The Final Diagnosis: Taking a Deeper Look at Ethical Issues

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Certain ethical considerations may come into play when the surety utilizes the various treatment options discussed during this program. In addition to good faith standards imposed by courts and by certain contract terms (including the implied covenant of good faith and fair dealing), some state statutes and regulations, as well as the American Bar Association's Model Rules of Professional Conduct[1] impose ethical obligations on attorneys. Conflicts of interest concerns raised by the joint representation of the principal and surety, the surety's decision to pursue or not pursue the principal's claims, and confidentiality issues are just some of the important ethical issues that the surety and claims professional should consider. This paper will discuss some of the issues that may arise when working to revive a dying contractor.

Conflicts of Interest Considerations

Ethical standards are the backbone that give support to the public's perception of the legal profession.[2] As the bones grow and develop in an ever-changing legal environment, competing interests keep them from becoming too rigid or too pliant. They must remain strong and healthy to support the public's trust in the legal profession and its ability to govern itself, and not become less respected than pond scum.[3] The ABA Model Rules, as well as applicable state ethics rules, prohibit a lawyer from representing a client whose interests are directly adverse to another client.

For example, ABA Model Rule 1.7 provides, in part, that with respect to current clients, "a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if: (1) the representation of one client will be directly adverse to another client; or (2) there is a significant risk that the representation of one or

[1] For purposes of this paper, the American Bar Association's Model Rules will be referred to as "ABA Model Rule ___".
[2] *In re Superior Coal Co.,* Case No. 97-1040-CH, Case No. 7-1041-CH, Case No. 97-1042-CH, 1998 Bankr. LEXIS 2070, *8 (S.D. Iowa April 2, 1998).
[3] *Id.*

more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer."[4] Each state has its own similar rule. For example, Rule 4-1.7 of the Rules Regulating the Florida Bar provides, in part, that a "lawyer shall not represent a client if the representation of that client will be directly adverse to the interests of another client, unless: (1) the lawyer reasonably believes the representation will not adversely affect the lawyer's responsibilities to and relationship with the other client; and (2) each client consents after consultation."[5] The ABA and state ethics rules provide some guidance on how to address conflicts when they arise. However, should those conflicts not be addressed, there can be serious consequences not only to the lawyers involved but to the surety whose interests are being represented.

Joint Representation Concerns

Under the rules of ethics, lawyers are prohibited from jointly representing parties with adverse interests. In construction litigation, it is not unusual for a lawyer to represent both the surety and the principal. A surety often will tender its defense to its principal's counsel at the request of the principal. This dual representation is often a business decision that is made based on the surety's relationship with its principal, and can also be convenient because the parties' interests are often aligned towards defending or prosecuting the claims at issue. Furthermore, the combined defense can streamline resolution of the claims as well as save time and expense for both parties.

Representation of both the surety and the surety's principal, however, can sometimes be problematic. While the parties may have common goals with respect to defense or recovery of claims, any time a lawyer represents more than one client, it is important to note the conflicts

[4] ABA Model Rules, Rule 1.7 (2019).
[5] Rules Regulating the Florida Bar, Rule 4-1.7 (2019).

that could arise to the extent the parties' interests may ultimately diverge. For example, when the surety tenders its defense to the principal's counsel, it is possible that the principal's attorney has a history and relationship with the principal. In such circumstances, the attorney may have a stronger sense of loyalty to the principal than the surety. However, counsel must be prepared to represent each party equally. Each client in the common representation has the right to loyal and diligent representation.[6]

Ethical principles govern the lawyer's representation and provide that when establishing a relationship between clients, the lawyer "should make clear that the lawyer's role is not that of partisanship normally expected in other circumstances and, thus, that the clients may be required to assume greater responsibility for decisions than when each client is separately represented. Any limitations on the scope of the representation made necessary as a result of the common representation should be fully explained to the clients at the outset of the representation."[7] The ABA Model Rules provide:

> (a) A lawyer shall:
>
> > (1) promptly inform the client of any decision or circumstance with respect to which the client's informed consent, as defined in Rule 1.0(e), is required by these Rules;
> >
> > (2) reasonably consult with the client about the means by which the client's objectives are to be accomplished;
> >
> > (3) keep the client reasonably informed about the status of the matter;
> >
> > (4) promptly comply with reasonable requests for information; and
> >
> > (5) consult with the client about any relevant limitation on the lawyer's conduct when the lawyer knows that the client expects assistance not permitted by the Rules of Professional Conduct or other law.

[6] ABA Model Rules, Rule 1.7, Cmt. 33 (2019).
[7] ABA Model Rules, Rule 1.7, Cmt. 32 (2019).

> (b) A lawyer shall explain a matter to the extent reasonably necessary to permit the client to make informed decisions regarding the representation.[8]

Thus, the ethical rules require the lawyer to inform both clients of facts and considerations necessary to make informed decisions regarding any joint representation.

Some of the issues that may need to be considered by the surety, principal and lawyer are potential conflicts that may arise over certain surety-specific defenses that may adversely affect the principal's position. Those defenses may include the surety's claims of overpayments to the principal by the obligee, fraudulent inducement by parties to write the bonds in the first instance, and material alterations to the underlying bonded obligation which could be contrary to the principal's position. Conversely, conflicts may arise when the principal, while not having valid defenses to a claim, seeks to delay or avoid payment for various reasons. Not only does such a situation impose conflicts of interest considerations among the parties but the lawyer's ethical obligations are implicated. The rules provide that a "lawyer shall not bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis in law and fact for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."[9]

As an example, the North Carolina State Bar considered the following ethical issues facing an attorney undertaking the joint representation of a surety and principal and opined as follows:

> Ordinarily, the interests of the surety and the general contractor will be aligned in defending a payment bond claim. However, the lawyer has an obligation to assert only valid defenses to the claims asserted and to avoid unnecessary delay in the proceedings. Rule 3.1 and Rule 3.2. The lawyer should explain these duties to both parties at the outset. If the general contractor insists upon a course of conduct that would violate the Rules of Professional Conduct, the lawyer must

[8] ABA Model Rule 1.4 (2019).
[9] ABA Model Rule 3.1 (2019).

> withdraw from the joint representation and advise both the general contractor and the surety to obtain separate counsel. See Rule 1.7(b).
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> Similarly, if the lawyer believes that an appropriate defensive action taken on behalf of the general contractor would interfere with a legal duty the surety owes to the claimant/supplier, such that the surety could be exposed to a bad faith claim, a conflict arises. In this situation, the lawyer must withdraw from the representation of both parties and may only continue with the representation of the general contractor with the consent of the surety. Rule 1.9(a).[10]

Ethical rules prohibit a lawyer from undertaking common representation of clients where contentious litigation or negotiations between them are imminent or contemplated.[11] At the outset, it is important to be cognizant of what rules govern the situation. Many states have modeled their state ethics rules after the ABA Model Rules. These rules are often written broadly and are may not be narrowly tailored to address specific factual scenarios. It is, therefore, imperative that counsel carefully consider, on a case by case basis, whether it is prudent to represent multiple parties (i.e., both the surety and the principal).

Florida goes a step beyond the ABA Model Rules. Florida requires that: (i) the lawyer must reasonably believe the representation will not be adversely affected; (ii) the client consents after consultation and, (iii) when representing multiple clients in a single matter, consultation "shall include the implications of the common representation and the advantages and risks involved."[12] The New York City Bar considers the following factors: (1) the nature of the conflict; (2) the likelihood that client confidences or secrets in one matter will be relevant to the other representation; (3) the ability of the lawyer or law firm to ensure that confidential information of the clients will be preserved; (4) the ability of the lawyer to explain, and the

[10] 2003 N.C. Eth. Op. 1 (Adopted April 18, 2003); s*ee also* Jonathan Bondy, Russ Fuller, Matthew Silverstein and Michael A. Stover, Ethical Issues In Tenders Of Defense And Joint Defense Agreements, pp. 3-4 (unpublished paper presented at ABA/TIPS Mid-Winter Meeting, January 23-24, 2014) for further discussion on N.C. Eth. Op. 1.
[11] ABA Model Rules, Rule 1.7, Cmt. 29 (2019).
[12] Rules Regulating the Florida Bar, Rule 4-1.7(c) (2019).

clients' ability to understand the foreseeable risks of the conflict; and (5) the lawyer's relationship with the clients.[13]

When the parties determine that their interests will not be adversely affected by joint representation, notwithstanding the existence of a concurrent conflict of interest, a lawyer may represent clients if: (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client; (2) the representation is not prohibited by law; (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and (4) each affected client gives informed consent, confirmed in writing.[14] When representation of multiple clients in a single matter is undertaken, the information necessary to make a client's consent an informed one should include explanation of the implications of the common representation and the advantages and risks involved.

When claims of conflicts of interest arise, the party moving to disqualify counsel on the basis of an actual or potential conflict typically bears the burden of proving the grounds for disqualification.[15] In *Caravousanos v. Kings County Hosp.,*[16] a principal defaulted on a hospital construction project and the obligee called upon the surety to complete. Later, the surety agreed to provide the obligee with a defense to the completion contractor's litigation against the parties. The law firm in question appeared on behalf of both parties. While still representing the obligee in that prior matter, the law firm, in a second matter, filed a motion to dismiss the obligee's claims against the surety. The obligee sought to disqualify the law firm from representing the

[13] ABA Committee on Professional Ethics of the Association of the Bar of New York City Opinion 2001-2.
[14] ABA Model Rule, 1.7(b); *see also* Rules Regulating the Florida Bar, Rule 4-1.7 (2019) (which has required informed consent of the clients should be reduced to writing or in the record since 2006).
[15] In *Great Am. Ins. Co. v. General Contrs. & Constr. Mgmt.,* Case No. 07-21489-CIV-UNGARO, 2008 U.S. Dist. LEXIS 37015 (S.D. Fla., May 6, 2008) (court found disqualification was not warranted under the circumstances when surety moved to disqualify opposing counsel on the basis that counsel also represented the surety in an unrelated matter and no written consent was obtained).
[16] *Caravousanos v. Kings County Hosp.,* 896 N.Y.S.2d 818 (N.Y. Sup. Ct. 2010).

surety in an adverse capacity under Rule 1.7 of the New York Rules of Professional Conduct. The court noted:

> It is well settled that "[a] party seeking to disqualify an attorney or a law firm, must establish (1) the existence of a prior attorney-client relationship and (2) that the former and current representations are both adverse and substantially related"... Furthermore, disqualification generally is not warranted unless there is a reasonable probability of disclosure of confidential information obtained as a result of the prior representation. It is not essential, however, that the prior client establish that confidential information will necessarily be disclosed in the course of the litigation. A reasonable probability of disclosure should be sufficient. Courts will infer the "reasonable probability of disclosure of confidences" from the particular nature of the past and present representations at issue.[17]

The court rejected the law firm's arguments against disqualification noting that the court may disqualify counsel not only for acting improperly, but also to avoid the appearance of impropriety.[18] Due to the potential conflicts that may arise, joint representation of both the surety and the principal should only be agreed upon by both parties after careful consideration and full disclosure of any issues that could arise.

False Claims Act Concerns

Conflicts of interest may also arise between the surety and principal and may result in potentially serious exposure to both parties. Ethical rules as well as state and federal statutes address obligations with regard to submission and communication of claims. Lawyers and surety professionals should be aware of the potential for sanctions and penalties associated with false claims submitted to the Government. ABA Model Rule 4.1 provides that in "the course of representing a client a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or (b) fail to disclose a material fact to a third person when disclosure is

[17] *Id.* at 823.
[18] *Id.* at 825.

necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6.[19]

The Federal False Claims Act[20] imposes liability on persons and companies that knowingly defraud government programs. The Act was "enacted in 1863 in response to cases of contractor fraud perpetrated on the Union Army during the Civil War."[21] It was expanded in 1986 and provided for the ability to assert claims in many forms, including overbilling and falsely claiming DBE status in order to pursue lucrative government contracts.[22] The 1986 amendments also lowered the level of intent required, lengthened the statute of limitations, and increased the civil remedies from double to treble damages with higher fines for each violation.[23] In 2009, the False Claims Act was again amended and, among other things, made clear that a false claim need not be directly presented to a government official or employee but can instead be presented to a government contractor or other recipient of federal funds.[24] Prior to the 1986 amendments, the False Claims Act was rarely used. However, between 1987 and 2016, there were 16,187 actions brought under the Act.[25] Moreover, in the fiscal year ending September 30, 2018, the Department of Justice obtained more than $2.8 billion in settlements and judgments from civil cases involving fraud and false claims against the Government.[26]

The False Claims Act essentially bars the following seven bad acts: (1) presenting false or fraudulent claims for payment; (2) making false records; (3) conspiracy; (4) receiving money

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[19] ABA Model Rule 4.1 (2019).
[20] 31 U.S.C. §3729 *et. seq.* (2019).
[21] Blake Wilcox, Frank Lanak and Keith Langley, *Advanced Problems Confronting Claims Handlers and Practical Approaches to Addressing Them* p. 8 (unpublished paper submitted at the Surety Claims Institute, June, 2018) *citing* S.REP. 99-345, 4, 1986 U.S.C.C.A.N. 5266, 5269; see also Patrick R. Kingsley and Bridget C. Giroud, *Sureties and False Claims Act Liability Today,* DRI FOR THE DEFENSE, October, 2018, at 22.
[22] Wilcox, et al., *supra* note 22, at 8.
[23] Kingsley, et al., *supra* note 22, at 23 *relying on* 13 Bus. & Com. Litig. Fed. Cts. §138:2 (4th ed. 2017).
[24] *Id.*
[25] *Id.* at 24.
[26] *See* Press Release, The United States Department of Justice, *Justice Department Recovers Over $2.8 Billion from False Claims Act Cases in Fiscal Year 2018,* December 21, 2018, https://www.justice.gov/opa/pr/justice-department-recovers-over-28-billion-false-claims-act-cases-fiscal-year-2018.

from the government while delivering less than required; (5) delivering or creating false receipts; (6) receiving property from a government employee not lawfully authorized to sell or pledge it; and (7) making a false record or statement to decrease an obligation to pay money.[27]The False Claims Act imposes a penalty on a person who presents for payment any claim upon or against the government knowing such claim to be false.[28] Two relatively recent federal court decisions highlight the potentially severe consequences of the False Claims Act to a surety. In each case, the courts determined that sureties can face exposure and potential liability for direct and indirect submission of false claims to the federal government.

In *Hanover Insurance Company v. United States,*[29] Hanover's principal, Lodge Construction, Inc., was terminated for default on a federal project known as the Everglades Upgrade project. Hanover tendered a new contractor together with payment for the difference between the unpaid balance of the contract with Lodge and the new contractor's price. Lodge and Hanover later challenged the default termination and sought money damages. Hanover notified the government that it was entitled to any funds recovered by Lodge pursuant to its indemnity agreement and Hanover's equitable subrogation rights. During the course of the litigation, the government moved to add claims against both Lodge and Hanover under the False Claims Act, the anti-fraud provision of the Contract Disputes Act and the Special Plea in Fraud Statute. The government claimed that Hanover directly committed fraud by pursuing Lodge's entire claim, which included a $1.1 million pass-through claim, knowing that the pass-through claim was false because Hanover had previously settled that claim in full for $370,000.[30]

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[27] John V. Burch, Jennifer Leuschner and Cristina Craddock, *Performance Bond Claims When the Project is Fully Complete and Accepted: Unique Problems with Government Bonds,* p. 2 *(*unpublished paper submitted at the Twenty-Ninth Annual Southern Surety and Fidelity Claims Conference, April, 2018) *relying on* 31 U.S.C. §3729.
[28] *Miller v. United States,* 213 Ct. Cl. 59, 70 (Ct. Cl. 1977).
[29] 134 Fed. Cl. 51 (2017).
[30] *Id.* at 58.

The court found that while Hanover was not liable for Lodge's penalties for fraud, Hanover could forfeit its subrogation rights to a claim that is found to be fraudulent. Further, Hanover could be held liable to the extent its own actions were fraudulent.[31] The court found that a performance bond surety is liable for any contractual damages sustained by the government, but could not be held liable for any extra-contractual penalties against the principal unless the bond so provided. The court further found that although Hanover could be held liable as Lodge's surety for contractual damages caused by Lodge, there were no such damages incurred. Therefore, Hanover could not be held liable as Lodge's surety for any judgment against Lodge pursuant to the government's counterclaims—except, pursuant to the Contract Disputes Act, Hanover could be liable the government's costs to review the fraudulent portion of Lodge's claims, if any such fraud was found—unless the performance bond provided otherwise.[32] As of this writing, this matter is still being litigated.

In *United States ex rel. Scollick v. Narula*,[33] plaintiff-relator Andrew Scollick filed suit on behalf of the United States against multiple defendants, including government contractors, their sureties, bonding agency and individual bond producer alleging a scheme to defraud the United States government by submitting bids to obtain government construction contracts. Scollick claimed the defendants participated in this scheme by fraudulently claiming or obtaining service-disabled veteran-owned small business status, HUBZone status, or section 8(a) status for certain companies to bid on and obtain set-aside contracts, when in fact the bidders did not qualify for the statuses claimed.[34] Scollick alleged that, as part of this scheme, the defendants falsely certified these statuses, made false claims regarding past performance, hid certain aspects of the

[31] *Id.* at 68.
[32] *Id.* at 69-70.
[33] Case No. 14-cv-01339-RCL, 2017 U.S. Dist. LEXIS 119530 (D.D.C. July 31, 2017).
[34] *Id.* at *4.

management and control of the companies at issue, and hid or falsified certain information regarding the employees of the companies. Initially, the court dismissed the allegations against the surety defendants because there were no allegations that the sureties knew the bids were fraudulent. Plaintiff then sought to amend the complaint, relying on a theory of indirect presentment. Plaintiff argued that the actions of the surety defendants in issuing bonds enabled the submission of false claims and that they continued to do business with the other defendants upon becoming aware that the other defendants were submitting false claims.[35] Scollick asserted that during the underwriting process, the surety defendants conducted on-site inspections of the principal's office and that the underwriting and due diligence would have reasonably revealed facts that they knew or should have known violated the government's service-disabled veteran-owned small business contracting requirements. Therefore, plaintiff alleged, the surety defendants perpetuated the alleged fraud by continuing to do business with the contractor.[36]The court permitted the amendment, finding that the allegations were sufficient to make claims against the surety defendants for conspiracy. As of this writing, the action is ongoing.

These cases illustrate that sureties can face real consequences when bonding principals contracting with the Government. The *Scollick* case raises the issue of potential conflicts of interest between the principal and surety when the surety is faced with exposure due to due diligence in underwriting. The *Lodge* case raises issues of which the lawyers and surety professionals should be aware when asserting claims against the Government since a surety who assists in rehabilitating its principal may also assist in asserting its principal's claims. In those instances, it is advisable for the surety and its lawyer to carefully review the principal's claims be

[35] *Id.* at *44.
[36] *Id.* at *46.

mindful of the requirements of claims certification under the False Claims Act as well as the Model Rules.

Confidentiality and Duty of Loyalty

Lawyers are bound to their clients by rules of loyalty and confidentiality. The ABA Model Rules provide that a "lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation".[37] Disclosure is also permitted under certain circumstances such as when the lawyer believes it is necessary to prevent reasonably certain death or bodily harm or to prevent the client from committing a crime.[38] The attorney-client privilege applies in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality additionally applies where evidence is sought from the lawyer through compulsion of law. The confidentiality rule applies not merely to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source.[39]

The Model Rules provide guidance as to how joint representation may affect confidential and privileged information:

> A particularly important factor in determining the appropriateness of common representation is the effect on client-lawyer confidentiality and the attorney-client privilege. With regard to the attorney-client privilege, the prevailing rule is that, as between commonly represented clients, the privilege does not attach. Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.[40]

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[37] ABA Model Rule 1.6(a) (2019).
[38] ABA Model Rule 1.6(b) (2019).
[39] ABA Model Rules, Rule 1.6, Cmt. 3 (2019); *but see Cornish v. Superior Court,* 257 Cal. Rptr. 383 (Cal. Ct. App. 1989) (Petitioner was the contractor and surety issued a payment bond. Surety retained firm to investigate and determine the validity of the claims during which time firm represented petitioner in related matters. Court found there were no confidential communications between petitioner and firm, and petitioner did not have a reasonable expectation the communication would not be shared with the firm's other clients).
[40] ABA Model Rules, Rule 1.7, Cmt. 30 (2019).

On the other hand, the Florida Bar has specifically rejected the position set forth in the Model Rules and adopted by some other jurisdictions: that no confidentiality exists within the context of a joint representation. In an opinion, the Florida Bar addressed confidentiality in a joint representation where a lawyer had represented both a husband and wife for years with regard to their estate planning.[41] Several months after the execution of new wills, the husband conferred separately with the lawyer that, unknown to his wife, he had executed a codicil making a substantial bequeath to another woman with whom he was having an extra-marital relationship. The husband asked the lawyer for advice regarding his wife's rights of election in the event she were to survive him. The Bar noted that a lawyer is ethically obligated to maintain in confidence all information relating to the representation of a client under the Rule 4-1.6 of the Rules Regulating the Florida Bar.[42] A lawyer, however, also has a duty to communicate to a client information that is relevant to the representation. Rule 4-1.4.[43] In the situation presented, however, the lawyer's duty to the wife conflicted with his duty to the husband. The Bar opined that the husband's duty of confidentiality must take precedence and the lawyer's ethical obligation of confidentiality to the husband prohibited disclosure to the wife. The Bar concluded that the attorney must withdraw from the representation of both the husband and the wife because of the conflict presented when the attorney was required to maintain the husband's separate confidences regarding the joint representation.[44]

The opinion of the Florida Bar illustrates the conflicts that could arise between a surety and its principal, as well as the ethics issues facing the lawyer, should joint representation go

[41] Fla. Bar Op 95-4 (May 30, 1997).
[42] Rule Regulating the Florida Bar 4-1.6 is similar to ABA Model Rules, Rule 1.6.
[43] Rule Regulating the Florida Bar 4-1.4 is similar to ABA Model Rules, Rule 1.4 and the comments to Rule 4-1.4 explain that the client should have sufficient information to participate intelligently in decisions concerning the objectives of the representation and the means by which they are to be pursued, to the extent the client is willing and able to do so.
[44] Fla. Bar Op 95-4 (May 30, 1997).

forward. For example, continued common representation could be an issue if one client asks the lawyer not to disclose to the other client relevant information. The lawyer has an equal duty of loyalty to each client, and each client has the right to be informed of anything bearing on the representation that might affect that client's interests and the right to expect that the lawyer will use that information to that client's benefit.[45] As discussed above, the lawyer should, at the outset of any joint representation, and as part of the process of obtaining each client's written consent, advise each client that information will be shared and that the lawyer will have to withdraw if one client decides that some matter material to the representation should be kept from the other.[46]

Settlement of Claims

The surety and principal may, ultimately, have differing goals with respect to claims resolution and conflicts of interest can arise. In situations where counsel is jointly representing the surety and its principal, it is often not only in defense of claims against the principal but, as discussed above, often in pursuit of affirmative claims. According to recently available statistics, close to 95 percent of pending lawsuits end in a pre-trial settlement.[47] While the principal often has strong feelings about its defense or affirmative position and the surety may be supportive of that position, conflicts may arise when one of the jointly represented parties favors settlement and the other does not.

ABA Model Rule 1.8 addresses specific rules with regard to conflicts of interests with current clients. Specifically, that Rule provides that a "lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the

[45] ABA Model Rules, Rule 1.7, Cmt. 31 (2019).
[46] *Id.*
[47] *See* Jon Rauchway and Mave Gasaway, *Endless liability? Evaluating whether to settle or litigate private environmental lawsuits at regulated sites,* November 9, 2018, https://www.americanbar.org/groups/environment_energy_resources/publications/trends/2018-2019/november-december-2018/endless-liability/.

clients…unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims … involved and of the participation of each person in the settlement."[48]

As a precondition to issuance of its bonds, sureties typically require the principal to execute a written indemnity agreement which memorializes, enhances and supplements its common law rights. Sureties draft their indemnity agreements broadly, and with extensive protections, and the courts, understanding the importance of the indemnity agreement, consistently enforce the agreements and the remedies granted to the sureties.[49] These indemnity agreements generally contain provisions that the surety has broad discretion to settle claims. A surety is entitled to reimbursement pursuant to an indemnity contract for any payments made by it in a good faith belief that it was required to pay, regardless of whether any liability actually existed.[50] Sureties enjoy such discretion to settle claims because of the important function they serve in the construction industry. The purpose of good faith clauses is to facilitate the handling of settlements by sureties and protect them from unnecessary and costly litigation.[51]

Courts have consistently recognized the power of the surety to settle claims.[52] However, in a joint representation context or when attempting to revive the dying contractor, the power of

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[48] ABA Model Rules, Rule 1.8(g) (2019).

[49] *Liberty Mut. Ins. Co. v. Aventura Eng'g & Constr. Corp.,* 534 F. Supp. 1290, 1304 (S.D. Fla. 2008) *relying on, e.g., The Revenue Markets, Inc. v. Amwest Surety*, 35 F.Supp.2d 899 (S.D. Fla. 1998) (enforcing the broad provisions of the indemnity agreement), *aff'd in part, rev'd in part*, 204 F.3d 1121, 209 F.3d 722, 204 F.3d 1121, 209 F.3d 725.

[50] *Aventura Eng'g & Constr. Corp.,* 534 F. Supp. at 1304 *relying on Thurston v. Int'l Fidelity Ins. Co.*, 528 So. 2d 128, 129 (Fla. Dist. Ct. App. 1988).

[51] *Aventura Eng'g & Constr. Corp.,* 534 F. Supp. at 1304 *citing United States Fid. & Guar. Co. v. Feibus,* 15 F.Supp. 2d 579, 584 (D. Pa. 1998).

[52] *See, e.g., Hutton Constr. Co. v. County of Rockland,* 52 F.3d 1191 (2nd Cir. 1995) (principal failed to comply with demand to post collateral and surety's rights under assignment and attorney-in-fact clauses were activated); *Marcelli Constr. Co. v. City of Lapeer,* No. 258314, 2006 Mich. App. LEXIS 860 (Mich. Ct. App. March 23, 2006) (Court found indemnity agreement plainly stated that principal gave surety full authority to settle *all* claims arising from the bonded project, and that principal ratified those decisions in advance giving surety contractual right to settle claims arising from the construction project including principal's claims against any project owners after a default); *James McKinney & Son, Inc. v. Lake Placid 1980 Olympic Games, Inc.,* 462 N.E.2d 137 (N.Y. 1984) (terminated principal

the surety to unilaterally settle claims can create serious conflicts of interests between the parties and ethical implications for counsel.[53] The ethical concerns are highlighted in the comments to ABA Model Rule 1.8 which provides, in part:

> Differences in willingness to make or accept an offer of settlement are among the risks of common representation of multiple clients by a single lawyer. Under Rule 1.7, this is one of the risks that should be discussed before undertaking the representation, as part of the process of obtaining the clients' informed consent. In addition, Rule 1.2(a) protects each client's right to have the final say in deciding whether to accept or reject an offer of settlement...The rule stated in this paragraph is a corollary of both these Rules and provides that, before any settlement offer… is made or accepted on behalf of multiple clients, the lawyer must inform each of them about all the material terms of the settlement, including what the other clients will receive or pay if the settlement… is accepted.[54]

The surety may determine that it is in its best interest to waive or otherwise release the principal's claims in order to resolve issues or minimize its exposure. Releasing those claims over the principal's objections can not only create conflicts that may necessitate the withdrawal of counsel but also implicate subsequent indemnity claims. The parties must consider the totality of the situation, the language of the indemnity agreement, the strength of the principal's claims, and cost of pursuit of those claims.

Conclusion

When assisting in rehabilitating a principal, sureties and their counsel should be cognizant of the ethical issues that can arise. Joint representation of the principal and surety must be agreed to only after careful consideration of the conflicts that can arise, how interests may not

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which initiated a bankruptcy proceeding had no right to maintain any of its claims against either the project's owner or manager since it was not the real party in interest owing to the fact that the company's surety, pursuant to a continuing indemnification agreement, obtained an assignment of all the company's rights with respect to the contract when the company filed for bankruptcy, and, pursuant to a settlement with the project owner, released the owner from all claims, causes of action, etc., which the surety had with respect to the contract in issue).

[53] *See also Capriotty v Bell,* Civil Action No. 89-8609, 1991 U.S. Dist. LEXIS 1930 (E.D. Pa. Feb. 19, 1991) (counsel disqualified from joint representation of surety and former adminstratrix of estate in part due to finding that the surety could benefit from settling with defendants for less than full relief demanded, for the standard reason that some recovery is better than none, and for the additional reason that the surety could then move against its principal the former administratrix for the balance of its claim).

[54] ABA Model Rules, Rule 1.8, Cmt. 13 (2019).

be necessarily aligned, and how confidential information could be shared. All parties must be aware of the good faith standards imposed by law, by contract and by statute and navigate those matters carefully and wisely.