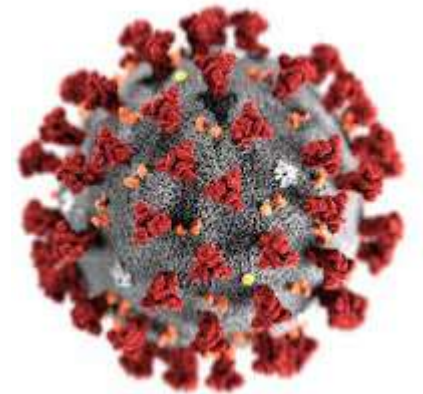


Protecting the Surety During the COVID-19 Pandemic



CONTRACTOR EVALUATION AND
PROTECTING BONDED
WORKING ASSETS

Disclaimer:

This presentation is for educational purposes and not intended to be legal advice. In any general presentation on legal topics, the audience should seek separate legal advice on their specific cases and facts. In this unique environment dealing with the impacts of a worldwide pandemic, this advice is even more important. The legal analysis of your claim may be dependent on facts, contractual language, laws of your jurisdiction and other issues beyond the scope of this presentation. We hope you find this brief presentation beneficial.



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Contractor Stress Test - All Hands On Deck

- ❖ COVID-19 disruptions could “fast track” an account to pre-default or default stage
- ❖ Project and Accounting Review
- ❖ Subcontractor, Labor and Supply Chain Analysis
- ❖ Contractor coordinating with Lender and Surety
- ❖ Talk to accounts now. Need 60- to 90-day Plan?

Contractor Stress Test - Overview

- ❖ Cash flow and liquidity – Work restrictions limiting cash flow? PA, NY, WA
- ❖ Type and structure of debt
- ❖ Management Structure
- ❖ Access to Working Capital- bank line?
- ❖ Status of Bonded Contracts – **shifting resources to non-bonded?**
- ❖ Types of Bonds Needed (Commercial accounts)
- ❖ Relationships with Lenders and Trade Creditors

Contractor Stress Test – Viability?

Likely Yes

Has access to cash or very liquid investments, owners willing to fund/participate in work-out. Access to COVID Stimulus?

Primary debt is unsecured trade debt and contractor making efforts to keep debt current

Good relationships with lender and trade creditors

Good knowledge of projects, costs to complete

Management has identified problem projects and has a plan

Planning with key creditors, including surety

Contractor Stress Test – Viability?

Likely No

Little to no assets or source of financing to fund operations or a work-out with key creditors.

Significant “priority” debt (tax and wage debt)

Poor relationships with lender and trade creditors

Inability to generate reliable project records

Management has no plan and is looking for others to solve

Unwilling to engage key creditors, including surety

Contractor Stress Test – If the Contractor is Viable. . .

- Consider Pre-Default Options to Help Preserve Enterprise Value and Protect Access to Bonded Working Assets
- Key Bonded Working Assets (aside from Bonded Receivables):
 - Equipment – Move to Surety controlled warehouse now?
 - Materials – Should we pre-pay and take delivery now?
 - Facilities – Rented or owned? Pre-pay now? Needed if remote staff?
 - Intellectual Property/Computers/Licenses – GET ACCESS NOW
- Key Project Management and Project Personnel

Contractor Stress Test – Agreements to Protect Access to Assets Needed for Completion

Equipment, Facility, and Intellectual Property Agreements

Typical Utilization Agreement (Lender, Principal, and Surety) Include (among others):

- Contractor will not permit any lien or encumbrance w/o prior consent unless the lienholder agrees to be bound by utilization agreement
- Surety/Principal utilization agreement – no payment by surety to principal
- Surety/Lender provisions
- For Real Property Facilities: Is Contractor paying rent? Mortgage? should record
- Fixtures (removable?): Record
- Intellectual Property (technically license):
 - Proprietary systems, software, inventions, designs, patents, patent applications, trademarks, copyrights, licenses, trade names, trade secrets and associated goodwill
- Computers low monetary value – on the front end, lender usually willing to allow use without fee

Contractor Stress Test – Agreements to Protect Access to Assets Needed for Completion

Retention Agreements with Key Management and Project Personnel?

- Retention Agreements assure personnel return to management and importantly to project. **Labor moving across State lines?**
- Identify Key Management Personnel:
 - Accounting and IT/IP?
 - Project Estimators?
- Identify Key Project Personnel:
 - Engineers
 - Supervisors
- Review Labor Agreements – Contractor obligation to fund payments to hold/commit labor?
- How to fund? Should surety fund? Lender?

Contractor Stress Test – Surety Bridge/Short-Term Financing

- Acknowledgement of Surety's Rights under GAI, Trust Fund rights, equitable subrogation
- Typically contain funds control, surety oversight/approval
- Grants liens in all assets (subject to intercreditor as applicable)
- Include owners/indemnitors as part of the “plan”
- Mechanism to return-to-normal
- Bonding during work-out term?

Contractor Stress Test – Agreements to Protect Access to Assets Needed for Completion

Intercreditor Agreements

- Between Surety and Principal's lender or between sureties
- Acknowledge/consent to other creditor's lien/priorities in specific assets
- Surety priority in "Bonded Working Assets"
- Bonded Working Assets: Bonded contracts, bonded receivables, equipment, associated general intangibles and intellectual property
- Lender priority in other Assets (other than Bonded Working Assets)
- Standstill provisions:
 - Surety no action against "Lender Priority Collateral" until all obligations to lender satisfied
 - Lender no action against "Surety Priority Collateral" until all surety loss reimbursed and no bond exposure

Contractor Stress Test – Agreements to Protect Access to Assets Needed for Completion

Intercreditor Agreement Variations

- Surety purchase of lender debt and collateral rights
 - Due Diligence
 - No defense to debt
 - Collateral value: equipment, “claims”
- Participation Agreement
 - Lender loan remains in place
 - Surety purchases portion of debt coupled with subordinated interest in collateral
 - Lender then makes credit available to Principal for use under approved budget
 - Principal may pledge additional collateral to support
 - Collateral liquidation provision

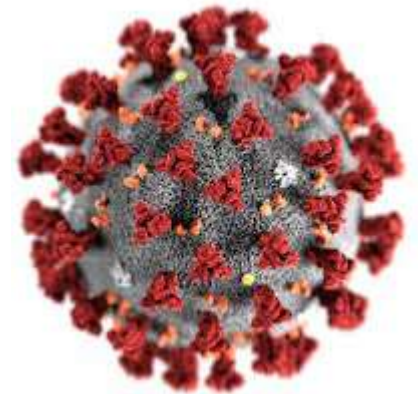
Contractor Stress Test – If Contractor Not Viable . . .

- ❖ Strategic Partner Acquisition? Teaming?
 - Key project, name, equipment?
- ❖ Use of Chapter 11 to Facilitate acquisition?
- ❖ Preference – tracing Issues
- ❖ **Available, “healthy” completion contractors? Options could be limited**
- ❖ Record UCC-1
- ❖ Move Equipment to Surety Controlled warehouse

Contractor Stress Test – Takeaways

- ❖ COVID 19 issues may fast track accounts to pre-default or default stage?
- ❖ Possible increase in financing arrangements to “flatten the curve” to prevent all-at-once defaults
- ❖ Available completion contractors? Options could be limited
- ❖ Secure labor, management, equipment, materials, facilities, and IP/IT now
- ❖ Be mindful of preference issues
- ❖ Bankruptcy may be a good option

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