

Memorandum

To: Edward Gallagher

From: Robert J. Duke

Date: January 7, 2005

Re: The Public Construction Bond Act

Through the Illinois Surety Association, staff learned that the Illinois Capital Development Board (“CDB”) intends to sponsor legislation in the current session of the General Assembly. CDB oversees the construction of new state facilities. The legislation would amend Section 1 of the Public Construction Bond Act (30 Ill. Comp. Stat. 550.1). Specifically Section 1 contains language that public works performance bonds are “deemed to contain.” The proposed legislation would add language that would be contained in bonds running to CDB:

For bonds relating to contracts between the Capital Development Board and a contractor, upon written notice by the obligee to the surety that the principal has defaulted with respect to undertakings, covenants, terms, conditions, and agreements, the determination of which is in the discretion of the obligee, the surety shall, within 10 days, (i) provide a completing contractor that is in compliance with Sections 30-20 and 30-22 of the Illinois Procurement Code to the obligee for approval or (ii) provide the obligee with the penal sum of the performance bond, the remainder of which shall be returned to the surety upon final completion of the project.

This provision would establish requirements regarding claims handling that are more stringent than the requirements currently in effect, in terms of the time requirement and the payment option. First, according to CDB contract documents, a surety must merely acknowledge receipt of the termination/default notice within ten days of receipt. Standard Documents for Construction, Para. 00501.5 (September 2002). Second, the surety has fifteen days after the execution of the takeover agreement to begin completion of the work. *Id.* Third, the surety’s payment option is limited by the amount “required to allow CDB to complete the work,” rather than payment of the entire penal sum. *Id.* at Para. 00720.4

I spoke to Jacob Miller of CDB to discuss the proposed legislation. I noted that the claims requirements are more stringent, which increases the surety’s risk. A surety usually addresses greater risk by increasing its underwriting requirements. The ultimate result may be reduced bond availability. Miller stated that the legislation was in response to recent experience of slow claims handling. He stated that in some cases the

surety does not respond, or takes a long time to hire a completing contractor. In addition, he was concerned with the quality of the completing contractor. He stated that in some cases, the contractor was not prequalified according to CDB procedures. I suggested that alternative language could be developed that would ensure that the progress of construction is not delayed and that the completing contractor is satisfactory to CDB. At the same time, the alternative language would contain reasonable claim handling requirements. He said CDB would consider alternative language that would be supported by the surety industry.

I have developed proposed language and attach a copy. I have attempted to address CDB's concern of maintaining project progress and using a satisfactory completing contractor, but with requirements that are more reasonable and similar to requirements currently in effect. I note that the contract document already permit the CDB to take over the work if the surety "fails to exercise its right to undertake the work." Standard Documents for Construction, Para. 00720.4 (September 2002). The last two sentences in the attached proposed language incorporates this concept.

Section 5: The Public Construction Bond Act is amended by adding the following after the fourth paragraph of Section 1, as paragraphs five and six:

Each bond securing contracts between the Capital Development Board ("CDB") and a contractor shall contain the following provisions whether such provisions are inserted in such bond or not: "Upon the default of the principal with respect to undertakings, covenants, terms, conditions, and agreements, the termination of the contractor's right to proceed with the work, and notice of such default by CDB to the surety, the surety shall promptly remedy the default by taking one of the following actions:

(1) The surety shall complete the work pursuant to a written takeover agreement, using a completing contractor selected by the surety and approved by CDB. As a minimum condition for approval by CDB, the completing contractor must be on the list of prequalified contractors with CDB; or

(2) The surety shall pay a sum of money to the obligee, up to the penal sum of the bond, necessary to complete the work. The surety shall respond to CDB's notice of default within ten (10) working days of receipt indicating the course of action that it intends to take. If the surety elects to complete the work with a completing contractor and if the CDB determines it is in the best interest of the State to maintain the progress of the work, CDB may continue the work until the completing contractor is prepared to commence performance. Subject to the penal sum of the bond, the surety shall be liable for expenses incurred by CDB to continue the work that exceed the unpaid balance of the contract sum.