heavy Civil, Inc., 819 S.E.2d 101, 103-04 (N.C. App. 2018); Hamilton Cnty. Bd. of Educ. v. Asbestospray Corp., 909 S.W.2d 783, 785 (Tenn. 1995); Wash. Pub. Power Supply Sys. v. Gen. Elec. Co., 778 P.2d 1047, 1049 (Wash. 1989).

7 *See, e.g.*, Okla. City Mun. Improvement Auth. v. HTB, Inc., 769 P.2d 131, 132-36 (Okla. 1988); City of Rochester v. Marcel A. Payeur, Inc., 152 A.3d 878, 882-83 (N.H. 2016).

8 *See, e.g.*, Hart v. Sternberg, 171 S.W.2d 475, 478 (Ark. 1943).

governments—the Authority claimed its case fell into an exception. The Arkansas Supreme Court had previously held that if a local government entity is suing to enforce a public right of the state government, the *nullum tempus* doctrine applies.[9] For this reason, the Eighth Circuit held that Arkansas courts determine the application of the *nullum tempus* doctrine to a local government entity based on the public-or-proprietary-*right* test.[10]

Additionally, the Eighth Circuit held that, because the Arkansas legislature had codified and expanded the *nullum tempus* doctrine, the doctrine no longer needed to maintain a mirror-image relationship with Arkansas's sovereign immunity doctrine.[11] The Authority attempted to argue otherwise because Arkansas municipalities do have a degree of immunity from lawsuits. However, this argument was rejected by the appellate court.[12]

The Authority attempted to characterize its lawsuit as enforcing a public right by arguing that the public has a right to a functioning sewer system. The Authority also argued that this lawsuit implicated a public right because the Authority had to use public funds to fix the pipeline. The appellate court also rejected these arguments.

The Eighth Circuit reasoned that the rights at issue in this case could be determined by the actions that the Authority were suing under: breach of contract, negligence, breach of express and implied warranties, and products liability. All of these actions implicate private rights and obligations originating from contracts—in other words, proprietary rights. Because all of the Authority's actions were seeking to enforce proprietary rights, the Authority's lawsuit was not saved by the *nullum tempus* doctrine.[13] For that reason, the appellate court affirmed the district court's dismissal of the Authority's claims.

Conclusion

The case presents a great "take away" for surety underwriters. In order to best protect itself when issuing bonds to contractors performing work for government entities, sureties must be aware of where a state follows the doctrine of *nullum*

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9 *Northwest Arkansas*, 47 F.4th at 710; *see also* Jensen v. Fordyce Bath House, 190 S.W.2d 977, 979-80 (Ark. 1945).

10 *Northwest Arkansas*, 47 F.4th at 710.

11 *Id.* at 709-10.

12 *Id.*

13 *Id.* at 710-11.

tempus and the variations among the jurisdictions which recognize the doctrine. Regardless of whether a state has expanded its *nullum tempus* doctrine based on either the public-or-proprietary-function or public-or-proprietary-right test, if a state still recognizes the *nullum tempus* doctrine, even in its most basic form, the doctrine will apply to all contracts with a state government—and potentially municipalities within those jurisdictions.

Calendar

April 19-21, 2023	**Motor Vehicle Product Liability Conference** Contact: Janet Hummons – 312/988-5656 Yasmin Koen – 312/988-5653	**Omni Scottsdale Montelucia** Scottsdale, AZ
April 21-22, 2023	**Toxic Torts & Environmental Law Conference** Contact: Theresa Beckom – 312/988-5672	**Omni Scottsdale Montelucia** Scottsdale, AZ
May 3-6, 2023	**TIPS/YLD Section Conference** Contact: Janet Hummons – 312/988-5656 Theresa Beckom – 312/988-5672	**Marriott Marquis** New York, NY
May 11-12, 2023	**Fidelity & Surety Law Spring Conference** Contact: Janet Hummons – 312/988-5656 Yasmin Koen – 312/988-5653	**Hyatt Regency Tahoe** Lake Tahoe, NV
August 2-8, 2023	**ABA Annual Meeting** Contact: Janet Hummons – 312/988-5656	**Hyatt Regency** Denver, CO

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