Perspectives of a Receiver with Regard to Sureties in Receivership Cases pertaining to Construction Companies in the State of Missouri

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Introduction

In a case where a receiver is appointed for a construction company, the receiver often has to deal with the complexities of the intersection of receivership law, construction law, surety law and laws pertaining to secured transactions. While there are many issues that arise in such cases, this paper, using a case study of a prior receivership case, addresses some of the more pressing issues that arise when there are competing claims of secured creditors and bonding companies and how these competing claims impact and affect the receiver's administration and the receivership case.

Background

In 2021, a Missouri bank petitioned the Court in St. Louis County, Missouri for an appointment of a receiver over a construction company that was engaged primarily with government contracts. The Missouri bank was the primary secured creditor of the construction company, holding a lien on various assets, including the equipment and receivables of the construction company. As there were a variety of government contracts, two bonding companies were also involved with regard to various bonds issued with regard to many of the projects. The Court appointed NMBL Strategies to serve as the Receiver. Of note, three days prior to the engagement of the Receiver, all employees were sent home. The company regularly operated across four to five states, with some projects occasionally being in other states. In addition, the company had established 13 operating entities over the past 10-12 years many of which were no longer operational.

As such, the company was entrusted to the Receiver to determine its future viability. After a thorough examination of the business, it was determined the best course of action was liquidation. There were many outstanding issues, including the liquidation of equipment, the collection of receivables, addressing unpaid debts to contractors from projects completed over the prior two years, dealing with various outstanding projects that needed to be completed and sorting through the priorities of secured claimants and bonding companies to the remaining assets of the company. At the time of the receivership, the two bonding companies were involved in multiple projects in various states of completion. Not surprisingly, there were multiple pending litigation cases against the company with countersuits on some that involved bonded projects. These unresolved litigation cases were pending in three states.

The Missouri bank was interested in having the Receiver collect the receivables of the company and pay the proceeds thereof to the Missouri bank. However, the bonding companies had other ideas, asserting that all or substantially all of the receivables were subject to their subrogation claims, which primed the Missouri bank. As indicated below, these competing interests had a material impact on the administration of this receivership case.

The Types of Bonds in Question

A common practice within the construction industry, especially large construction jobs for city, state or federal entities, is to require performance and/or payment bonds. While there are other options, these are typically the most common. These bonds are in place to ensure the performance of the project is completed (performance bond) or that no liens can be filed against the city/state/federal government entity who owns the project (payment bond).

Performance Bond - A performance bond is issued to one party of a contract as a guarantee against the failure of the other party to meet obligations specified in the contract. It is also referred to as a contract bond.[1]

Payment Bond - A payment bond is a type of surety bond issued to contractors which guarantee that all entities involved with the project will be paid.[2]

The Bonded Jobs

After the receiver's initial assessment to liquidate, one of the bonding companies elected to audit the projects they had bonded. These auditors spent approximately a week collecting as much information as possible on the projects, including all contracts related to the projects, invoices to the clients, invoices from contractors/consultants and any other available project notes. After further due diligence, it became clear that there would be multiple subrogation claims that would permit the bonding companies to stand in the shoes of the company to collect certain receivables. Unfortunately for the Missouri bank, the subrogation rights of the bonding companies to a variety of receivables primes the rights of secured creditors to enforce their security interest in such receivables.

It was initially believed that the bonding companies would want the rights to all open receivables, because of the sheer number of claims in the case, which was not favorable to the Receiver or the secured creditors who were already seeing potential additional losses. After a review of the contracts between the bonding companies and the construction company, as well as shared case law showing the sureties subrogation rights, it was agreed and determined that each right would be on a project-by-project basis. In turn, the Receiver performed an analysis of the projects and broke them into the following groups:

1) *Projects with less collectable accounts receivable than claims against them* - These projects were immediately remitted to the bonding company for collection, because they were of negative value to the receivership and would only result in additional costs to the receivership.
2) *Projects with more accounts receivable than claims against them* – These projects were collected by the Receiver and then the bonding company provided a list of claims paid on the project. In turn, the Receiver paid out the claim to the bonding company and retained the balance of collections within the receivership to be paid to the Missouri bank, as the primary secured creditor.
3) *Projects that accounts receivable were close to the claims against them* – These projects were more time intensive, because it required the Receiver to complete significant research to assess if there was any potential for future claims. In addition to assessment of future claims, the

[1] Investopedia - https://www.investopedia.com/terms/p/performancebond.asp
[2] NFP - https://www.nfp.com/property-and-casualty/surety/blog/what-is-a-payment-bond

Receiver had to determine how much effort would be put into collection of the receivables. Eventually the Receiver determined even without future claims identified, if there was less than $1,000 of value after payment on claims there was a breakeven on collections and any project with less than $1,000 in net value should be turned over to the bonding company.

The Funding of the Receivership Estate and Who Bears the Risk of the Cost of Administration

It is typical in a receivership case for the moving party to fund the administrative expenses of the receivership case, including fees and expenses, to the extent there are limited unencumbered funds in the estate. This is codified in the Missouri Commercial Receivership Act. Section 515.625.1(1) RSMo provides that a "receiver may recover from estate property **secured by a lien** or the proceeds thereof the reasonable, necessary expenses of preserving, protecting, or disposing of the estate property to the extent of any benefit to a **duly perfected secured creditor**." Likewise, the "expenses incurred during the administration of the estate have priority over the **secured claim of any secured creditor** obtaining or consenting to the appointment of the receiver". Section 515.625.1(2) RSMo

After working through projects and filing claims, the bonding continued to ask for significant information on projects from both the Receiver and former employees; however, the bonding companies were not willing to contribute to or pay for the administration of the receivership estate, which would include the fees and expenses of the Receiver and its professionals, purportedly due to the assertion that their subrogation rights were not secured claims or perhaps due to an assertion that they did not procure or consent to a receiver . The bonding companies also might argue that once subrogation rights are triggered, the receivables in play may not be assets of the receivership estate. As the bonding companies asserted their subrogation rights, the Receiver determined that spending significant effort supporting the bonding companies was not fiscally responsible to the receivership estate, given the lack of funding for case administration and their unwilling to carve out administrative funds. Consequently, the Receiver informed the bonding companies that any of these additional efforts to assist them would need to be funded by the bonding companies and not through the receivership funds that were subject to the liens of secured creditors. The Receiver informed the bonding companies that the Receiver would assist them to the extent possible, but with limited funds within the receivership estate, it was difficult to provide the type of support demanded by the bonding companies. This placed the Receiver in a difficult position as it would have to litigate with the bonding companies as to whether they would be obligated to pay a proportionate share of the receivership estate administration. As the Missouri bank was the moving party for the appointment of the Receiver, it thus incurred a disproportionate amount of the funding of the receivership estate. Furthermore, the cost and expense of any action to be taken by the Receiver to attempt to compel the bonding companies to fund estate administration would then come from the proceeds of the secured claim of the Missouri bank, which was reluctant to fund this litigation.

As of the termination of the receivership, there were $6,320,259.80 in claims filed against one bonding company of which $5,452,384.55 was verified and paid. The other bonding company paid out $3,094,303.13 in claims filed plus engaged new general contractors for project close out of four of the projects in which the bonding company estimated losses in excess of $1,160,000 based upon the performance bonds. The Missouri bank received the proceeds from the sale of the equipment and also received some of the proceeds of the receivables, namely, those not claimed by the bonding companies.

Key Takeaways

1) Bonding companies have rights that supersede secured creditors rights, but only specific to the bonded project.
2) Due to these subrogation rights, the amount of funds available to the Receiver might be limited, thereby hampering its efforts to administer the receivership case.
3) The statutory language of the Missouri Commercial Receivership Act does not expressly address the bonding companies' liability for the expense of the administration of the receivership estate in situations where funding is inadequate.
4) A secured creditor needs to evaluate a receivership case and its costs in situations where many of the assets are subject to subrogation rights and claims.
5) Assessment of true project values is critical to establishing who takes the lead between the Receiver and the bonding company.