



Demystifying the Surety Industry's Expedited Dispute Resolution Bond

BY PHILIP L. BRUNER AND PATRICIA H. THOMPSON

THE UNIQUE PURPOSE OF THE EXPEDITED DISPUTE RESOLUTION PERFORMANCE BOND

Since Travelers introduced its expedited dispute resolution (EDR) performance bond in early 2015, the bond has started to take hold, as obligees and general contractors increasingly take advantage of the distinct benefits it offers.

The EDR bond was originally designed to be used as an alternative to letters of credit or conventional performance bonds on complex design-build projects, such as

those undertaken by public-private partnerships involving sophisticated developers, designers and contractors, to promptly resolve critical factual and legal issues over whether the contractor was in default and whether the obligee could invoke the surety's obligation to perform. To that end, one of the distinguishing characteristics and benefits of the EDR bond is its specially crafted process for the expedited resolution of any dispute between the parties to the bond as to the obligation of the surety to complete a defaulted

contractor's performance obligations under the contract.

The advantage of the EDR bond is that it addresses the concerns of the surety and obligee regarding both the letter of credit and the traditional performance bond: The surety's obligation to perform cannot be invoked merely "on demand," as under a letter of credit, and the obligee's right to performance upon a contractor's disputed default will be promptly adjudicated and the project not unduly delayed. Since introduction of the Travelers EDR bond, the early

adjudication principles of the EDR bond are being implemented widely on other, more traditional projects.

As with any innovation, some in the construction industry have confused EDR bonds with construction default insurance, failed to appreciate how the dispute resolution process in EDR bonds is different from those of and resolves certain problems inherent in traditional modes of construction dispute resolution or simply misunderstood how the EDR bond works.

Regarding the first area of confusion, there are fundamental distinctions between the EDR bond and default insurance.

First, EDR bonds are neither analogous to nor offered as a market alternative to any form of subcontractor default insurance (SDI). The two products differ widely in purpose and coverage. Broadly speaking, when a surety's obligations are properly triggered under the EDR bond, it obligates a surety to perform or to complete a defaulted general contractor's construction contract for the benefit of the project owner or other named obligee on the bond (which could be a general contractor). On the other hand, SDI obligates an insurer to reimburse a general contractor for a portion of the costs advanced by that general contractor to cure its subcontractor's breach of contract.

Another crucial difference between the EDR bond and SDI is the carefully tailored process by which the EDR bond allows the parties to quickly obtain a decision by a neutral adjudicator with construction expertise, who resolves any dispute among the parties on the crucial, time-sensitive question of whether the surety has an obligation to perform the principal's contract upon declaration of default by the obligee. SDI insurance offers no dispute resolution procedures.

AN OUTLINE OF THE EDR BOND'S ADJUDICATIVE PROCESS: DECIDING WHETHER THE SURETY IS LIABLE TO PERFORM

Much has been written about whether litigation or arbitration offers a better forum for resolving the myriad types of disputes that can arise from troubled construction projects. Arguments advanced for and against each of these traditional resolution processes have little to do with the unique dispute adjudication resolution procedures of the EDR bond. The bond is intended to provide a superior and swift solution for the critical questions as to whether a contractor and obligee have complied with their obligations under the bonded contract and whether the surety is obligated to perform the bonded contract.

Specifically, unlike lawsuits, which can resemble multi-headed hydras fighting over many tiers of claims, the EDR bond defines only three issues to be addressed in the proceeding:

- is the contractor in default;
- has the obligee performed its obligations under the contract; and
- is the surety liable under the bond?

The bond also insures the participation of only three parties: the surety, obligee and principal, which are the only parties necessary to resolve the key questions of whether the surety's performance obligations have been triggered. The bond's adjudicative process is crafted to resolve this issue quickly enough to allow the project to proceed with as little impact on the schedule as possible; based on the decisions of an impartial decision-maker knowledgeable about construction and its processes, surety and dispute resolution law, and the facts specific to the project at issue (the Travelers EDR bond provides that the decision-maker must be from the JAMS Global Engineering and Construction panel pursuant to JAMS Rules); and with a decision that is binding and obligates the parties

to perform, while also preserving the parties' rights to later seek a de novo review if warranted. Court review is the bond's default option, but the parties can agree on appellate arbitration.

The EDR bond's speedy decision process begins when an obligee declares the principal or general contractor to be in default and demands performance by the surety. At that point, the surety has 15 days to decide whether it will comply with the demand and, if so, how. In the event the surety declines or fails to agree to perform within that 15-day window, then either the surety or the obligee has 10 days to initiate an adjudication with JAMS, which has promulgated a unique set of expedited rules specifically for the purpose of resolving these disputes.

Three days after a proceeding has been filed with JAMS, an adjudicator from JAMS' expert construction panel is chosen by the parties or, failing their agreement, by JAMS itself. Then, upon confirmation of the adjudicator and payment of initial fees, the 30-day clock for the adjudicator to make a decision on the default demand begins to run.

To offset the stated concerns of some that urgency will outweigh the accuracy and sufficiency of the evidence considered by the adjudicator, the EDR bond balances the goal of a speedy decision with the right of the adjudicator to ascertain the relevant facts and resolve any legal issues. In addition, it is within the adjudicator's sole discretion to manage the process to obtain information from the parties and other witnesses, including experts. In turn, the parties may agree to extend the deadline for issuing the adjudicator's decision, in the event they need more time to obtain the information requested.

Another unique aspect of this process is the efficacy of the

adjudicator's decision, which is to be in writing, reasoned and admissible in any subsequent proceeding. After a decision is rendered, the parties have five days to request any clarification, which the adjudicator is to provide within five days. Unless and until subsequently vacated or modified, pursuant to any party's appeal de novo to a court of competent jurisdiction, the decision is binding on and enforceable by the parties through the completion of the principal's obligations pursuant to the bonded construction contract. Thus, if the adjudicator determines that the surety is liable to make any payments or otherwise perform, the surety must comply promptly and continue its performance until the principal's obligations are completed, even if the surety wishes to appeal the adjudicator's decision. Importantly, unlike either litigation or traditional arbitration, not only is the decision rendered quickly, but an appeal will cause no delay in the completion of the project.

USING EDR BONDS SHOULD RESULT IN LESS LITIGATION

It is expected that the expedited nature of this resolution process and the fact that the adjudicator's decision is both binding and subject to de novo judicial review will result in less litigation over performance claims under EDR bonds. Travelers' bond was modeled in part on a dispute resolution method commonly used in Great Britain, known as expedited construction adjudication.

Like the procedures outlined in Travelers' bond and JAMS' related rules, Britain's construction adjudication process provides that disputes arising during construction will be decided by a party-agreed-upon neutral with proven expertise in construction law, usually within 30 days of submission of the dispute.

This expedited method has been credited with reducing construction litigation in the Great Britain by 80%. Moreover, the British experience is that parties usually accept a neutral adjudicator's decisions. Thus, under this expedited resolution process, delays are minimized, dispute resolution expenses are curtailed and, usually, litigation is avoided altogether, notwithstanding the preservation of the parties' rights of appeal.

REASONS TO EXPAND THE USE OF EDR BONDS

It seems clear that the expedited dispute resolution procedure in the EDR bond form would help resolve one of the chief criticisms of performance bonds: the harm believed to be caused to the project by the surety's perceived delay in investigating a claim or the surety's outright refusal to perform. The great success of similar expedited dispute resolution methods in Britain and the obvious benefit to the parties of an early resolution of performance bond disputes should encourage obligees, general contractors, sureties and others in the construction industry to give serious consideration to using such an accelerated, less expensive, business-positive process for resolution of performance bond claims as well as other construction disputes. As noted above, Travelers intentionally made its bond form available to the market for such purposes.

In its 2019 Global Construction Disputes Report, Arcadis observes that contractually required adjudication has become the third most popular means of resolving construction disputes, explaining, "[I]f sophisticated project participants continue to invest in early resolution techniques, we

believe that the overall value of disputes will continue to decline." Arcadis also advises, "When [construction] disputes do arise, project participants should be driven to address [resolvable issues] as early as possible. ... [U]nlike fine wine, disputes do not get better or less expensive with age."

Indeed, even when early adjudication is not required by project documents, the parties to any surety or other construction dispute can minimize delays and costs by voluntarily adjudicating their dispute using an expedited process based on that defined in the EDR bond form and the referenced JAMS expedited dispute resolution rules.



Philip L. Bruner, Esq. is a JAMS neutral based in Minneapolis. He is one of the world's leading

arbitrators, mediators and resolvers of construction, engineering and infrastructure claims. For more information, email pbruner@jamsadr.com.



Patricia H. Thompson is a JAMS full-time neutral based in Miami. She focuses her practice

in construction, employment, surety, fidelity, financial insurance matters and other complex commercial disputes in state and federal courts. For more information, email pthompson@jamsadr.com.

Digital reprint authorized for email and website marketing.
Copyright © 2020 by *Construction Executive*. All rights reserved.