



The Surety & Fidelity  
Association of America



NASBP

The Surety & Fidelity Association of America  
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The National Association of Surety Bond Producers  
1828 L Street, NW, Suite 720  
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February 25, 2009

The Honorable Ann Melton  
County Judge Executive  
424 Public Sq., Suite 1  
Columbia, KY 42728

Re: Surety Bond Requirements for Courthouse Projects

Dear Honorable Melton:

The National Association of Surety Bond Producers (“NASBP”) is a national trade association of professional surety bond producers, representing over 5,000 personnel who specialize in surety bonding, issuing bid, payment and performance bonds for the Nation’s construction projects and other types of bonds, such as license and permit bonds. The Surety & Fidelity Association of America (“SFAA”) is a national trade association representing insurance companies writing surety and fidelity bonds. Among the memberships of NASBP and SFAA are those companies that place or write the vast majority of contract performance and payment bonds in the Commonwealth of Kentucky.

Questionable practices recently have been brought to our attention about a number of county courthouse construction projects throughout the Commonwealth of Kentucky. These practices center on discrepancies between statutory and contractual bond requirements and the actual bonds furnished by construction managers at risk which have received awards to build these projects. More specifically, the contracts for a number of county courthouse projects properly have required that the construction manager at risk furnish the county with performance and payment bonds to insure the “faithful performance of the Contract and payment of obligations arising thereunder” in amounts equal to “100% of the Contract Sum.” The term “Contract Sum” is a defined term in the contract and represents the sum of the construction manager at risk’s fee *and* the “Cost of the Work.” The “Cost of the Work” includes all material, equipment, labor, subcontracts, etc. to build the courthouse project. Yet, the amount of the performance and payment bonds actually being furnished by the construction managers at risk hired by the counties

for these courthouse projects are in the range of five to six percent of the estimated Cost of the Work, seemingly providing bonded protections solely for the amount of the fee being paid to the construction manager at risk, a considerable departure from the required “100% of the Contract Sum.” Interestingly, on the face of the performance bonds for these projects are descriptions of the projects that include the estimate of the Project Cost, which, in every instance, is considerably more than the face amount of the bond.

The requirement for the construction manager at risk to furnish bonds equal to “100% of the Contract Sum” on these courthouse projects mirrors Kentucky Revised Statute § 45A.190, which establishes a statutory requirement that on public works projects exceeding \$40,000, performance bonds “shall be furnished” “in an amount equal to one hundred percent (100%) of the contract price as it may be increased” It also states that a payment bond “in an amount equal to one hundred percent (100%) of the original contract price” shall also be furnished “for the protection of all persons supplying labor and material to the contractor or his subcontractors.” Further, this bonding requirement is also consistent with Kentucky Administrative Regulation 200 KAR 5:305, stating, in part, that “[a] contract shall not be awarded to a contractor who fails or refuses to give bond to the Commonwealth if required as provided by KRS 45A.190.” This Regulation states that a contractor may be declared in default of a contract, and its bond forfeited, if the contracting agency determines that the contractor is “in breach of the terms and conditions of the contract....”

The Rules of Administrative Procedure of the Court of Justice, Part X, Real Property Management (AP Part X) promulgated by the Kentucky Court of Justice, the compliance of which is required for all court facility projects requested by the Court of Justice and authorized by the Kentucky General Assembly, explicitly recognizes these statutory and regulatory requirements. In Chapter 15 of that Guide, it, in part, states:

**“15-4 General Contractor (GC) and Construction Management Service Provider (CM) Bonds**

**A. Required Bonds:**

1. Over \$25,000: Every contractor with a proposed contract for services exceeding \$25,000 shall, prior to the award of such contract, give a bond or bonds to the Owner as obligee, in a form satisfactory to AP Part X, executed by a surety company authorized to do business in the Commonwealth of Kentucky, and in a penal sum equal to one hundred percent (100%) of the contract amount, as it may be increased, the conditions of which shall bind the contractor, as principal, and the surety, to the performance of the contract according to the terms, conditions, and specifications of the contract, and any changes or modifications thereto, and to the payment of all costs for labor, materials, equipment, supplies, taxes, and other proper charges and expenses incurred or to be incurred in the performance of the contract.”

These Rules have the effect of law and are referenced and incorporated into the county’s contracts with the construction management at risk for these county courthouse projects.

*Obtaining bonds from the construction manager at risk for 100% of the contract price is vital to protect the financial interests of taxpayers and the many downstream businesses—the subcontractors and suppliers to the construction manager at risk—that work on these projects. Failure to obtain any bonds from the construction manager at risk, or obtaining bonds in amounts less than 100% of the contract price—that is, amounts not*

fully reflective of the total amount payable under the contract by the county to the construction manager at risk—both constitute statutory and regulatory violations and material breaches of these courthouse contracts. More importantly, the construction manager at risk's failure to provide 100% bonds subjects the contracting agencies and taxpayer funds to unnecessary and unwarranted financial risk that will jeopardize the completion of the project and the viability of subcontractors and suppliers should the construction manager at risk become insolvent or fail to pay its obligations.

Subcontractors and suppliers that directly contract with the construction manager at risk rely on the protections afforded them by the payment bond furnished by the construction manager at risk to the contracting authority. Subcontractors and suppliers that directly contract with the construction manager at risk on these types of public works projects do not have mechanic lien rights against public property. If the construction manager at risk fails to pay its subcontractors and suppliers due to bankruptcy or for other reasons, such subcontractors and suppliers do not have an alternative means to get paid for their labor and materials except the payment bond provided by the construction manager at risk—that is, they cannot place a lien against the public property and without a direct contract with the county, they cannot sue the county. Only the payment bond furnished by the construction manager at risk to the county protects these subcontractors and suppliers with a payment remedy should the construction manager at risk fail to pay them. Despite what some may be saying, subcontractor payment bonds do *NOT* provide any payment protection to subcontractors and suppliers who contract directly with the construction manager at risk.

The counties also rely upon the performance bond furnished by the construction manager at risk to provide the county with performance protections in case the construction manager at risk defaults before completion of the courthouse project. In that scenario, the performance bond is a guarantee by the surety to the county that the construction manager at risk's contract will be completed for the Contract Sum and the project will be built. When the construction manager at risk defaults before the completion of the project, another contractor is usually hired to fix the problems and complete the project. Usually, these costs to fix and to complete, especially on large public works projects, greatly exceed the Contract Sum and the question comes down to who is going to pay the additional costs required to complete the project. With a construction manager at risk's performance bond solely in a bond amount of \$500,000 to \$700,000, any additional costs over that amount will have to be paid by county taxpayers if the project is to be completed. For your information, the additional costs caused when the construction manager defaulted on the contract for construction of the Bullitt County Judicial Center easily exceeds \$1,000,000.

It is our understanding that performance and payment bonds from the construction manager at risk have *NOT* been furnished on several county courthouse projects even though construction on those projects has already commenced. Further, on other courthouse projects, bonds have been furnished, but apparently only in the amount of the construction manager's fee (approximately 5-6% of the Project's Cost of the Work) instead of bonds for 100% of the Project's Cost of the Work. Without requiring the strict

enforcement of the bonding requirements clearly and unambiguously stated in the county's contract with the construction manager at risk, the county is unintentionally putting its own financial resources into jeopardy as well as those of local subcontractors and suppliers working for the construction manager at risk. This is a problem that mandates your immediate attention.

We respectfully request your review of the performance of any construction management at risk contracts to construct a court facility to ensure that they are being administered in strict accordance with statutory, regulatory and contractual requirements. To that end, many of these contracts require the construction manager at risk to provide performance and payment bonds for 100% of the Project's Cost of the Work to the county before the start of any construction. Compliance is required to protect the interests of Kentucky taxpayers properly. We would be glad to work with you or answer any questions to ensure that the bonding requirements for your project are met.

Yours sincerely,

Mark H. McCallum  
General Counsel  
NASBP

Edward G. Gallagher  
General Counsel  
SFAA

cc: Lynn Schubert, SFAA  
Richard Foss, NASBP