PROJECT OVERSIGHT, CONTROL, AND STAFFING

Christina Craddock
David A. Harris
Heather Shore
*Michael J. Sugar, III***

Introduction

The process of completing a project after a principal's default is like jumping on a moving train. What is the management structure? Who's on the surety's team? What is the status of the work? Are there pending change orders? Does the surety need to step in immediately and shore up the project? Who's going to complete the work? Are there DBE requirements? Union or non-union labor? These questions and more are often key considerations to a surety during its investigation and after it elects to perform. In this paper we explore project oversight, control, and staffing issues that must be addressed by the completing surety.

I. Oversight: Management of the Project after a Default

Upon the initial notice of an intent to declare default, or when a default declaration is received, a performance bond surety's initial task is to become familiar with the bonded scope of work and the status of the completed work. Such familiarity is necessary to complete a thorough investigation of the performance bond claim and essential to taking on completion of the work.

Four areas that are essential for the surety to address to ensure an effective transition of the oversight and management of the project during the surety's completion are outlined below.

A. Addressing Project Presence Pre-Default

Rarely is the notice of default the surety's first notice of issues arising on a bonded project.[1] The American Institute of Architects A312-2010 Performance Bond requires the obligee to provide the principal and the surety with notice that the obligee is "considering declaring" a default.[2]

** We would like to express our gratitude to Brianna Jordan, associate attorney at Brown & Ruprecht, PC, for her contribution to the research and writing of this article.

[1] The sequence and timing of how a default is declared and what a surety receives from an obligee varies significantly depending on the obligee, terms of the bonded contract, and bond form. Indeed, even when a surety receives pre-default notice, that notice may be quickly followed by notice of a default and termination of the principal.

[2] AM. INST. OF ARCHITECTS, AIA 312-2010, Performance Bond § 3.1 (2010) [hereinafter AIA A312-2010 Performance Bond].

Even without a formal notice requirement, it is typical that the surety will learn of issues between the obligee and principal before a default is declared.

Thus, upon notice of a potential default, the surety should have "boots on the ground":[3]

1) obtaining project information;
2) investigating the progress of the work;
3) identifying project materials; and
4) documenting the project status.[4]

1. Obtaining Project Information

The surety's first source for project information is its principal. Under the terms of a typical surety indemnity agreement, the principal has a contractual obligation to provide the surety with access to its books and records.[5] Additional provisions might require the principal to provide information to the surety on the condition of the work on bonded projects.[6] These provisions are routinely upheld as valid and enforceable.[7]

---

[3] Prior to a default, the surety must have the consent of the principal to send people to the project.

[4] The surety's investigation of a performance bond default is beyond the scope of this paper. For more information on the surety's investigation see David J. Krebs & Shannah J. Morris, *Ch. 3, The Surety's Obligations Under the Performance Bond: To Perform or Not to Perform, in* BOND DEFAULT MANUAL 109 (Mike F. Pipkin et al. eds., Am. Bar Ass'n, 4th ed. 2015).

[5] As an example, the indemnity agreement might require:

> *Upon Surety's request, Principal and Indemnitors shall immediately turn over to Surety, or its designee, as often as requested and at a time and place and in a manner determined by Surety, such books, records, accounts, documents, computer software and other electronically-stored information, as and when requested by Surety.*

J. Michael Egan, Jr., Omar J. Harb, & Brett D. Divers, *Ch. 7, The Indemnity Agreement and the Handling of Surety Claims, in* THE SURETY'S INDEMNITY AGREEMENT: LAW AND PRACTICE 323, 323 (Marilyn Klinger et al., eds., Am. Bar Ass'n, 2d ed. 2008) (alteration in original).

[6] *Id.* at 326.

[7] *See e.g.* RLI Ins. Co. v. Nexus Servs., Inc., No. 5:18-CV-00066, 2018 WL 3244413, at *12 (W.D. Va. July 2, 2018); Cont'l Cas. Co. v. Construct Solutions, Inc., No. 1:15-cv-01848-TWP-DML, 2017 WL 2214930, at *3 (S.D. Ind. May 19, 2017);Colonial Sur. Co. v. A&R Capital Assoc., No. 13-CV-7214 (LDH) (ARL), 2017 WL 1229732, at *8 (E.D.N.Y. Mar. 31, 2017); Great Am. Ins. Co. v. JMR Constr. Corp., No. 2:15–CV–2226 JCM (NJK), 2015 WL 8328267, at *4 (D. Nev. Dec. 8, 2015); Travelers Cas. & Sur. Co. of Am. v. Padron, No. 5:15–CV–200–DAE, 2015 WL 1981563, at *8 (W.D. Tex. May 1, 2015); Developers Sur. & Indem. Co. v. Hansel Innovations, Inc., No. 8:14–cv–425–T–23TBM, 2014 WL 2968138, at *8 (M.D. Fla. July 1, 2014).

Depending on the wording of the performance bond, the obligee may have no duty to provide the surety with project information prior to a default. However, when the obligee has provided the surety notice of a potential default and asked the surety to take action, it cannot expect the surety to undertake an investigation of the principal's performance of the work without providing the surety with access to project information.[8]

From whatever source it is available, the surety should seek to identify and obtain the following information prior to the default:

- Contract documents including all change orders
- Submittals, RFIs and other design documents
- Pay applications
- Pending and approved requests for change orders
- Claim correspondence
- Photographs
- Detailed time & material tickets
- Payroll and tax records
- Principal's subcontracts including change orders and any claims, correspondence, etc.
- Current and prior schedules (including delay schedules)
- The identification of the principal's project management team
- Material inventories
- Stored material logs
- Subcontractor pay applications
- Material invoices
- Daily reports and field notes
- Any outstanding mechanic's liens filed against the project
- Insurance documentation
- Required permits
- Documentation of any back charges to subcontractors and suppliers
- Documentation of any claims or requests for time extensions

The information requested will depend on the type of project, the principal's scope of work, the status of the project, as well as other factors. There should be no delay in making an initial request. As information is gathered, the surety may make additional requests for information.

No matter what is requested, it is important for the surety to seek to understand how the principal organizes its project documents. Electronic documents should be captured in native

[8] What is required of the obligee depends on the bond form and state law, if applicable. Generally, the obligee has an obligation to substantiate its allegations before the surety's duty arises. *See* Krebs & Morris, *supra* note 4, at 115-16; *See also* David J. Krebs, *Ch. 1, Investigation and Management of Claims*, *in* MANAGING AND LITIGATING THE COMPLEX SURETY CASE 1, 9-12 (Tracey L. Haley & Christopher R. Ward eds., Am. Bar Ass'n, 3d ed. 2018) (including discussion on the obligee's burden to show a prima facie claim).

format. If a proprietary or subscription system is used, the principal should provide the surety with access rights.[9] To the extent the principal is cooperating with providing information and documentation, the surety should seek to ascertain not only the raw data but the knowledge of the principal's employees as to where information is located, how it can be used, and what unwritten practices the principal has followed that may assist the surety with using the information obtained. The surety may want to engage a consultant early in this process to assist in obtaining other pertinent documents while the principal is still solvent and cooperative.

2. Oversight by the Surety's Consultant

As soon as the surety realizes it needs to obtain documents, it should also consider engaging a construction consultant. A consultant can assist in determining what documents and information are necessary to evaluate the project as well as serve as the surety's on-site presence at the principal's office or the jobsite to gather the information and observe the principal's practices. The consultant may also assist the surety in identifying key project personnel, issues with the principal's and/or obligee's work, and a variety of other potentially important issues.

The surety consultant may also be retained before the default to oversee or monitor, with the consent of the principal, the progress of the principal's work.[10] This not only aids the surety's investigation of a potential default, but also assists the surety in transitioning the completion of the work to a new contractor, if necessary. When the default occurs, the surety will likely want the consultant to prepare a cost-to-complete analysis, evaluate the status of the schedule, and identify any scope gaps, and gather the documents and information necessary to re-let the project. Pre-default presence on the project by the surety's consultant will also help to establish the scope of work remaining on the project so that a cost-to-complete analysis may be more accurately developed.

3. Documenting the Project Status

A final pre-default step by the surety is to document the status of the entire project. This will assist in preparing bid documents for a new contractor, documenting pending and future claims against the obligee, and protecting against defenses the principal might raise.

Documenting the project will require conducting a project walkthrough, taking photographs of the entire site, and taking videos where necessary and appropriate. Walkthrough with the obligee's supervisor or inspector, the owner's (if not the obligee) representative, and a representative of the principal can also prove very valuable. This walkthrough should be requested by the principal. Generally speaking, pre-default contact between the surety and obligee should not take place without the consent of the principal.

---

9 Access and use of these systems are often assigned to the surety in the indemnity agreement. *See* Egan et al., *supra* note 5, at 365.

10 It is important that the surety not take any affirmative action prior to the default. Such action could be perceived as volunteering to take over the work.

The surety representative charged with documenting the project status should prepare an initial report of relevant observations as to the condition of the work. That report should be updated at regular intervals as the work progresses and upon each jobsite visit. Consistent documentation of the progress of the work will also assist the surety in defending any future delay or acceleration claims the obligee may assert.

For certain work it may be useful to take photographs on a regular basis from the same location from pre-default through the completion of the work. Technology may assist in this with GPS-equipped drones that can survey the same area as previously documented.

B. Establishing the Project's New Management Structure

Much has been written about the tension between the surety's obligations to a bond obligee and to its principal. Those tensions are often highlighted when a surety agrees to complete the principal's work.

On any given performance default, the surety may be juggling the following issues: (1) the principal's arguments that it was improperly defaulted; (2) the obligee's demands for the original schedule to be met; (3) the principal's argument the surety interfered with its contract with the obligee; and (4) negotiations with and oversight of a third-party contractor. For all of these reasons (and more), it is important that the surety establish a management structure for the completion of the principal's work.

1. Identification of the Surety's Team

For most completion projects, there are three tiers to the surety's team on the construction side: (1) the surety's claim personnel; (2) a construction consultant; and (3) the completion contractor. It can also be very beneficial for the surety to engage an attorney with knowledge of construction issues and default situations to assist with navigating through the myriad issues that arise as the surety takes over.

The surety's completion team begins with the internal management structure of the surety's claim department. Clear lines of authority need to be in place for the numerous decisions that will need to be made in the course of the claim. Those who are acting as the surety's agents for the completion of the work need to know how the decision making process works for the surety and what will be expected of them. Does the surety have an in-house engineer who should be closely consulted on all construction issues? How does the surety's payment requisition process work? Who should be included on project communications? Will the construction consultant be given the authority to negotiate change orders on the surety's behalf?

The next layer of the surety's team is often its construction consultant. The consultant may be engaged to oversee all aspects of construction from bid to turnover. The consultant might be on-site regularly or might act as the completion contractor's initial point of contact with the surety once the project is re-let and work has resumed. The surety should expect the consultant to provide a budget for its services during the bid process, as the completion contractor begins work, during completion efforts, and during the punch list and close-out process.

Finally, the completion contractor will eventually be a member of the surety's team. The completion contractor is often least familiar with surety completion efforts and it is important that clear lines of communication be established. The obligee may prefer direct communication with the completion contractor or require that the surety have the surety claims representative or the surety construction consultant function as the point of contact.

2. Retaining the Principal's Staff

It may be desirable for the surety and obligee to retain some of the principal's staff. This may include key project personnel such as the principal's project manager and/or superintendent, or even the entire workforce dedicated to the project. This decision is often based, in large part, on the status of the project.

C. Identifying and Securing Project Resources

As previously discussed, the surety has a right to project resources. To take advantage of that right, the surety must implement a system for identifying and securing those resources. Often the surety consultant will take the lead in this effort. However, it is important with a cooperating principal to discuss this issue up front. A list of resources should be made available in the bid package, and the completion contractor should clearly identify which resources it plans on using.

1. Technology

It is imperative to determine the principal's technology resources, including proprietary software and other computer programs used in the completion of the work. Resources also include the work product represented in the principal's electronic files. Obtaining native format documents will save time and allow a smoother transition for the completion contractor. The computers used by the principal's key personnel should be backed-up. If the principal uses a cloud-based document storage system (e.g. DropBox), the surety's consultant should be given full access rights, immediately.

2. Materials and Equipment

It is essential that the surety identify and secure project materials and equipment as soon as possible. This is especially important for materials specially ordered or fabricated for the job or single source materials.[11] Once materials go missing, they are rarely found. The completing surety may be required to pay for unsecured and lost materials without compensation from the obligee. Perhaps even more damaging to the overall project are the resulting delays that may occur as materials with long lead times are re-ordered. The surety may then be faced with the choice of paying acceleration charges or risk exposure to liquidated damages.

The obligee should be the surety's main ally in ensuring that project materials are secured. The obligee is often familiar with which materials are special ordered and their status in the

[11] *See* Mike F. Pipkin, Nina S. McDonald, & Jason Stonefeld, *Ch. 3, Types of Claims Covered*, *in* THE LAW OF PAYMENT BONDS 81, 87-89 (Kevin L. Lybeck et al., eds., Am. Bar Ass'n, 2d ed. 2011) (discussing the surety's liability for materials under the Miller Act).

supply chain, and whether and where they are stored. If the project materials have been delivered to the job site they should be inventoried and secured for future use. The surety should notify the obligee as soon as practicable of the obligee's obligations to secure on-site, project specific materials.

It is important to document the condition of stored materials. The surety needs to be prepared to take steps to address damaged materials immediately. A future delay may be avoided if defects in the stored materials are addressed before the material is needed.

Equipment on a bonded project is often rented by the principal and supplied by third-party vendors. It is often advantageous to maintain these relationships and hand them off to the completion contractor. To do so, timely paying key vendors and extending rental agreements will assist in ensuring the opportunity to transfer the equipment to the completion contractor. The surety should attempt to ratify the key vendors for this very purpose.

D. Understanding Contractual Requirements

The completing surety's obligations with respect to the management and oversight of a project are contained within the bonded contract. It is important for the completing surety's team to understand what those contractual requirements are and to ensure they are undertaken by the completion contractor.

The surety and its consultant should review the contract documents and ascertain the responsibility the completing contractor has for the following items:

- Project manager and superintendent(s)
- Quality assurance ("QA") and quality control ("QC")
- Subcontractor requirements
- Insurance and bonding
- Permits and licenses
- Stored material billing and securing requirements

The remainder of this section discusses these and other contract management and oversight provisions found in the AIA A201-2007 General Conditions.[12]

1. Architect

The AIA A201-2007 General Conditions outline an expansive and ongoing role for the project architect. This standard form contract contemplates that the obligee, or "Owner," will contract with the architect and requires the obligee to "employ a successor architect as to whom the Contactor has no reasonable objection" if the original architect's services are terminated.[13]

---

[12] *See, e.g.,* AM. INST. OF ARCHITECTS, AIA A201-2007, General Conditions § 4.1.3 (2007) [hereinafter AIA A201-2007 General Conditions].

[13] AIA A201-2007 General Conditions § 4.1.3.

The architect is responsible for the administration of the contract and has a duty to visit the site, act on behalf of the obligee, provide the obligee with information on the progress and quality of the work, and to report any defects and deficiencies.[14]

Additional duties of the architect relate to the approval of submittals, the preparation of change orders, giving change directives, determining when the project is substantially complete, and reviewing and approving applications for payment.[15]

2. Superintendent

The contractor has a duty under the AIA A201-2007 General Conditions to "employ a competent superintendent and necessary assistants." [16] The superintendent is expected to be on site and represent the contractor at all times.

In transitioning the work to a completion contractor, the surety should ensure that the name and qualifications of completion contractor's superintendent are provided to the obligee's architect if the AIA A201-2007 General Conditions are in use. Under the AIA A201-2007 General Conditions, the architect may then offer written objections to the use of that person as a superintendent and the completion contractor will need to find a new superintendent if those objections are "reasonable and timely."[17] This duty to inform the obligee, through its architect of the completion contractor's superintendent, is a continuing duty.

3. Schedules

In most cases, the obligee will have a construction schedule previously provided by the principal.[18] If possible, any extensions to the time for completion of the work should be agreed to between the obligee and surety in a takeover agreement. The completion contractor will then have the obligation to provide a revised schedule to the obligee.

If the obligee will not agree to any extensions to the schedule, under the AIA A201-2007 General Conditions the surety will have the obligation to "perform the Work in general accordance with the most recent schedules submitted" by the principal.[19]

4. Access to Work

Under the AIA A201-2007 General Conditions, the surety and its completion contractor have the obligation to "provide the Owner and Architect access to the Work in preparation and progress wherever located."[20]

---

14 AIA A201-2007 General Conditions § 4.2.1-.3.
15 *See, e.g.*, AIA A201-2007 General Conditions §§ 4 7, and 9.
16 AIA A201-2007 General Conditions § 3.9.1.
17 AIA A201-2007 General Conditions § 3.9.2-.3.
18 AIA A201-2007 General Conditions § 3.10.
19 AIA A201-2007 General Conditions § 3.10.3.

5. Intellectual Property

The principal's intellectual property is typically assigned to the surety for its use on the bonded project. That does not necessarily include intellectual property of others. The surety and its completion contractor must work to ensure that proper rights to these critical project documents are obtained.

If an infringement suit is brought against the completion contractor, it will have the duty to defend and hold the obligee and its architect harmless. However, under the AIA A201-2007 General Conditions, no such duty arises where "a particular design, process or product of a particular manufacturer or manufacturers is required by the Contract Documents, or where the copyright violations are contained in Drawings, Specifications or other documents prepared by the Owner or Architect."[21]

6. Safety Measures

The completing surety undertakes numerous project safety obligations on behalf of the defaulted principal. Generally, the principal has the duty to "be responsible for initiating, maintaining and supervising all safety precautions and programs in connection with the performance of the Contract."[22] Some contracts require that the contractor employ a full-time safety supervisor to oversee on-going work and verify compliance with governmental/OSHA requirements. Those duties include complying with all applicable laws, posting warnings, ensuring hazardous materials and equipment are properly stored and maintained, and designating an employee to be responsible for the prevention of accidents.[23]

7. Insurance and Bonds

The AIA A201-2007 General Conditions provide for specific insurance and bond obligations that the completing surety must meet.[24] Those obligations include maintaining worker's compensation insurance and general liability coverage at amounts set forth in the contract documents. The surety might also insist that the completion contractor should also meet the bond requirements and provide its own surety that will provide additional security to the completing surety and the obligee, both of whom should be identified as bond obligees.

One item of insurance that is critical for the surety to immediately investigate is the requirement to provide completed operations coverage. It is critical to know whether this obligation exists upfront, while the principal is still operational. Obtaining completed operations coverage after the principal has ceased operations is extremely difficult.

---

20 AIA A201-2007 General Conditions § 3.16.

21 AIA A201-2007 General Conditions § 3.17. There is an exception to this exception that requires the contractor to promptly notify the architect if the contractor has reason to believe the contract documents contain an infringing material.

22 AIA A201-2007 General Conditions § 10.1.

23 AIA A201-2007 General Conditions § 10.

24 AIA A201-2007 General Conditions § 11.

II. Control: Continuation of the Work

In some ways it is odd that the primary obligation of a performance bond surety is to complete the work of its defaulted principal. Modern sureties are not contractors. They typically do not have the people or infrastructure necessary to perform the work. When a surety is responsible for taking control of a project and continuing the work those tasks will be contracted to others.[25] Below are categories of tasks the surety and its construction consultant perform to ensure the work on the project continues.

A. Confirm the Scope of Work

Sometimes the surety bonds a plumbing subcontractor and that subcontractor's scope of work is clearly defined in the contract documents, with clear references to plumbing submittals, shop drawings and other documentation. Experience shows that this may be the exception and not the rule. Sometimes a masonry subcontractor has undertaken to perform all of the concrete work. Other times the electrical work is divided between multiple subcontractors. Even a general contractor's scope of work may be difficult to initially determine. Have there been any change orders?

To determine what it is that will be expected of the surety in its effort to complete the work, the following should be examined:

- Initial bid package including all RFIs, addenda, and supplemental instructions
- Signed contract with all incorporated contract documents
- Design documents, including the drawings, specifications and submittals, related to the bonded principal's scope of work incorporated within the signed contract
- Signed change orders
- Pending or submitted change orders
- Contract correspondence, especially related to issues that may result in change orders
- Prior and current billings

B. Shore Up the Project

Before a completion contractor is identified, the surety may have to engage existing subcontractors or others to shore up the project to meet critical milestones or meet safety requirements required by the contract. Continuation of environmental protections, safety measures, and other such items are essential for the protection of the project and the public. If these items are not immediately identified and addressed, the surety could be exposed to additional liability and costs. As such, it is important to review project status and inspection reports immediately upon a default to determine what has been done in the past, what concerns

[25] Much has been written on the performance methods available to the surety and the decision process it must undertake in deciding which method to use on a particular project. That issue is beyond the scope of this paper. *See, e.g.*, Charles W. Langfitt, Bennett J. Lee, & Robert C. Niesley, *Ch. 3, Performance Options Available to the Surety, in* THE LAW OF PERFORMANCE BONDS 59 (Lawrence R. Moelmann et al., eds., Am. Bar Ass'n, 2d ed. 2009).

may be open, and create a plan to address these items immediately. In some situations, the surety may employ a contractor for months to shore up the project while the investigation and re-bid process progresses.

C. Document Outstanding Issues

The surety should not assume that all issues between the defaulted principal and the obligee have been properly documented according to the contract terms. Once the surety, through its investigation, determines the outstanding issues on the project, those items should be documented according to the project requirements. The completing surety may reserve its rights within a completion agreement with the obligee. This will help ensure that the surety does not take on liability beyond its bonded obligations when it commits to completing the project. Items to document with the obligee may include:

- Delay claims
- Payment issues, including overbilling
- Defective work of others
- Design defects

D. Supplementation Issues

Increasingly in default situations, the obligee has undertaken rights it has under the bonded contract to supplement the defaulted principal's work. This supplementation will impact the contract funds available to the surety and may also make it more difficult to determine what work, particularly alleged defective work, the principal performed and what work was performed by the obligee's supplementation forces. The surety should make it clear to the obligee that it is the obligee's responsibility to supervise its own contractors and document what work is performed in supplementing the work of the defaulted principal.

Conflicts sometimes arise between the obligee's rights to supplement under the terms of the bonded contract and the surety's completion options set out in the performance bond. Those conflicts need to be addressed up front with the obligee, and the surety's rights with respect to payments withheld should be reserved.

E. Ratification of Subcontractors and Vendors

When appropriate, the financial risk of undertaking the completion of a contract can be mitigated by ratifying key subcontractors. Ratifying prior to the bid process allows the surety the opportunity to reduce the scope of the bid package to the supervision and oversight of the bonded contract along with any self-performed work of the bonded principal.

F. Re-bidding the Bonded Contract

The surety and its consultant's completion efforts typically lead to a re-bid package whereby the bonded principal's scope of work is officially awarded to a completion contractor. When preparing the re-bid package and the completion contract, the surety should identify scope gaps, delays, and consider any special contract considerations. On Federal projects, Federal

Acquisition Regulations requirements may apply to the completion contractor.[26] Bids should be examined for completion and the competency of the bidding parties. Also, ensure that the bidding parties have all required licenses. The insurance and bonding requirements of the bonded contractor should be assumed by the completion contractor.

The surety, obligee, and completion contractor will need to work out a payment plan. Will the surety have to certify any payment application prior to the completion contractor taking over? How will applications for payment be submitted to the owner? Will the surety have to submit a separate payment application or will the completion contractor prepare the application to the obligee? Typically the surety's construction consultant stays involved throughout the completion of the project to monitor the progress of the work by the completion contractor and to review payment applications and facilitate payment to the completion contractor.

When preparing a bid package, the surety should consider providing a draft completion contract. Making the completion contract part of the bid package reduces the need to negotiate the terms later and makes the contractors obligations more clear.

III. Staffing: Subcontractor and Labor Issues

Staffing a jobsite is of major concern for a surety when taking over a construction project and, in particular, a federal project.[27] Contracting with the Federal Government is a highly regulated process which requires in-depth knowledge and an appreciation for the litany of governing statutes and regulations, including the FAR. The completing surety must be aware of these regulations and their applicability to staffing the project. Below we discuss: (1) DBE requirements and their applicability to the completing surety; (2) the National Labor Relations Act; (3) the Davis-Bacon Act and Fair Labor Standards Act applicability to certified payroll, minimum pay and overtime; and (4) tax obligations that may arise while the surety is managing or taking over a project.

A. DBE Requirements

Congress has established a twenty-three percent government-wide goal for awards of contracts to small businesses, including small disadvantaged businesses. The government also offers programs and financial assistance to encourage Disadvantaged Business Enterprises," to obtain and perform government contracts.[28]

The DBE program requires state and local transportation agencies that receive United States Department of Transportation financial assistance to establish contracting goals for the

---

[26] Heather F. Shore & Diane Hastings Lewis, *Navigating Surety Claims on a Federal Project*, 56 FOR THE DEF. 48 (2014).

[27] Staffing issues on federal projects is addressed below. Many similar issues may arise on non-federal projects. The applicable requirements of the particular jurisdiction and contract must be carefully reviewed in any completion scenario to ensure compliance.

[28] Disadvantaged Business Enterprises are referred to hereinafter as "DBE."

participation of DBEs.[29] The surety must be aware of all DBE and similar requirements when managing (prior to a takeover arrangement) or taking over a project, to ensure that DBE requirements are being met, or that the completion contractor is excused from the requirements pursuant to the guidelines established by the governing authority.

The United States Small Business Administration is responsible for the management and oversight of the small business procurement process across the Federal Government.[30] The purpose of the SBA is to ensure that small businesses receive a "fair proportion" of federal contracts.[31]

Generally, there are three fundamental objectives of disadvantaged contracting or DBE initiatives: "(1) increase participation of DBEs in government contracting, (2) improve DBE access to bonding, capital, and knowledge of bid processes, and (3) remedy historical discrimination in government contracting."[32]

DBE programs vary from agency-to-agency and at the federal, state, and local levels; but the DBE program offered by the DOT has acted as a model for other agency DBE programs.[33] 49 C.F.R § 26.5 defines a DBE as a for-profit small business that is "at least 51 percent owned by one or more individuals who are both socially and economically disadvantaged or, in the case of a corporation, in which 51 percent of the stock is owned by one or more such individuals; and whose management and daily business operations are controlled by one or more of the socially and economically disadvantaged individuals who own it."[34]

The DOT has adopted a rebuttable presumption that certain groups classified by the SBA as disadvantaged, such as Black Americans, Hispanic Americans, Native Americans and women, are socially and economically disadvantaged for purposes of classification of DBEs by DOT.[35] On a case-by-case basis, individuals not classified as disadvantaged will be considered disadvantaged if it is proven that the group is, in fact, disadvantaged.

49 C.F.R. § 26.71 outlines the requirements of a DBE with respect to daily business operations being controlled by one or more of the socially and economically disadvantaged individuals. The management structure and operation of the entity is to be viewed as a whole. According to 49 C.F.R. § 26.71:

---

29 The United States Department of Transportation is referred to hereinafter as "DOT."

30 The United States Small Business Administration is referred to hereinafter as "SBA."

31 13 C.F.R. § 124.101 *et seq* (2018).

32 Cynthia Rodgers-Waire & Lisa D. Sparks, *The Surety's Obligation to meet Disadvantaged Business Enterprise (DBE) Requirements* (unpublished paper submitted at the 27th Annual Northeast Surety & Fidelity Claims Conference on Sept. 21-23, 2016).

33 *Id*. at 2.

34 49 C.F.R § 26.5 (2018).

35 Rodgers-Waire & Sparks, *supra* note 34, at 3.

> [t]he socially and economically disadvantaged owners must possess the power to direct or cause the direction of the management and policies of the firm and to make day-to-day as well as long-term decisions on matters of management, policy and operations. (1) A disadvantaged owner must hold the highest officer position in the company (e.g., chief executive officer or president). (2) In a corporation, disadvantaged owners must control the board of directors. (3) In a partnership, one or more disadvantaged owners must serve as general partners, with control over all partnership decisions.[36]

1. Types of DBEs

a. Women-Owned Business Enterprise

To qualify as a Women-Owned Business Enterprise and obtain access to the women's contracting program, the business must be small (as defined by the SBA), at least fifty-one percent owned by a woman or group of women, and the women must be involved in the day-to-day operation as well as involved in long-term decision making.[37] In addition, to qualify as economically disadvantaged, the WBE must:

> [m]eet all the requirements of the women's contracting program, [b]e owned and controlled by one or more women, each with a personal net worth less than $750,000 [or] [b]e owned and controlled by one or more women, each with $350,000 or less in adjusted gross income averaged over the previous three years [or] [b]e owned and controlled by one or more women, each with $6 million or less in personal assets.[38]

b. Minority-Owned Business Enterprise

In order to qualify as a Minority-Owned Business Enterprise "MBE", the enterprise must be a small for-profit business that is at least fifty-one percent owned, operated, and controlled by one or more socially and economically disadvantaged minority individuals. To be economically disadvantaged, an individual must have a net worth of less than $750,000, excluding the value of the individual's ownership in the firm and principal residence. Any individual in the following groups has a rebuttable presumption of being socially and economically disadvantaged: Black Americans, Hispanic Americans, Native Americas, Asian-Pacific Americans, Subcontinent Asian Americans, and women.[39] The MBE must be managed by the socially and economically disadvantaged individual who has knowledge of the firm's primary business and a proven ability to run the day-to-day affairs of the business.

---

[36] 49 C.F.R. § 26.71 (2018).

[37] Women-Owned Business Enterprises are referred to hereinafter as "WBE."

[38] SMALL BUS. ADMIN., https://www.sba.gov/federal-contracting/contracting-assistance-programs/women-owned-small-business-federal-contracting-program (last visited Oct. 8, 2018); *see* 13 C.F.R § 127.200 *et seq* (2018).

[39] 49 C.F.R. § 25.6 (2018).

c. Economically Disadvantaged Section 8(a) Program

To qualify for the SBA's Section 8(a) program, the enterprise must be at least fifty-one percent owned and controlled by one or more individuals who are both economically and socially disadvantaged. The owner of the economically disadvantaged business must have a personal net worth of $250,000 or less, excluding the value of the business and personal residence.[40] That individual must also have an average adjusted gross income for three years of $250,000 or less, and have $4 million or less in assets. That individual must manage day-to-day operations and make long-term decisions for the company.[41] This program offers a broad range of assistance to Section 8(a) businesses, including loans, training, counseling, marketing assistance, and executive training and development.

d. Historically Underutilized Business Zone

The Historically Underutilized Business Zone program is intended to assist small businesses located in economically distressed communities to obtain federal contracts.[42] A HUBZone is an area of high unemployment (fourteen percent unemployment rate or higher) or low income (no more than eighty percent of non-metropolitan state median household income). In order to be certified under the SBA's HUBZone program, the enterprise must be a Small Business Concern with its principal office located in a HUBZone and have at least thirty-five percent of its employees living in a HUBZone.[43] The Federal Government has a goal of awarding at least three percent of its contracts to HUBZone-certified enterprises.[44]

e. Veteran-Owned Small Business

To qualify as a Veteran Owned Small Business concern, the business must be at least fifty-one percent unconditionally owned by one or more eligible Veterans.[45] Or, in the case of any publicly-owned business, at least fifty-one percent of the stock must be owned by one or more Veterans, and management and daily business operations must be controlled by such Veterans.[46] The Department of Veterans Affairs offers a wide variety of assistance to Veterans that qualify as a VOSB, including VOSB application assistance, counseling services, entrepreneurial and

---

40 Once a firm is accepted in to the Section (8)a program, the limit on an individual's net worth increases to $750,000.

41 13 C.F.R § 124.1001*et seq*. (2018); SMALL BUS. ADMIN., https://www.sba.gov/federal-contracting/contracting-assistance-programs/8a-business-development-program (last visited Oct. 8, 2018).

42 The Historically Underutilized Business Zone is referred to hereinafter as "HUBZone."

43 13 C.F.R § 126.200 et seq. (2018); SMALL BUS. ADMIN., https://www.sba.gov/federal-contracting/contracting-assistance-programs/hubzone-program (last visited Oct. 8, 2018).

44 13 C.F.R § 126.200 et seq. (2018); SMALL BUS. ADMIN., https://www.sba.gov/federal-contracting/contracting-assistance-programs/hubzone-program (last visited Oct. 8, 2018).

45 Veteran Owned Small Business is referred to hereinafter as "VOSB"; 38 C.F.R. § 74.3 (2018).

46 *Id.*

other business-related training programs, and loan assistance. Some of these programs are available to the spouses of Veterans who have qualified for the VOSB program.

f. Service-Disabled Veteran-Owned Small Business

Meeting the criteria for a Service-Disabled Veteran-Owned Small Business substantially increases the firm's ability to obtain federal set-asides because so few businesses qualify specifically as a service-disabled, Veteran-owned business.[47] The business must be a small business that is at least fifty-one percent unconditionally and directly owned and controlled by one or more service-disabled Veterans who hold the highest officer positions within the firm and are involved in the daily management and operations of the business, including involvement in long-term decision making.[48] The owner must have a service-connected disability, as determined by the United States Department of Veterans Affairs or Department of Defense, with an honorable separation or discharge. Notably, sole source awards will be delivered if certain conditions are met.

2. Types of DBE Contract Requirements

There are several types of DBE contractual and statutory requirements. For example, some requirements are in the form of a set-aside.[49] A set-aside is when a certain procurement is

---

47 Service-Disabled Veteran Owned Small Business is referred to hereinafter as "SDVOSB."

48 13 C.F.R. § 125.12 *et seq* (2018); *see also* SMALL BUS. ADMIN., https://www.sba.gov/federal-contracting/contracting-assistance-programs/service-disabled-veteran-owned-small-businesses-program (last visited Oct. 8, 2018).

49 Significantly, DOT is adamant that the DOT DBE program is not a quota or set-aside program, and it is not intended to operate as one. Following significant debate in Congress over the issue of whether the DBE program requires quotas or set-asides, DOT changed the language to make it clear that the ten percent statutory goal contained in the governing rules is an aspirational goal at the national level and that the rules do not specifically set any funds aside for any person or group. The Code of Federal Regulations governing the DBE program does not require any recipient or contractor to a have ten percent (or any other percentage) DBE goals or participation. And unlike former part 23, it does not require recipients to take any special administrative steps (*e.g.*, providing a special justification to DOT) if their annual overall goal is less than ten percent. Recipients must set goals consistent with their own circumstances. DOT uses the ten percent goal as a means of evaluating the overall performance of the DBE program nationwide. There are no reported instances where DOT has sanctioned a state for not meeting these goals. Section 26.43 of the Code of Federal Regulations states that recipients are prohibited from using quotas under any circumstances. The Section also prohibits set-asides except in the most extreme circumstances where no other approach could be expected to redress egregious discrimination. Section 26.53 of the Code of Federal Regulations also outlines what bidders must do to be responsive and responsible on DOT-assisted contracts having DBE goals. Bidders can meet this requirement either by having enough DBE participation to meet the goal or by documenting good faith efforts, even if those efforts did not actually achieve the DBE goals. Recipients are prohibited

available to DBE firms only; no other entity is allowed to bid.[50] True set-aside requirements are only applicable on occasion.[51] DOT's program does not allow set-asides except in extreme circumstances where no other approach could be expected to redress egregious discrimination.

The regulations and rules governing the DBE program talk in terms of quotas or goals. DOT is adamant that its program is goals-driven and does not set any funds aside for any particular person or group. A quota means he job is required to have a certain percentage of the work be performed by a DBE firm, including subcontractors and suppliers.[52] The DOT's ten percent requirement, which has been used by many programs since, is a quota.

The surety must be familiar with these goals and understand the procedures for requesting reconsideration or appealing a decision that DOT has made to disqualify a completion contractor or its completing subcontractors.

A bidding preference is another type of DBE requirement. A bidding preference allows a DBE that is not the lowest responsible bidder to still win the contract. A bidding preference "can include easier access to capital, reduction or elimination of the bonding requirement and compensation for other deficiencies, extending even to price."[53] Outreach programs are also utilized to fulfill DBE requirements. Outreach programs require contractors to reach out to DBEs and ensure the DBEs have equal access and opportunity to participate.[54]

3. Applicability

An understanding of all DBE requirements is critical for the completing surety, especially when the project is funded or jointly funded on a federal, state, or local level.[55] "If the bonded contract contains DBE compliance requirements, the surety should determine what percentages were required at the outset and what percentages, to date, have been met," and ensure that the DBE requirements continue to be met through project completion.[56] It is helpful to consult with a lawyer who is knowledgeable of the FAR and other government regulations.

Further, the performing surety should typically avoid doing business with DBEs on a time and material or cost-plus basis, unless the DBE has a long history of performing and managing

---

from denying a contract to a bidder simply because it did not obtain enough DBE participation to meet the goal.

50 Rodgers-Waire & Sparks, *supra* note 34, at 6.

51 *Id.*

52 *Id.*

53 Rodgers-Waire & Sparks, *supra* note 34, at 7.

54 *Id.*

55 Grace Winkler Cranley & Andy J. Chambers, *Ch.11, Performing Surety's Additional Obligations, in* BOND DEFAULT MANUAL 587, 653-57 (Mike F. Pipkin et al., eds., Am. Bar Ass'n, 4th ed. 2015).

56 *Id*. at 655.

its own work on federal or similar projects with DBE quotas.[57] It is better that the surety utilize not-to-exceed pricing on the completion work, so that if the completion contractor struggles with meeting DBE quotas and the other owner-driven requirements, the surety is not left paying for the increased costs associated with the same.

4. Request for Waiver

Agencies have broad discretion to waive or reduce DBE requirements. Bidders can be responsive and responsible on DOT-assisted contracts through documentation showing "good faith efforts" and special or exceptional circumstances, even if the efforts do not achieve the DBE goals.[58] To determine whether "good faith efforts" have been made by the bidder, the agency must scrutinize the documentation submitted by the bidder in support of its attempt to comply with DBE requirements.[59] Likewise, a surety may attempt to demonstrate that suitable DBEs are not available by submitting sufficient documentation showing its good faith effort to meet the DBE goals.[60] In such circumstances, the agency should not continue to require compliance with a strict DBE goal simply because the surety did not obtain enough DBE participation to meet the goal; its "good faith effort" showing should be sufficient to obtain a waiver.[61] When the good faith effort alleges that there are no available DBEs suitable for the position, the inquiry should include research that lead to that conclusion, "including consultation with the DBE community and at least one public hearing."[62] If a DBE declines to bid or perform on any given job due to unavailability, that too should be documented and submitted along with an application for waiver.[63]

According to commentators: "[i]f the DBE participation plan original intended to use a DBE in a particular trade, it may be necessary to explore options in other trades and divisions to make up lost percentages, even though that could lead to termination or an otherwise good subcontractor to utilize a DBE."[64] Early communication with the Contracting Officer and agency concerning DBE requirements is necessary to ensure compliance throughout the process. Waivers are never guaranteed and appeal rights are very limited.[65] If, at any time throughout the construction process, the surety is aware of any violations of the DBE requirement or DBE fraud, it should immediately notify the appropriate agencies and authorities to avoid civil or criminal proceedings.[66]

---

57 *See* Gerard P. Brady &Jared Hand, *The Perils of Doing Business with Disadvantaged Business Enterprises*, 32 CONSTR. LAW. 37, 39-40 (2012).

58 "Good faith efforts" is defined as "efforts to achieve a DBE goal or other requirement of this part which, by their scope, intensity, and appropriateness to the objective, can reasonably be expected to fulfill the program requirement." *See* 49 C.F.R. §§ 26.15 and 26.5 (2018).

59 49 C.F.R. §§ 26.15

60 Cranley & Chambers, *supra* note 57, at 656.

61 *Id*.

62 49 C.F.R. § 26.15 (2018); *see* Rodgers-Waire & Sparks, *supra* note 34, at 12.

63 Rodgers-Waire & Sparks, *supra* note 34, at 13.

64 *Id*.

65 *Id*.

66 Cranley & Chambers, *supra* note 57, at 658.

B. The National Labor Relations Act

The National Labor Relations Act regulates the activity of employees, employers, and labor organizations.[67] While generally sureties typically avoid union disputes, it is important to understand these issues in the event the surety has bonded a project which requires the use of union trades or contractors. Also, the surety should be aware of the trap of falling into the legal role of "employer" on these types of projects, so that it can avoid claims of unfair labor practices.

The National Labor Relations Board is the main enforcement mechanism of the NLRA.[68] The NLRB has two principal functions: "(1) to prevent or remedy unfair labor practices, as defined by the Act, whether committed by employers, employees or unions, and (2) to conduct secret ballot elections in which employees select or reject collective bargaining representatives."[69]

On January 30, 2009, President Obama issued Executive Order 13496, which became 74 FR 6407, requiring federal contractors to post and provide notice to their employees of their rights under federal labor laws. The contractor must physically post the notice in a conspicuous place.[70] If a significant portion of the contractor's workforce is not proficient in English, then the contractor must provide the notice in the native language of those employees.[71] The DOL has an official poster meeting all notice requirements, and the official poster may reproduce and use exact duplicate copies.[72] Certain exemptions apply, as outlined in 29 C.F.R. § 471.3. An exemption can also be requested.[73]

29 U.S.C. § 158(f) discusses agreements covering employees in the building and construction industry and provides that employers who are "engaged primarily in the building and construction industry" may "enter into agreements with a union that require the employer to give the union an opportunity to refer qualified applicants for job openings, and that specify minimum employment qualifications or provide for priority in hiring opportunities based on seniority."[74]

---

67 29 U.S.C. § 141 (2016); The National Labor Relations Act is referred to hereinafter as "NLRA." Although the NLRA is sometimes referred to as the "Labor Management Relations Act," that designation properly applies only to the Taft-Hartley Amendments of 1947, which re-enacted the NLRA.

68 The National Labor Relations Board is referred to hereinafter as "NLRB."

69 4 DOING BUSINESS IN THE UNITED STATES § 52.01(2)(d) (2018); 29 U.S.C. § 159(b) (2016); 29 U.S.C. § 160(a) (2016); *see also* 29 U.S.C. § 153 (2016).

70 29 C.F.R. § 471.2(d)(1) (2018).

71 29 C.F.R. § 471.2(d) (2018).

72 29 C.F.R. § 471.2(e) (2018).

73 29 C.F.R. § 471.3 (2018).

74 4 DOING BUSINESS IN THE UNITED STATES § 52.02(2)(d)(ii) (2018); *see* 29 U.S.C. § 158(f) (2016).

Agreements in the construction industry may shorten the time permitted to join the union after employment begins to seven days, rather than thirty days.[75]

1. Unfair Labor Practices

29 U.S.C. § 158(a) lists five basic unfair labor practices that may be committed by an employer. Specifically, this provision states that an employer may not (1) "interfere with, restrain or coerce employees into the exercise of rights guaranteed" by the NLRA; (2) "dominate or interfere with the formation or administration of any labor organization or contribute financial or other support" to labor organizations; (3) "discriminat[e] in regard to hir[ing] or tenur[ing] of employment or any term or condition of employment to encourage or discourage membership in any labor organization"; (4) "discharge or otherwise discriminate against an employee because he has filed charges or given testimony under this subchapter"; (5) "refuse to bargain collectively with the representatives of his employees" in regard to wages, hours, and terms and conditions of employment.[76]

Under certain circumstances, the NLRB can pierce the corporate veil and impose personal liability on the individual members of the employer if the employer is engaged in efforts to evade obligations under collective bargaining agreements.[77] In *NLRB v. Ace Masonry, Inc.*, the Court upheld a NLRB decision that:

> [P]ierced Ace/Bella's corporate veil and held that various members of the … family were jointly and severally liable for the $140,082.16 due to unions and employees under the CBAs [Collective Bargaining Agreements], primarily because several members of the family personally appropriated the companies' funds in an effort to evade those obligations under the CBAs.[78]

2. Employee Rights

29 U.S.C. § 157 provides:

> [E]mployees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and shall also have the right to refrain from any or all such activities except to the extent that such right may be

---

75 29 U.S.C. § 158(f)(2) (2016).

76 29 U.S.C. § 158(a) (2016); *see also* 4 DOING BUS. IN THE U. S. § 52.03 (2018); notably, 29 U.S.C. § 158(a) lists five basic unfair labor practices prohibited to be committed by labor unions.

77 NLRB v. Ace Masonry Inc., 700 F. App'x 19, 21 (2d Cir. 2017).

78 *Ace Masonry Inc.*, 700 F. App'x at 21. Notably, Bella Masonry LLC was a second entity created by Ace Masonry, Inc., with a substantially similar ownership and management structure used in an attempt to evade said obligations.

> affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 8(a)(3).[79]

The Taft-Hartley amendment granted employees the right to refrain from organized labor, unless there is an agreement between an employer and the union requiring union membership or financial support.[80] Employee rights are not unqualified; an employee must relinquish individual desires for the betterment of the collective bargaining unit.[81] Employee rights are also restrained by reasonable limitations imposed by employers.[82]

C. Certified Payroll, Minimum Pay, Overtime Pay

The surety should be intimately aware of the Davis-Bacon Act and Fair Labor Standards Act when signing certified payrolls on behalf of a defaulted principal or when taking over a project. These laws regulate a contractor's obligations to provide certified payrolls and to ensure minimum and overtime pay for employees.

1. The Davis-Bacon Act: Overview and Requirements

The Davis-Bacon Act requires laborers and mechanics to be paid prevailing wages.[83] If the contract was established after January 1, 2015, the laborers and mechanics must also be paid rates acceptable under Executive Order 13658.[84] The DBA prevailing wage is a combination of a basic wage rate and any fringe benefits listed in the Davis-Bacon wage determination: "The contractor's obligation to pay at least the prevailing wage listed in the contract wage determination can be met by paying each laborer and mechanic the applicable prevailing wage entirely as cash wages or by a combination of cash wages and employer-provided bona fide fringe benefits."[85] *Bona fide* fringe benefits can include, but are not limited to, pensions, insurance, health care or hospital care, vacation, and holiday pay.[86]

The DBA is designed to protect minimum wage and fringe benefits for workers on federal construction projects.[87] When the DBA was originally enacted in 1931, Congress wanted to prevent contractors from underbidding federal projects while underpaying their workers during

---

79 29 U.S.C. § 157 (2016).

80 4 DOING BUSINESS IN THE UNITED STATES § 52.02(2) (2018).

81 *Id*.

82 *Id.*

83 The Davis-Bacon Act is referred to hereinafter as "DBA."

84 1 LAURIE E. LEADER, WAGES & HOURS: LAW AND PRACTICE § 12.02(2) (2018).

85 U.S. DEP'T OF LABOR, WAGE & HOUR DIV., *Fact Sheet #66: The David-Bacon and Related Acts ("DBRA")* (April 2009), https://www.dol.gov/whd/regs/compliance/whdfs66.pdf.

86 40 U.S.C. § 3142 (2016); *see also* Michele Leo Hintson & Kournti Mason, *Facing the Department of Labor: A Primer on Prevailing Wage Laws and Their Impact of Sureties,* (unpublished paper submitted at the 27th Annual Northeast Surety & Fidelity Claims Conference on Sept. 21-23, 2016).

87 Hintson & Mason, *supra* note 91, at 2.

the Great Depression.[88] At that time, the Federal Government funded approximately sixty percent of all new construction in the United States.[89] Compliance with the DBA is necessary for:

> [E]very contract in excess of $2,000, to which the Federal Government or the District of Columbia is a party, for construction, alteration, or repair including painting and decorating, of public buildings and public works of the Government or the District of Columbia that are located in a State or the District of Columbia and which requires or involved the employment of mechanics or laborers…[90]

If the prime contract is more than $2,000, then each subcontract, no matter the value, must also comply with the DBA.[91] To determine if the contract is for construction, alteration, or repair, refer to 29 C.F.R. § 5.2(j), which defines construction, alteration, or repair as:

> All types of work done on a particular building or work at the site thereof, including work at a facility which is deemed a part of the site of the work within the meaning of paragraph (l) of this section by laborers and mechanics employed by a construction contractor or construction subcontractor … including without limitation -- (i) Altering, remodeling, installation (where appropriate) on the site of the work of items fabricated off-site; (ii) Painting and decorating; (iii) Manufacturing or furnishing of materials, articles, supplies or equipment on the site of the building or work … (iv) [specific transportation routes].[92]

If the surety negotiates a new contract with the owner, it should be aware that the applicable provisions of the DBA must be set out in their entirety in the contractor's subcontract agreements with its subcontractors; it is not sufficient to merely cite to the Act. Moreover, when negotiating a price with the tender or takeover contractor, the surety must take into account the DBA wage requirements which will likely drive up its costs to complete the project.

29 C.F.R. § 5.2(k) defines public buildings or public works as "buildings or work, the construction, prosecution, completion, or repair of which … is carried on directly by authority of or with funds of a Federal agency to serve the interest of the general public regardless of whether title thereof is in a Federal agency."[93] A variety of workers are considered laborers or mechanics for Davis-Bacon purposes despite the actual contractual relationship that exists between the contractor and the worker.[94]

---

88 *Id.*
89 *Id.*
90 40 U.S.C. § 3142(a) (2016).
91 *Id.*; 9 FIELD OPERATIONS HANDBOOK § 15b00(d) (2010); *see also* 1 LEADER, *supra* note 89, § 12.02(1)(a).
92 29 C.F.R. § 5.2(j) (2018).
93 29 C.F.R. § 5.2(k) (2018).
94 29 C.F.R. § 5.2(o) (2018).

Prevailing wages are determined by wages paid to certain classes of laborers on certain types of construction projects in a particular area.[95] Prevailing wage determinations come in two forms, general and project. General wage determinations are provided when a particular type of construction in a particular geographic area are firmly established.[96] Project wage determinations must be specifically requested and apply only to individual contracts.[97] The United States Department of Labor Wage and Hour Division publishes an "All Agency Memoranda" to provide guidance for determining prevailing wages.[98] Ultimately, "the contracting agency is responsible for determining the applicable wage determination to furnish all parties involved on a project."[99] It is important to advise construction clients to fill out prevailing wage surveys if they receive them from the government; otherwise, the wage determinations can be skewed and inaccurate if only a small handful of contractors respond.

The wage rates must be conspicuously posted at the jobsite so workers can easily see them.[100] DOL has promulgated a Davis-Bacon poster (WH-1321), which can be found on the DOL website.[101]

Contractors and subcontractors covered by the DBA must submit weekly payroll and weekly payroll statements to the contracting officer containing wage and benefit information paid to each individual engaged in DBA work.[102]

29 C.F.R. § 5.5(a)(3)(i) states:

> Such records shall contain the name, address, and social security number of each such worker, his or her correct classification, hourly rates of wages paid (including rates of contributions or costs anticipated for bona fide fringe benefits or cash equivalents thereof of the types described in section 1(b)(2)(B) of the Davis-Bacon Act), daily and weekly number of hours worked, deductions made and actual wages paid.[103]

Further, each weekly statement must contain a "Statement of Compliance," as required by 29 C.F.R. § 5.5(a)(3)(ii)(B), certifying the payroll statement complies with all DBA requirements

---

95 Hintson & Mason, *supra* note 91, at 6.

96 29 C.F.R. § 1.5(a) (2018); 2 HENRY L. GOLDBERG, FEDERAL CONTRACT MANAGEMENT P 10.13(3)(b) (2018).

97 29 C.F.R. § 1.5(b) (2018); 2 GOLDERG, *supra* note 102, P 10.13(3)(b).

98 The United States Department of Labor is referred to hereinafter as "DOL."

99 Hintson & Mason, *supra* note 91, at 7.

100 U.S. DEP'T OF LABOR, WAGE & HOUR DIV., *Fact Sheet #66*, *supra* note 71.

101 WH-1321 can be found at https://www.dol.gov/whd/regs/compliance/posters/fedprojc.pdf.

102 29 C.F.R. § 5.5(a)(3)(ii)(A) (2018).

103 29 C.F.R. § 5.5(a)(3)(i) (2018). Address and social security number are not required for weekly submissions but are required to be maintained to comply with basic record keeping requirements.

and that the information submitted is accurate.[104] DOL has provided Option Form WH-347, which is available online, but its use is not required. These records must be kept for three years and made readily available upon request of the contracting agency and the DOL.[105]

Although subcontractors are responsible for maintaining and gathering the payroll records and other information necessary for the contractor to prove compliance with the DBA, ultimately it is the contractor's responsibility to ensure that its subcontractors are complying with the DBA, and that all DBA information and documentation is accurate and is accurately submitted.[106] If a subcontractor has violated the DBA, the general contractor will ultimately be held liable and fined by the government for such violations. The contractor cannot contract away this obligation by the terms of its subcontracts with its various subcontractors. It is advisable to include a clause in every subcontract agreement that requires the subcontractor to reimburse, indemnify, and hold the contractor harmless from any and all DBA violations, as investigating and challenging the government's claim of a DBA violation can be very costly and time-consuming.

There are at least 32 states, and many local cities, that have their own prevailing wage laws – otherwise known as "little" Davis-Bacon Acts.[107] When there are overlapping prevailing wage requirements, contractors must comply with both; the Davis-Bacon Act does not preempt state or local prevailing wage laws.[108] Thus, if state or local laws are more restrictive than the Davis-Bacon Act, i.e. prevailing wages are higher and work standards are more restrictive, then the surety must ensure the completing contractor will comply with the state or local law.[109]

2. The Fair Labor Standards Act: Overview and Requirements

The Fair Labor Standards Act, originally enacted in 1938, regulates wages and hours of employment and child labor, among other things.[110] Under the FLSA, "an employer is required to pay its employees a minimum wage, and must pay an overtime rate of not less than one and one-half times the employee's regular rate of pay for work over forty hours in a workweek."[111] While sureties will rarely have to deal with claims under the FLSA, it is important to understand the FLSA and its application to projects that the surety may be temporarily managing between the time of default and the takeover by a replacement or tender contractor.

The FLSA is quite broad, making it an area of concern for contractors and employers. In order to be an enterprise covered by the FLSA, the enterprise must be engaged in commerce or in the production of goods for commerce, which includes employees that handle, sell, or otherwise work on goods that have been moved in or produced for commerce.[112] Specifically:

---

104 29 C.F.R. § 5.5(a)(3)(ii)(B) (2018).
105 29 C.F.R. § 5.5(a)(3)(i) (2018); *see* Hintson & Mason, *supra* note 91, at 8.
106 Hintson & Mason, *supra* note 91, at 8.
107 *Id*. at 4.
108 *See* Frank Bros. v. Wis. Dep't of Transp., 409 F.3d 880, 897 (7th Cir. 2005).
109 *Id*.
110 The Fair Labor Standards Act is abbreviated as "FLSA."
111 2 GOLDBERG, *supra* note 102, P 10.13(2).; 29 U.S.C. § 207(a)(2)(C) (2016).
112 29 C.F.R. § 779.237 (2018).

> Enterprise 'engaged in commerce or in the production of goods for commerce' means an enterprise that-- (A)(i) has employees engaged in commerce or in the production of goods for commerce, or that has employees handling, selling, or otherwise working on goods or materials that have been moved in or produced for commerce by any person; and (ii) is an enterprise whose annual gross volume of sales made or business done is not less than $500,000 (exclusive of excise taxes at the retail level that are separately stated).[113]

If an enterprise does not meet the monetary minimum to be covered by the FLSA, but it has employees that are engaged in interstate commerce, then those employees are covered by the FLSA and the enterprise must comply with FLSA requirements.

Although the FLSA is quite broad, it is also riddled with exceptions from its requirements, such as executives, professional and administrative employees, and certain commissioned sales employees, among other enumerated workers.[114]

Under the FLSA, employers must be diligent about keeping detailed records for each of their covered employees. There is no required form, but the employer must keep basic information such as the employee's full name, address, occupation, hours worked, payments made and the workweek covered by that payment.[115] Such records should be kept for no fewer than three years.[116] All employers with employees covered by the Act must post somewhere in a workplace, and keep posted, a conspicuous notice explaining the Act.[117]

D. Tax obligations

It is important for the surety to be aware of tax obligations that may arise when taking over a project. The surety, at the outset, should demand the bond principal's tax returns, including state, federal, and all related payroll taxes to ensure the principal has been paying its taxes as required by law and to verify any potential liability for unpaid taxes. In addition, the surety should also request copies of all documents required to be maintained pursuant to the DBA and FLSA.

For example, a Miller Act performance bond must contain a provision stating that the surety:

> shall provide coverage for taxes the Government imposes which are collected, deducted, or withheld from wages the contractor pays in carrying out the contract

---

113 29 U.S.C. § 203 (2016).
114 29 U.S.C. § 213 (2016); 2 GOLDBERG, *supra* note 102, P10.13(2).
115 29 U.S.C. § 211 (2016).
116 U.S. DEP'T OF LABOR, WAGE & HOUR DIV., *Fact Sheet #21: Recordkeeping Requirements under the Fair Labor Standards Act* (July 2008), https://www.dol.gov/whd/regs/compliance/whdfs21.pdf.
117 U.S. DEP'T OF LABOR, EMPLOYMENT LAW GUIDE, https://webapps.dol.gov/elaws/elg/minwage.htm (last visited Oct. 8, 2018).

> with respect to which the bond is furnished."[118] If the government does not receive the required taxes from the bonded principal, "[t]he Government shall give the surety on the bond written notice, with respect to any unpaid taxes attributable to any period, within 90 days after the date when the contractor files a return for the period, except that notice must be given no later than 180 days from the date when a return for the period was required to be filed[.][119]

Pursuant to the Miller Act, the government is not required to detail with specificity the contracts, bonds, and amounts of delinquent taxes; the Miller Act simply requires notice to be given in a timely manner to alert the surety that the contractor has not made payments as required by law.[120] Once notice has been given to the surety, the government must commence an action against the surety to recover unpaid taxes within one year from the date of the notice.[121] The government's ability to collect pre-judgment interest depends on the relevant state law.[122]

If a surety opts to takeover a project, or must manage the project for the time period between the principal contractor's default and the surety's takeover, it must take into consideration the tax implications of doing so. Any member of the principal's team who assists the surety during its transition period, or will stay on as part of the takeover, should be paid through a payroll process provider hired by the surety. Because the payroll process provider deals directly with the funds and will be responsible to withhold all necessary taxes, the surety can guarantee all taxes are being properly withheld and shed itself from having liability for the taxes. There are other options available to the surety to ensure taxes are being properly withheld. For example, the surety can engage a project consultant and require that company to place individuals working on the project on the consultant's payroll. The consultant would then charge the surety a ten percent to fifteen percent markup to cover associated fees and incidentals. Another option for the surety is to withhold an amount equal to the taxes to be paid, then remit quarterly tax returns to the government on behalf of the individual. It is important to note, the IRS will look to anyone associated with the construction project, including the surety management, for payment of sums owed for unpaid taxes. The surety must be proactive with respect to tax obligations including ensuring that all documents required by the state and federal tax authorities are being maintained.

Conclusion

Completing a project after a principal's default is no easy task. Myriad issues, both pre- and post-default, arise out of a pending or actual default, many of which the surety cannot always readily identify or even control. The surety's most valuable tool in addressing the array of project issues is to be prepared and to understand project oversight, control, staffing, and legal issues. To that

---

[118] 40 U.S.C. § 3131(c)(1) (2016).

[119] 40 U.S.C. § 3131(c)(2) (2016).

[120] Lisa D. Sparks & Marc A. Campsen, *The Surety's Exposure for Wage and Related Liabilities* (unpublished paper submitted at the 26th Annual Northeast Surety & Fidelity Claims Conference on Sept. 16-18, 2015) (quoting United States v. Am. Mfrs. Mut. Cas. Co., 901 F.2d 370, 373 (4th Cir. 1990)).

[121] 40 U.S.C. § 3131(c)(3) (2016).

[122] Sparks & Campsen, *supra* note 126, at 9.

end, as soon as the surety is on notice of an impending or actual default, the surety must immediately collect all documentation and other information related to the project and put in place consultants and control mechanisms so that it can move as quickly as possible to assess the status of the project and keep construction moving along once a default and termination is issued. The surety must contemporaneously analyze the project holistically, which includes identifying key project management members, determining the status of staffing requirements, and identifying rules, regulations, and other legal issues. Moreover, gathering comprehensive project information and documentation as quickly as possible will give the surety the opportunity to make the most informed decisions, and to mitigate its potential damages. With an understanding of these principals, the surety will be able to identify these key issues and documents in the face of a default, which will assist the surety in making informed decisions about how to get the project back on track and completed as efficiently as possible without running afoul of applicable laws and regulations.