

COMMERCIAL surety claims

A case study on the bond producer's role in assisting a client to avoid loss and maintain surety credit through bankruptcy

BY ARMEN SHAHINIAN



A **TEAM APPROACH** may well be the best way to maintain surety credit during a debtor/principal's bankruptcy reorganization process. One critical member of such a team is the surety bond producer, who can serve a key facilitative role during a principal's bankruptcy reorganization to avoid loss and to maintain surety credit. This critical topic was highlighted at the NASBP Annual Meeting & Expo in San Antonio during a robust commercial surety claims panel discussion on "Commercial Surety and Bankruptcy," which focused on a successful case study. This impressive panel included a surety claims attorney, a surety bond producer, a surety CEO, a surety claims representative, and a CEO of a former commercial debtor/principal.

The panel was moderated by Armen Shahinian of the law firm of Wolff & Samson PC in West Orange, New Jersey and New York, New York. Rob McDonough, Regional Director at AON Risk Solutions, with responsibility for commercial and construction surety in New York, New Jersey and Connecticut, was the surety bond producer involved in the case study. Stephen Haney, Division President for ACE Surety and its Chief Underwriting Officer for Global Surety, provided the perspective of the surety underwriter. Henry ("Hank") Minissale, Vice President of Surety Claims at ACE Surety, brought to the panel the perspective of the manager of a surety claims department. Joe Page provided the perspective of the bond principal, having recently served as Senior Executive Vice President, Chief Administrative Officer, and General Counsel of Synagro Technologies, Inc. (Synagro), headquartered in Baltimore, Maryland.

Synagro is a waste removal and processing contractor, employing over 800 people in 34 states and serving more than 600 municipal and industrial water and wastewater facilities. Synagro filed for Chapter 11 bankruptcy protection in the spring of 2013. The primary goal of a Chapter 11 bankruptcy is the financial rehabilitation, rather than liquidation, of a debtor's business. A successful reorganization entails the continuation of the debtor's business under a confirmed reorganization plan. Unfortunately, the vast majority of Chapter 11 proceedings do not culminate in a successful reorganization. And what factors can make the difference? Certainly, a team approach and a facilitative surety bond producer can maximize the chances of a successful reorganization.

This case study involves the process of Synagro successfully reorganizing, while continuing to operate as normal, continuing to pay its employees, continuing on-going capital projects, and maintaining surety credit. At the time of its bankruptcy filing, it had outstanding surety bonds of nearly \$110 million issued by eight sureties. Page managed the pre-bankruptcy negotiations with both the sureties and Synagro's lenders, which ultimately led to negotiated first-day orders under which the sureties' bonds remained in place for the benefit of the post-petition debtor entity.

During a bankruptcy proceeding, it is important to educate both the court and counsel for the debtor and lenders regarding the nature of a surety bond. Often both the management of debtor



Panelists of the commercial surety claims process presentation: "Commercial Surety and Bankruptcy: The Professional Surety Bond Producer's Role in Avoiding Loss and Maintaining Surety Credit through Bankruptcy." From left, moderator Armen Shahinian of Wolff & Samson PC, Rob McDonough of Aon NY, Joe Page, formerly of Synagro Technologies, Hank Minissale of ACE Surety, and Stephen Haney of ACE Surety.

entities and counsel for debtors and lenders do not immediately appreciate the fact that surety bonds, while issued by insurance companies, are not like traditional insurance policies. The tendency on the part of some debtors is to lump their surety bonds with insurance policies in preparing first-day orders, seeking to keep in place their insurance policies. Under the Bankruptcy Code, insurance typically is property of the debtor estate, having been purchased by the debtor through payment of a premium in order to obtain the benefit of coverage in the event of an insured loss. In contrast, surety bonds are extensions of surety credit which, under the Bankruptcy Code, are properly characterized as financial accommodations. As such, they are *not* property of the debtor estate and are not capable of being assumed by the debtor without the surety's consent.

When a bonded principal files for bankruptcy protection, seeking to reorganize, typically it will continue to need surety bonds to operate. Those bonds may be license, permit, contract and other bonds, but regardless of type, if the debtor is seeking to maintain operations as a Chapter 11 debtor, surety credit may

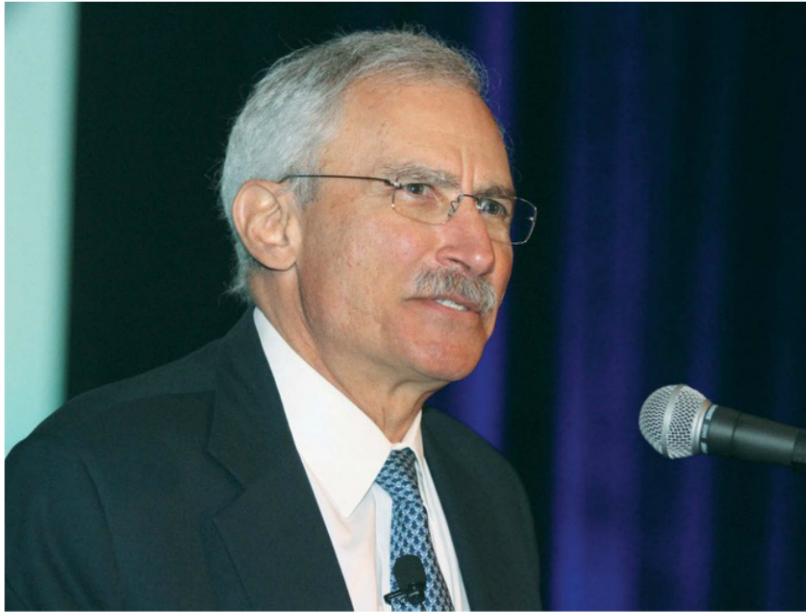
be no less essential to the viable reorganization of the debtor than is bank credit. It is the role of the surety's counsel to ensure that the court, the debtor, and the bank's lender understand that reality so that appropriate protections can be put into place to provide comfort to the surety that, should defaults occur after the filing of the bankruptcy petition, the surety's resulting claim against the debtor estate is treated, at minimum, as an expense of administration entitled to priority over claims of general unsecured creditors.

Even though surety bonds are financial accommodations that the debtor cannot assume, the Bankruptcy Code provides for an automatic stay, which can prevent cancellation of the surety's bonds in the absence of the filing of a motion seeking relief from the stay in order for the surety to send cancellation notices.

With a relationship with both the debtor and the surety, the surety bond producer can play a critical role in facilitating communications when a bankruptcy is imminent. The surety bond producer, in appropriate circumstances, can facilitate both protection of the surety with respect to outstanding bonds and assist a

debtor in furtherance of a potentially successful reorganization by allowing its operations to continue to function unimpaired during the bankruptcy process by obtaining bonding even after the bankruptcy petition is filed. Both of these goals may be accomplished pursuant to a negotiated "First-Day Order," which provides administrative expense status, and perhaps some collateral, in order to induce the surety to keep its bonds in place and to possibly issue new bonds during the bankruptcy. Pre-bankruptcy communication is critical in order that the debtor's business is not unduly disrupted. A surety bond producer is in a unique position to fulfill this critical facilitative role.

In the Synagro matter, even though over \$100 million of bonds were outstanding, no losses were sustained by the sureties as a result of proactive management of both the sureties' exposure and negotiations with the debtor and, through the debtor, with its lenders. That process included educating the parties in interest regarding why it was in their mutual interest to retain surety credit and protect the surety against loss. If the debtor entity had not retained surety credit, then it would likely have been



Moderator Armen Shahinian of Wolff & Samson PC.

unable to successfully restructure and refinance the company's debt. In this case the parties were able to avoid problems because, with the assistance of the bond producer, the sureties got the attention of the debtor/principal's management before the bankruptcy filing and negotiated first-day orders that protected the sureties, as continued surety credit post-petition was essential to the debtor's reorganization efforts.

Most successful reorganizations in which the surety is able to avoid loss are reorganizations in which the reason for the bankruptcy filing is *not* that the debtor entity is incapable of operating a business successfully. Rather, they involve situations in which the debtor is able to operate at a profit but for its debt load, which it is incapable of servicing and sustaining. Where there is a viable underlying business that is capable of operating at a profit with a different capital structure, a Bankruptcy Code section 363 sale of the debtor's assets as an operating company will generally provide the best opportunity for at least the secured creditors to receive some distribution in excess of what would be received in a liquidation. Under

these circumstances, it is important to allow for continued operations, which will often require maintenance of surety credit. The result is that all of the creditors that might benefit from a successful reorganization, as well as debtor's management, have an interest in the maintenance of surety credit and understand its importance to the ability of the debtor to reorganize. Under those circumstances, protections available to lenders in bankruptcy, such as administrative expense status and, potentially, collateralization, may be made available to the surety. If administrative expense status is achieved, the surety will be assured

of no loss if the debtor is able to successfully reorganize and confirm a plan of reorganization, because confirmation of a plan of reorganization requires payment of administrative expense claims, such as that possessed by the surety under a typical surety program order.

The surety bond producer can play an important role in helping sureties avoid a loss and assisting debtor/principals to maintain surety credit and, potentially, to successfully reorganize. The Synagro case study serves as a model for bond producers and sureties on commercial accounts that are seeking financial restructuring. The surety bond producer was effective in getting the attention of the debtor's management well before the bankruptcy filing so that the debtor could successfully operate with surety credit post-petition and the sureties could put that surety credit in place with protections that resulted in no loss to the sureties with respect to both their pre- and post-petition exposures. ●

Armen Shahinian is a surety and construction attorney and member of Wolff & Samson PC practicing in West Orange, NJ and New York, NY. He is a past Chair of the ABA Fidelity & Surety Law Committee, a member of the Board of Directors of the Surety Claims Institute and an Advisor to the Surety Claims Advisory Committee of the Surety & Fidelity Association of America. He can be reached at 973-530-2002 or ashahinian@wolffsamson.com.

GRANITE_{RE, INC.}

The Creativity, Flexibility,
and Service You Deserve
From a Surety Partner

www.granitere.com
1-800-440-5953