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COMMITTEE NEWS

Fidelity & Surety Law

Revisiting The Surety's Proof Of Claim In Bankruptcy

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Nothing is perhaps so run-of-the-mill for surety bankruptcy practitioners as preparing and submitting a proof of claim in a principal's and/or indemnitor's bankruptcy case.[1] We docket the bar date; tailor our preferred narrative addendum; corral all the usual attachments; check the boxes and fill in the blanks on the Form B410 or case-specific coversheet(s); file; then repeat with the next case that crosses our desks. Lest this process grow *too* mechanical, this article goes back to basics about why we bother with bankruptcy proofs of claim and touches on a handful of the strategic decisions involved in preparing them.

The Bankruptcy Claims Process

Ratable distribution—*i.e.,* "equal and consistent treatment among similarly situated creditors"[2]—is a core tenet of the United States Bankruptcy Code. This principle

Read more on page 17

1 The author gratefully acknowledges and recommends Chapter VI of Surety Aspects of Bankruptcy Law and Practice (Michael E. Collins & Chad L. Schexnayder, eds., Am. Bar Ass'n 2021) (hereafter "Surety Aspects"), which chapter was principally authored by Michael A. Stover of Wright, Constable & Skeen, LLP. The chapter is essential reading for anyone involved in preparing a surety's proof of claim.

2 In re Fultonville Metal Prod. Co., 330 B.R. 305, 312 (Bankr. M.D. Fla. 2005).

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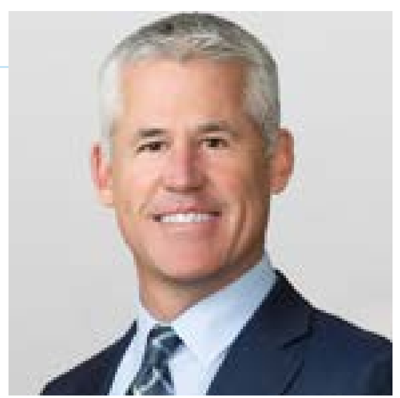
Chair Message



Christopher R. Ward
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It was great to see many of you at our Midwinter Meeting in New Orleans in January! Attendance was outstanding and the Roosevelt Hotel and New Orleans did not disappoint. But, even more importantly, the fidelity, surety, and construction programming certainly lived up to their billing—they were as educational as they were entertaining. I cannot thank the co-chairs of those programs enough for their hard work. On Wednesday prior to the programming, we made a lot of progress in our annual business meetings towards improving our efficiency and instituting changes I believe will benefit our membership moving forward. We also worked further on starting to institute the new and fresh ideas of the chairs that follow me, Blake Wilcox (Chair-Elect) and Bruce Corriveau (Chair-Elect Designee). I'm extremely excited about their respective visions and the energy they are already bringing to further improving the FSLC. Finally, we kicked off the inaugural year of our new Emerging Leaders program with a class of ten up-and-coming leaders, including special programming and social events aimed at facilitating their further involvement in the FSLC. The programming was a resounding success. We will continue the program for the 2024 Emerging Leaders class at the upcoming Spring Meeting. Nurturing our young leaders is essential to the continued vitality of the FSLC, and I know Blake and Bruce are committed to expanding on those efforts.

Please make plans to attend our Spring Meeting in La Jolla, California. The program is aptly titled Suretyland: For the Love of Surety – *Fall in love with surety again with an advanced study of the contract and commercial surety's rights, claims, and strategies*. Having gotten a preview of the topics being covered, the program is really a must attend. The written material will undoubtedly be the go-to source on many of the advanced topics being covered. The program is being co-chaired by Gina Lockwood (Merchants Bonding Company) and Scott Williams (Manier & Herod) of Surety News fame. It comes as no surprise to those that know them—they have approached the program with energy and creativity that can't be matched. What they have in store for you is guaranteed to be one of a kind. And, as if the stellar programming isn't enough, we will be at the Estancia Hotel in La Jolla, which is an absolutely beautiful venue. We have some great social events planned on both Wednesday and Thursday evenings to take advantage of the location, as well as a golf event planned for Friday afternoon. I can't wait to see you there!

As a reminder, make sure to take advantage of our VLOG series on the FSLC webpage (ambar.org/fslc). The VLOG series is made up of video presentations by industry professionals who provide insight on cutting edge fidelity and surety topics. The VLOG library, which continues to expand, includes easy to watch presentations on a broad range of fidelity and surety topics to be used as training tools, valued references, and general education for surety and fidelity firms and companies.

And, finally, please get involved! We have many opportunities for members to be involved in committee activities, including contributing to publications and the VLOG series, participating on one or more of our numerous active sub-committees, and/or presenting at in-person conferences. If you are interested in getting more involved, please do not hesitate to contact me personally, and I'd be glad to help.

See you in La Jolla!

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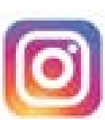

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Fidelity And Surety Law Committee's Emerging Leaders Program

The Fidelity and Surety Law Committee kicked off its inaugural Emerging Leaders Program at the 2024 Midwinter Meeting held in New Orleans, Louisiana. The Emerging Leaders Program, initiated by FSLC Chair Chris Ward, is a new program committed to identifying and developing emerging leaders in the fidelity and surety community. The program provides leadership programming and social opportunities to the participants to assist them in identifying various leadership opportunities within the FSLC. The program will be held annually, with a different class of participants selected each year. Program participants are asked to attend both the FSLC Midwinter Meeting and the Spring Meeting.

The inaugural Emerging Leaders class is comprised of Christopher Joseph (Adams & Reese), Dominick Weinkam (Watt Tieder), Jennifer Whritenour (Intact), Jessica Derenbecker (Arch), Luis Aragon (Liberty), Monica Uribe (Clark Hill), Morgan Fletcher (Chubb), Nathan Diehl (Paskert Divers), Taylor Ward (Manier & Herod), and Todd Lerner (Travelers). Please congratulate these Emerging Leaders on their selection to the program and contributions to our industry.

On Tuesday, January 23, the day prior to the start of the 2024 Midwinter Meeting, the Emerging Leaders participated in a full day of programming planned and coordinated by David Bresel (Zurich) and Patrick Ryan (Clyde & Co.). After an exercise designed to get to know one another, program participants learned about the inner workings of the FSLC from past chairs Carol Smith and Darrell Leonard and about the Tort Trial & Insurance Practice Section, the umbrella committee over FSLC, from Chris Ward. Program participants also had an in-depth roundtable discussion with future FSLC chairs Blake Wilcox and Bruce Corriveau on the future of leadership in the FSLC. After a presentation and caucus on generational differences and stress, program participants enjoyed social time at dinner and in the French Quarter. On

Caption: Back row (left to right): David Bresel, Dominick Weinkam, Nathan Diehl, Christopher Joseph, Patrick Ryan; Front row (left to right): Todd Lerner, Monica Uribe, Jennifer Whritenour, Taylor Ward, Morgan Fletcher. Not shown: Jessica Derenbecker and Luis Aragon

Wednesday, January 24, program participants attended FSLC business meetings and were introduced at the Vice-Chairs Meeting.

The final installment of the inaugural Emerging Leaders Program for this year's class will take place at the Spring Meeting in La Jolla, California in May. Our Emerging Leaders will continue with programming, team building exercises, social activities, and further discussions about advancing the FSLC. If you are interested in learning more about the FSLC Emerging Leaders Program or being a part of a future class of Emerging Leaders, please contact Melissa Lee (mlee@manierherod.com) or David Bresel (david.bresel@zurichna.com).

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Don’t Fumble Privilege – Tips And Recent Case Law To Guard Privilege

Ashley B. Robinson
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Protecting privilege is part of every attorney’s playbook. Surety professionals, however, need to be aware of the players involved, the types of privileges that need to be guarded, and how to protect them. The lines of privilege are often blurred in the field of surety claims by the surety’s obligations to its principal, the surety’s duty to investigate claims, the ever-present potential for litigation to arise out of a claim, and the layers of counsel involved in a variety of roles.

The precepts of privilege are simple. Attorney-client privilege encourages clients to make full disclosure to their attorneys but limits the protection of that disclosure to only the information necessary to obtain informed legal advice.[1] The work product doctrine “is intended to preserve a zone of privacy in which a lawyer can prepare and develop legal theories and strategy with an eye toward litigation, free from unnecessary intrusion by his adversaries.”[2] The work product doctrine is broader than the attorney-client privilege and extends beyond confidential communications between the attorney and client to “any document prepared in anticipation of litigation by or for any attorney.”[3]

Of course, these privileges are muddled in surety claims by investigations performed by attorneys and decisions resulting from the investigation that are both legal and business in nature. The surety privilege issues are further mired by the fact that few courts have addressed suretyship privilege and most that do rely on the factually similar insurance cases to provide guidance, even while admitting that “[S]uretyship is not insurance.”[4]

While there is no perfect playbook to address every potential situation, and case law is not consistent in all jurisdictions, there are guidelines surety professionals can follow. First, before the surety even receives a claim, it needs to have a plan for protecting privileged communication and documents because the burden of establishing that the information or document is privileged will be on the surety asserting the privilege. All personnel involved in the claims process need to understand two basic concepts:

Read more on page 26

1 Fisher v. U.S., 425 U.S. 391, 403 (1976).

2 Schaeffler v. U.S., 806 F.3d 34, 43 (2d Cir. 2015) (citing U.S. v. Adlman, 134 F.3d 1194, 1196 (2d Cir. 1998) (internal quotation marks omitted)).

3 Barnard v. Powell Valley Elec. Coop., 2021 U.S. Dist. LEXIS 249430, at *8-9 (E.D. Tenn. Mar. 5, 2021).

4 U.S. v. Dobco Inc., 2023 U.S. Dist. LEXIS 145926, at *6 (S.D.N.Y. Aug. 17, 2023) (citing Pearlman v. Reliance Ins. Co., 371 U.S. 132, 140 n.19 (1962)).

Beyond Receipt of Collateral: Examining Alternative Outcomes from Making Collateral Demands

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The majority of written indemnity agreements include a provision allowing the surety to demand and receive collateral from the indemnitor. Such collateral is often used to pay claims and to protect the surety against loss and expense.[1] The provision is commonly regarded as a safeguard for the surety against exposure from claims against surety bonds.[2] However, claims professionals focusing solely on the likelihood of receipt of full collateral may decide against pursuing a collateral demand.

While the advantages of securing collateral are apparent, this article takes a different perspective: it explores the merits of making these collateral demands irrespective of whether the surety receives the collateral, in whole or in part.

The underlying premise is that a material default occurs when the indemnitor fails to provide collateral.[3] While the surety would in most cases prefer to obtain the collateral, this default serves to nonetheless open up other opportunities for the surety to protect itself against loss and mitigate its bond exposure. This article provides an overview of this phenomenon.

Opportunities Following a Collateral Demand Default

A surety's indemnity agreement is designed to protect the surety through multiple provisions.[4] When the indemnitor fails to fulfill its obligation to meet a collateral demand, the surety can look to other parts of the indemnity agreement for rights and enforcement remedies to protect against, and mitigate, its bond exposure and potential for loss and expense. The following identifies some of the more common means the surety uses to protect itself, even after failing to obtain collateral.

Read more on page 33

1 *See, e.g.*, RLI Ins. Co. v. Nexus Servs., 470 F. Supp. 3d 564, 571 (W.D. Va. 2020) (noting that surety may use collateral to pay claims); *Phila. Indem. Ins. Co. v. Ohana Control Sys.*, 450 F. Supp. 3d 1043, 1051 (D. Haw. 2020) (identifying purpose of collateral requirement as loss avoidance).

2 Great Am. Ins. Co. v. Fountain Eng'g., Inc., No. 15-CIV-10068-JLK, 2015 U.S. Dist. LEXIS 144289, at *2 (S.D. Fla. Oct. 22, 2015) (holding "[a] collateral security provision provides that once a surety . . . receives a demand on its bond, the indemnitor must provide the surety with funds which the surety is to hold in reserve") (citation omitted).

3 *See* Developers Sur. & Indem. Co. v. Renew Maint. & Constr., Inc., No. 1:17-00495-KD-N, 2018 U.S. Dist. LEXIS 225105, at *4 (S.D. Ala. Oct. 5, 2018) (noting default exists when failing to comply with terms of indemnity agreement).

4 *See, e.g.,* Fucich Contracting, Inc. v. Shread-Kuyrkendall & Assocs., No. 18-2885, 2019 U.S. Dist. LEXIS 67132, at *7–8 (E.D. La. Apr. 19, 2019) (listing various protections found in indemnity agreement).

Case Note: *Cornice & Rose Int'l, LLC v. Four Keys, LLC et. al.*

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On August 11, 2023, the United States Court of Appeals for the Eighth Circuit issued a unanimous, 3-0, decision in *Cornice & Rose International, LLC v. Four Keys, LLC*.[1] The court addressed claims, which arose under the Architectural Works Copyright Act of 1990 (AWCPA)[2]. The court affirmed the district court's ruling that there was no actionable copyright infringement where an uncompleted building was purchased in a sale approved by a bankruptcy court, and that building was later completed. The court explained that the architectural copyright claims under the AWCPA were precluded by the bankruptcy court's order approving the sale in the property owner's Chapter 7 liquidation proceeding.[3]

Background

McQuillen Place Company, LLC ("McQuillen") retained the architectural firm Cornice & Rose ("C&R") to design a building to be built in Charles City, Iowa (the "Building"). C&R obtained copyright protections under the AWCPA for its drawings and for the building, i.e. the tangible embodiment of its design work product.[4] First Security Bank & Trust Company (the "Bank") was the primary lender on the construction project to McQuillen and held a first mortgage on the Building.[5]

When the Building was approximately ninety percent complete, McQuillen halted construction and filed for bankruptcy under Chapter 11.[6] The bankruptcy was later converted to a Chapter 7 liquidation proceeding.[7]

During liquidation proceedings, the United States Trustee moved to sell the Building to the Bank. C&R objected to the sale on various grounds, including that its copyright protection in the building itself would be infringed by such an order authorizing the sale.[8] In response, the Bank proposed language in its pre-hearing brief to address this objection, which the court incorporated into its corresponding order authorizing the sale of the completed building, as follows:

1 76 F.4th 1116 (8th Cir. 2023).
2 Pub. L. No. 101–650, §§ 701–706, 104 Stat. 5133–34 (1990) (codified at scattered sections of 17 U.S.C.).
3 *Four Keys*,76 F.4th at 1119.
4 *See* 17 U.S.C. § 102(a)(5) and (8).
5 *Four Keys*,76 F.4th at 1119.
6 *Id.* at 1118–19.
7 *Id.* at 1119.
8 *Id.*

> So long as the new owner or its architect or agents do not use the Plans or Drawings in which C&R claims a copyright, the new owner may use and occupy the Property, develop the Property, and complete the existing interior and exterior of the Property, free and clear of existing and future claims of C&R, including claims of copyright infringement. The new owner may not use C&R's Plans or Drawings without first making arrangements satisfactory to C&R for their use. Nothing contained herein shall preclude future claims of copyright infringement resulting from the improper or unauthorized use of the Plans or Drawings by any new owner or third parties.[9]

The bankruptcy court entered an order authorizing the sale of the uncompleted Building to the Bank, adopting the language proposed by the Bank. Paragraph 19 of the Order provided:

> **Copyright:** So long as the Purchaser, or its assignee, or its architect or agents do not use the Plans or Drawings or any work in which C&R holds a valid copyright (the C&R Intellectual Property), the Purchaser, or its assignee, may use and occupy the Property, develop the Property, and complete the existing interior and exterior of the Property, free and clear of existing and future claims of C&R, whether for copyright infringement or otherwise. The Purchaser, or its assignee, or its architect or agents may not use the C&R Intellectual Property without first making arrangements satisfactory to C&R for the use of C&R Intellectual Property. Nothing contained herein shall preclude future claims of copyright infringement resulting from the improper or unauthorized use of the C&R Intellectual Property by the Purchaser, or its assignee, or any third parties.[10]

C&R filed a motion to reconsider, citing the AWCPA and arguing that under its contract with McQuillen, the license for the use of the Building was conditioned on full, complete, and timely payment. Because that had not occurred, there was no license for the construction of the Building and therefore the Building was an infringing copy of the architectural work.[11] At the hearing on C&R's motion to reconsider, the bankruptcy court commented: "So you're telling me if you don't sign off on it and everybody just walks away… nobody can do anything until you're paid in full? … I'll just say I've never heard of that."[12] The following day, C&R's motion was denied.

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9 *Id.* at 1119–20.
10 *Id.* at 1120.
11 *Id.*
12 *Id.*

While C&R's appeal was pending, the Trustee sold the Building to the Bank, and the Bank assigned its interest to Four Keys, LLC ("Four Keys"), which hired various companies to finish the nearly-complete Building. The appeal was dismissed as moot.[13]

C&R then sued the Bank, Four Keys, and other parties engaged in completing the Building, alleging that all defendants infringed C&R's architectural works copyright because completing the Building was an "infringing derivative work" created without permission. C&R also sought a declaratory judgment that any rental or sale of the Building, without express permission from C&R, would be further copyright infringement.[14] The district court dismissed both of those claims because (i) C&R failed to allege any copying, (ii) the Building owner's right to finish the Building was protected from a claim of copyright infringement under 17 U.S.C. § 120(b), and (iii) the claims were barred under the doctrine of *res judicata*.[15]

C&R also sued for copyright infringement of its technical drawings but lost on summary judgment. C&R, again, appealed.[16]

Analysis

The Eighth Circuit considered two issues on appeal: whether the lower court erred in dismissing C&R's architectural works copyright and declaratory judgment claims; and whether the court erred in granting summary judgment on the technical drawings copyright claim "on the basis of arguments that [C&R] did not have an opportunity to respond to" (referring to new arguments that two defendants raised in their reply brief).[17]

The appellate court found that *res judicata* applied to the intellectual property claims that C&R sought to relitigate.[18] In opposing the bankruptcy sale, C&R argued it had copyright protections under the AWCPA from the buyer finishing the Building. The bankruptcy court's order, rejecting C&R's argument and authorizing the sale and completion of the Building, was a final judgment and precluded from further litigation. Thus, the district court properly granted the defendants' motion to dismiss those claims.[19]

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13 *Id.*
14 *Id.*
15 *Id.* at 1121.
16 *Id.*
17 *Id.*
18 *Id.* at 1122.
19 *Id.*

The appellate court then analyzed the second issue regarding the district court's denial of C&R's motion to file a sur-reply on its technical drawings infringement claim. The Eighth Circuit concluded that C&R's argument that it did not have an opportunity to file a sur-reply was frivolous, in part because it was not raised to the district court in a motion to reconsider (and instead filed a "Notice of Intention to File a Response," which the district court treated as a motion for leave to file a sur-reply, a pleading that was "generally disfavored").[20]

The Eighth Circuit continued to explain that neither in the district court, nor on appeal, did C&R explain what it would have argued in such a sur-reply brief, and it made no showing on appeal that the district court would have reached a different result had C&R been allowed to file a sur-reply. Accordingly, the Eighth Circuit found no abuse of discretion and affirmed the district court's order.[21]

The concurring opinion affirmed the district court's rulings that the Building owner's right to alter or destroy the building granted in the AWCPA includes a bona fide purchaser's right to complete the unfinished building, and that completion of the Building did not "create a copy," nor did such completion become a "derivative work."[22]

Conclusion

The AWCPA grants a building owner's right to alter or destroy the building without consent of the copyright holder of the architectural work. This protection is codified in 17 U.S.C. § 120(b). This ruling illustrates that the building owner's right to alter or destroy the building granted in the AWCPA includes a bona fide purchaser's right to complete the unfinished building, and such completion of a building does not "copy" the architectural work by creating an unauthorized derivative work.

The takeaway may be that a building owner's right to alter or destroy the building includes the right to *complete* the building without fear of copyright infringement.

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20 *Id.* at 1123.
21 *Id.*
22 *Id.* at 1124.

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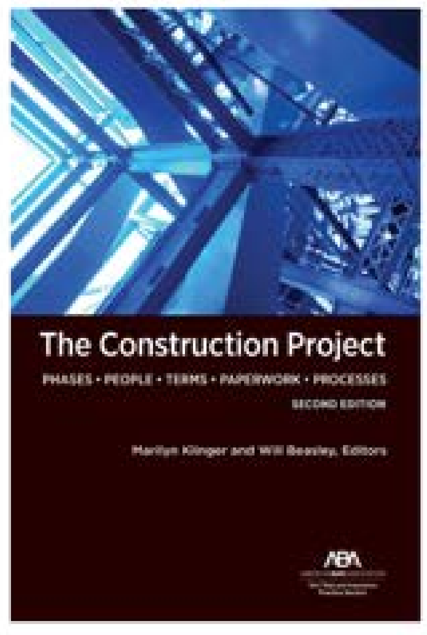

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Revisiting... continued from page 1

is effectuated through the claims process, which is designed to streamline the settlement of the debtor's estate in an orderly fashion such that "all the legal obligations of the debtor, no matter how remote or contingent, will be able to be dealt with in the bankruptcy case."[3]

The Bankruptcy Code thus defines a "claim" broadly. A claim in bankruptcy includes any "right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured[.]"[4] *Every* kind of claim gets administered in the bankruptcy court—even prospective claims that are dependent on some future uncertainty to come to fruition.

Surety claims, like all claims, are deemed allowed and treated as *prima facie* valid upon the filing of a timely proof of claim.[5] The party asserting a claim is generally required (among other things) to identify the claim value, describe its basis, designate whether the claim is or could be entitled to priority, and identify whether the claim is fully or partially secured.[6] Supporting documentation should not be omitted, as it is rule-required, for instance, "when a claim, or an interest in property of the debtor securing the claim, is based on a writing".[7] More on this later.

Although presumed to be valid upon proper filing, claims are nonetheless subject to challenge via formal objection.[8] Chapter 11 plans typically fix a time for claim objections, and Chapter 7 trustees are merely tasked with examining claims and objecting "if a purpose would be served."[9] The Bankruptcy Code takes a pragmatic approach by failing to specify a precise deadline. Generally, objections are asserted later in a case, after there is some indication that there will be sufficient assets for distribution to warrant going through the objection exercise. A filed objection does not result in automatic disallowance of the claim. Instead, an objection initiates a contested matter[10] (think of a "mini-case" like an ordinary litigation matter) whereby the challenger bears the initial burden to rebut the *prima facie* validity of the claim, and only thereafter must the claim proponent prove its entitlement.[11]

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3 Midland Funding, LLC v. Johnson, 581 U.S. 224, 228 (2017).

4 11 U.S.C. § 101(5)(A); *see also* § 101(5)(B) (including in the definition of "claim" a right to an equitable remedy for breach giving rise to a right to payment).

5 11 U.S.C. § 502(a); Fed. R. Bankr. P. 3001(f); *see also* In re Parker Excavating, Inc., No. 08-19552 M.E.R., 2013 Bankr. LEXIS 4902, at *4 (Bankr. D. Colo. Nov. 19, 2013).

6 *See* Fed. R. Bankr. P. 3001–3003.

7 Fed. R. Bankr. P. 3001(c)(1).

8 Section 502 of the Bankruptcy Code governs claims allowance/disallowance. *See also* Fed. R. Bankr. P. 3007 (concerning objection procedures). Beware omnibus objections allowed under Rule 3007, because it is easy to miss that a claim you care about is subject to procedural objection.

9 11 U.S.C. § 704.

10 *See* Fed. R. Bankr. P. 9014; *see also* In re Simmons, 765 F.2d 547 (5th Cir. 1985).

11 *See, e.g., Parker*, 2013 Bankr. LEXIS 4902 at *5 (internal citations omitted).

Why bother submitting a proof of claim in bankruptcy? At the end of the day, it is the filing of a proof of claim that unlocks a creditor's ability to participate in any distributions of the debtor's assets, whether pursuant to a plan or in a liquidation.[12] A proof of claim has additional utility in communicating key aspects about a creditor's position outside of affirmative motions-practice in the bankruptcy case or negotiating with a debtor's professionals.[13]

The Surety's Claim in Bankruptcy: A General Overview

Payments under bonds to obligees/third-party claimants, losses in the form of professional fees and expenses, unpaid premium—all these make up a surety's claim in bankruptcy. The *sources* from which the surety's rights arise make for a longer listing: (1) under the surety's Indemnity Agreement; (2) under its bonds; (3) through subrogation; (4) by assignment; (5) by rights in collateral; (6) through trust fund rights; and (7) pursuant to common law rights like common law indemnity, exoneration, and *quia timet*.[14]

A frequent problem is that the surety may still be investigating, negotiating, litigating, expecting, or merely fearing potential future claims at such time as a proof of claim deadline rolls around. A surety's claim may be partially or entirely disputed or as-yet uncertain. No matter. For proof of claim purposes, the surety asserts its contingent and unliquidated claim for all possible liabilities (usually in an amount equal to the penal sums of all outstanding bonds) and reserves a right to amend as the surety's actual losses and expenses become further liquidated.[15] Assessing current LAE and open exposure is just the first part of assembling a surety claim in bankruptcy.

Another basic consideration for the surety is diagnosing whether its claim is secured, unsecured, or partially secured.[16] A surety may have a secured claim *and*

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12 *See* Fed. R. Bankr. P. 3002(a); *Id.* at 3003(c)(2–3); In re Enron Corp., 2003 Bankr. LEXIS 2115, at *5–6 (explaining that in a Chapter 11 context, "[i]f the debtor does not schedule a particular claim, or the claim is scheduled as disputed, contingent, or unliquidated, then a creditor must file a proof of claim, otherwise such creditor shall not be treated as a creditor with respect to such claim for the purpose of voting and distribution."); In re Davis, 936 F.2d 771, 773–74 (4th Cir. 1991) (explaining that in a Chapter 7 context, "failure of creditors to timely file proofs of claim results in their exclusion from the Trustee's Proposed Order of Distribution."). Rule 3002 further provides that a secured creditor "must file a proof of claim or interest for the claim or interest to be allowed[,]" but a lien securing a claim is not void due to the failure to file a proof of claim; s*ee also* 11 U.S.C. § 506(d)(2) (explaining that a lien against the debtor's property will remain despite failure to file a proof of claim).

13 While a proof of claim may be the surety's first chance to communicate its interests, or to correct inaccuracies about the surety bond program contained in the debtor's filings, this is *not* to say that earlier and much more proactive action should not be taken when needed.

14 *VI. Surety Claims in Bankruptcy* in Surety Aspects, 245. Full explanation and analysis of these rights must necessarily be reserved for such full-length books.

15 Liberal amendment is generally favored "where the purpose is to cure a defect in the claim as originally filed, to describe the claim with greater particularity or to plead a new theory of recovery on the facts set forth in the original claim." *In re W.T. Grant Co.*, 53 B.R. 417, 420 (Bankr. S.D.N.Y. 1985) (internal quotation omitted). Amendment to describe formerly contingent surety losses as having since been paid and liquidated is particularly appropriate given that the Code specifically contemplates the surety's claim becoming "fixed" post-petition. *See* 11 U.S.C. § 502(e)(2).

16 *See* Id. § 506(a)(1).

an unsecured claim, depending on the value of the claim relative to the value of the property securing it. There are two variables at play: claim value and collateral value. Both may be unknown, but the surety's claim is nonetheless secured to the value and extent of the surety's liens and other interests in property of the bankruptcy estate.

The surety's secured interest may take many forms—*e.g.,* an interest in real property given to the surety as collateral; cash collateral taken pursuant to the Indemnity Agreement; a perfected security interest in bank accounts, CDs, equipment, accounts receivable, or other assets by recordation of the Indemnity Agreement as a financing statement; judgment lien(s); subrogation rights in bonded contract balances[17]; rights of setoff; and so on. What makes a secured claim is any charge or interest in "property in which the estate has an interest," *i.e.* property of the bankruptcy estate.[18]

Unique for the surety contending with its principal's and/or indemnitor's bankruptcy is an evaluation between the comparative advantages of asserting a claim for reimbursement versus a claim for subrogation. The Bankruptcy Code effectively commits the surety to a choice: either the surety may rely on a right of a reimbursement or the right to be subrogated to a claim of an entity that the surety has paid, but not both.[19] This rule, imposed by companion sections of the Code, guards against double-liability to the bankruptcy estate. Practically speaking, while a "502/509 election" must ultimately be made, the surety is perfectly entitled to reserve alternative rights in the proof of claim. But it begs early evaluation of each possible route. For example, if the surety's claim for reimbursement would be secured, it likely makes sense to seek reimbursement, and quite the opposite in the event the claim to which the surety would be subrogated to is secured. It is not just the surety's own position that must be considered, but also the positions of parties it pays or may pay.

Questions of priority also come into play when analyzing the surety's claim in bankruptcy. Generally, a claim by a surety to recover payments made post-petition under the terms of a prepetition indemnity or guarantee agreement is treated as a

17 This all-important concept in contract surety deserves special mention. Bankruptcy courts recognize the performing surety's interests in remaining bonded contract funds as a secured claim because, pursuant to the surety's equitable subrogation rights, the surety holds an equitable lien in such funds (superior in priority to the trustee and other creditors). Am. Sur. Co. of New York v. Bethlehem Nat. Bank of Bethlehem, Pa., 314 U.S. 314, 317 (1941); In re E.R. Fegert, Inc., 88 B.R. 258, 260 (B.A.P. 9th Cir. 1988); In re Padula Constr. Co., 118 B.R. 143 (Bankr. S.D. Fla. 1990).

18 *See* 11 U.S.C. §§ 101, 506(a)(1), and 541.

19 *See, e.g.,* In re Fiesole Trading Corp., 315 B.R. 198, 205 n.11 (Bankr. D. Mass. 2004) (discussing the "parallel nature" of § 502(e)(1)(C) and § 509(b)(1)(A) and a surety's election between Section 509 reimbursement and Section 509 subrogation claims). Courts are somewhat split as to whether Section 509 supplants equitable subrogation, or whether the two coexist independently, but the majority trend is for bankruptcy courts to recognize equitable subrogation under state law and subrogation under Section 509 as separately available. 4 Collier on Bankruptcy § 509.02 (Alan N. Resnick & Henry J. Sommer, eds. 16th ed. 2013); *see also VI. Surety Claims in Bankruptcy* in Surety Aspects, 280–82.

prepetition claim.[20] Surety payments are not granted special priority simply because the pre-petition creditor's claim is satisfied post-petition. But the Code does afford administrative expense priority for a claim which is (1) an actual, necessary cost of preserving the estate, or (2) an actual, necessary cost incurred by a creditor "making a substantial contribution" to the debtor.[21] When bonds are issued post-petition or prepetition bonds that could otherwise have been cancelled remain in place during the bankruptcy, the surety may have an enforceable administrative expense claim for its premium allocable to the post-petition period.[22] Similarly, bond losses attributable to the debtor's post-petition operations may also be accorded administrative priority, depending on the circumstances.[23]

These are just some of the issues at stake when working to characterize the surety's claim and certainly not an exclusive list. Preparing a proof of claim demands assessment of the universe of the surety's liabilities and potential liabilities, as well as the universe of the surety's interests and potential interests.

Is a Proof of Claim *Really* Necessary?

Almost invariably, the surety should file a proof of claim, regardless of whether liquidated or contingent, to preserve its right to participate in any distributions resulting from the bankruptcy case.

Limited circumstances potentially justify skipping a proof of claim. In a no-asset Chapter 7 case, of course, no proof of claim is required.[24] Theoretically (but unheard of in practice), the Chapter 11 debtor's schedules may satisfactorily list the value of the surety's claim and indicate that it is neither contingent nor unliquidated nor disputed. In such case, no proof of claim may be needed.[25]

Other unique case characteristics and surety-specific factual considerations may also obviate the need for proof-of-claim filing. Take, for instance, a prepackaged Chapter 11, in which both plan and disclosure statement are filed at or around the petition date. Assume the plan calls for reorganized debtor(s) to emerge from

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20 11 U.S.C. § 502(e)(2).

21 *See VI. Surety Claims in Bankruptcy* in Surety Aspects, 269–274, for a comprehensive discussion.

22 *See id.* at 269–71.

23 Consider the additional possibility that the surety may be *subrogated* to the administrative expense claim of a party it pays under a bond. A prototypical illustration might involve utility bonds in a commercial case. A utility bond obligee may have rights in an assurance fund established by a commercial debtor in its bankruptcy case to ensure payment of post-petition utility bills. If the surety pays a utility bond claim encompassing post-petition utility obligations, the surety may have subrogation rights to the obligee's rights in the fund.

24 *VIII. Chapter 7 Liquidation in* Surety Aspects, 396.

25 *See* 11 U.S.C. § 1111(a); Fed. R. Bankr. P. 3003(b)(1) and (c)(2). The author suggests no proof of claim *may* be needed because she has never seen debtors' schedules, even if roughly accurate, fully describe the panoply of surety rights of common law indemnity, subrogation, setoff/reimbursement or the complete bases by which a surety's claim may be secured.

bankruptcy with continued operations. If early negotiation with debtor's counsel produces consensual agreement to reaffirm the bond program and indemnity obligations—and this commitment (in writing) is secured prior to the bar date—perhaps the surety need not jump through proof-of-claim hoops. In other words, plan or confirmation order language may do all the work to ensure the surety's claim "rides through" the bankruptcy. (Weigh any outside risk that the debtor will be unable to confirm its intended plan.)

The surety's individual line card and collateral position, too, may bear on the decision to file a proof of claim. If 100% secured by letter(s) of credit issued well prior to the petition date, the surety may already have all the protection it needs. If the surety can safely estimate its potential losses to be near zero or within risk-tolerance—such that the expense of preparing a proof of claim outstrips the surety's potential loss or the surety's desire to participate in any bankruptcy distribution—claim preparation might be given a pass. Bankruptcy cases and sureties' individual considerations vary. But electing not to file a proof of claim remains the exception, not the rule.

Contents of the Surety's Proof of Claim

Form B410[26] is generally the required proof of claim coversheet,[27] and it is signed and filed with the bankruptcy court (or, increasingly in large chapter 11s, a designated claims administrator). Completing the coversheet alone is rarely sufficient to describe the surety's claims, so common practice is therefore to append an accompanying narrative setting forth the basis for the surety's claim in numbered paragraphs or sections:

- Identifying where notices and pleadings related to the proof of claim are to be sent;
- Describing the surety's bonds issued on behalf of a debtor or co-debtor, with additional reference to a line card, schedule, first-day surety bond motion exhibit, or other "bond summary" exhibit;[28]
- Describing and appending a copy of any written surety Indemnity Agreement;

26 United States Courts, https://www.uscourts.gov/forms/bankruptcy-forms/proof-claim-0 (last visited Feb. 23, 2024).

27 A case-specific proof of claim form may exist, particularly in complex Chapter 11 cases. Always check for these approved forms and be mindful of local rules and filing procedures—particularly now that appointed claims administrators and e-filing predominate in commercial Chapter 11s.

28 No need to append the bonds themselves; instead, a note that "copies of bonds are available on request" probably suffices. In itemizing open bonds, consider reserving a specific right to amend to include other bonds issued or to exclude bonds no longer in force. Even canceled bonds may merit inclusion, given open statute(s) of limitation and/or other tail-liability considerations.

- Setting forth a claim for unpaid premium, if any, and identifying whether subject to administrative priority (and/or reserving rights to claim such priority);
- Setting forth a claim for paid bond losses or asserting claims on the grounds that the surety may become subject to potential claims alleging nonperformance by the principal, including by reference to a schedule exhibit describing any liquidated losses as of the date of filing and/or claims received that may yet be paid;
- Setting forth other expenses or professional fees incurred or that may be incurred;
- Setting forth any judgment the surety has obtained against the debtor, appending that judgment/evidence of attachment of judicial lien;
- Setting forth any other bases by which the surety's claim is secured, appending evidence as applicable (*e.g.,* replacement liens granted by adequate protection order or other adequate protection, prior-perfected security interests, mortgages or deeds of trust against real property, cash collateral/collateral agreements, bonded project proceeds, trust fund rights, etc.);
- Referencing letters of credit held as surety collateral—though critically, not admitting that those letters of credit render the surety's claim in any way "secured" by property of the estate;[29]
- Setting forth a claim for all contractual and common-law surety rights, including subrogation[30], exoneration, and indemnification;
- Submitting alternative claims for and on behalf of bond obligees, reserving rights that such claims may be entitled to priority;

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29 Under the independence principal, a letter of credit is the independent obligation of the issuer, such that a letter of credit and its proceeds do not constitute property of the bankruptcy estate. *See, e.g.*, Pro-Fab, Inc. v. Vipa, Inc., 772 F.2d 847, 852–53 (11th Cir. 1985). Accordingly, the surety's status as a letter of credit beneficiary does not make the surety "secured" in the amount of such letter of credit for purposes of a proof of claim coversheet or addendum. *See* 11 U.S.C. §§ 506, 541. Note further that letters of credit taken in the immediate prepetition period such as may be subject to attack as indirect preferences may merit special sensitivity in their textual description. Describing a letter of credit by the party on whose account it was issued, issuing bank, identifying number, and amount may make sense for purposes of the surety's proof of claim addendum.

30 In the contract surety setting, do not forget that subrogation rights may include subrogation to the setoff rights of a common obligee on multiple projects, bonded or unbonded.

- Setting forth a claim for setoff[31] (or recoupment), or reserving rights regarding the same;
- Reserving rights to, *e.g.,* assert administrative claims for obligations arising out of post-petition activities or bonds in effect post-petition and amend/ supplement the proof of claim;[32]

Containing additional non-waiver language, *e.g.,* that the proof of claim shall not constitute an admission of liability under bonds, nor the election of any remedy.

The contents of the surety's proof of claim narrative will vary according to the circumstances. Everyone who regularly prepares surety proofs of claim has their favorite forms and phraseology, and excellent examples appear on the claims registers of commercial and contract bankruptcy cases across the country. But perhaps consider revisiting your own favored narrative addendum to assess whether it *overexplains*, or shares too much, with the effect of unnecessarily locking the surety into a particular position. (Less may be more, so long as Code-required contents are hit?) Food for thought.

Challenges to the Surety's Contingent Claim

No surety proof-of-claim article would be complete without mentioning one of the most common claims objections that the surety is likely to receive, namely, that the surety's claim should be disallowed as "contingent"—*i.e.,* "not yet accrued and … dependent on some future event that may never happen."[33]

Contingent claims are generally disallowed if they meet the following factors: (1) the claim is for reimbursement or contribution,[34] (2) the claim is asserted by an entity that is liable with the debtor on an underlying claim, and (3) the claim is contingent at the time of its allowance or disallowance.[35] If a creditor is *not* a surety, the Bankruptcy Code generally allows contingent claims and simply estimates the amount of the

31 *See, e.g.,* In re Eastern Freight Ways, Inc., 577 F.2d 175, 180 (2d Cir. 1978).

32 Many practitioners advocate for the surety's addendum to include a reservation of rights directed at the debtor's assumption/rejection of executory contracts. This issue tangentially featured in a case in which the surety's proof of claim specifically (and by all accounts *correctly*) described the bond program as a financial accommodation incapable of assumption. In re Falcon V, L.L.C., 620 B.R. 256, 266 n.48 (Bankr. M.D. La. 2020). Given that debtors' assumption/ rejection elections entitle the counterparties affected to contest listed cure amounts, this author questions the strict necessity of this kind of reservation or of setting forth the surety's position on assumption in a proof of claim addendum.

33 *Contingent*, Black's Law Dictionary (9th ed. 2009); *see also* In re Mitrano, No. 08-12890-SSM, 2008 WL 4533659, at *1 (Bankr. E.D. Va. Sept. 25, 2008) ("A debt is contingent only if liability is dependent on an uncertain event, the classic example being the liability of a surety, guarantor, or accommodation maker.").

34 *In re Falcon V*, 620 B.R. at 269–70 ("Courts have consistently held that the 'concept of reimbursement includes indemnity'") (internal citation omitted).

35 *See* In re Drexel Burnham Lambert Grp., 146 B.R. 92, 95–96 (S.D.N.Y. 1992); In re Tri-Union Dev. Corp., 314 B.R. 611, 616–17 (Bankr. S.D. Tex. 2004).

claim for purposes of allowance.[36] But if the creditor is a surety—one "liable with the debtor on or has secured the claim of a creditor"[37], to use Code parlance—the Code requires disallowance of the contingent claim. The rationale behind this is that the estate could be exposed to double liability by holders of the same underlying payment obligation (which is to say, a creditor obligee/bond claimant on the one hand, and the surety asserting claim for repayment based on that same claim).[38]

Potential disallowance does not justify skipping a proof of claim just because the surety's claim is wholly contingent at the time of filing. What if surety losses actualize during the pendency of the case in the form of paid claims? Amendment of a timely proof of claim after a contingency is resolved is expressly contemplated by the Code.[39] Even after formal disallowance, a contingent claim may become fixed by payment, and the surety may seek reconsideration.[40] Of course, reconsideration may not be successful or of any practical benefit if the contingency is resolved after significant passage of time. But reconsideration may be particularly viable in, *e.g.,* a subchapter V bankruptcy case, where plan payments tend to be ongoing for several years after confirmation.

For a final "thought experiment", we might question whether a surety facing unknown and unrealized bond loss really holds a "contingent" claim if it has exercised its contractual rights to demand collateral under the Indemnity Agreement prior to the bankruptcy case.[41] Picture the general setup: Faced with even potential loss under its bonds, and following the strict language of its Indemnity Agreement, the surety requests that it be furnished with collateral in a *discrete dollar-amount* to protect itself against loss. The surety's right to demand collateral security is contractual; the performance due from the indemnitor(s) virtually immediate.[42] Is there anything really contingent (future, uncertain, or conditional) about the surety's claim to be

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36 *See* 11 U.S.C. § 502(c); *VI. Surety Claims in Bankruptcy* in Surety Aspects, 297–301.

37 11 U.S.C. § 502(e)(1).

38 Inquiring readers may wish to study Chapter 11 claim objections. The documents titled "ECF Nos. 2844–2861"—located in In re Fieldwood Energy, LLC, No. 20-33948, 2023 WL 3484646, (Bankr. S.D. 2023)— are a good source of information on the subject.

39 *See* 11 U.S.C. § 502(e)(2).

40 *See* *Id.* § 502(j).

41 Note that the surety's right to demand collateral post-petition is constrained by the automatic stay of 11 U.S.C. § 362.

42 The best reasoned decisions nationally even recognize the surety's right of specific performance to enforce its right to collateral security. *See, e.g., Travelers Cas. & Sur. Co. of Am. v. W.P. Rowland Constructors Corp.*, No. CV–12–0390–PHX–FJM, 2013 WL 2285204, at *4 (D. Ariz. May 22, 2013) (holding that there was no adequate remedy at law for defendants' repudiation of their collateral security obligations where the surety knew it would have claims filed against it, but did not know the amount of those claims); *Fid & Deposit Co. of Md. v. C.E. Hall Constr., Inc.*, 2012 U.S. Dist. LEXIS 45539, 2012 WL 1100658, at *3-4 (S.D. Ga. Mar. 30, 2012) ("[O]ther courts have recognized that where liability of a surety under an indemnification agreement has not yet been determined, but claims are expected, specific performance for any collateral security provision is proper.").

collateralized in the amount demanded?[43] But enough on contingent clams for those bravely still reading.

Conclusion

If this article does nothing more than to suggest that proof-of-claim filing is far from routine or one-size-fits all, then mission accomplished. And for all those of you hardly needing such a reminder, so much the better. Consider this article merely an invitation to dust off those favored "POC addenda" to ensure they are working in service of adequately characterizing the surety's claims in bankruptcy.

43 Anecdotes are welcome if you have litigated this very issue before a bankruptcy court when faced with a contingent-claim objection.

Don't Fumble... continued from page 10

1. Privilege protection is limited.
2. Privilege can be waived.

1. Privilege Protection is Limited

Attorney client privilege extends only to communication for the purpose of obtaining or conveying legal advice, not to the facts conveyed.[5] While there is no question that legal advice sought from an attorney is protected, questions arise when an attorney conducts an investigation into the claim. The mere involvement of an attorney—whether in-house or outside counsel—does not create "a blanket obstruction to discovery of its claims investigation"[6] When determining whether privilege will apply, courts will consider "whether the attorney functioned as a mere conduit, claims adjustor or claim investigator, or rather, whether the attorney functioned in the attorney's professional capacity in dispensing legal advice."[7] "If 'the attorney functioned as a mere conduit, claims adjustor or claim investigator,' then attorney-client privilege does not attach to protect the communication."[8]

Factual information gathered during an attorney's investigation of an incident is discoverable, even if the information became known solely through the attorney's efforts.[9] "'[C]ommunications related to the claims handling functions (such as investigation, gathering and summarizing information, and valuation of the claim) are ordinary business activities of the insurance company typically handled by an adjuster or investigator and thus are not entitled to attorney client privilege[,]' but 'communications related to the actual provision of legal advice are still protected by the attorney-client privilege'"[10] This analysis and conclusion has been applied to surety investigations.[11]

Challenges arise when communications from counsel serve the dual purposes of both ordinary business activities and conveying legal advice. While ideally counsel and sureties would abstain from dual-purpose communication, the reality is that the lines between legal and business advice are not clear and the two are often

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5 Upjohn Co. v. U.S., 449 U.S. 383 (1981).

6 St. Paul Reins. Co. v. Com. Fin. Corp., 197 F.R.D. 620, 633–34 (N.D. Iowa 2000) (internal citations omitted).

7 Rodriguez v. Progressive Select Ins. Co., 2023 U.S. Dist. LEXIS 148422, at *9 (M.D. Fla. June 2, 2023) (citing Ranger Constr. Indus. Inc. v. Allied World Nat'l. Assur. Co., No. 17-81226-CIV, 2019 U.S. Dist. LEXIS 17603, 2019 WL 436555, at *6 (S.D. Fla. Feb. 4, 2019)).

8 *Id.*

9 Hello Farms Licensing MI, LLC v. GR Vending MI, LLC, 2023 U.S. Dist. LEXIS 164647, at *10 (E.D. Mich. Sep. 15, 2023) (citing Askew v. City of Memphis, No. 14-cv-2080-STA-tmp, 2015 U.S. Dist. LEXIS 180889, 2015 WL 12030096, at *2 (W.D. Tenn. July 23, 2015)).

10 Appalachian Cmty. Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 2022 U.S. Dist. LEXIS 244909, at *31-32 (E.D. Tenn. Apr. 25, 2022) (internal citations omitted).

11 Safeco Ins. Co. of Am. v. M.E.S., Inc., 2014 U.S. Dist. LEXIS 205355, at *37 (E.D.N.Y. Apr. 11, 2014).

combined. This is especially true because in-house lawyers perform both legal and business functions.

There is a split in the federal appellate courts on the proper test to determine privilege protection for dual-purpose communications. The Ninth Circuit applies the "primary purpose test," wherein privilege will apply if the primary purpose of the communication was to seek legal advice.[12] The District of Columbia, on the other hand, applies the "significant purpose test" under which communication will be privileged if "one of the significant purposes" of the communication is to obtain legal advice.[13] The significant purpose test is the least restrictive of the two tests. Lastly, the Seventh Circuit held that dual-purpose communications involving business/tax advice and legal advice are never privileged.

Recently, the United States Supreme Court was poised to resolve the split, but, after receiving many amicus briefs on the issues and hearing oral argument, the Supreme Court allowed the split to continue and dismissed the writ as "improvidently granted."[14]

1. Based on the Supreme Court's failure to address the circuit split, sureties should make an effort to preserve privilege by:
2. Separating communication on legal advice from business advice.
3. Complying with the stricter test and ensuring that the "primary purpose" of each communication to and from its counsel is legal advice.
4. Labeling privileged communication from the outset as "confidential and privileged."
5. As early in the claims process as possible, establishing the date when the surety reasonably anticipates litigation over the claim, to trigger the work product privilege. A decision to deny the claim or a threat of litigation by the claimant would be determinative, but the date can be pushed earlier if properly documented.

2. Unguarded Privilege Can Be Waived

The privileges granted to attorney-client communications and work product are limited and should be strongly guarded because the privilege can be easily waived. Given our technological advances, it is easier than ever for electronically stored

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12 In re Grand Jury, 23 F.4th 1088, 1094–95 (9th Cir. 2022).

13 In re Kellogg Brown & Root, Inc., 756 F.3d 754, 760 (D.C. Cir. 2014).

14 *See* In re Grand Jury, 598 U.S. 15, 143 S. Ct. 543 (2023) (per curiam).

privileged communications and work product to fall into unintended hands. Parties have a duty to take reasonable measures to ensure and maintain the privilege.[15]

a) Waiver of privilege by disclosure

Generally, the attorney-client privilege is waived if it is voluntarily disclosed to third parties.[16] Voluntary waiver occurs when it is purposefully disclosed to third parties or produced in litigation.

What if the disclosure is inadvertent? Federal courts have determined that the disclosure of privileged documents does not operate as a waiver if (1) the disclosure is inadvertent, (2) the holder of the privilege or protection took reasonable steps to prevent disclosure, and (3) the holder promptly took reasonable steps to rectify the error, including notifying the other side and following Federal Rule of Civil Procedure 26(b)(5)(B), if applicable.[17] Under this three-part analysis, courts will consider whether the disclosure was truly inadvertent or if the disclosing party simply failed to review the documents for privileged communication before they were disclosed. An additional consideration in electronic disclosures is whether the disclosing party failed to reasonably test the reliability of the keyword searches by appropriate sampling of the documents before production.[18]

Another exception to the general rule of waiver is the "common interest doctrine" or "joint defense privilege." While these terms are often used interchangeably, some jurisdictions have distinguished them.[19] Under the common interest doctrine or joint defense privilege, disclosure of privileged communications to a party who shares a common legal interest does not waive the privilege.[20] The common legal interest doctrine or joint defense privilege merely extends the privilege to communications with parties with a common legal interest.[21] The doctrine of common legal interest is narrowly construed and does not extend to shared business interests.[22]

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15 Harleysville Ins. Co. v. Holding Funeral Home, Inc., 2017 U.S. Dist. LEXIS 162058, at *16 (W.D. Va. Oct. 2, 2017).

16 Monterey Bay Military Hous., LLC v. Ambac Assurance Corp., 2023 U.S. Dist. LEXIS 9646, at *22 (S.D.N.Y. Jan. 19, 2023).

17 *See, e.g.*, Shields v. Boys Town La., Inc., No. 15-3243, 2016 U.S. Dist. LEXIS 190695 at *2 (E.D. La. May 24, 2016); Pilot v. Focused Retail Prop. I, LLC, 274 F.R.D. 212, 8–9 (N.D. Ill. 2011); Audubon Soc'y of Portland v. Zinke, No. 1:17-cv-00069-CL, 2018 U.S. Dist. LEXIS 53570 at *12–13 (D. Or. Mar. 27, 2018).

18 Felman Prod. v. Indus. Risk Insurers, No. 3:09-0481, 2010 U.S. Dist. LEXIS 74970, *10 (S.D. W. Va. July 23, 2010).

19 In re Sealed Case, 29 F.3d 715, 719 n.5 (D.C. Cir. 1994). This distinction is not addressed for purposes of this article.

20 Monterey Bay Military Hous., LLC v. Ambac Assurance Corp., 2023 U.S. Dist. LEXIS 9646, at *25–26 (S.D.N.Y. Jan. 19, 2023).

21 Tonti Mgmt. Co. v. Doggie, No. 19-13134, 2020 U.S. Dist. LEXIS 253052, at *10 (E.D. La. June 25, 2020) (quoting Power-One, Inc. v. Artesyn Tech., Inc., 2007 WL 1170733, at *2 n.2 (E.D. Tex. Apr. 18, 2007)).

22 Firefighters' Ret. Sys. v. Citco Grp. Ltd., 2018 WL 2323424, *4 (M.D. La. May 22, 2018); Action Ink, Inc. v. Anheuser-Busch, Inc., 2012 WL 12990577, *2 (E.D. La. Dec. 19, 2012).

In the context of suretyship, the common interest doctrine or joint defense privilege can be asserted between a surety and its principal.[23] Of course, this can also be problematic "because 'the surety and principal are at war and in alliance at the same time.'"[24] While the common interest doctrine applies to some communications between the surety and its principal, it does not provide a blanket protection over all communication.[25] The common interest privilege is limited to communication regarding their aligned interest made in anticipation of litigation.[26] Thus, if the surety is working with the principal regarding investigation and defense of the claim but is also seeking collateral or indemnity, the communications regarding defense of the claim should be separate from the indemnity communications.

b) Waiver of one equals waiver of all

Once a privileged attorney-client communication is revealed to a third party or otherwise waived, then the party waives privilege as to all communications on the same subject matter.[27] This is why it is important to carefully guard privilege and restrict who receives the privileged communications.

This argument of waiver as to all communications on the same subject matter was recently addressed in a wrongful termination and subcontractor performance bond case, *Cornerstone Pavers, LLC v. Zenith Tech., Inc.*[28] In *Cornerstone*, it was argued that a waiver occurred when an email sent by an employee of the general contractor was produced in discovery and included the line "[f]rom conversations below, . . . I feel that at this point in the project that it would be unwise to kick [subcontractor] off and try to completely bring in someone new as there isnt [sic] enough time."[29] The referenced "conversation below" had been redacted as a privileged communication with the general contractor's attorney. The subcontractor sought to compel the production of the "conversation below," arguing that the disclosure of the reference to the conversation waived privilege as to all communications on the same subject matter. The court disagreed, finding that a statement that a communication occurred is not a disclosure of that privileged communication.

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23 U.S. v. Dobco Inc., 2023 U.S. Dist. LEXIS 22891, at *4 (S.D.N.Y. Dec. 22, 2023).

24 *Id.* at *4 (citing Amy L. Fischer, The Attorney-Client/Work Product Privileges and Surety Investigative Information: Applying Old Rules to Turn New Tricks, 34 TORTS & INS. L.J. 1009, 1010 (1999)).

25 *Id.*

26 *Id.*

27 Barnard v. Powell Valley Elec. Coop., 2021 U.S. Dist. LEXIS 249430, at *8 (E.D. Tenn. Mar. 5, 2021); (Mooney ex rel. Mooney v. Wallace, No. 04-1190, 2006 WL 8434638, at *8 (W.D. Tenn. July 12, 2006) (quoting United States v. Skeddle, 989 F. Supp. 905, 908 (N.D. Ohio 1997)).

28 Cornerstone Pavers, LLC v. Zenith Tech., Inc. (In re Cornerstone Pavers, LLC), 654 B.R. 507 (Bankr. E.D. Wis. Sep. 28, 2023) (Halfenger G.).

29 *Id.* at 511.

While the decision in *Cornerstone* correctly held that the disclosure of the email was not a disclosure of the privileged communication, it is an example of the potentially snowball effect of disclosing even a portion of privileged communication in discovery.

c) Waiver of privilege by failing to provide a privilege log

The consequence for failing to timely produce a detailed privilege log may be severe –including waiver of the privilege. Courts consider several factors in determining if privilege has been waived, including: (i) the length of the delay in asserting the privilege, (ii) the willfulness of the transgression, and (iii) the harm to the other parties caused by the delay.[30] However, the length of the delay alone can result in a waiver.[31] Similarly, a waiver can occur when the privilege log is deficient in describing the privilege.[32] This is because broad or conclusory assertions of privilege are not sufficient.[33]

The reasoning behind waiver of privilege for failure to timely produce a privilege log is in the Federal Rules of Civil Procedure, which require that: "a party withholding otherwise discoverable information by claiming privilege must: (i) expressly make the claim; and (ii) describe the nature of the documents, communications, or tangible things not produced or disclosed--and do so in a manner that, without revealing information itself privileged or protected, will enable other parties to assess the claim."[34] The Ninth Circuit details that a privilege log should include "(a) the attorney and client involved, (b) the nature of the document, (c) all persons or entities shown on the document to have received or sent the document, (d) all persons or entities known to have been furnished the document or informed of its substance, and (e) the date the document was generated, prepared, or dated."[35] Other courts have issued local rules to codify information that must be contained in a privilege log.[36]

Based on the level of detail required in some privilege logs, it is worthwhile to start preparing the privilege log from the moment the claim is made and at the very least include:

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30 Huseby, LLC v. Bailey, 2021 U.S. Dist. LEXIS 141504, at *49 (D. Conn. July 29, 2021).

31 *Id.* (finding that waiver occurred when a privilege log was not provided for seven months after the discovery was issued)*; see also* Monterey Bay Military Hous., LLC v. Ambac Assurance Corp., 2023 U.S. Dist. LEXIS 9646, at *50 (S.D.N.Y. Jan. 19, 2023) (finding the work product privilege waived when it had not been asserted in nine revised privilege logs over an extended period of time.).

32 *Allied World Ins. Co. v. Keating*, 2022 U.S. Dist. LEXIS 31462, at *12–13 (D. Conn. Feb. 23, 2022) (noting that a single-row description of nearly 900 pages as emails, mediation statements and invoices, throughout various dates by various authors/creators and received by various recipients is functionally equivalent to providing no privilege log at all.).

33 Preston Hollow Capital LLC v. Nuveen Asset Mgmt., LLC, 343 F.R.D. 460, 468–69 (S.D.N.Y. 2023).

34 GE v. APR Energy, PLC, 2020 U.S. Dist. LEXIS 75658, at *1 (S.D.N.Y. Apr. 29, 2020) (citing Fed. R. Civ. P. 26(b)(5)(A)).

35 *In re* Google RTB Consumer Priv. Litig., No. 22-MC-308 (PKC) (JLC), 2023 U.S. Dist. LEXIS 40772, at *6–7 (N.D. Cal. Mar. 10, 2023) (citing In re Grand Jury Investigation, 974 F.2d 1068, 1071 (9th Cir. 1992)).

36 *Keating*, *supra*, 2022 U.S. Dist. LEXIS 31462, at *12–13.

1. The date of the document;
2. The names of the sender and receiver, including the attorney involved;
3. A brief description of the document; and
4. The nature of the privilege.

d) "At issue" waiver

Another way that waiver can occur is when the privileged communication is "at issue" in the litigation, meaning that the privileged communication will be required to evaluate the validity of the claim or defense.[37] In the context of suretyship, the "at issue" waiver was raised in an indemnity action, *W. Sur. Co. v. PASI of LA, Inc.,*[38] by the indemnitors, in an attempt to compel the correspondence by and between the surety and its attorneys and consultants related to the settlement of bond claims.[39] The court found that the privilege had not been waived by the indemnity action because, under the terms of the indemnity agreement, the surety had complete discretion to settle the claim. Therefore, communications about the settlement decision were not "at issue" to prove the indemnity case.[40]

Absent such a strong indemnity agreement, another court found that, by seeking indemnity, the basis for the liability and the reasonableness of the settlement paid, including the mental impressions and analysis of counsel, were at issue and thus privileged communications were discoverable.[41]

Similarly, in a recent payment bond case*, Travelers Casualty v. Bunting Graphics, Inc.*,[42] the court considered whether privileged communications and work product should be disclosed when the indemnitors asserted claims of bad faith against a surety in paying claims, which the indemnitors asserted should have been paid at a lower value. The court noted that the indemnitors' claim that payment should have been made at a lesser amount does not give the indemnitors "carte blanche into Travelers' claims decision without some initial showing regarding whether the [claim] should have been paid for a lower value." However, this holding left open the possibility of discovering privileged communications related to "claims decisions" if the indemnitors provided sufficient evidence that the claim should have been paid for a lower value.

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37 Blackmon v. Bracken Constr. Co., 2020 U.S. Dist. LEXIS 190028, at *19 (M.D. La. Oct. 14, 2020).

38 2019 U.S. Dist. LEXIS 19710, at *6 (M.D. La. Feb. 7, 2019).

39 *Id.* at *6.

40 *Id.*

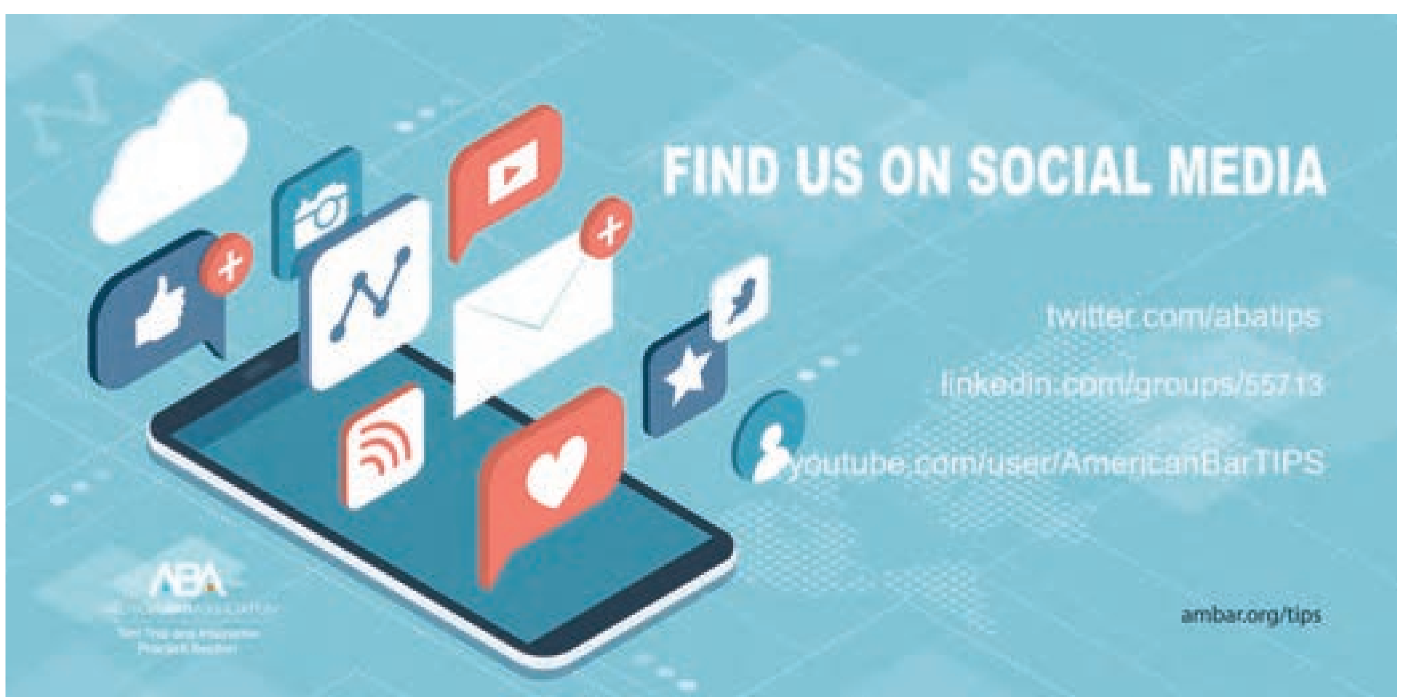
41 Conoco, Inc. v. Boh Bros. Constr. Co., No. 97-1378, 191 F.R.D. 107, 111 (W.D. La. 1998).

42 2023 U.S. Dist. LEXIS 31369, at *3 (W.D. Pa. Feb. 22, 2023).

Tips to Avoid Waiver

Based on the many ways that waiver of privilege can occur either voluntarily or inadvertently, here are some tips for preserving privilege:

1. Limit who is copied on communication with attorneys and ensure that the recipients are not forwarding the communication.
2. When communicating with the principal or principal's counsel regarding the claim, label each communication "joint defense privileged" and request that they do the same, and keep all indemnity communications separate.
3. When producing ESI, include counsels' (in-house, outside counsel, and principal's counsel) names and email addresses in the keyword search so as to flag all potentially privileged communications and test the reliability of the keyword searches by sampling the documents before production.
4. Restrict access to electronically stored privileged communications and work product, including password protection and restricted sharing capabilities.
5. Clearly mark and store privileged communications and work product outside of the general file material.
6. Create the privilege log once a claim is made and diligently maintain it.
7. During litigation, take reasonable steps to ensure that privileged communications are not inadvertently disclosed.



Beyond... continued from page 11

1. **Indemnification**: By the nature of the indemnity agreement, the surety is entitled to seek indemnification regardless of whether it has issued a collateral demand.[5] Nonetheless, courts will tend to side with the surety more often on its indemnification claim if the surety initially attempted to mitigate potential losses by demanding collateral under the terms of the indemnity agreement.[6]

2. **Compelling Payments**: The surety can pursue legal action to enforce its collateralization rights by way of specific performance and compel the indemnitor to surrender collateral.[7] In so doing, this provides the surety with an opportunity to consider enforcing its collateral demand in court and seek restraints, and other relief, against the indemnitor's assets or accounts.

3. **Assignment of Claims**: Upon a default, following the failure to deposit collateral, the indemnity agreement assigns the rights, title, and interest of the indemnitor's claims and causes of action to the surety.[8] The surety can leverage this provision to expand its sources of recovery and to globally resolve claims with bond obligees.[9]

4. **Triggering Security Interests**: Under an indemnity agreement, an indemnitor typically provides broad assignments and other security to the surety, including rights in connection with receivables, equipment, materials, insurance proceeds, subcontracts, subcontractor bonds, and other security interests. Upon a default, following the failure to deposit collateral, the surety is entitled to exercise its right to this security provided under the indemnity agreement.[10] To perfect this right, the surety may also decide to file the indemnity agreement as a financing statement under the UCC.

5. **Access to Books/Records**: Access to the indemnitor's books and records can help to mitigate bond exposure, and identify other recovery sources from

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5 *See* Aegis Sec. Ins. Co. v. Raks Fire Sprinkler, LLC, No. 1:21-CV-265, 2021 U.S. Dist. LEXIS 141415, at *11 (M.D. Pa. July 29, 2021) (recognizing indemnification rights can be broader when based on contract than common law).

6 *See, e.g.,* Ideal Electronic Security Co. v. Int'l Fid. Ins. Co., 129 F.3d 143, 150 (D.C. Cir. 1997) (rejecting principal's contention there was no obligation to reimburse attorneys' fees accrued by surety as it did not furnish collateral).

7 *See, e.g.*, Carles Constr., Inc. v. Travelers Cas. & Sur. Co. of Am., 56 F. Supp. 3d 1259, 1282 n. 61 (S.D. Fla. 2014) (holding surety has right to compel payments from principal and/or indemnitor when they decline to provide collateral as security for bond); Developers Sur. & Indem. Co. v. Bi-Tech Constr., Inc., 964 F. Supp. 2d 1304, 1309 (S.D. Fla. 2013) (recognizing right by surety to seek injunctive relief to compel deposit of such collateral, in addition to any other remedy at law or in equity that Surety may possess).

8 *See* Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp., 534 F. Supp. 2d 1290, 1306 (S.D. Fla. 2008) (recognizing breach triggered the assignment clause and assignment of principal's rights arising out of the construction contract).

9 *See e.g.*, Carr v. Davis, 63 S.E. 326, 328 (W. Va. 1908) (identifying fraudulent transfer claims may be pursued by the surety).

10 *See* Granite Re, Inc. v. Exec. Const. Mgmt. Co., 2018 U.S. Dist. LEXIS 203090, *8–9 (E.D. Mich. 2018); Aventura Eng'g, 534 F. Supp. 2d at 1306 (recognizing breach triggered the assignment clause).

the indemnitor or even third parties.[11] The indemnitor's ability to successfully object to a books and records demand may be avoided by the contractual right to do so in the indemnity agreement, as well as if the indemnitor fails or refuses to comply with the surety's demand for collateral.[12]

6. **Common Law Relief**: "Quia timet" is a remedy in common law granting the surety equitable relief to protect itself against potential loss.[13] The collateral demand provides the surety with an additional common law right to secure the assets or accounts of an indemnitor. This common law right is in addition to the contractual right to collateral under the indemnity agreement.

7. **Right to Freeze Funds:** When a surety receives bond claims, common law recognizes that the surety may send a freeze funds letter to the bond obligee.[14] Upon a default, following the failure to deposit collateral, the surety may possess a contractual right to send a freeze funds letter to the bond obligee.[15] Given that the failure to deposit collateral would be objectively clear, a freeze funds letter arising from a default under the indemnity agreement provides the surety with the contractual ability to secure bonded contract funds when faced with potential exposure.

8. **Right to Settle**: Surety professionals often face an indemnitor who objects to settlement of a claim and may insist that the surety litigate the claim. Some indemnity agreements provide that an indemnitor must post collateral as part of any request to the surety to litigate the claim.[16] The surety may

11 *See* W. Sur. Co. v. FutureNet Grp., Inc., No. 16-CV-11055, 2016 U.S. Dist. LEXIS 74512, at *1 (E.D. Mich. June 8, 2016) (recognizing surety protected by freezing indemnitors' assets and granting surety full access to indemnitors› financial records).

12 Nexus Servs., 470 F. Supp. 3d at 580–81 (holding that "[u]ntil Surety has been furnished with conclusive evidence of its discharge without loss from any Bonds, and until Surety has been otherwise fully indemnified as hereunder provided, Surety shall have the right of access to the books, records and accounts the Indemnitor(s) for the purpose of examining and copying them.")

13 Bond Safeguard Ins. Co. v. Dixon Builders I, LLC, No. CV 2010 10 4223, 2011 Ohio Misc. LEXIS 879, at *20–21 (Ct. Com. Pl. Feb. 4, 2011) (recognizing that *quia timet* allows court to impose equitable remedy: (1) if surety can show that debts are due; (2) if principal refuses to pay; and (3) surety becomes liable).

14 *See* Balboa Insurance Co. v. U.S., 775 F.2d 1158 (Fed. Cir. 1985) (recognizing stakeholder duty of Government to protect contract funds for surety upon receipt of notice from surety); Ins. Co. of the West v. U.S., 83 Fed. Cl. 535, 539 (Fed. Cl. 2008) (holding that notice to Government of potential default or actual default by contractor "can trigger the Government's "stakeholder" duty to act with reasoned discretion to protect the interest of the surety in remaining contract funds.").

15 Granite Re, 2018 U.S. Dist. LEXIS 23090 at *8–9; Aventura Eng'g, 534 F. Supp. 2d at 1306 (holding that breach triggered the assignment of principal's rights to surety).

16 *See* Renew Maint., 2018 U.S. Dist. LEXIS 225105 at *17–19 (holding that indemnity agreements often provide that surety with authority to make payments and resolve all claims unless principal/indemnitors request surety litigate and post collateral to secure amount of possible judgment and expenses of litigation.).

raise the indemnitor's failure to deposit collateral in a later challenge by the indemnitor to the settlement of a bond claim by the surety.[17]

9. **Defense to Claim of Bad Faith**: Similarly, the indemnitor may seek to challenge the settlement of a bond claim by accusing the surety of acting in bad faith.[18] Courts typically rule against the indemnitor who fails to furnish collateral upon demand, and recognize the surety's broad discretion to settle as a defense to a claim of bad faith, even when the indemnitor contests the settlement terms.[19]

10. **Tender of Defense**. A surety has discretion to tender the defense of a bond claim to its principal. The surety and principal sometimes disagree whether a tender of defense is appropriate. To the extent the bond principal or indemnitor has failed to deposit collateral, as required by a surety demand, the surety may point to such default under the indemnity agreement to the extent the surety declines to tender the defense of a litigated bond claim to the principal.[20]

11. **Declining Financing and Bonds**. Most indemnity agreements contain clauses providing that the surety is not required to finance or issue bonds for the principal. These clauses are often enforced by the courts and generally provide the surety with absolute contractual defenses.[21] The surety may, however, also rely on a default arising from an indemnitor's failure to deposit collateral, in addition to the indemnity agreement's other contractual defenses, in defending against a lawsuit by a bond principal alleging that the surety failed to finance or issue bonds.

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17 Fid. and Dep. Co. of Md. v. D.M. Ward Const. Co., Inc., 2008 U.S. Dist. LEXIS 53971, 2008 WL 2761314, *3 (D. Kan. Jul. 14, 2008) (holding that "[p]ursuant to this clause, defendants bargained away the right to contest how plaintiff handled claims upon the bonds unless they were willing to post collateral satisfactory to plaintiff. In cases with similar contractual clauses, courts have held that the indemnitor may not make a claim of bad faith where it failed to post the required collateral[]"); Aventura, Eng'g, 534 F. Supp. 2d at 1316; *Developers,* 2018 U.S. Dist. LEXIS 225105 at *17 (holding that indemnity agreements provide surety with authority to make payments and resolve claims, if among other things, the indemnitors fast to post collateral).

18 *See* Transamerica Ins. Co. v. Avenell, 66 F.3d 715, 721 (5th Cir. 1995) (holding that the surety did not act in bad faith by settling contested claim when principal failed to post collateral); Travelers Cas. & Sur. Co. of Am. v. Grace & Naeem Uddin, Inc., No. 08-61868-CIV-COHN/SELTZER, 2009 U.S. Dist. LEXIS 109602, at *5 (S.D. Fla. Nov. 24, 2009) (involving indemnitors' bad faith claim as to settlement).

19 U.S. Sur. Co. v. Best Const. Drywall Servs., *Inc.*, 2018 U.S. Dist. LEXIS 83222, 2018 WL 2267109, *2–3 (M.D. Fla. May 17, 2018) (holding that "defendants fail to show that they posted any collateral. The . . . failure to post collateral precludes the defendants' relying on the defense of bad faith[]") (citation omitted)); Fid. & Dep. Co. of Md. v. C.E. Hall Const., Inc., 627 Fed. Appx. 793, 795-796 (11th Cir. 2015) (holding surety settled bond claim in good faith after defendant failed to post collateral); *See e.g.,* Ebasco Constructors v. A.M.S. Constr. Co., 599 N.Y.S.2d 866, 866 (App. Div. 2d Dept. 1993)(holding that surety had right and acted in good faith in settling claim when indemnitors failed to deposit collateral with surety).

20 *See, e.g.,* Ebasco Constructors v. A.M.S. Constr. Co., 599 N.Y.S.2d 866, 866 (App. Div. 2nd Dept. 1993) (noting in analogous context that surety does not have to litigate bond claim when indemnitors fail to deposit collateral).

21 *See* Travelers Indem. Co. v. Buffalo Motor & Generator Corp., 397 N.Y.S.2d 257, 258 (App. Div. 4th Dept. 1977) (upholding clause in indemnity agreement allowing surety to decline to issue bonds).

Conclusion

Given the reasons identified in this article, the surety facing bond claims or other exposure under its bond or the indemnity agreement is advised to consider demanding collateral from the indemnitor, unless there are justifications against doing so, such as the indemnitor being protected by a bankruptcy stay or state court receivership. The benefits gained by the surety underscore the importance of not overlooking this opportunity. Ideally, the surety would prefer the indemnitor to fulfill the collateral demand. However, even if the surety lacks certainty that the principal or indemnitors will actually provide collateral, there are compelling reasons to make the demand anyway, as the surety still stands to gain even if the collateral demand is unfulfilled.

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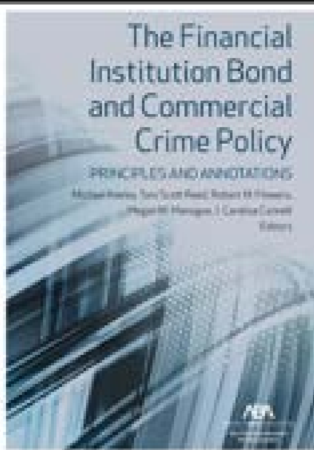

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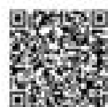

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