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Virtually all public contracts, and many private contracts, require any contractor bidding for the work to provide a surety bond guaranteeing payment and performance obligations. In order to obtain surety bonds, contractors must demonstrate financial strength and viability. If a contractor lacks sufficient financial strength to qualify for surety bonds, then it is effectively foreclosed from bidding on or being awarded public contracts and at least some private contracts.

There are many factors that go into a contractor's ability to obtain surety bonds. Financial strength can be measured in terms of capitalization of the company, debt, ongoing projects, and track record of success. If a contractor is weak or overextended in one or more of these areas, it may find it difficult, or even impossible, to obtain bonding. That in turn may make it difficult for the contractor to obtain work, including work that in the past might have been its bread and butter.

Obviously, it may not be anyone's fault if a contractor is financially weak or otherwise unable to bond. Financial weakness may result from poor estimating, poor project management, bad luck or factors beyond anyone's control, and sometimes even reasonably strong contractors may have difficulty bonding (for example, the surety markets became very hard immediately following the 9/11 attacks). But what if a contractor's financial weakness or inability to bond is directly attributable to the conduct of another party, for example an owner wrongfully withholding payments on a project? Or an owner wrongfully declaring the contractor to be in default, and calling its bond? In those circumstances, can the contractor claim damages from the owner for its impaired bonding capacity? In other words, can the contractor claim lost profits on jobs it was unable to bid but otherwise reasonably expected to be awarded?

These questions have been commonly posed in disputes between contractors and owners in Colorado and other jurisdictions. Until recently, it was an open question as to whether a contractor could seek lost profits due to impaired bonding capacity in Colorado. That question is no longer open, as the Colorado Supreme Court decided, in *Denny Construction v. City and County of Denver*, 199 P.3d 742 (Colo. 2009), that claims of lost profits due to impaired bonding capacity may be awarded if they are established with reasonable certainty.

Denny was a contractor for Denver Water on the construction of an office building. Denver Water withheld certain amounts under the contract, claiming that Denny was in default under the contract. Not surprisingly, Denny's surety restricted its access to bonding and ultimately declined to provide any bonds on future projects. This effectively precluded Denny from bidding on any public contracts. Denny claimed that, as a result of its impaired bonding capacity, it had lost over $1,500,000 in additional profits over a three-year period during which it was unable to bid on public projects.

The case was tried to a jury, which determined that the Denver Water wrongly declared Denny to be in default on a contract. The jury awarded a total of $1,063,000, which consisted of relatively modest damages (about $25,000) for payments owed under the contract for work performed, plus approximately $150,000 for costs, expenses and unreimbursed payments made by the surety as the result of Denver Water's claim on the performance bond. Most of the damages were for lost profits attributable to contracts that Denny could not bid due to impairment of its bonding capacity.

The Court of Appeals reversed the verdict, reasoning that while Denny submitted a list of projects it believed it could not bid due to its loss of bonding capacity, it did not identify any specific projects that it actually lost as a result of its lost bonding capacity. Of course, it would have been next to impossible for Denny to prove which projects it actually lost, since it was not in a position to bid. In support of its holding that such claims are speculative as a matter of law, the Court of Appeals further reasoned that

> Whether a party bidding on a particular public project is successful in obtaining the contract depends on a host of factors in addition to bonding capacity. Moreover, profit on such a contract is dependent, in part, on unpredictable future events such as weather, changes in labor and materials costs, and changes in management personnel, to name a few. In short, Denny's theory of lost profits is based on inferences piled upon inferences.

Denny Construction v. City and County of Denver, 170 P.3d 733, 739 (Colo. App. 2007) (citations and quotation omitted).

The Supreme Court disagreed, noting the critical importance of bonding capacity to the construction world. In reaching this decision, the Supreme Court placed significant emphasis on the factual record presented by Denny (including financial statements, lists of contracts, and other documents, as well as testimony from a variety of individuals) that demonstrated that Denny was "an established and generally profitable construction company and … that … about half its revenues came from public works projects that required bonds." Id. at 744. Additionally, Denny's expert testified that the loss of bonding capacity caused a significant drop in Denny's profits based on his analysis of "data from 2000 through 2005, including market and industry conditions, Denny's financial statements and bidding history, the number of public works contracts typically won by Denny, and the profits from those contracts." *Id*. at 745. Perhaps significantly, the Board presented no expert testimony of its own, relying solely on its cross-examination of Denny's expert. *Id.*

There are important lessons to learn from Denny: For contractors seeking to prove a claim of lost profits due to impaired bonding capacity, it is critical to assemble a factual record that demonstrates a history of performance and profit, together with expert testimony demonstrating a causal link between the impaired bonding capacity and lost profits. Of course, the contractor also must prove wrongful conduct by the owner resulting in impaired bonding capacity. For owners defending against a claim of impaired bonding capacity, it is not sufficient to simply argue that the claims of lost profit are speculative, or, in the words of the Court of Appeals, "based upon inferences piled upon inferences." Instead, a defending entity should present its own expert to analyze the claimant's financial records and history, together with various market conditions, other financial considerations, and the variety of other factors that either might not result in the contractor being awarded certain work in the future or might result in any such work not being profitable.

Finally, this entire situation might have been avoided, from the owner's perspective, had the owner included a waiver of consequential damages clause in the contract. There is little question that claims premised on lost or impaired bonding capacity are consequential damages. While owners may feel there is little benefit to them in a waiver of consequential damages clause (because a great many of an owner's damage claims are consequential, while a great many of a contractor's claims are direct), that does not hold true in the case of lost bonding capacity. At least in Colorado, on a project in which a bond is required, a waiver of consequential damages may very well benefit an owner as well as a contractor.
