

CONTENTS

PREFACE	iii
EDITOR’S INTRODUCTION	v
CONTRIBUTORS	vii
CONTENTS	xvii
CHAPTER I: Bond, Contractual and Statutory Provisions and the General Agreement Of Indemnity <i>Armen Shahinian and Brian Kantar</i>	
Introduction.....	1
I. Bond Provisions	2
A. Bid Bond	6
B. Performance Bond.....	8
C. Payment Bond	12
D. Combination Performance and Payment Bond	14
E. Subcontractor Default Insurance	14
II. Contractual Provisions	15
A. Termination	18
B. Disputes	20
C. Payment.....	21
D. Protection of Persons and Property	23
E. Insurance	23
F. Changes in the Work	24
G. Multiple Prime Contracts	26
H. Subcontracts	27
III. Co-Surety Agreements	28
IV. Reinsurance Agreements.....	30
V. SBA Guaranteed Bonds	31
VI. Statutory Provisions	31
VII. Indemnity Agreement Provisions.....	35
A. The Indemnity Clause	38
B. The Right-to-Settle Provision	40
C. The Prima Facie Evidence Clause.....	41
D. The Collateral Deposit Provision	42

E.	The Assignment Clause.....	44
F.	The Attorney-in-Fact Clause.....	46
G.	The Books and Records Provision	47
H.	Other Provisions.....	48
	Conclusion.....	49

CHAPTER II: Construction Contract Provisions Critical to the Performing Surety: Scope Of Work, Contract Price, and Time Of Completion
Shannon J. Briglia and Jarrod Stone

	Introduction.....	51
I.	Contract Documents Defining the Surety’s Obligation to Perform	52
	A. The Bond.....	52
	B. The Bonded Contract	54
	C. Evaluation of the Contract Documents to Ascertain the Surety’s Obligation to Perform	55
II.	Contract Provisions Impacting Scope of Work.....	57
	A. Defining the Scope of the Surety’s Responsibility for Performing the “Work”	57
	B. Surety’s Responsibility for Performing Change Order Work.....	60
	C. Cardinal Changes	61
	D. Effect on the Surety’s Obligation to Perform of the Obligee’s Supplementation of the Principal’s Forces Prior to or Following Default	63
	E. Effect upon the Surety of the Obligee’s Completion of the Work.....	67
	F. The Surety’s Responsibility for Correction of Defective Work.....	67
	1. Contract and Bond Requirements	67
	2. Patent and Latent Defects	68
	3. Contract Limitations and Statute of Repose	71
	a. Limitations Contained in the Bond.	71
	b. Statutory Limitations.....	73
	c. Statutes of Repose.	74

- G. Complications Arising from the Requirements of Sole Source or Proprietary Subcontractors, Equipment, or Materials..... 75
- H. Changes to the Scope of Work Necessitated by the Principal’s Termination..... 76
- III. Contract Provisions Impacting Contract Price..... 76
 - A. Definition of the Contract Sum or Price..... 77
 - B. Bond Provisions Defining the Contract Sum 80
 - C. Procedures for Payment of the Contract Price 81
 - D. Cost of Correcting Defective Work, Performing Punch List Work, and Warranty Work..... 83
 - E. The Impact of Overpayment on the Surety’s Obligation to Perform..... 84
 - F. The Surety’s Exposure to Backcharges and Setoffs..... 86
- IV. Contract Provisions Impacting Time of Completion 87
 - A. Definition of Contract Time or Time of Performance..... 87
 - 1. Contract Provisions Defining Time of Performance 87
 - a. Date of Commencement/Notice to Proceed. 87
 - b. Definitions of Substantial Completion and Final Completion or Acceptance. 88
 - c. Provisions Permitting Extension of the Contract Time. 89
 - d. General Requirement of a Change Order, Construction Change Directive, or a “Claim” for an Adjustment to the “Contract Time.”..... 90
 - e. Changing the Time of Completion Through a Change Order. 90
 - f. Changes in the Contract Time Resulting from Construction Change Directives..... 90
 - g. Changes in the “Contract Time” and Minor Changes in the Work..... 91
 - h. Changes in the “Contract Time” Resulting from “Claims.”..... 91
 - B. Event-Specific Contract Provisions Providing for Extensions of the Contract Time 92
 - 1. Delays Caused by Owner, Architect, Separate Contractor, or Other Causes 93
 - 2. Delays Caused by Nonpayment..... 93

3.	Right to Additional Time Relative to Clarifications from Architect	94
4.	Right to Additional Time Relative to Unknown Conditions.....	94
C.	Bond Provisions Impacting Time of Performance	95
1.	AIA A312 Performance Bond (1984 Edition).....	95
a.	Surety Exposure to Delay “Costs” and/or Liquidated Damages.....	95
b.	Notice to the Surety of Changes to Contract Time.....	97
c.	Contractor and Owner Defaults.....	97
2.	AIA A312 Performance Bond (2010 Edition).....	98
D.	Contract Provisions Involving Time That Impact the Surety	99
1.	Claims for Delay.....	99
2.	No Damages for Delay	100
3.	Liquidated Damages Provisions	100
E.	The Effect of the Obligee’s Failure to Timely and/or Properly Default the Principal.....	102
	Conclusion	105
	Appendix: Identification of Documents That May Comprise the “Contract Documents”	106

**CHAPTER III: The Surety’s Obligations Under the
Performance Bond: To Perform or Not To Perform**
David J. Krebs and Shannah J. Morris

	Introduction.....	109
I.	Notice from the Obligee and the Surety’s Response.....	113
A.	Purpose of the Investigation	114
1.	The Duty to Independently Investigate.....	115
2.	The Right to Independently Investigate.....	117
B.	Contents of the Obligee’s Notice	118
1.	Default and Termination?	119
2.	Demand To Perform?.....	121
3.	Dedication of Remaining Bonded Contract Funds? ...	122
C.	Surety’s Initial Response.....	122
1.	Inadequate Notice of Claim	123
2.	Initial Request to Obligee for Documents and Information	124

3.	Initial Request to Principal for Documented Position.....	127
4.	The Surety’s Own File.....	130
5.	Always Read the Contracts: the Bonded Contract and the Bond.....	130
6.	Accounting of Remaining Bonded Contract Funds....	132
II.	The Contract and Bond Form: What Options Are Possible?	135
A.	Types of Bonds.....	135
1.	Statutory Bonds	135
2.	AIA Bonds.....	136
3.	Subcontractor Bonds.....	138
4.	Defeasance Bonds.....	140
5.	Manuscript Bonds.....	141
6.	Completion Bonds	142
7.	Combination Performance and Payment Bonds	142
8.	Bonds for Public/Private Partnership Projects.....	143
9.	Indemnity Bonds.....	144
B.	Embedded Surety Obligations in the Bonded Contract....	146
III.	The Project: What Options Are Desirable?.....	147
A.	The Surety’s Investigation After the Initial Production	147
1.	Conducting the Investigation After the Initial Production.....	149
2.	Assembling the Team of Investigators	150
a.	Investigating Alleged Delay Claims.....	150
b.	Investigating Alleged Defective Work Claims.	151
3.	Analyzing the Results of the Investigation	151
B.	Risk Assessment: The Surety’s Performance Options	152
1.	Financing	152
2.	Takeover	156
3.	Tender	158
4.	Buy Back	160
5.	Decline to Perform.....	161
IV.	Defenses to Performance.....	165
A.	Failure to Meet the Conditions Precedent in the Bond.....	165
1.	Implied Conditions in the AIA A311 Performance Bond	166
a.	<i>L & A Contracting</i> : Termination Required.	167
b.	<i>DCC Constructors</i> : Termination Not Required. ..	168

2.	Express Conditions in the AIA A312 Performance Bond	169
a.	Paragraph 3.1 Notice	170
b.	Paragraph 3.2 Declaration of Default and Termination	171
c.	Paragraph 3.3 Dedication of Contract Funds	173
B.	Improper Default/Termination	174
1.	Distinction between Breach and Default	174
a.	What Is a Material Breach?	176
b.	Compliance with Termination Clause of the Bonded Contract	177
2.	Substantial Completion	179
C.	Obligee's Breach of the Bonded Contract	182
1.	Improper Cure Notice	184
2.	The Surety's Right to the Defenses of the Principal	186
a.	Design Issues	186
b.	Impossibility	190
c.	Cardinal Change	191
d.	Waiver of Contract Requirements	193
e.	Owner's Implied Duty of Cooperation	194
f.	Differing Site Conditions	195
g.	Hypertechnical Inspection	196
D.	Obligee's Impairment of the Surety's Rights	196
1.	Alteration of the Bonded Contract	196
2.	Changes in the Obligee or Principal	198
3.	Overpayment	198
4.	Statutory Exoneration Defenses	200
5.	Contractual and Statutory Limitation Periods	201
6.	Dispute Resolution Rights	204
7.	Failure to Allow Surety to Complete: <i>Green River</i> and <i>Dooley & Mack</i>	204
	Conclusion	208

CHAPTER IV: Financing the Principal

George J. Bachrach, Michael A. Stover, and Shane C. Meham

Introduction	209
--------------------	-----

- I. The Surety’s Financing of the Principal as the Surety’s Performance under the Performance Bond 212
 - A. Introduction 212
 - B. The Surety’s Common-Law and Indemnity Agreement Rights 214
 - 1. The Surety’s Common-Law Rights 215
 - 2. The Surety’s Indemnity Agreement Rights 216
 - 3. The Surety’s Financing Agreement Rights..... 221
 - C. The Performance Bond..... 222
 - 1. Miller Act Performance Bond..... 223
 - 2. AIA Document A311 Performance Bond (1970 Ed.) 226
 - 3. AIA Document A312 Performance Bond (1984 Ed.) and (2010 Ed.) 227
 - 4. Other Bond Forms 229
 - D. Financing the Principal Prior to a Declaration of Default. 229
 - 1. Default vs. Formal Declaration of Default 232
 - 2. The Financing Surety—Is It a Volunteer?..... 234
 - 3. The Surety’s Right to Mitigate Damages Without the Obligee’s Consent to the Surety’s Financing of the Principal 236
 - E. The Financing Surety as a Performing Surety—What Does the Surety Have to Pay and When in Order to Become a Performing Surety?..... 237
 - F. Penal Sum Issues—The Limit of the Financing Surety’s Performance Bond Liability 240
- II. Advantages and Disadvantages in Financing the Principal 243
 - A. Advantages in Financing the Principal..... 243
 - 1. Learning Curve 243
 - 2. Demobilization and Mobilization/Job Momentum and Continuity 243
 - 3. Completion Contractor Mark-Up 245
 - 4. Principal’s Image, Presence, and Preservation of Claims..... 245
 - 5. Subcontracts..... 246
 - 6. Reduce Potential Claims of the Principal and the Indemnitors Against the Surety 246
 - 7. Salvage Considerations..... 247
 - B. Disadvantages in Financing the Principal 248

1.	Credit Against the Performance Bond Penal Sum	248
2.	Fixing the Loss	249
3.	Payment of Claims Not Covered by the Performance Bond	250
4.	Costs of Monitoring the Work	252
5.	Completing the Work—The “10 Percent Problem” and “Tail-End Let-Downs”	252
6.	Problems of Reinsurance	253
7.	Distractions and Disruptions by the Principal’s Other Creditors	253
8.	Potential Risks to the Surety Beyond the Penal Sum of the Performance Bond	256
III.	The Principal’s Request for the Surety’s Financial Assistance...	256
A.	The Principal’s and the Indemnitors’ Request for the Surety’s Financial Assistance	257
B.	The Surety’s Notice Letter	261
C.	The Surety’s Investigation	262
IV.	The Surety’s Investigation—The Information, Documentation, and Analysis That Is Necessary Prior to the Surety’s Making the Decision to Finance the Principal	262
A.	Cash	263
1.	How Much?	263
2.	Other Sources of Cash	264
B.	Capacity of the Principal to Perform the Work	265
1.	Technical Ability to Perform the Work	265
2.	Ability to Manage the Work and Supervise the Subcontractors	266
3.	Ability to Close Out the Bonded Contracts	266
4.	Summary	267
C.	Character of the Principal and the Indemnitors	267
D.	Collateral	268
1.	Making the Decision	270
2.	Obtaining the Collateral Security	271
E.	Estimating the Amount of Financial Assistance	274
F.	Summary	275
V.	The Methods of the Surety’s Financing of the Principal	275
A.	Advancing or Lending Money to the Principal	276
B.	Guaranteed Bank Loan	277
C.	“Back-Door Financing”	278

D.	Providing Additional Bonds to the Principal	280
VI.	Intercreditor Agreements	281
VII.	Financing the Subcontractor Principal	287
VIII.	Interim Financing	288
A.	Introduction—Why Does the Surety Interim Finance the Principal?.....	288
B.	Documentation	289
1.	Interim Financing Term Sheet/Agreement	289
2.	Promissory and Confessed Judgment Note	290
IX.	Procedures and Mechanics for the Surety’s Financing of the Principal	291
A.	Documenting the Principal’s Need for the Surety’s Financing	293
B.	Preserving the Surety’s Indemnity Rights.....	295
1.	Affirming the Indemnity Agreement	296
2.	Defining the Surety’s Losses	296
3.	Granting Liens and Security Interests to the Surety ...	296
4.	Voluntary Letters of Default and Termination	297
C.	The Special Account for the Surety’s Financing.....	297
1.	Establishing the Special Account	297
a.	Joint Control Special Account.....	298
b.	Two Special Accounts and a Special Operating Account.	299
c.	Cash Collateral and Zero Balance Special Accounts.....	300
d.	Third-Party Administered Special Account.	301
2.	Letters of Direction.....	302
3.	Mechanics and Procedures.....	303
4.	Claims of Third Parties Against the Special Account	304
a.	Bank Setoff Rights.	304
b.	Garnishments by the Principal’s Creditors.....	305
c.	Claims of a Bankruptcy Trustee or Debtor.	306
D.	Use of the Bonded Contract Funds from the Special Account	306
1.	Use of the Funds—Mechanics and Procedures Generally	306
2.	Payment of the Principal’s Bills on the Bonded Projects	307

	a.	The Principal's Subcontractors and Suppliers.....	307
	b.	The Principal's Labor.....	309
	c.	Taxes on the Principal's Labor.....	309
	3.	The Principal's Overhead and General Operating and Administrative Expenses	310
	4.	Reimbursement of the Surety's Losses from the Special Account.....	312
E.		Sale of the Principal's and/or the Indemnitors' Collateral Security	312
F.		The Surety's Right to Repayment and Reimbursement	312
G.		The Surety's Right to Stop Financing and to Take Over the Work on the Bonded Projects.....	318
H.		Additional Consideration to the Surety	319
	1.	The Surety's Release Through the Date of the Execution of the Agreement.....	319
	2.	Waiver of Jury Trial Rights	319
I.		Termination	320
J.		Bankruptcy Provisions	321
	1.	Bonded Contract Funds	322
	2.	Assumption/Rejection of the Bonded Contracts.....	324
	3.	The Surety's Post-Petition Financing of the Principal/Debtor	325
	4.	The Surety's Relief from the Automatic Stay.....	326
	5.	Burden of Proof on Bankruptcy Issues	327
K.		Miscellaneous Provisions.....	331
	1.	Agreement That the Surety Has No Obligation to Provide Financing.....	331
	2.	Agreement on the Execution of Future Bonds for the Principal.....	331
	3.	Books and Records and Access to the Bonded Project Job Sites	332
	4.	Other General Provisions.....	332
L.		Summary	333
X.		Financing the Principal in Bankruptcy.....	333
XI.		Risks to the Surety Beyond the Penal Sum of the Performance Bond.....	336
	A.	Alter Ego	336
	B.	Domination.....	337
	C.	Tax Liabilities	338

1.	Section 3401 [26 U.S.C. § 3401]	340
2.	Section 6672 [26 U.S.C. § 6672]	340
3.	Section 3505 [26 U.S.C. § 3505]	341
4.	Tax Levies Against the Bonded Contract Funds [26 U.S.C. § 7426]	341
D.	Environmental Claims	343
1.	The Security Interest Exemption	344
2.	Exercising Decision Making Control	345
3.	Collateral Security Containing Hazardous Wastes	347
4.	Summary	348
XII.	Reimbursing the Financing Surety’s Losses—Indemnity and Subrogation Rights	348
A.	Introduction	348
B.	The Surety’s Indemnity Rights under the Indemnity Agreement	348
C.	The Surety’s Subrogation Rights	349
	Conclusion	351
	Books	354
	Articles and Papers	357

CHAPTER V: Takeover

Christopher R. Ward and Patricia Wager

	Introduction	361
I.	The Surety’s Option and Right to Take Over and Complete	363
A.	The Effect of the Language of the Performance Bond on Takeover and Completion	363
B.	Common-Law Right to Take Over and Complete	366
C.	Common Performance Bond Forms	367
1.	Miller Act Performance Bonds	367
2.	Standard Industry Performance Bond Forms	369
a.	AIA A311 Performance Bond	370
b.	AIA A312 Performance Bond	370
c.	ConsensusDocs 260 Performance Bond	371
d.	ConsensusDocs 470 and ConsensusDocs 471 Performance Bonds	372
e.	EJCDC’s C-610 Performance Bond	372
D.	Rights Granted in the Indemnity Agreement Pertinent to Takeover and Completion	373

1.	Right to Take Over and Complete	374
2.	Rights of Assignment	374
3.	Power of Attorney and the Surety's Right to Settle the Principal's Claims.....	378
4.	Inception of the Surety's Rights under the Indemnity Agreement.....	380
II.	Deciding Whether to Take Over and Complete	381
A.	Key Factors	381
B.	Advantages of Completion by the Surety.....	392
C.	Disadvantages of Completion by the Surety	397
1.	Potential Waiver of Penal Sum Protection.....	397
2.	Other Potential Disadvantages.....	404
III.	The Takeover Agreement.....	409
A.	Use of Takeover Agreement Form.....	411
B.	Identification of Parties	412
C.	Defining the Scope of Work.....	413
D.	Confirmation of the Contract Accounting.....	415
E.	Manner of Payment	416
F.	Protecting the Penal Sum	419
G.	Preserving Claims and Reserving Rights	422
H.	Latent Defects and Warranties	426
I.	Delay Damages and Extensions of Time	427
J.	Protecting Materials and Equipment on Site.....	432
K.	Past and Future Changes	433
L.	Identification of the Completion Contractor	435
M.	Other Clauses	436
N.	Takeover Without a Formal Takeover Agreement.....	438
IV.	Claims and Defenses Asserted by the Principal and Indemnitors after Takeover.....	441
A.	Domination/Alter Ego	442
B.	Abuse of Rights.....	446
C.	Wrongful Interference with Contractual Relations	448
D.	Loss of Prospective Economic Advantage.....	450
E.	Failure to Mitigate.....	452
	Conclusion	454

CHAPTER VI: Tender

E.A. "Seth" Mills, Jr. and Bradford R. Carver

- Introduction..... 455
- I. The Surety’s Right to Tender 456
 - A. Miller Act Performance Bonds..... 456
 - B. AIA A311 Performance Bonds 457
 - C. AIA A312 Performance Bonds 457
 - D. Other Bond Forms 458
- II. Advantages and Disadvantages in Tendering a Completion Contractor 458
 - A. Advantages to Tendering 458
 - B. Disadvantages of Tendering..... 460
- III. When Is Tender Appropriate?..... 461
 - A. Factors to be Considered 462
 - 1. Status of Project Completion 462
 - 2. Condition of the Work in Place and Susceptibility of the Work to Latent Defects 463
 - 3. Specific Language of the Bond, if Any, Concerning the “Tender” Option 463
 - 4. The Willingness of the Oblige to Accept a “Tendered” Completion Contractor and the Basics of the Arrangement 464
 - 5. The Comparative Cost of Tender as Contrasted to Other Performance Options 465
 - 6. The Risk to Surety Based on Other Performance Options 467
 - 7. The Impact on Indemnity and Salvage 468
 - B. Other Considerations..... 469
 - 1. Ratification of Subcontractors 469
 - 2. What Role, If Any, Can the Principal Play? 470
 - 3. Materials 470
 - a. On Site..... 470
 - b. In Transit. 470
 - c. Specially Fabricated. 471
 - 4. Public Obligees..... 471
 - a. Statutory Bid Requirements. 471
 - b. Approval Requirements..... 472
 - 5. Material or Labor Price Escalations..... 472
 - 6. Tendering a Time–and–Material Contractor 472
 - 7. Tendering a Unit Price Contractor..... 473
- IV. Negotiations 474

A.	Factors to Consider.....	477
1.	Obligee’s Concerns.....	477
2.	Tendered Completion Contractor’s Concerns	478
3.	Dual Obligees	478
B.	Critical Issues to Address.....	479
1.	Defective Work, Warranties, and Latent Defects	479
2.	Principal’s Claims and Defenses	479
3.	Payment Use Provisions	480
4.	Dispute Provisions.....	480
	Conclusion	481

CHAPTER VII: Completion by the Bond Obligee

Lee M. Brewer and Omar J. Harb

	Introduction.....	483
I.	Bases for Surety’s Option to Have Obligee Complete.....	484
A.	Performance Bond Provisions.....	484
1.	Miller Act Performance Bond.....	484
2.	AIA A311 Performance Bond	486
3.	AIA A312 Performance Bond (1984 Edition).....	486
4.	AIA A312 (2010) Performance Bond (2010 Edition).....	487
B.	Statutes and Regulations.....	488
II.	Advantages and Disadvantages in Having the Obligee Complete the Project.....	488
A.	Advantages of Obligee Completion.....	488
1.	LAE Savings.....	488
2.	Limitation to Penal Sum	489
3.	Investigation/Reservation of Rights.....	491
4.	Mitigation of Damages	492
B.	Disadvantages of Obligee Completion	492
1.	Potential for Litigation.....	492
2.	Inefficiency	492
3.	Increased Losses	493
4.	Loss of Control of the Scope of Work.....	494
5.	Risk of Extra-Contractual Liability	494
III.	Completion by the Obligee Without Notice to the Surety	495
A.	Surety Discharged.....	495
B.	Surety Not Discharged.....	496

Conclusion 497

**CHAPTER VIII: The Federal Government and the
Performing Surety
*Jennifer A. Fiore and John E. Sebastian***

Introduction..... 499

I. Pre-Default Options of the Government 499

 A. Permitting the Principal to Continue Performance of the
 Contract under a Revised Delivery Schedule..... 500

 B. Permitting the Principal to Continue Performance of the
 Contract by Means of a Subcontract or Other Business
 Arrangement with an Acceptable Third Party, Provided
 the Rights of the Government Are Adequately Preserved 501

 C. Executing a No-Cost Termination Settlement Agreement 501

II. Default and Termination 502

 A. The Government’s Right to Terminate 502

 B. Factors to Consider..... 503

 C. Effect of Termination..... 504

III. Surety’s Options upon Default Termination 505

 A. Financing the Principal to Complete the Project..... 506

 1. Considerations 506

 2. Issues to Address in the Agreement with the
 Government 507

 B. Takeover..... 508

 1. Considerations 508

 2. Issues to Address in the Takeover Agreement..... 509

 C. Tender 511

 1. Considerations 511

 2. Issues to Address in the Agreement..... 513

 D. Completion by the Government 514

IV. The False Claims Act..... 514

 A. Elements for a Claim..... 515

 1. Definition of a Claim 516

 2. False or Fraudulent Claim..... 516

 3. Contractor Acting “Knowingly” under the FCA 517

 B. *Qui Tam* Actions 517

 C. Contractor Ethics in the FAR..... 518

V. Securing the Bonded Contract Funds..... 519

A.	Prohibitions on Assignment	519
a.	Involuntary assignments.....	520
b.	Novation agreement.....	520
B.	SAM Registration.....	520
VI.	Preserving and Pursuing Pre-Default and Post-Default Claims	
	Against the Government	521
A.	The Tucker Act.....	522
B.	The Contract Disputes Act (“CDA”).....	523
VII.	How the Government Lets and Funds Contracts	525
A.	Best Value/Contractor Rating	525
B.	Federal Set-Aside Programs	526
C.	Federal Fiscal Law Overview: What You Need to Know.....	529
1.	Introduction.....	529
2.	Understanding Fiscal Law Terminology	530
a.	Fiscal Year.....	530
b.	Period of Availability.....	530
c.	Obligation.....	530
d.	Budget Authority.....	531
e.	Authorization Act.....	531
f.	Appropriations Act.....	531
g.	Comptroller General and Government Accountability Office (GAO).....	531
h.	Legacy Accounting Classification (commonly known as “Fund Cites”).....	532
i.	Period of Availability.....	533
3.	Analyzing the Cost to Complete: Use of Expired Funds in Funding Completion Contracts and/or Contract Modifications.....	534
a.	Contract Modifications.....	535
b.	Bid Protests	535
c.	Termination for Default.....	536
d.	Termination for Convenience of the Government.....	537
D.	Judgment Fund Access.....	538
1.	The Judgment Fund	538
2.	Judgment Fund Access under the Contract Disputes Act of 1978.....	540
a.	Consent Judgments.....	540
b.	Compromise Settlements.....	540
c.	Interest.....	541

d. Attorney’s Fees.	541
e. Expert Witness Fees.	541
Conclusion	541

CHAPTER IX: The Surety’s Relationship with the Completion

Contractor

Theodore M. Baum and Gregory M. Weinstein

Introduction.....	543
I. Delivery Method for Completion and Its Impact on the Relationship with the Completion Contractor	544
A. Tender or Takeover?	544
B. Use of Surety’s Accounts—Required or Forbidden?	545
1. Use of Consultants.....	545
2. Relationship between Attorney and Consultants in Negotiating Completion Agreements	546
3. Ratification of Subcontractors of the Principal.....	546
II. The Completion Contractor Bidding Process.....	547
A. Pre-Bid Meeting	547
B. Inclusion of Form of Agreement in Bid/Request for Proposal.....	548
C. Inclusion/Exclusion Remediation of Principal’s Work in Place	548
D. Managing Project Completion.....	549
III. Key Issues to Be Addressed in the Completion Agreement	550
A. Scope of Work.....	550
B. Payment and Preparation of Pay Applications to Obligee	551
C. Time for Completion.....	554
D. Claims for Extra Work	555
E. Insurance and Bonding.....	556
F. Preserving Rights and Claims of the Surety (Takeover Scenario).....	557
G. Warranty Obligations	558
H. Indemnity	559
I. Default and Termination	559
J. Termination for Default	560
K. Termination for Convenience.....	561
Conclusion	562

**CHAPTER X: The Surety's Relationship with the Principal's
Subcontractors and Suppliers**
Todd R. Braggins and Bruce C. King

Introduction.....	563
I. Use of the Principal's Subcontractors and Suppliers after a Default	564
A. Reasons to Use an Existing Subcontractor/ Supplier	564
B. Reasons Not to Use an Existing Subcontractor/Supplier ..	565
II. Use of a Ratification Agreement with an Existing Subcontractor.....	567
A. Confirms the Subcontract Documents That Govern Completion of the Work.....	568
B. Confirms the Financial Status of the Subcontract	568
C. Confirms Subcontractor Will Complete the Remaining Scope of Its Original Subcontract	568
D. Confirms the Cost to Complete the Remaining Work.....	569
E. Confirms and Resolves Pending Change Order Requests.	569
F. Confirms Schedule and Time Extensions	570
G. Confirms the Subcontractor's Consent for the Surety to Assign the Ratification Agreement to the Completion Contractor.....	570
H. Resolves Pending Subcontractor Claims.....	570
I. Affirms Obligation of the Subcontractor to Provide Insurance and Bonds	571
J. Arranges Payment of Amounts Due to the Subcontractor	571
III. Enforcement Options when Dealing with an Unwilling Subcontractor.....	571
A. Assignment Provisions in the Prime Contract General Conditions	572
B. Assignment Provisions in the Subcontract.....	574
C. Assignment Provision in the Indemnity Agreement	575
D. Subrogation	576
IV. Alternatives to a Ratification Agreement.....	577
A. Assignment of the Subcontract to the Surety	577
B. Assignment of the Subcontract to the Obligee or the Completion Contractor.....	578
C. Negotiation of a New Subcontract with the Existing Subcontractor	578

- D. Negotiation of a Subcontract with a New Subcontractor .. 579
- V. Claims Against Subcontractors and Their Insurers..... 580
- VI. The Surety’s Rights against the Subcontractor’s Surety 581
 - A. The Surety’s Status as the Named Oblige in the Subcontractor’s Bond or as a Successor–in–Interest..... 581
 - B. Practical Issues When Surety Sues Another Surety 582
- VII. The Subcontractor’s Rights under the Principal’s Payment and Performance Bond 583
 - A. Payment Bond Claims 583
 - B. Performance Bond Claims 584
- VIII. The Subcontractor’s Claims against the Principal and/or the Oblige 585
 - A. Claims against the Principal 585
 - B. Claims against the Oblige 585
- Conclusion 586

CHAPTER XI: The Performing Surety’s Additional Obligations
Grace Winkler Cranley and Andy J. Chambers

- Introduction..... 587
- I. Insurance Considerations for the Surety in a Bond Default 589
 - A. Common Construction Industry Insurance Coverages..... 592
 - 1. Commercial General Liability Insurance..... 592
 - a. Coverage Exclusions 596
 - b. Builder’s Risk Insurance. 602
 - c. Errors and Omissions and Professional Liability Coverage. 606
 - d. Workers’ Compensation and Employer’s Liability Insurance. 608
 - e. OCIP, CCIP, and Other “Wrap Up” Insurance Programs. 608
 - f. Completed Operations Coverage..... 610
 - g. Other Insurance Coverages. 611
 - B. The Interplay between Surety Bonds and Insurance Policies 612
 - 1. Distinctions between Suretyship and Insurance 612
 - 2. The Surety’s Ability to Recover Against Insurance Policies 614

	3. The Surety's Equitable Subrogation Rights.....	615
	4. The Surety's Assignment Rights	616
	5. The Surety's Rights of Exoneration and Indemnification.....	617
II.	Extra-Contractual Damages.....	617
	A. Bad Faith	618
	1. Common Law Bad Faith.....	618
	2. Statutory Causes of Action	630
	3. Bad Faith Standard and Damages	633
	4. Claims by Principal.....	635
	B. Liability for Tort Claims Against Principal	637
	C. Liability for Penalties and Punitive Damage Awards Against Principal	639
	D. Liability for Taxes.....	641
	1. Miller Act Bonds	641
	2. Little Miller Act Bonds.....	643
	E. Liability for Interest	643
	F. Liability for Attorneys' Fees	645
	G. Liability for Environmental Claims	646
	H. Liability for LEED Certification	648
III.	Bond Defaults and DBE Considerations.....	651
	A. What Is a DBE?.....	651
	B. The TEA-21 in Its Constitutional Context.....	652
	C. What DBE Issues May Arise in the Bond Default Context?	653
	1. When the Defaulting Contractor Is a DBE or part of a DBE Teaming Agreement	653
	2. When the Completion Work Is to be Performed by DBEs	655
	a. Availability Concerns.....	655
	b. Capacity Concerns.....	657
	D. Fraud or Misrepresentation Concerns and the Surety	657
IV.	Obligations Beyond Completion: Statutes of Limitations and Statutes of Repose Considerations.....	659
V.	Bonded Contract Closeout	664
	A. Closeout Requirements and Documents.....	666
	1. Certificate of Substantial Completion.....	666
	2. Certificate of Final Completion	667

- 3. Application for Final Payment, Release of Lien
Forms, Consent of Surety 667
- 4. Project Submittals 668
- 5. Warranties 668
- 6. Other Considerations 669
- VI. Reservations of Rights 669
 - A. Purpose and Function of an Effective Reservation of
Rights 670
 - B. Risks of Waiver and Estoppel 671
 - 1. Estoppel 672
 - 2. Waiver 674
 - C. Requirements for an Effective Reservation of Rights 677
- Conclusion 679

**CHAPTER XII: The Performing Surety’s
Mitigation of Loss
*Joel M. Long and Denise C. Puente***

- Introduction 681
- I. Avenues of Mitigation/Recovery 681
 - A. Legal 681
 - 1. Contractual 681
 - a. Indemnity Agreement 681
 - b. Collateral Deposit Provision 683
 - c. Assignment Provision 685
 - d. UCC Filing Provision 689
 - e. Attorney-in-Fact Provision 690
 - f. Right to Settle Provision 692
 - g. Takeover Provision 697
 - h. Right to Finance Provision 698
 - i. Books and Records Provision 700
 - j. Trust Fund Provision 701
 - 2. Statutory 702
 - a. Principal’s Duty to Indemnify and Reimburse 702
 - b. Trust Fund Statutes 704
 - 3. Common Law/Equitable 705
 - a. Subrogation 705
 - b. Indemnification/Reimbursement 707
 - c. Contribution 708

	d. Exoneration.....	708
	e. <i>Quia Timet</i>	709
II.	Sources of Mitigation/Recovery	710
	A. Contract Funds	710
	1. Bonded Contract Funds	710
	2. Non-Bonded Contract Funds	710
	a. Common Obligee Theory.....	710
	B. Collateral.....	712
	C. Obligee	712
	D. Principal	713
	E. Indemnitors.....	714
	F. Other Sureties.....	715
	G. Third Parties	715
	1. Subcontractors and Suppliers.....	715
	2. Design Professionals.....	716
	3. Financial Professionals	717
	a. Accountants.....	717
	b. Banks.....	717
	c. Bond Agents/Brokers.....	718
	H. Insurance	719
III.	Obstacles to Mitigation/Recovery	719
	A. Obligee Claims and Defenses.....	719
	B. Principal/Indemnitor Claims and Defenses.....	720
	1. Bad Faith.....	720
	2. Tortious Interference.....	724
	3. Breach of Fiduciary Duty	725
	C. Third Party Claims	725
	Conclusion	726

CHAPTER XIII: Bankruptcy—The Principal’s Default and the Surety’s Performance

Chad Schexnayder and Kirsten Worley

	Introduction.....	727
I.	The Bankruptcy Landscape	728
	A. The Chapters of the Bankruptcy Code	728
	B. Key Concept: “Property of the Estate” (11 U.S.C. § 541)	730
	C. The Automatic Stay.....	731
	1. General Principle	731

	2. Notice of Default/Termination of Bonded Contracts..	733
	3. Protection and Control of the Bonded Contract Funds	735
D.	Notice to Obligee	736
	1. Permitted Communication Among Creditors	737
	2. Stronger Communication to the Obligee	739
	3. Notice to the Obligee of Other Rights	740
E.	Cash Collateral Motion Practice.....	740
F.	Motion for Relief from Stay.....	744
	1. Stay Relief Based upon Cause, Including Lack of Adequate Protection	745
	2. Stay Relief Based upon Lack of Equity and Bonded Contract Funds Not Being Necessary to an Effective Reorganization.....	746
	3. The Surety’s Use of Both Grounds for Stay Relief ...	747
G.	Motion for Abandonment.....	748
II.	Control of Project.....	750
	A. Motion for Relief from Stay.....	750
	B. Executory Contract Motions	751
	1. Standards for Assumption.....	753
	2. Action by the Surety	754
III.	Subcontractor/Vendor Issues	756
	A. Motion for Relief from Stay.....	756
	B. Supplier Reclamation Claims.....	758
	C. Assumption and Assignment of Subcontracts and Supplier Purchase Orders	759
IV.	Discovery of Books and Records.....	760
	A. Schedules, Statement of Financial Affairs, and First Day Motions	761
	B. Creditors’ Meeting	761
	C. Tax Return Request.....	761
	D. Rule 2004 Examination.....	762
V.	Post-Petition Financing of the Principal	763
	A. The Legal Framework for Surety Lending to a Principal/ Debtor—Section 364.....	764
	1. Unsecured Debt in the Ordinary Course of Business .	765
	2. Unsecured Debt Outside the Ordinary Course of Business.....	766

3. Debt to Be Accorded Superpriority Status or to Be Secured by Estate Assets	766
4. Debt to be Secured by Extraordinary Means Priming Liens	767
5. The Safe-Harbor for the Post-Petition Financier	768
6. Some Practical Considerations to Post Petition Financing	769
7. The Negotiation	772
B. Drafting and Implementing the Post-Petition Financing Agreement and Order	775
Conclusion	782
Appendix A: The Bonded Contract Funds before the Bankruptcy Court	784
Appendix B: Common Obligee – The Surety’s Right to Contract Funds from Other Projects	795
TABLE OF CASES	799

CONTENTS

EDITORS' INTRODUCTION	iii
------------------------------------	-----

CONTENTS	v
-----------------------	---

FORM	PAGE
1.1 Standard Form 25 Performance Bond	1
1.2 AIA A311 Performance Bond	3
1.3 AIA A312–1984 Performance Bond	5
1.4 AIA A312–2010 Performance Bond	9
1.5 ConsensusDocs Form 260 Performance Bond	13
1.6 EJCDC Form C-610 Performance Bond	17
1.7 AIA A312 Payment Bond (2010 Ed.)	25
1.8 AIA A312 Payment Bond (1984 Ed.)	29
1.9 AIA A311 Payment Bond	33
1.10 ConsensusDocs Form 261 Payment Bond	35
1.11 EJCDC Form C-615 Payment Bond	39
1.12 Standard Form 25A Payment Bond	47
3.1 Contractor/Project Information	49
3.2 Sample Form of Notice to the Indemnitors	55
3.3 Sample Letter to Obligee Demanding That Contract Funds Be Withheld	57
3.4 Sample Status Inquiry Letter to Obligee with Notice	59

3.5	Sample Status Inquiry Letter to Obligee	61
4.1.1	Principal's and Indemnitors' Request for Surety's Financial Assistance	63
4.1.2	Surety's Financing Notice Letter to Principal and Indemnitors	67
4.2.1	Interim Financing Term Sheet	73
4.2.2	Promissory and Confessed Judgment Note	81
4.3	Financing, Collateral, and Special Account Agreement	89
4.3.1	Indemnity Agreement (omitted)	117
4.3.2	List of Bonded Contracts and Bonds	119
4.3.3	Principal's and Indemnitors' Request for Surety's Financial Assistance—Form 4.1.1 (omitted)	121
4.3.4	Surety's Financing Notice Letter to Principal and Indemnitors—Form 4.1.2 (omitted)	123
4.3.5	Collateral–Security Agreement	125
4.3.6	Voluntary Letter of Default and Termination	131
4.3.7	Letter of Direction	133
4.3.8	Irrevocable Assignment and Irrevocable Power of Attorney	135
5.1	Takeover Agreement	139
6.1	Demand Letter for Obligee to Mitigate Damages	159
6.2	Tender and Release Agreement	161
7.1	Performance Bond Release and Partial Assignment	171

7.2	Letter Agreement Re: Completion by Obligee	177
8.1	Voluntary Letter of Default and Termination—Federal Projects	181
8.2	Takeover Agreement—Federal Projects	183
9.1	Completion Agreement (Short Form)	201
9.2	Completion Agreement (Long Form)	217
10.1	Ratification Agreement	251
13.0	Equities Section That Can Be Useful in Surety Briefs in Bankruptcy	257
13.1	Notice to Common Obligee	259
13.2	Notice of Appearance and Request for Notice	261
13.3	Request for Debtor’s Tax Return	263
13.4.1	Notice of Non-Consent to Use of Cash Collateral (with Authorities)	265
13.4.2	Notice of Non-Consent to Use of Cash Collateral (Short Form)	269
13.5	Surety Objection to Use of Cash Collateral	271
13.6	Motion for Relief from Stay—Bonded Contract Proceeds	279
13.7	Motion for Relief from Stay—Bonded Contract Completion	297