

**TENTH ANNUAL
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**THE SURETY AND THE FEDERAL GOVERNMENT:
TO FINANCE, TO TAKEOVER, OR TO DO NOTHING, THAT
IS THE QUESTION**

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I. INTRODUCTION

This paper will address some practical considerations which the surety claims professional faces when the bonded principal teeters on the brink of default due to financial instability. The principal and the Government contracting agency have come to loggerheads, and the Government resorts to its ultimate weapon and terminates the contract for default. In both situations, the surety has several options. In the event the contractor is financially unstable, the surety can provide financial assistance to the principal to enable it to complete the project. This can be done either by direct financing or by so-called "backdoor financing" which is often a euphemism for making payments to subcontractors and suppliers under the payment bond in order to avoid the stigma of direct financing to the principal. The surety may also initially do nothing and let the normal progression of events occur which oftentimes results in termination of the principal's contract. Then, the surety must decide whether it will enter into a takeover agreement with the Government; attempt to tender a contractor to the Government; or do nothing and potentially litigate with the Government over excess procurement costs, liquidated damages and other claims which the Government may assert against the surety.

In the second scenario, the surety no longer has the financing option because the Government has terminated the contractor for default. The surety may or may not have a viable principal which will attempt to contest the validity of the termination for default. However, the surety is still faced with a decision as to whether or not it will complete via a takeover agreement; attempt to tender a contractor, do nothing and stand by the principal and let the principal contest the validity of the termination for default.¹

This paper will address some of the potential perils and pitfalls flowing from the surety's decision as to how to respond to these varying situations.

The first issue is the impact of surety's decision to respond to the potential default on the prosecution of pre-default "construction claims" which are defined for the purpose of this paper as ordinary claims which arise out of the construction process, e.g., claims for extras, time extensions, etc. The second area of inquiry is what impact will the surety's decision have in responding to a potential default on its ability to prosecute pre-termination claims which may be unique and/or personal to the surety such as claims for improper payments, payments in violation of the terms of the contract, improper release of retainage, etc. The third issue is the surety's ability, if any, to contest, in its own right, the validity of a termination for default by the Government. This paper will also address the ability of the surety to contest affirmative claims by the Government against the surety for excess procurement costs, liquidated damages, etc. Finally, we will address the ability of the surety, under certain scenarios, to collect payments which the surety makes under either its payment bond or performance bond when the Government still holds the contract funds, has misdirected payment of the contract funds,

¹ There will be overlaps between the discussions contained in this paper and George Bachrach's paper presented at this program on the Surety and the United States Court of Federal Claims - Revisited. This paper will focus on the specific situations described above.

or improperly paid the contract funds.²

II. FINANCING THE PRINCIPAL

A. "CONTRACT CLAIMS"

When a financially troubled principal contacts a surety, the surety claims person's investigation generally involves an inquiry as to whether or not the principal contends it has traditional contract claims against the Government. As we all know, there is virtually never an occasion when the contractor does not have such a claim which the contractor generally offers to the surety as collateral in order to avoid giving the surety something truly of value. However, on occasions, these contract claims may have some value. This discussion assumes that, after investigation, the surety concludes the contractor's claim have some value. If the surety elects to finance the principal then, initially, there is no impediment to the prosecution of the contract claims. Claims will be prosecuted just as if the contractor did not have financial difficulties. The only difference will be that the surety will likely be footing the bill for the experts and attorneys' fees.

However, as oftentimes occurs, there may come a time when the principal will lose interest in cooperating with the surety, and its key officers, project manager, and indemnitors disappear into the sunset leaving the surety with an empty shell. A default may occur because the principal, despite the surety's financial assistance, simply does not prosecute the job; the surety elects to withhold further funding because of the principal's recalcitrance; or despite the surety's best efforts, the principal is simply incompetent and the Government terminates the principal. Alternatively, the project is completed but the claims have not been resolved. The surety is still seeking salvage through the claims. In that event, the surety is now facing a different situation and its valuable collateral may still have value but, as a practical matter, the surety may never be able to collect on that value.

The law is clear that, absent a takeover agreement, a surety, whether it be a financing surety or not, is not a contractor under the Contract Disputes Act and cannot prosecute traditional contract claims. See Westech Corp. v. United States, 20 Cl. Ct. 745 (1990), Universal Sur. Co. v. United States, 10 Cl. Ct. 794 (1986). Therefore, absent measures taken

² The comments in this paper are premised upon an interpretation that the United States Supreme Court did not change the playing field in its decision in Blue Fox, Inc. v. Department of the Army, 119 S. Ct. 687 (1999). In that case, the plaintiff, a subcontractor, sued the United States Government under the Administrative Procedure Act seeking to assert an equitable lien on contract funds held by the Department of the Army. The Supreme Court found the Administrative Procedure Act did not waive sovereign immunity and the subcontractor had no standing to sue the United States Government. This result is not new nor is it surprising. This result not only follows traditional principles of sovereign immunity but also follows the established precedent in both the United States Court of Claims and the Federal Circuit. See Erickson Air Crane v. United States, 731 F.2d 810, 813 (Fed. Cir. 1984); United States v. Johnson Controls, Inc., 713 F.2d 1541, 1557 (Fed. Cir. 1983); Putnam Mills Corp. v. United States, 479 F.2d 1334 (Ct. Cl. 1973). However, in a few unfortunate paragraphs, the U.S. Supreme Court made some comments which cast doubt on the surety's rights to pursue the Government under the doctrine of equitable subrogation. The United States Department of Justice has apparently seized upon these comments which were, in dicta, in Blue Fox, and takes the position that a surety can no longer sue the United States Government pursuant to the Tucker Act under the doctrine of equitable subrogation. There is pending litigation which should answer this precise question.

in the initial stages of the decision to finance to attempt to ensure that the surety's rights to prosecute the claims are protected, the surety may lose its ability to prosecute the claims.

The law is not at all clear whether or not there is anything which the surety may do to protect its rights to prosecute pre-termination claims when it finances the principal and the principal later becomes uncooperative. The surety claims person may immediately conclude the power of attorney provision contained in most standard form General Agreements of Indemnity allows the surety to prosecute the principal's contract claims. However, this may not be the answer. There are several hurdles which must be overcome. First, any claim against the Government pursuant to the Contract Disputes Act must be certified. The Certification Provision provides:

"(c) Amount of claim; certification; notification; time of issuance; presumption; authorization of certifier

(1) A contracting officer shall issue a decision on any submitted claim of \$100,000 or less within sixty days from his receipt of a written request from the contractor that a decision be rendered within that period. For claims of more than \$100,000, the contractor shall certify that the claim is made in good faith, that the supporting data are accurate and complete to the best of his knowledge and belief, that the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable, and that the certifier is duly authorized to certify the claim on behalf of the contractor....

(6) The contracting officer shall have no obligation to render a final decision on any claim of more than \$100,000 that is not certified in accordance with paragraph (1) if, within 60 days after receipt of the claim, the contracting officer notifies the contractor in writing of the reasons why any attempted certification was found to be defective. A defect in the certification of a claim shall not deprive a court or an agency board of contract appeals of jurisdiction over that claim. Prior to the entry of a final judgment by a court or a decision by an agency board of contract appeals, the court or agency board shall require a defective certification to be corrected.

(7) The certification required by paragraph (1) may be executed by any person duly authorized to bind the contractor with respect to the claim."

41 U.S.C. § 605 (c).

FAR 33.207(e) further reduces this provision to provide:

"The certification may be executed by any person authorized to bind the contractor with respect to the claim."

If the principal has become uncooperative, there may no longer be anyone who is authorized to bind the contractor. If the contractor either forfeits its charter or simply exists as a shell, the surety will face the quandary of who can bind the contractor. Oftentimes, there is no one left and, the ability to prosecute the claim is gone.

While General Agreements of Indemnity issued by various sureties vary, a standard provision is the attorney-in-fact provision which oftentimes reads as follows:

"ATTORNEY-IN-FACT. Each of the undersigned hereby irrevocably appoints the surety or any person or persons designated by the surety to act as their attorney-in-fact with the right to exercise all their rights assigned to the surety by this Agreement and there named execute and deliver any and all additional other assignments of documents deemed necessary by the Surety to vest absolute title to any and all monies, property and rights hereby assigned; to provide the protection and rights to the Surety contemplated by all the provisions of this Agreement." (Emphasis added.)

In Admiralty Construction Company v. Dalton, 156 F.3d 1217 (Fed. Cir. 1998), the surety relied upon this provision of the General Agreement of Indemnity to both file an appeal with the Armed Services Board of Contract Appeals contesting the assessment of liquidated damages and excess procurement costs and a suit in the United States Court of Federal Claims contesting the assessment of the same damages. The surety filed the suit styling it Admiralty Construction By National American Insurance Co. v. Dalton. The Federal Circuit found there was no jurisdiction for these cases. While the Admiralty case involved a suit by the surety contesting excess procurement costs and liquidated damages, the legal analysis should not differ when applied to pre-default termination claims. In Admiralty, the Court found that the surety which brought the action, pursuant to the power of attorney provision, did not transform itself into a contractor for Contract Disputes Act jurisdiction because the General Agreement of Indemnity was not a contract between the surety and the Government. *Id.* at 1222. The Court also found the Tucker Act did not confer jurisdiction on the Court because there was no express contract between the surety and the government, and the doctrine of equitable subrogation did not extend to the surety's qualification as a contractor under the Contract Disputes Act.

Assuming a surety would try to bring the action in the name of the principal and have the complaint in the contractor's name and simply signed by the surety as attorney-in-fact for the principal to try to place form over substance, there is another danger in relying upon the General Agreement of Indemnity.

The Anti-Assignment Act, 41 U.S.C.A. §15 (1987 and Supp. 1999), prevents the

assignment of a Government contract except under certain limited circumstances, none of which are applicable to a surety. See 41 U.S.C.A. §15(b) (permitting a contractor to assign to financial institutions funds due or to become due from the United States). The General Agreement of Indemnity assigns rights to the surety. Even if the surety brought the action in the name of the contractor, assuming discovery as to who was the real party in interest, the question becomes whether or not the Anti-Assignment Act would prohibit the surety from prosecuting such a claim because the surety is prosecuting a claim assigned to it. A court could reasonably find the Anti-Assignment of Claims Act would bar such an action because the surety is an assignee.

Another pitfall which may face the surety under this scenario is the risk of false certification. The required certification is to be under oath and, the individual who signs the claim could be prosecuted for false certification, 41 U.S.C.A. §604 (1987). Therefore, even if the surety has an appropriate power of attorney, the surety will have to ensure that it does an adequate investigation so that it is convinced that the individual who certifies the claim is not subject to attack by the Government for alleged false certification.

However, there may be another alternative available to the surety. In its initial financing agreement, there is nothing to prohibit the principal from giving a specific power of attorney to the surety authorizing the surety to act in its behalf on all matters arising out of the contract. There are dangers to this such as the principal later claiming the surety settled too cheaply, ignored facts, or otherwise acted in bad faith. However, with regard to the Government, while there is no known judicial precedent, a true power of attorney, which is obtained early in the surety's negotiations with the principal, may give the surety an option to prosecute the principal's contract claims. Attached to this paper as Appendix 1 is such a power of attorney. This power of attorney was successfully used in negotiating a traditional contract claim with the Government. The validity of it was never tested by the courts but, the Government accepted this Power of Attorney and agreed to deal with the surety rather than the contractor. In that case, the Government had refused to deal with the surety when the surety initially relied upon the General Agreement of Indemnity's Power of Attorney provision. This specific power of attorney also contains provisions releasing the surety from liability for its handling of the principal's contract claims

B. SURETY'S PERSONAL CLAIMS

A surety's decision whether to finance a principal or not should have no impact on the surety's ability to prosecute claims which may be unique to the surety such as alleged overpayment claims, material deviation from the contract, etc. The basis for these claims will be under the Tucker Act and doctrine of equitable subrogation. An example of this is found in National Surety Company, 118 F.3d 1542 (Fed. Cir. 1997). Here, the surety prevailed on a claim against the Government because the Government improperly released contract funds in a situation where the contract required that retainage would not be released until a scheduling diagram was submitted. However, care has to be exercised in characterizing these claims because to the extent the surety contends there is a breach of the underlying construction contract there may be issues as to the surety's standing to assert these claims. See Admiralty Constr. Co., 156 F.3d at 1222; Ransom v. United States, 900 F.2d 242, 245 (Fed Cir. 1990).

C. MISCELLANEOUS ISSUES, TERMINATION FOR DEFAULT CLAIMS, AND AFFIRMATIVE CLAIMS OF THE GOVERNMENT

By financing the principal, the surety attempts to avoid the termination of the contract for default and, presumably, this will not become an issue. However, the surety, as a practical matter, may face claims for liquidated damages, which are asserted against the surety through the principal which would deplete the available contract balance. If the principal remains viable and cooperative then, the contest over liquidated damages will, generally, be based on a claim for time extensions, mismanagement of the contract by the Government, changes to the contract, etc. These, as discussed above, can be prosecuted by the principal as a Contract Disputes Act claim subject to the appropriate certification procedures. If the principal becomes uncooperative, then, the same analysis applies to the surety's predicament as it does on affirmative claims against the Government. The surety may not have the ability to contest these except through the guise of a contest over contract balances discussed later.

D. RIGHT TO THE CONTRACT FUNDS

This issue most often arises when the Government asserts a right of setoff against the contract funds whether it be as a result of an IRS lien or problems on unrelated contracts. The courts have drawn a distinction as to the surety's rights to contest the Government's right of setoff between a payment bond surety and a performance bond surety. The courts have found that a payment bond surety's rights to the contract funds are inferior to the Government's right of setoff. See United States v. Munsey Trust Co., 332 U.S. 234, 243 (1947); United States v. Unites States Fidelity & Guar. Co., 475 F.2d 1377, 1383 (Ct. Cl. 1973). Likewise, the courts have found that a performance bond surety's rights to the contract funds are paramount to the Government's right of setoff. See Security Ins. Co. v. United States, 428 F.2d 838, 841 (Ct. Cl. 1970).

In Aetna Casualty and Sur. Co. v. U.S., 845 F.2d 971 (Fed. Cir. 1988), the Federal Circuit looked beyond the form of the arrangement between the surety and the principal to find the surety which factually enabled the principal to complete by making payments which were not covered by its payment bond; payments in excess of its payment bond liability; and payments directly to the principal was truly a performance bond surety and its rights to the contract funds were superior to the IRS' right of setoff.

However, in recent years, certain contracting officers have taken the position that form over substance should prevail. In at least one instance (a matter which is still pending), the contracting officer has contended that a surety, which assisted completion by making payments to subcontractors and suppliers for work performed after the contractor acknowledged its financial problems; guaranteeing payments to subcontractors and suppliers for future work and paying for that work; and monitoring the job on a weekly basis, did not qualify as a performance bond surety because the drafts issued by the surety noted that payments were made under its payment bond; the surety's attorneys and consultants referred to these payments as payment bond payments; and the release and assignments obtained by the surety identified the payment bond. Therefore, it is suggested that, when the surety decides to finance, whether it be by direct financing or backdoor financing, the surety should

try, to the extent possible, to ensure that form comports with substance by identifying any payments made as payments under its performance bond; refer to all guarantees of payments as guarantees under its performance bond; possibly modifying any release and assignment to identify a release of the performance bond; and referring to all dealings with claimants as handling the claims under the performance bond. There are potential pitfalls because, if disaster strikes, a court may or may not recognize the payments made by the surety as reducing the penal sum of the performance bond and, the penal sum of the surety's payment bond may not be reduced. It is suggested that these risks exist whenever a surety elects the financing option. However, that is a topic for another day.

III. TAKEOVER OR TENDER?

A. CONTRACT CLAIMS

In this scenario, the principal has been terminated for default and the surety must decide whether it will takeover the contract or attempt to tender another contractor to the Government.

If the surety elects to takeover and enter into a takeover agreement with the Government which incorporates the contract by reference then, the surety may believe that it is safe and free to prosecute pre-default contract claims. As pointed out in George Bachrach's paper, the Court of Claims found in Travelers Indemnity Co. v. United States, 16 Cl. Ct. 142 (1988) that the surety could prosecute claims under the Contract Disputes Act because the takeover agreement constituted a contract between the Government and the surety. Prior to enactment of the Contract Disputes Act, the Court of Claims reached a similar result in Carchia v. United States, 202 Ct. Cl. 723, 485 F.2d 622 (1973). However, there is a hidden danger in relying upon those cases and assuming that, if the surety executes a takeover agreement, it will be entitled to prosecute the pre-default contract claims. In Travelers supra, while the court found Travelers could pursue its claims under the Contract Disputes Act, none of the claims actually asserted by Travelers were traditional contract claims. In fact, the Court of Claims stated:

"In Counts II, III, IV, V, and VIII of the complaint, however, Travelers also seeks to recover allegedly improper payments based, collectively, upon the construction contract, payment bond, and performance bond. In this connection we believe, at least by implication, that the performance and payment terms of the construction contract between Macomb and the government (necessary to complete the project) were expressly incorporated into the Takeover Agreement between Travelers and the government. Paragraph 8 of the Takeover Agreement provides as follows:

The Surety agrees to complete the work required by the defaulted Contract ... [between Macomb and the government] in accordance with the terms and

conditions so that contract. The Government will pay the contractor (Surety) in the manner provided by the contract, but not in excess of the Surety's costs and expenses, the balance of the contract price unpaid at the time of default, subject, however, to the following conditions.

As Travelers can maintain an action under the CDA based upon the Takeover Agreement, we hold that it may also maintain an action based upon the construction contract terms to the extent that they are incorporated by reference into such agreement. This we hold for the additional reason that whereas here the CAFC has held that "a surety ... is as much a party to the government contract as the contractor." See Balboa, 775 F.2d at 1160 (emphasis added).

The Court of Claims appears to emphasize that a surety which enters into a takeover agreement may only be able to assert claims which arise out of the portions of the construction contract which are necessary to complete the project which could exclude pre-default contract claims.

Moreover, the courts, when analyzing the Contract Disputes Act, appear to focus in "single point of contact" for contract claims. The Contract Disputes Act was designed to avoid the problem of the Government having to deal with duplicitous claims. See, Tuttle/White Contractors, Inc. v. United States, 228 Ct. Cl. 354, 656 F.2d 644 (1981). One would wonder what would occur if the surety which entered into a takeover agreement attempted to assert pre-default contract claims and, the principal also asserted those same claims. Therefore, it is not at all certain whether or not a takeover surety will be able to assert pre-default contract claims.

Attached as Appendix 2 is a form of Takeover Agreement which has been utilized to try to protect the surety in this precise situation. The Takeover Agreement specifically provides that the surety will be allowed to prosecute claims and be entitled to the same protection as if it was the original contractor. Again, this has never been tested through litigation but, it has been accepted by the Government in allowing the surety to prosecute, through the contracting officer level, pre-default construction claims.

If the surety elects to takeover, there should be no doubt but that the surety will be entitled to prosecute post-termination contract claims to the extent the takeover agreement specifically incorporates the underlying construction contract by reference.

If the surety elects to tender and the Government accepts the tender, then, the same analysis applies to pre-construction contract claims as if the surety is a financing surety. The surety has no contract with the Government and would not be allowed to prosecute pre-default construction claims absent some form of agreement with the principal. If the surety tenders,

it should not likely be concerned about post-default termination claims because they will be the responsibility of the tendering contractor.

B. SURETY CLAIMS

If a surety elects to takeover the contract, the surety should be able to prosecute claims which are unique to the surety on two theories. First, these claims could be asserted under the Tucker Act pursuant to the doctrine of equitable subrogation. See National Sur. supra. Alternatively, pursuant to the opinion in the Travelers case supra, to the extent these claims arise from the Government's mismanagement of the contract, resulting in damage to the surety, or alternatively affects the surety's ability to collect the contract funds, the surety, after compliance with the procedural aspects of the Contract Disputes Act, may prosecute these claims as contract claims arising out of the takeover agreement which incorporates the contract by reference.

C. VALIDITY OF THE TERMINATION FOR DEFAULT

If the surety elects to takeover the contract or tender, the surety likely will not have any ability to contest the validity of the termination for default. It is certainly clear that, under the tender scenario, the surety has no ability to contest the termination for default because it has no contract with the Government and it is a stranger to the contract. See Fidelity and Deposit Co. of Maryland v. United States, 31 Fed. Cl. 540 (1994). While there apparently are no reported cases on the ability of the takeover surety to contest the validity of the termination for default, the same analysis should apply as to a tendering surety because the surety is a stranger to the contract and, the question of the validity of the termination for default is between the principal and the Government.

D. AFFIRMATIVE CLAIMS BY THE GOVERNMENT

If the surety tenders, there may be a basis for the surety to contest the validity of the Government's affirmative claims such as liquidated damages claims. In Transamerica Insurance Company v. United States, 31 Fed. Cl. 532 (1994), the surety tendered a contractor to the Government and, paid the completing contractor the completion costs in excess of the remaining contract balances. The Government later issued a final decision assessing liquidated damages against the principal. The contractor did not challenge the contracting officer's final decision. Transamerica filed suit for the contract balance as it was on the date of the default without any reduction for liquidated damages. The Government moved to dismiss Transamerica's complaint arguing that Transamerica had not met its burden to demonstrate that it was a completing surety because it did not assume direct responsibility for the completion of the work. The Court of Claims rejected this argument and found that the surety, which had tendered a contractor and arranged for completion, met the jurisdictional requirements of the Tucker Act to seek recovery of the contract balance as it existed on the date of default. Id. at 536. Thus, the surety was able to contest the assessment of liquidated damages through the backdoor under the guise of a dispute over the contract balance. However, this ruling was limited to the extent the contract balances existed as of the date of default. Id. Thus, the surety which tenders and presumably pays for excess procurement costs should have the ability to contest the Government's assessment of liquidated damages.

A takeover surety will have the same rights pursuant to not only the Tucker Act but also the takeover agreement which gives it the ability to prosecute claims arising from the completion of the work, i.e., diminishment of the contract balance by the Government's assessment of liquidated damages.

E. RIGHT TO CONTRACT FUNDS

Whether the surety completes via a takeover agreement or through a tender should not impact the surety's rights to claim the contract funds free of setoff by the Government because the surety is clearly a performance bond surety whose rights are superior to the Government. See Aetna Casualty & Sur. Co. v. United States, 845 F.2d 971 (Fed. Cir. 1988); Universal Sur. Co. v. United States, 10 Cl. Ct. 794 (1986).

IV. "DO NOTHING"

While the surety may have very good reasons to elect to do nothing because the principal is either financially viable or the surety believes there are substantive defenses to the termination for default, there certainly are perils in the government contracting arena to the surety which elects this option.

A. CONTRACT CLAIMS

Absent an agreement with the principal or a specific power of attorney, it is fairly clear the surety will have no ability to assert either pre-default construction claims or post-default termination claims because the surety has no contract with the Government. There is no jurisdiction under the Contract Disputes Act nor would there be jurisdiction under the Tucker Act for asserting equitable subrogation claim because the courts have held that a surety's bond is not a contract for Contract Disputes Act jurisdiction. See United States v Seaboard Sur. Co., 817 F.2d 956, 961 (2d Cir. 1987); Transamerica Ins. Co. V. United States, 31 Fed. 602, 605 (1984).

B. SURETY CLAIMS

Under this scenario, the surety's initial loss will likely be payment bond claims. The surety will still be able to assert claims to contract funds which were improperly disbursed. However, because the surety is a payment bond surety, it will not only be subject to the Government's right of setoff for unrelated issues, IRS claims, claims on other projects. See United States v. Munsey Trust Co., *supra*.

C. GOVERNMENT CLAIMS

The surety may be faced with a situation in which it will have no ability to contest the Government's excess procurement claims except in a defensive posture. Moreover, the surety may not be able to assert its principal's affirmative claims, the surety's own affirmative claims for the Government's actions in administering the contract, or any setoffs by the Government against the contract funds. While there is limited, if any, case law directly applicable to this issue, if the surety does nothing and the Government completes, the surety's

only loss to the point in time when the Government seeks its excess reprocurement costs will be payment bond losses. Under existing case law, the surety's rights to the contract funds are subject to the Government's right of setoff. To the extent the Government has setoff against the contract balances for excess reprocurement costs, the payment bond surety's rights have been eliminated. If there are still excess reprocurement costs, the surety does not qualify under the Contract Disputes Act to prosecute the principal's pre-termination claims. Moreover, even if the surety asserts its claims under the Tucker Act pursuant to the doctrine of equitable subrogation, the surety's, as a payment bond surety, rights are still inferior to the Government's rights. Moreover, while the court in *Transamerica supra* did not directly decide this case, the question is whether or not, if the Government issues a final decision in asserting excess reprocurement costs against the contractor and the contractor does not appeal, does that act as collateral estoppel against the surety? The *Transamerica* case would indicate that it does not but, that case was limited to a performance bond surety. The result may be different in a "do-nothing" option, and the surety's only defense may be arguing its claims as a set-off against the Government seeking its excess reprocurement costs.

It is suggested that, if the surety elects the do nothing option, in light of the potential pitfalls, this should only be taken if the surety has a financially strong principal and the surety gets substantial collateral with real value.

V. CONCLUSION

George Bachrach's paper addressed the overall rights of the surety in the Federal Court of Claims. This paper has tried to take those principles and apply them to some of the practical issues which the surety faces in determining what actions it will take when faced with a default situation. In certain areas, there is limited case law. When the surety claims professional analyzes and plans its actions, It should be kept in mind that virtually every possible scenario for a dispute with the federal government should be considered prior to making the decision as to what option to elect.

APPENDIX 1

POWER OF ATTORNEY

BACKGROUND: The undersigned, [PRINCIPAL], a [STATE] corporation, with its principal place of business at [ADDRESS] (the "Grantor"), contracted with the United States ("U.S.") under Contract No. _____ to perform certain construction services at [_____] (the "U.S. Contract"). Surety issued its payment and performance bonds in connection with the construction services to be provided under the U.S. Contract naming the Grantor as principal, and the U.S. as obligee. The U.S. Contract has been terminated for the convenience of the U.S. and the Grantor is entitled to certain sums under the U.S. Contract arising out of, or resulting from, the termination for convenience.

PURPOSE: The Grantor is in default in various obligations owing to Surety and has requested the financial assistance of Surety in satisfying all payment and performance obligations owing on construction work for which bonds have been issued by Surety, including the U.S. Contract. The Grantor is unable to fulfill its financial obligations and desires to appoint Surety and any of its officers, employees and agents, its attorneys-in-fact to do and otherwise deal with the U.S. in connection with the termination for convenience of the U.S. Contract.

Section 1: Grant of Power

GRANT: The Grantor hereby appoints Surety, a [STATE] corporation, [ADDRESS], and any of its officers, employees and agents, its attorneys-in-fact with the intention that said attorneys-in-fact shall be able to act in its place in all matters described herein from the date of this Power of Attorney. Said attorneys-in-fact shall have all of the powers, discretions, elections and authorities granted by statute, common law, under any rule of court, by custom or by contract, including the U.S. Contract, in connection with prosecuting all claims with the U.S. in connection with the U.S. Contract, including without limitation, the power to make or file claims, negotiate with, deal with, contract with, execute documents for and on behalf of the Grantor and receive, accept and negotiate all checks or drafts issued, from time to time, in connection with the U.S. Contract and its termination for the convenience of the U.S.

Section 2: Duration of Power of Attorney

POWER COUPLED WITH AN INTEREST: The Grantor irrevocably grants to its attorneys-in-fact all powers stated herein, such power being coupled with an interest.

Section 3: Additional Powers

In addition to the powers granted above, and not in limitation thereof, said attorneys-in-fact shall also have the following powers:

PROPERTY RIGHTS: To enforce, administer, convey, release or otherwise deal with any and all property rights or interests of the Grantor, whether tangible or intangible, in connection with the U.S. Contract upon such terms and conditions as said attorneys-in-fact

consider to be appropriate. Said attorneys-in-fact may surrender, compromise, grant interests in, or otherwise deal in all respects with the property rights, including contract rights, of the Grantor related to, directly or indirectly, the U.S. Contract.

COLLECTION OF DEBTS: To collect and receive, with or without the institution of suit or other legal process, all debts, monies, interest, and demands that now are due or may hereafter become due, owing, or otherwise payable or belonging to the Grantor under the U.S. Contract. Said attorneys-in-fact may use and take all lawful actions in Grantor's name, or in the name of Surety, or otherwise, to recover the same and to compromise the same.

ENDORSEMENTS: To endorse all checks or drafts drawn to the order of the undersigned.

DEPOSITS: To deposit funds in any banking or savings institution or in any "money market" account, whether or not insured, in the name of Surety and/or the Grantor or otherwise.

PAYMENTS: To pay all bills, accounts, claims, and demands now due or becoming due subsequent to the execution of this Power of Attorney in connection with the U.S. Contract, by payment of its own funds, by offset, or otherwise. Any such payment made with funds of Surety shall be for the account of the Grantor and shall be due, owing and payable to Surety by the Grantor.

GOVERNMENTAL RETURNS AND REPORTS: To prepare, make, execute, and file any and all federal, state, local or other governmental returns, reports, claims, or declarations. This power shall include the power to represent Grantor (directly or through attorneys, accountants, or other agents) in any matter before any federal, state, or local governmental agency.

DOCUMENTS: To execute, seal, acknowledge, and deliver any instruments, documents or papers deemed necessary, advisable or expedient with respect to any of Grantor's property or other rights or obligations under the U.S. Contract.

RELEASES: To give discharges, releases, consents and receipts in connection with the U.S. Contract.

LITIGATION: To institute, maintain, defend, compromise, arbitrate, prosecute, settle or otherwise dispose of any and all actions, suits, equitable or administrative hearings, claims (including governmental and tax claims), as to which Grantor is or may become a party or in which Grantor may have an interest, and may assert or waive any and all rights, privileges and defenses available to Grantor.

EMPLOYMENT OF OTHERS: To employ, supervise and discharge such attorneys at law, accountants, or other persons as and to the extent said attorneys-in-fact shall deem necessary or advisable in connection with the matters described herein.

Section 4: Supplemental Provisions

RATIFICATION AND RELEASE: The Grantor ratifies all acts hereafter taken by said attorneys-in-fact by virtue of these presents. The Grantor further releases any claim it may now have, or may hereafter have, in connection with the actions of its attorneys-in-fact relating to the U.S. Contract, and shall indemnify and save each of them harmless from any costs, expense, liability or other claim now existing or at any time hereafter arising.

PHOTOCOPY: Grantor authorizes the use of a photocopy of this Power of Attorney, in place of the original copy executed by Grantor, for the purpose of effecting the terms and provisions hereof.

BINDING UPON SUCCESSORS: Any act or thing lawfully done hereunder by said attorneys-in-fact shall be binding upon the successors and assigns of Grantor.

PROCEDURE FOR SIGNING NAME: All business transacted hereunder for Grantor or for its account shall be transacted in its name, and all endorsements and instruments executed by said attorneys-in-fact for the purpose of carrying out the foregoing powers shall contain Grantor's name, followed by the name of said attorneys-in-fact and the designation "attorney-in-fact."

LEGAL REPRESENTATION: Said attorneys-in-fact may use all means and processes of the law for the full and effectual execution of the business herein described, and in Grantor's name may make and execute due acquittance and discharge, and appear for and represent Grantor before any judge, justice, or any judicial, administrative, or governmental officer in any court of official proceeding, and there on Grantor's behalf institute, answer, defend, or reply unto all actions, causes, matters, and things whatsoever relating to the U.S. contract and these presents.

OBLIGATION OF THIRD PARTIES: Said attorneys-in-fact may do any and all things herein described without the obligation on the part of any person dealing with said attorneys-in-fact to ask further authorization as a prerequisite to obligating the Grantor in any manner, without obligation on the part of any person dealing with said attorneys-in-fact to see to the application or use of any funds, proceeds or property passing to said attorneys-in-fact in Grantor's name or in the name of said attorneys-in-fact in connection with any such transaction.

VALIDITY OF ACTS: Said attorneys-in-fact may act in all matters with respect to all powers described herein as freely, fully, and effectively as Grantor could or might do if present.

ACTION BY ONE ATTORNEY: Any action authorized hereunder may be taken by Surety, and any of its officers, employees and agents, and the action by any of the foregoing for and on behalf of Surety shall be binding upon said Surety.

OTHER POWERS OF ATTORNEY: The powers granted hereunder shall be in addition to any other powers or rights granted unto Surety its officers, employees and agents under other powers of attorney or other instruments heretofore executed and delivered. Nothing herein shall limit or impair the equitable subordination rights of Surety, as a surety, but shall be in addition thereto.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this ____ day of _____, _____.

ATTEST:

THE PRINCIPAL

(SEAL)

By: _____
Name:
Title:

STATE OF _____, CITY/COUNTY OF _____ TO WIT:

On this ____ day of _____, _____, before me, the undersigned officer personally appeared _____, who acknowledged himself/herself to be the [TITLE] of [PRINCIPAL], a [STATE] corporation, and that he/she, as such [TITLE], being authorized so to do, executed the foregoing instrument for the purposes therein contained, by signing the name of the corporation by himself/herself as [TITLE].

In witness whereof I hereunto set my hand and official seal.

Notary Public

My Commission expires: _____

APPENDIX 2

SURETY TAKEOVER AGREEMENT

THIS AGREEMENT is entered into this ____ day of _____, 1999 by and between the United States of America (hereinafter called the "Government"), represented by the Contracting Officer executing this Agreement, and _____ (hereinafter called the "Surety").

recitals

WHEREAS, on or about _____ the Government entered into a construction contract with Principal in the contract amount of \$_____ (the "Contract"), for the [describe the contract].

WHEREAS, as required under the terms of the Contract, Principal and the Surety executed and delivered to the Government certain bonds dated _____, a Performance Bond, Bond No. _____ in the penal sum of \$_____ (the "Performance Bond") and a Payment Bond, Bond No. _____ in the penal sum of \$_____ (the "Payment Bond") (the Performance Bond and the Payment Bond may be hereinafter collectively referred to as the "Bonds");

WHEREAS, on or about _____, 199_, the Government defaulted Principal and terminated its right to proceed under the Contract and made demand on Surety to honor its obligations under its Bonds. A copy of the letter is attached hereto as Exhibit 1;

WHEREAS, the Surety desires to effect the completion of the work covered by the Contract in order to preserve continuity of performance, to expedite completion and to avoid the expense, delay and inconvenience of reprocurement;

WHEREAS, the Surety is willing and desires to complete or procure the completion of the Contract under the Performance Bond in accordance with the terms of this Agreement as a measure of cooperation with the Government and as a measure of minimizing its costs; and

WHEREAS, pursuant to its Performance Bond, Surety is willing to cause the Contract to be completed in accordance with the provisions of this Agreement, provided that in as doing it may receive the entire Contract Balance in accordance with the Contract and as hereafter described and set forth below.

NOW, THEREFORE, in consideration of the agreements and undertakings hereinafter set forth, and for other good and valuable consideration, the receipt and adequacy thereof being hereby acknowledged, the Government and the Surety agree as follows:

1. All Recitals set forth above are incorporated by reference.
2. Surety will procure the performance of the Contract in accordance with its terms and conditions and on such different terms and conditions as may be subsequently agreed upon by Surety and Government. Surety agrees to keep its payment bond in place for the protection of laborers and materialmen having valid claims for labor and/or materials supplied to Principal before the Contract termination date. The Government acknowledges that the Surety, by its execution of this Agreement, is acting in its capacity as the Surety of Principal, and that the Surety is not assuming any obligations or liabilities beyond those set forth in the Bonds.
3. Such performance of the obligations under the Contract shall be made by _____ as Completion Contractor, and Obligee hereby consents to Surety's designation of _____ as the contractor to complete the work under the Contract.
4. Completion contractor shall have full authority to act in every respect for Surety, as if Surety were performing the physical work and doing all other acts required of Surety hereunder. Surety hereby designates Completion Contractor as Surety's agent for the completion of the Contract. During the progress of the work, Government shall have the right to deal directly with the Completion Contractor, with the exception that the Completion Contractor shall not be authorized to execute or enter into any change order or any extension of reduction of time for the completion of the Contract. Surety must execute all change orders, extensions and/or reductions of time as may be required for completion of the Contract.

Except as limited by this Agreement, Government and Surety acknowledge that Completion Contractor shall process and handle for its own account and on behalf of Surety, all necessary paperwork, and all other matters required for the prosecution of the work. The authority of the Completion Contractor to deal directly with Government may be revoked by Surety on five (5) days write notice to Completion Contractor and Government.

All documents pertaining to pay estimates, progress payments, final payments, change orders, extensions or reduction of time, shall be delivered for approval and execution to Surety's representative:

Surety

and

Consultant

5. In the event a dispute arises between Government and Completion Contractor, or Completion Contractor is in default under the terms of the original Contract, Government shall give Surety notice thereof as quickly as reasonably possible.
6. Except as otherwise provided in this Agreement, the Surety is entitled to all rights, title and interest of Principal in and to the Contract in all respects as if the Surety were the original

party to the Contract. The terms and conditions of the Contract, including the Disputes provision of the Contract, are specifically incorporated herein by reference as if fully set forth herein. The Government acknowledges that the Surety shall have all rights in the Contract, including rights to submit claims, under the Disputes clause of the Contract as if the Surety was the original party to the Contract. Such rights shall include but not be limited to the right to assert all claims which may arise out of the Contract as if the Surety was the original contractor. Nothing contained herein shall impair any defenses which the Government may have to any claim asserted by the Surety.

7. The Government and the Surety agree that as of the date of this Agreement:

- (1) The authorized amount of the Contract, including approved modifications, is the sum of \$_____;
- b) Principal has earned the sum of \$_____;
- c) Principal has been paid the sum of \$_____;
- d.) Principal has not been paid the retainage in the sum of \$_____ as a result of work performed under the Contract by Principal;
- e.) The Government is holding \$_____ which was paid to Principal but which has been returned to the Government;
- f.) The "Contract Balance" shall be hereinafter defined as \$_____; and
- g.) The "Contract Balance" shall be paid to the Surety pursuant to the terms and conditions of the Contract.

8. The Government agrees that the entire Contract Balance is dedicated to and will be applied to the completion of the Contract. Upon execution of the Takeover Agreement, the Government will pay the amount listed in paragraph 7e) which the Government is currently holding. The Government will not withhold any of the Contract Balance from the Surety because of any third party claims from any alleged assignees, successors, creditors or transferees of Principal, or any other party making claim to any of such proceeds or balances against the Contractor or the Surety under the Bonds. Surety represents that it is entitled to payment of such remaining Contract Balances, and to the extent of such Contract Balances paid by Government to Surety, agrees to indemnify Government against, and to hold it harmless from, any and all charges, claims, causes of action incurred by reason of Government paying such remaining contract balances to Surety. This indemnity is specifically limited to the amount of the Contract Balance paid by Government to Surety.

9. The Government will pay the Contract Balance directly to Surety in accordance with the terms of the Contract and this Agreement, plus or minus any approved change orders, additions or deletions, to which the Surety may become entitled pursuant to the terms of the Contract, subject, however, to the following conditions and limitations:

a) Nothing in this Agreement shall be construed as a waiver of any rights of the government against Principal or the Surety, or as a waiver of any rights, remedies, claims or defenses of Principal or the Surety against the Government. All rights, remedies, claims or defenses which the Government, Principal or Surety now have or may hereafter acquire against each other are expressly reserved.

b) By entering into the Agreement, the Surety does not waive, prejudice, or in any way adversely affect any rights, remedies, claims or defenses that Surety or Principal might have against the Government, except as to the Governments mitigation of damages in accepting completion of the Contract by the Surety.

c) The Government acknowledges that Surety, in entering into this Takeover Agreement, does not acknowledge the validity of the Government's action with regard to the Contract or any other action taken by the Government except as hereinabove stated. It is not the intention of Surety to waive, prejudice, or in any way adversely affect any right, remedy, claim or defense that Principal has against the Government.

d) The Surety shall be entitled to prosecute any such claim which the Principal may have as if the Surety was the original Contractor.

10. Surety asserts its rights to the Contract Balance by reason of Surety's rights of subrogation and indemnity as to Principal, and also by reason of its contractual assignment contained in various indemnity agreements given it by Principal, and pursuant to the Bonds.

11. The time for completion of the work under the Contract is extended to _____
() calendar days from _____, making _____ as the established contract completion date.

12. The assessment of any liquidated damages under the Contract may begin on the established contract completion date, as defined above. Calculation of any such liquidated damages shall be done in accordance with the Contract.

13. The Government and the Surety hereby agree that the Government will not interfere with the Surety's use of all approved materials, appliances and equipment of any type, shape or form which may be stored on or about the Project or materials that may have been fabricated for use in connection with the Contract by Principal whether or not presently upon the Project site, subject to the Government's rights under the Contract.

14. Surety, who will have no employees or representatives on the job site, shall have no obligation to furnish any insurance under the Contract, so long as its Completion Contractor provides insurance coverage equivalent to that required under the Contract.

15. The liability of the Surety under this Agreement and the Performance Bond for the performance of the work, after the expenditure of the Contract Balance, its limited to the penal sum of the Performance Bond in the amount of \$_____. Nothing in this Agreement constitutes a waiver of such penal sum or an increase in the liability of the Surety under the Performance Bond. The Surety's total liability under this Agreement and its Bonds shall not

exceed the penal sum of each of the Bonds. The penal sum of the Performance Bond shall be reduced by a sum equal to payments made by Surety, in discharging its obligations under the Performance Bond, in excess of the Contract Funds received from the Government.

In the event that Surety expends the penal sum of its performance bond in performance of the Contract, Government agrees that Surety shall have no further liability or obligation under the performance bond nor with respect to any performance obligation assumed under this Agreement.

16. The Government and the Surety do not intend by any provision of this Agreement to create any third-party beneficiaries, nor to confer any benefit upon or enforceable rights under this Agreement or otherwise upon anyone other than the Government and the Surety. Specifically, the Government and the Surety acknowledge that nothing in this Agreement shall extend or increase the rights of any claimants under the Bonds.

17. All payments to be made by the Government to the Surety under this Agreement shall be made payable to Surety, and mailed, unless and until the Government is notified in writing of any different address, to:

Surety

18. Any disagreement between the Government and the Surety may become a dispute by compliance with requirements of the disputes clause of the Contract; and, in the event the surety disputes some matter, the Surety shall be entitled to exercise such rights as afforded by said disputes clause in the Contract Disputes Act of 1978, as amended.

19. This Agreement constitutes the whole of the understanding, discussions, and agreements by and between the parties hereto. Any written or oral discussions conducted prior to the effective date hereof, shall not in any way vary, alter or modify the terms of this Agreement. This Agreement shall not be amended or altered in any way except in writing and executed by both the Government and the Surety.

20. This Agreement may be executed in one or more counterparts, each of which shall be deemed an original.

21. Any notices which are required to be given by the terms of this Agreement or the Bonds shall be made as follows:

For the Government:

For the Surety:

22. The parties hereby agree to cooperate fully with each other to the end that the Project may be completed as efficiently and expeditiously as reasonably possible under the

circumstances.

23. The provisions of this Agreement shall be applied and interpreted in a manner consistent with each other so as to carry out the purposes and intent of the parties, but, if for any reason any provision is unenforceable or invalid, such provision shall be deemed severed from this Agreement and the remaining provisions shall be carried out with the same force and effect as if the severed portion had not been a part of this Agreement.

24. This Agreement becomes effective upon execution by all parties to this Agreement.

25. Nothing contained in this Agreement shall be considered as an admission of liability by any party.

26. This Agreement shall extend to and be binding upon the parties and their respective successors and assigns. No right shall accrue hereunder to or for the use of any other person, firm, corporation or government entity other than the parties hereto and their respective successors, assigns, and reinsurers.

IN WITNESS WHEREOF, the parties hereunder have caused to set their hands and seal.

ATTEST: UNITED STATES OF AMERICA

By:

DATE: _____

ATTEST: SURETY

_____ By: _____

DATE: