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by

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SURETIES AND LETTERS OF CREDIT

Introduction - Focus of Inquiry

Owners and their legal counsel must be very careful in preparing and in handling claims involving surety bonds and letters of credit. This paper addresses some of the unique challenges associated with asserting surety bond claims and in calling letters of credit. The authors will discuss these challenges and specific cases during the Concurrent Afternoon Session. Attached to this paper are several forms that practitioners should find useful in representing their municipalities.

I. Surety Bonding

A. General Overview – Relationship of the Parties

What is suretyship?

> Suretyship is, essentially, a nexus of three relationships: the relationship between the principal obligor and the obligee (embodied in the underlying obligation), the relationship between the secondary obligor and the obligee (embodied in the secondary obligation), and the relationship between the principal obligor and the secondary obligor (embodied in the duties of performance and reimbursement and the doctrines of restitution and subrogation). *See Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, Suretyship Defenses - Introductory Note (1996).*

What is a surety bond? It is a tripartite agreement among a principal obligor (contractor), an obligee (owner), and a secondary obligor (surety) to provide personal security for the payment of a debt or performance of an obligation. *See Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, Suretyship Defenses - Introductory Note (1996). See e.g. Balboa Ins. Co. v. United States,* 775 F.2d 1158, 1160 (Fed. Cir. 1985); *Bell BCI Co. v. HRGM Corp.,* 276 F.Supp.2d 462, 463 (D. Md. 2003); *General Motors Acceptance Corp. v. Daniels*, 303 Md. 254, 259, 492 A.2d 1306, 1309 (Md. 1985); *Atlantic Contracting & Material Co., Inc. v. Ulico Casualty Co.*, 380 Md. 285, 299, 300, 844 A.2d 460, 468 (Md. 2004); and *Masterclean, Inc. v. Star Ins. Co.,* 347 S.C. 405, 408-09, 556 S.E.2d 371, 373-74 (S.C. 2001).

As a result of the duties flowing from the contractor to the surety, the surety's decision as to whether to provide a bond typically depends on a risk assessment. *See Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, Suretyship Defenses - Introductory Note (1996).* The surety must assess the risks that the contractor will not perform the underlying obligation and that, if so, the surety will not be able to successfully to pass the cost of its performance to the contractor despite the existence of the contractor's duties. *Id.*

One of the owner's primary goals in a construction project should be non-interference with the surety's rights and performance obligations. *Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, §§37-49* address the various suretyship defenses available to a surety against the owner's attempt to enforce a bond. The general rule is that if, after the surety enters into a bond, the owner does an act that changes the risks that were the subject of the surety's assessment, there is the potential for a loss to the surety. *Id.* In most cases, in the absence of the surety's agreement to the contrary, a surety is discharged to the extent that such acts would otherwise cause the surety to suffer a loss; in some cases, the discharge is total. *Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, Suretyship Defenses - Introductory Note (1996).* An agreement to the contrary, especially in the form of consent to such an act or waiver of discharge resulting from such an act, is common in many contexts. *Id.*

Public projects typically include (i) a bid bond, (ii) a performance bond, (iii) a payment bond, (iv) a maintenance bond, and (v) a supply bond. For purposes of this paper, the focus is on the enforcement of the two most important bonds which are the performance and payment bonds.

1. Performance Bond

In a performance bond, a surety guarantees performance of the contract and completion of the project if the bonded contractor defaults. *See Pennsylvania Nat'l Cas. Ins. Co. v. City of Pine Bluff*, 354 F.3d 945, 949 (8th Cir. 2004) ("A performance bond protects the owner, or obligee, ensuring project completion if the general contractor defaults"); *National Fire Ins. Co. v. Fortune Constr. Co.*, 320 F.3d 1260, 1274 (11th Cir. 2003) (true performance bond requires a surety to guarantee the performance through completion of the underlying contract); *Aetna Casualty & Surety Co. v. United States*, 845 F.2d 971, 973-74 (Fed. Cir. 1988); *Dadeland Station Assocs., LTD. v. St. Paul Fire & Marine Ins. Co.*, 2003 U.S. Dist. LEXIS 21527 (S.D. Fla. June 13, 2003), *appeal on other grounds*, 383 F.3d 1273 (11th Cir. 2004) (recognizing that performance bond is a contract, with the surety's obligations subject to the law of contracts); *Mountain Funding, Inc. v. frontier Ins. Co.*, 2003 U.S. Dist. LEXIS 16563 (N.D. Ill. Sept. 19, 2003) (the principal's performance is guaranteed and the obligation of the principal becomes the obligation of the surety). Under a performance bond, when the contractor fails to perform its contractual duties, the surety can discharge its duties under the bond by taking over and completing the contract itself, or by tendering the costs of completion to the owner. If the surety does not do either of these things, the owner can sue the surety on the bond. *See Westchester Fire Ins. Co. v. United States,* 52 Fed. Cl. 567, 574 (2002).

2. Payment Bond

In a payment bond, the surety guarantees the contractor's duty to the owner to pay the contractor's laborers, subcontractors, and suppliers. *See Pennsylvania Nat'l Cas. Ins. Co. v. City of Pine Bluff,* 354 F.3d at 947.

3. Interpretation and Enforcement of Bonds

Most jurisdictions now differentiate between compensated and uncompensated sureties for the purpose of determining contractual liability. Under common law, the enforcement of a surety obligation was interpreted under the principle of "strictissimi juris" meaning of the strictest right or law; to be interpreted in the strictest manner. *Black's Law Dictionary (8th ed. 2004)*. The strict interpretation of surety bonds has evolved with the creation of "compensated sureties." The modern view is to treat a compensated surety like an insurance company and construe the surety bond like an insurance policy in favor of the owner. *See Chapman v. Hoage,* 296 U.S. 526, 528-531, 56 S. Ct. 333, 80 L. Ed. 370 (1936); *Maryland Cas. Co. v. Fowler,* 31 F.2d 881, 884 (4th Cir. 1929); *Winston Corp. v. Continental Casualty Co.*, 508 F.2d 1298, 1302 (6th Cir. 1975); *Nobel Ins. Co. v. City of New York,* 2006 U.S. Dist. LEXIS 70816 (S.D.N.Y. Sept. 29, 2006); and *Berry v. United States Fidelity & Guaranty Co.*, 249 Md. 150, 157, 238 A.2d 907, 910 (1968).

B. Bond Claims

1. Investigation

Owners must be very careful in handling their claims against contractors and sureties. The defenses that are asserted by contractors and sureties are inexorably linked to the conduct of the owner and the contractor during the contract. Practitioners need to objectively review the owner's administration of the contract, the contractor's performance and the specific requirements of the contract and the bonds before notifying the contractor and the surety of the contractor's default. The owner and its counsel should obtain answers to following questions:

- Has the owner complied with the terms of the contract?
- Has the owner properly administered the contract?
- Has the owner complied with the terms of the surety bonds?
- Has the contractor complied with the terms of the contract?
- What is the specific section(s) of the contract that has been breached by the contractor and is the contractor's default a material default?
- How has the owner documented the contractor's performance and non-performance of work during construction?

- If the owner has hired an independent third-party project manager, does that project manager agree that a material default has occurred?

- Has the owner regularly inspected the contractors work?

- Has the owner maintained project records and other documents to support its claim that a material default has occurred?

- What, if any, documents support the owner's position that a material default has occurred?

- Are there architect and engineer reports to support the owner's position that a material default has occurred?

- Are there pending disputes between the contractor and any subcontractors?

- Did the owner pay a subcontractor after notice of a dispute between the contractor and a subcontractor?

- Did the owner accept subcontractor work without the review of that work by the contractor or accept the subcontractor work without the contractor's consent?

- Did the owner directly pay a subcontractor, after notice of a dispute between the contractor and the subcontractor, without the consent of the contractor?

- Are there problems with the plans and specifications that the owner prepared or were prepared, at the owner's request, by a third-party architect-engineer? Remember the owner is responsible for improper or defective design specifications under the doctrine set forth the Supreme Court in *United States v. Spearin*, 248 U.S. 132, 136, 39, S. Ct. 59, 63 L. Ed. 166, 169 (1918).

- Has the owner made demands upon the contractor that are inconsistent with the terms of the contract and the plans and specifications?

- Have there been other contractor defaults during the project and, if so, how were they resolved?

- Has the owner waived previous defaults by the contractor?

- Did the owner notify the surety and obtain its written consent to the waiver of defaults before continuing with the contract?

- Have any representatives of the owner made admissions against the interests of the owner?

- What statements, if any, has architect-engineer made to the contractor and subcontractors regarding the performance of the contract and the construction of the project?

- Has the owner timely paid the contractor for accepted work?

- What Change Orders and Field Orders were approved by the owner or the architect/engineer?

- What, if any, effect did the Change Orders and Field Orders have on the Scope of Work, Contract Time, Contract Sum, the project schedule and the contractors ability to perform the contract?

- Are there unresolved pending Change Orders that are interfering with the contractor's performance?

- Have there been material changes to the Scope of Work to be performed by the contractor?

- Did the changes in the Scope of Work amount to a "Cardinal Change"?

- Have there been changes to the Contract Time and/or the Contract Sum?

- Did the owner notify the surety and obtain the surety's prior written consent before modifying the Scope of Work, the Contract Time or the Contract Sum?

- Do the bonds waive notice to the surety of changes in the Scope of Work, Contract Time and Contract Sum?

- Has the owner taken any actions that impair the surety's rights, including the surety's right of equitable subrogation?

The answers to the questions will certainly determine how the owner and its counsel should approach asserting a claim against the surety. At the early stage in the claim process, the owner may still have an opportunity to improve the documentation of the contractor's default and to avoid some of the defenses that a surety may otherwise assert to the enforcement of performance and payment bonds. Ideally, owners should include their counsel in the claim process as early as possible so that counsel can advise the owners as to what actions to avoid so as to not discharge or release the surety.

2. The Notice to Cure – Default Notice

After completing their investigation, the owner and its counsel have concluded that the contractor has in fact failed to perform its obligations under the contract and that a material default has occurred. The owner needs to issue a "notice to cure" or "cure notice" to the contractor to begin the claim process. Construction contracts tend to be some of the most complex commercial contracts and almost always incorporate a significant number of documents such as general conditions, plans, specifications, and procurement codes and regulations. Make sure that the cure notice is issued in writing and is consistent with the terms of all of the contract documents and the bonds.

The contents of the cure notice are very important. The cure notice must not only tell the contractor that it is in default, but it also should identify with some specificity the deficiencies in the contractor's performance. *International Verbatim Reporters v. United States*, 9 Cl. Ct. 710, 723 (1986). The cure notice must tell the contractor what steps are the necessary to cure the default and it must require a cure period that is not less than the period of time permitted in the contract. *Hannon Elec. Co. v. U.S.*, 31 Fed. Cl. 135, 148 (1994); *Bell BCI Co. v. HRGM, Corp.*, 2004 U.S. Dist. Lexis 15305 (D. Md. 2004) *citing International Verbatim Reporters v. United States*, 9 Cl. Ct. 710, 723 n. 6 (1986). The cure notice "need not cite each and every failure, but it must list with enough particularity the performance failures which have placed the contractor in danger of termination for default." *Composite Laminates, Inc. v. United States*, 27 Fed. Cl. 310, 318 (1992) quoting *International Verbatim Reporters, Inc. v. United States*, 9 Cl. Ct. 710, 721 (1986) ("Where the plaintiff has received prior notice of its failures, whether by telephone, letter, or word of mouth, that information will be considered properly in conjunction with the cure notice"). In the context of contractor default, courts have found that "[a] declaration of default sufficient to invoke the surety's obligations . . . must be made in clear, direct, and unequivocal language." *L & A Contracting Co. v. S. Concrete Serv., Inc.*, 17 F.3d 106, 111 (5th Cir. 1994) (finding insufficient notice of default when owner's letters never mentioned the word "default"); *Elm Haven Constr. Ltd. P'ship v. Neri Constr., LLC*, 281 F. Supp. 2d 406 (D. Conn. 2003) (insufficient notice when letters only complained about performance and financial status); *Balfour Beatty Constr., Inc. v. Colonial Ornamental Iron Works, Inc.*, 986 F. Supp. 82, 86 (D. Conn. 1997) (insufficient notice when letters only mention delay in performance).

Make certain that the owner has well documented the contractor's deficient work and do not overlook the procedural requirements contained in the owner's code and regulations with respect to declaring a default under a contract and in terminating a contract. Failure to comply with the procedures set forth in the owner's procurement code and regulations will create additional defenses for the contractor and its surety.

3. Termination of the Contract

Remember that an owner's decision to terminate the contract must be legally justified and well supported otherwise the owner has exposed itself to breach of contract claims and consequential damages from the contractor. In addition, the wrongful termination of the contract by the owner discharges the surety from its obligations under the bonds. Is there a material default that justifies the termination of the contract? Has the contractor partially cured its default in response to the cure notice, and does the remaining uncured deficient work still constitute a material default under the contract? Essentially this issue comes down to measuring the contractor's performance against the contract, the plans and the specifications. The contractor's default can come in many shapes and sizes, but the key for the practitioner is to ensure that the owner has documented the default and that it can legitimately support its position that a material default has in fact occurred under the contract. Build the case prior to issuing the cure notice and in terminating the contract. Make sure that the contractor's efforts to cure its default still permit the owner to terminate the contract. Unless a contractor is in such financial trouble that it can no longer operate and it has abandoned the project, the contractor will make some effort to cure its default or otherwise respond to the cure notice in a manner that creates a factual issue as to not only the contractor's performance, but the owner's actions during construction. Remember the contractor has every incentive to obfuscate the issue of its default considering the fact that it has significant exposure to the owner and to its surety.

Can the owner terminate the contract before the end of the cure period? There is some authority for the proposition that the owner does not have to wait until the end of the cure period to terminate a contract where the contractor receives a cure notice and takes no action to provide the owner with any indication that it is seeking to cure its default. *See e.g. Cervetto Bldg. Maint. Co. v. United States*, 2 Cl. Ct. 299, 303 (1983) (when a contractor does not make further efforts to cure, an early termination causes "no harm). Some cases have held that the contractor needs to provide assurances to the owner that it can complete the contract on time and cure its default. *See J. D. Hedin Constr. Co. v. United States*, 187 Cl. Ct. 45, 57, 408 F.2d 424, 431 (1969) ("Parties are entitled to ask for reassurances when persons with whom they have contracted have by word or deed created uncertainty about their ability or intent to perform, and they are entitled to treat the failure to provide such assurances as a repudiation of the contract." *Composite Laminates, Inc. v. United States*, 27 Fed. Cl. 310, 323-24 (1992) (see cases cited therein); *and Danzig v. AEC Corp.,* 224 F.3d 1333 (Fed. Cir. 2000).

The authors believe that owners should rarely, if ever, terminate the contract during the cure period. The issue of whether the contractor has in fact undertaken efforts to cure becomes a factual question between the contractor and the owner and certainly raises an additional defense for the benefit of the surety when the owner seeks to enforce the performance bond. The more prudent approach is for owners to carefully craft their cure notice with the understanding that while the decision to terminate a contract can be made prior to the end of the cure period, the act of terminating the contract should not occur until after the cure period has expired.

C. Surety's Defenses Against the Owner

The drafters of the *Restatement of the Law, Third, Suretyship and Guaranty (1996)* provide a well noted warning to practitioners:

> **There is probably no area of suretyship law in which there is less consensus than the law of suretyship defenses. Rules vary from jurisdiction to jurisdiction, from context to context, and from common law to the Uniform Commercial Code.** (Emphasis added). *Restatement of the Law, Third, Suretyship and Guaranty, Chapter 3, Suretyship Defenses - Introductory Note (1996).*

1. Release, Extension, or Modification of the Contract

The *Restatement of the Law, Third, Suretyship and Guaranty, §§ 39-41* describe the effect of a release, extension, or other modification of the underlying obligation. According the Restatement, two interrelated questions must be initially answered. First, what is the effect of a release, extension, or modification of the underlying obligation on the duties owed to the surety by the contractor? Second, what is the effect of the release, extension, or modification of the underlying obligation on the relationship between the surety and the owner? *Id.*

The *Restatement* adopts a bifurcated approach to impairment of the surety's status. When the impairment fundamentally alters the risks imposed on the surety, the resulting situation is no longer that for which the surety bargained. *See Restatement of the Law, Third, Suretyship and Guaranty, §37, Comments and Illustrations.* Accordingly, the surety is discharged from its obligation. *Id.* When the consequences of the impairment are only a potential increase in cost of performance that cannot be shifted to the contractor, the Restatement adopts the view espoused in U.C.C. § 1-106 (1995) that an aggrieved party's remedy should put that party in as good a position, but not a better one, as would have been the case if the other party had not impaired the aggrieved party's rights. *Id.* Restatement of the Law, Third, Suretyship and Guaranty, §§39-41 provide rules discharging the surety from liability on the surety's obligation to the extent that the impairment of recourse would otherwise prejudice the surety, and providing for recovery from the owner if the loss has already occurred because the surety's obligation has been performed.

a. **Release of the Contractor Discharges the Surety**

Pursuant to *Restatement of the Law, Third, Suretyship and Guaranty, §39*, to the extent that the owner releases the contractor from its duties pursuant to the underlying obligation the contractor is also discharged from any corresponding duties of performance and reimbursement owed to the surety unless the terms of the release effect a preservation of the surety's recourse (*Restatement §38*). *See Restatement of the Law, Third, Suretyship and Guaranty, §39(a)*. The surety is also discharged from any unperformed duties pursuant to the bond unless (i) the terms of the release effect a preservation of the surety's recourse, or (ii) the language or circumstances of the release otherwise show the owner's intent to retain its claim against the surety. *See Restatement of the Law, Third, Suretyship and Guaranty, §39(b)*. If the surety is not discharged from its unperformed duties pursuant to the bond by operation of Section 39(b), the surety "is discharged from those duties to the extent: (i) of the value of the consideration for the release; (ii) that the release of a duty to pay money pursuant to the underlying obligation would otherwise cause the surety a loss, and (iii) that the release discharges a duty of the contractor other than the payment of money." *See Restatement of the Law, Third, Suretyship and Guaranty §39(c).*

According to the *Restatement of Law, Third, Suretyship and Guaranty, Comments and Illustrations, §39*, an owner may release the contractor from its duties pursuant to the bond in a number of different circumstances. In some cases, such as an accord and satisfaction, the release is intended to discharge all claims of the owner (including claims against other obligors) with respect to those duties. In those cases, the surety is discharged by the release. *Id.* In other cases, however, the release is intended to discharge only the owner's claim against the contractor, leaving the owner free to pursue the surety. *Id.* Section 39(b)(b) does not discharge the surety when the release is intended to discharge only the contractor. *Id.* This intent can be reflected in a provision of the release effecting a preservation of recourse of the surety or otherwise indicating that the surety remains liable, or inferred from circumstances that indicate such intent. *Id.* In the absence of such a provision or such circumstances, the surety is discharged. *Id.* Note, however, that if the surety is not discharged by operation of Section 39(b), the release may nonetheless discharge the surety as provided in Section 39(c). *Id.*

The *Restatement of the Law, Third, Suretyship and Guaranty, §39* provides useful illustrations regarding the release of the contractor and the discharge of the surety:

> Illustration:
>
> 3. D agrees to construct a building for C for $1,000,000. S issues a performance bond for D's obligation. At the completion of construction, C refuses to pay the remaining contract balance, claiming that not all work required by the construction contract was performed. In response, D asserts that the work was performed in accordance with the contract. After negotiation, the parties agree to a compromise, pursuant

> to which D agrees to accept $50,000 less than the contract price in exchange for a release from C with respect to all obligations pursuant to the construction contract. The release of D also discharges S from its duties pursuant to the performance bond.
>
> Illustration:
>
> 4. D agrees to construct a building for C for $1,000,000. S issues a performance bond for D's obligation. Soon after starting construction, D abandons the project. Investigation reveals that D is insolvent and has essentially no assets other than equipment left at C's work site. Realizing the futility of pursuing D, C agrees to release D from its obligations pursuant to the construction contract in exchange for title to the abandoned equipment. The circumstances indicate that C intended to retain its claim against S. S is not discharged pursuant to paragraph (b) *[Restatement §39(b)]*, but is discharged to the extent provided in paragraph (c) *[Restatement §39(c)]*.

b. <u>Extension of Time</u>

According to the Restatement of the Law, Third, Surety and Guaranty, §40, Comments and Illustrations, the surety is discharged from its duties pursuant to the bond to the extent that it would otherwise suffer a loss because of the extension. Loss may result from an extension of the due date of the underlying obligation in two ways. Most often, the loss is caused by the legal effect of the extension. That is, but for the inability of the surety to enforce its rights against the contractor before the expiration of the extension, the loss would not have occurred. *See Restatement of the Law, Third, Surety and Guaranty, §40, Comments e and f.* Sometimes, the loss is caused by the motivational impact of the extension. Id. That is, but for the extension, the principal obligor would have acted in a manner that would have resulted in the principal obligor bearing the cost of performance; as a result of the extension, however, the principal obligor acted in such a manner that the cost of performance would be borne by the surety. *See Restatement of the Law, Third, Surety and Guaranty, §40, Comment g.* In either case, the surety is discharged to the extent of loss caused by the extension.

c. <u>Modification of the Contract (Underlying Obligation)</u>

According to the *Restatement of the Law, Third, Surety and Guaranty, §41, Comments and Illustrations*, a modification of the underlying obligation can cause the surety a loss by making the underlying obligation more difficult or expensive to perform, thereby increasing the likelihood that the surety will be called on to perform the secondary obligation. If the contractor is insolvent or otherwise unable to fulfill its duty of reimbursement or restitution, the surety would suffer a loss to the extent that its unreimbursed cost of performance exceeds that which would have been the case if the modification had not been made. *Id.* According the *Restatement of the Law, Third, Surety and Guaranty, §41*, the surety is discharged to the extent of that loss. *See e.g. Fidelity Deposit Company of Maryland et al. v. Olney Associates, Inc.*, 72 Md. App 367, 372, n. 2, 530 A.2d 1, 4-5 (Md. Ct. App. 1987) (citing to the *Restatement, Security, ch. 5, Section 12* (predecessor to the *Restatement of the Law, Third, Surety and Guaranty,*

(1996). In *Olney Associates, Inc.*, the Court stated "We note that where, without the surety's consent, the principal and the creditor modify their contract, otherwise than by the extension of time of payment, a compensated surety is discharged if the modifications materially increases his risk, but his obligation is reduced to the extent of the loss due to the modification." *Id.*

The *Restatement of the Law, Third, Suretyship and Guaranty, §41* provides useful illustrations regarding the modification of a contract and the discharge of the surety:

> Illustration:
>
> 1. B agrees to construct a building for O in accordance with specifications contained in the contract. S issues a performance bond to O with respect to this contract. Later, O and B agree to a modification of the contract pursuant to which a different, more complicated climate control system is to be installed in the building. The modification of the construction contract correspondingly modifies B's duties to S. Thus, B has a duty to S to perform the contract as modified or reimburse S for the cost of S's performance of its bond. (If, however, the modification imposes risks on S fundamentally different from those present originally, S will be discharged. See § 41(b)(i) and Comment d.)
>
> Illustration:
>
> 2. B agrees to construct a building for O in accordance with specifications contained in the contract. S issues a performance bond to O with respect to this contract. Later, O and B agree to a modification of the contract pursuant to which a different, more complicated climate control system is to be installed in the building **without additional compensation to B**. Later, B, who is insolvent, defaults on the contract, and S is called upon to complete construction. S is discharged to the extent that the modified climate control system adds to the costs of S not recoverable from B by S. (emphasis added).

2. Impairment of the Surety's Right of Equitable Subrogation

Court's have long recognized the surety's right of subrogation to unpaid contract balances on its bonded projects where there has been a default by the contractor, a demand by the owner, and performance by the surety pursuant to the suretyship obligation. "A surety has an equitable right of subrogation to contractor funds retained by the government when the surety pays debts of the contractor to subcontractors pursuant to a payment bond." *Int'l Fid. Ins. Co. v. United States*, 25 Cl. Ct. 469, 473 (1992) (citing *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 141-42, 83 S. Ct. 232, 9 L. Ed. 2d 190 (1962)). "Equitable subrogation is one of a surety's principal mechanisms for reducing loss." *Pennsylvania Nat'l Cas. Ins. Co. v. City of Pine Bluff*, 354 F.3d at 951 citing *Prairie State Bank v. United States*, 164 U.S. 227, 231, 17 S. Ct. 142, 41 L. Ed. 412, 32 Ct. Cl. 614 (1896) (recognizing surety's subrogation rights as "elementary");

Nobel Ins. Co. v. City of New York, 2006 U.S. Dist. LEXIS 70816 (S.D.N.Y. Sept. 29, 2006).

Equitable subrogation "is the substitution of another person in the place of the creditor to whose rights he succeeds in relation to the debt." *Federal Land Bank v. Joynes,* 179 Va. 394, 401, 18 S.E.2d 917 (1942). "One who rests on subrogation stands in the place of one whose claim he had paid, as if the payment giving rise to the subrogation claim had not been made." *United States v. Munsey Trust Co.*, 332 U.S. 234, 242, 67 S. Ct. 1599, 91 L. Ed. 2022, 2029 (1947). Upon total satisfaction of the underlying obligation, the surety is subrogated to all rights of the owner with respect to the underlying obligation to the extent that performance of the bond contributed to the satisfaction. *See Restatement of the Law, Third, Suretyship and Guaranty §27(1).* Where the surety discharges its obligation under a performance bond, under traditional equitable subrogation principals, the surety is entitled to "stand in the shoes" of the government and seek reimbursement from the principal. *Restatement of the Law, Third, Suretyship and Guaranty, §31* (recognizing the surety's subrogation right to contract balances).

The United States Supreme Court has stated the requirements for equitable subrogation as follows: "(1) that the person seeking its benefits must have paid a debt due to a third party before he can be substituted to that party's rights and (2) that in doing this he must not act as a mere volunteer, but on compulsion, to save himself from loss by reason of a superior lien or claim on the part of the person to whom he pays the debt, as in cases of sureties, prior mortgagees, etc." *Prairie State National Bank v. United States*, 164 U.S. 227, 231, 17 S. Ct. 142, 41 L. Ed. 412 (1986) *citing Aetna Insurance Co. v. Middleport*, 124 U.S. 534, 8 S. Ct. 625, 31 L. Ed. 537 (1888).

The *Restatement of the Law, Third, Suretyship and Guaranty, §29* provides a useful illustration regarding when a surety has a right of subrogation:

> Illustration:
>
> 3. P has agreed to construct a building for C. S has issued a payment bond for P's obligation to pay for labor and materials, subject to a maximum of $100,000. P is charged with notice of S's obligation. P defaults on its obligation. The total claims for labor and materials are $120,000. S pays $100,000 of these claims and asserts subrogation rights to $90,000 in contract funds remaining in C's hands. S is not entitled to subrogation because all of the claims for labor and materials have not been satisfied. If S pays the remaining $ 20,000 of claims for labor and materials, S will be entitled to subrogation to C's rights. If C applies $20,000 of the contract funds to the remaining claims, S will be subrogated to the remaining contract funds.

The *Restatement of the Law, Third, Suretyship and Guaranty, §31* provides useful illustrations regarding the surety's right of subrogation to unpaid contract funds:

Illustration:

1. B agrees to construct a building for O for $400,000. S issues a performance bond to O pursuant to which S agrees to be jointly and severally liable with B on the obligation to O. B defaults on the construction project, and S completes construction. At the time of B's default, O had paid B $100,000 in accordance with the terms of the construction contract. As "return performance," the remaining $300,000 of the contract price is security for B's underlying obligation to O and, therefore, S is subrogated to O's rights to the return performance.

Illustration:

2. B agrees to construct a building for O for $400,000. S issues a payment bond to O pursuant to which S agrees, jointly and severally with B, to discharge all claims for labor and materials in conjunction with the construction of the building. B finishes construction of the building, but defaults on its obligation to discharge claims for labor and materials; S discharges the claims. At the time of B's default, O had paid B $340,000 in accordance with the terms of the construction contract. As "return performance," the remaining $60,000 owed under the contract is security for B's underlying obligation to O to discharge the claims for labor and supplies.

Illustration:

3. Same facts as Illustration 2, except that O is owed $60,000 by B on a claim unrelated to this contract. O may not set off this $60,000 claim against the right of S, obtained through subrogation, to the $60,000 as "return performance" constituting security for the underlying obligation.

The *Restatement of the Law, Third, Suretyship and Guaranty, §37* provides useful illustrations regarding the impairment of suretyship status:

Illustration:

1. S has issued a performance bond with respect to P's contract to construct a house for O for $100,000. Pursuant to the contract between O and P, O is to pay P monthly for the portion of the work completed that month minus a 15 percent "retainage." After completing 60 percent of the project and receiving $51,000 ($60,000 minus the $9,000 retainage) from O, P defaults. S completes the project at a cost to S of $40,000. After S completes the project, O pays the $9,000 retainage to P, who, despite this payment, is insolvent. Had O paid the retainage to P before S completed the project, S would have been discharged to the extent of $9,000 by application of §38 (impairment of collateral). S has a claim against O for $9,000 because the payment to P would have discharged S from the secondary obligation to that extent.

Illustration:

2. Same facts as Illustration 1, except that the payment to P is made before S completes the project but without the knowledge of S. S has a claim against O for

> $9,000 because the payment to P would have discharged S from the secondary obligation to that extent.

3. Consent by the Surety

It is well settled law that, even though a construction contract provides that alterations may be made during the progress of the work, radical or revolutionary changes -- changes not fairly within the contemplation of the parties at the time the contract was made -- changes constituting a material departure from the original undertaking -- do not come within its terms and will therefore release a non-consenting surety upon the usual performance bond. *See Massachusetts Bonding & Ins. Co. v. John R. Thompson Co.*, 88 F.2d 825, 829 (8th Cir. 1937) *citing Equitable Surety Co. v. U.S., to Use of McMillan & Son*, 234 U.S. 448, 457, 34 S. Ct. 803, 58 L. Ed. 1394 (1914), *United States v. Freel*, 186 U.S. 309, 317, 22 S. Ct. 875, 46 L. Ed. 1177 (1902), *Maryland Casualty Co. v. Moore*, 82 F.2d 189 (1st Cir. 1936), *Salt Lake City v. Smith*, 104 F. 457 (8th Cir. 1900), and *American Bonding Co. v. United States* 167 F. 910 (9th Cir. 1909).

It is also well settled that material changes not so extensive as to constitute a departure from the original contract -- changes which are fairly within the scope of the original undertaking -- changes which may reasonably be said to have been originally contemplated by the parties as permissible alterations -- are covered by a construction contract permitting alterations, and the making of such changes does not release the surety on the ordinary performance bond. *See Massachusetts Bonding & Ins. Co. v. John R. Thompson Co.*, 88 F.2d at 829 *citing United States v. Freel*, 186 U.S. 309, 317, 22 S. Ct. 875, 46 L. Ed. 1177 (1902); *Equitable Surety Co. v. U.S., to Use of McMillan & Son*, 234 U.S. 448, 456-457, 34 S. Ct. 803, 58 L. Ed. 1394 (1914); and *United States v. Walsh*, 115 F. 697, 704, 705 (2d Cir. 1902).

There is authority to support the proposition that a surety can give advance consent to changes in the bond and the Scope of Work under the contract. The United States Court of Appeals for the Sixth Circuit enforced the following waiver clause that was contained in a bond:

> The said SURETY for value received hereby stipulates and agrees that no change, extension of time, alteration or addition to the terms of the contract or to the WORK to be performed thereunder of the SPECIFICATIONS accompanying the same shall in any way affect its obligation on this BOND, and it does hereby waive notice of any such change, extension of time, alteration or addition to the terms of this contract to the WORK or to the SPECIFICATIONS.

See McWayne, Inc. v. Fidelity & Deposit Company of Maryland, 372 F.3d 798, 804 (6th Cir. 2004) (applying Ohio law).

The *Restatement of the Law, Third, Surety and Guaranty §6* expressly states that "each rule of the Restatement stating the effect of suretyship status may be varied by contract between the parties subject to it." The *Restatement of the Law, Third, Suretyship and Guaranty, §6 - Reporter Notes* acknowledge that the existence of the parties' power to contract is usually assumed and that litigation typically relates to the terms of the parties' agreement rather than to their power to agree. The *Restatement, §6 -*

Reporter Notes further refer to the U.C.C. and state "A good parallel is provided by U.C.C. § 1-102(3) (1995), which provides that U.C.C. provisions may be varied by agreement, except as otherwise provided in [the U.C.C.] and except that the obligations of good faith, diligence, reasonableness and care prescribed by [the U.C.C.] may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable." Practitioners should assist owners in drafting their own bond forms that contain the surety's consent to subsequent modifications to the Scope of Work, Contract Time and Contract Sum.

4. Owner's Interference with Surety's Rights Under the Bond

Courts have consistently held that an owner's action that deprives a surety of its ability to protect itself pursuant to performance options granted under a performance bond constitutes a material breach, which renders the bond null and void. *See St. Paul Fire & Marine Ins. Co. v. City of Green River, Wyoming,* 93 F. Supp. 2d 1170, 1178 (D. Wyo. 2000) (City Board did properly notify St. Paul of the contractor's default but it prohibited St. Paul from exercising its contractual right to perform itself or to participate in the selection of the replacement contractor); *L&A Contracting Co. v. Southern Concrete Serv., Inc.*, 17 F.3d 106, 110-11 (5th Cir. 1994); *Balfour Beatty Constr. Inc. v. Colonial Ornamental Iron Works, Inc.*, 986 F. Supp. 82, 86 (D. Conn. 1997); *Insurance Co. v. Metropolitan Dade County*, 705 So. 2d 33, 34-35 (Fla. Dist. Ct. App. 1997); and *Dragon Constr., Inc. v. Parkway Bank & Trust*, 287 Ill. App. 3d 29, 678 N.E.2d 55, 58, 222 Ill. Dec. 648 (Ill. App. Ct. 1997) (owner's "failure to provide adequate notice of [contractor's] termination . . . stripped [surety] of its right to limit its liability and constituted a material breach of contract which rendered the surety bonds null and void."). Failure to adhere to a performance bond notification requirement is a material breach, resulting in the loss of an owner's rights under the bond. *See School Bd. of Escambia County. v. TIG Premier Ins. Co.*, 110 F. Supp. 2d 1351, 1353 (N.D. Fla. 2000).

A good example of how not to handle a performance bond claim is found in *Balfour Beatty Constr. Inc. v. Colonial Ornamental Iron Works, Inc.*, 986 F. Supp. 82 (D. Conn. 1997). In Balfour, the performance bond provided that when the owner declared a contractor's default, the surety could remedy the default, or, after reasonable notice to the surety, the owner could arrange for remedy of the default at the surety's expense. *Id.*, 986 F. Supp. at 85-86. The owner failed to notify the surety of the default, allowed the contractor to complete the work in an untimely fashion, and then it sought recovery from the surety. *Id.* Because the owner's actions "denied the [surety] the opportunity to exercise any of its options under the performance bond," the owner could not recover under the performance bond. *Id.*

II. Letters of credit.

A. General Overview and Relationship of the Parties.

A letter of credit is a definite undertaking by an issuer to a beneficiary at the request of or for the account of an applicant to honor a documentary presentation by payment or delivery of an item of value. U.C.C. §5-102(10), UCP 600 Article 2 – definition of credit).

Letters of credit generally are of two types. Commercial letters of credit are used to facilitate a commercial transaction and the credit of the bank is substituted for the credit of the buyer in the sale of a commodity. In this type of transaction, the issuing bank pays money against presentment of a draft that is accompanied by invoices and other documents. With commercial letters of credit the issuer Bank expects to pay and pays the money when the transaction goes well and is completed.

The second type of letter of credit, and the letter of credit you will most likely encounter as a municipality, is a standby letter of credit. Standby letters of credit are used in a variety of situations as a guarantee that a customer will perform an underlying financial obligation to a third-party. In a municipal context, the letter of credit is often provided in lieu of a surety bond on construction projects or to insure performance of other financial obligations. With a standby letter of credit the issuer Bank does not expect to pay and is only called upon to pay if the transaction is in default.

With a standby letter of credit the applicant is usually a contractor or vendor in a municipal contract, the issuer is the bank or financial institution and the beneficiary is the local government unit. UCP Article 2, Definitions; U.C.C §5-102(2), (3), and (9). In a letter of credit transaction, there are three separate commitments which come into play. *See e.g. Southern Energy Homes, Inc. v. AmSouth Bank of Alabama*, 709 So. 2d 1180, 1185 (1998). First, there is the customer/applicant-bank contract or agreement, binding the bank to issue a letter of credit in exchange for the right of reimbursement upon payment of a draft. *Id.* Second, there is a contract between the customer/applicant and the beneficiary that the letter of credit is intended to facilitate, and thirdly, the letter of credit itself binds the bank to honor drafts drawn by the beneficiary if the documents are in order. *Id.*

The issuer of a standby letter of credit is deemed to be primarily liable but will only be required to make payment if the customer/applicant defaults on its obligation to the beneficiary. *See Consolidated Aluminum Corp. v. Bank of Virginia*, 544 F. Supp. 386, 394 (D. Md. 1982). The letter of credit is not usually considered a contract between the issuer and the beneficiary as there is no signed written agreement or consideration for the promise to pay, only the obligation to honor its commitment in the letter of credit if a draft is presented with the appropriate documents. Article 5 of the U.C.C. and the UCP 600 imposes the duty on the issuer to honor the letter of credit therefore establishing the legal relationship between the issuer and the beneficiary.

Although the terms of a standby letter of credit can vary, virtually all standby letters of credit are irrevocable, unless specifically stated otherwise, and payable upon presentation of a sight draft and certification of default. UCP 600 Article 3, Interpretations and Article 7, Issuing Bank Undertaking; U.C.C. §5-106(a). If the sight draft and the certification comply with the requirements of the letter of credit, then the beneficiary has an unqualified right to demand payment and the issuer has an unqualified obligation to make payment. U.C.C. §5-108(a).

B. Interpretation of Letters of Credit.

Execution on letters of credit is controlled by the independence principle that dictates that the issuer must honor drafts irrespective of any dispute between the customer/applicant and the beneficiary. Courts have generally held that the relationship between the issuing bank and the beneficiary is an independent relationship and the court should not look beyond this independent contract into the contract between the applicant and the beneficiary to resolve any issues between other parties. *Southern Energy Homes, Inc. v. AmSouth Bank of Alabama, et al.*, 709 So 2d 1180, 1185 (Ala. 1998); U.C.C. §5-103(d). The independence principal together with the requirement for strict compliance with the terms and conditions of the letter of credit, make the issuing bank's obligation "ministerial." *Id.* Under these circumstances, the banks sole obligation is to determine if the documents on their face strictly comply with the terms and conditions of the letter of credit and the bank's liability is defined within the four corners of the document. *Id.* The bank need not exercise any discretion when determining whether or not there has been compliance with the terms and conditions of the letter of credit. U.C.C. §5-108, *Consolidated Aluminum Corporation v. Bank of Virginia*, 544 F. Supp. 386, 395 (D. Md. 1982).

A majority of jurisdictions follow the strict compliance rule rather than the substantial compliance. This principal requires strict compliance with all terms and conditions of the letter of credit before the issuer/bank must pay on the letter of credit. *See American National Bank v. Cashman Marine Contacting,* 550 So. 2d 98, 101 (Fla. App. 1989) for a discussion of the jurisdictional split on this issue. Strict Compliance is preferred so the bank knows the precise nature of its obligation and can look within the four corners of the letter of credit to define its obligations and risk. This interpretation is supported by the UCP and most state's U.C.C. as well. UCP Article 2, Definitions and Article 7, Issuing Bank Undertaking; U.C.C. §5-108. The Fourth Circuit has concluded that the UCP also supports a strict compliance interpretation of letters of credit. *Courtaulds North America, Inc. v. North Carolina Nat'l Bank*, 528 F.2d 802 (4th Cir. 1975).

The U.C.C. authorizes letters of credit to be controlled by other agreements and/or with reference to other documentation. The U.C.C. specifically authorizes agreements or documents to be varied by agreement. U.C.C. §1-102(3) and §5-103(c). Most letters of credit are controlled by the International Chamber of Commerce Uniform Customs and Practice for Documentary Credits. The UCP was recently revised and the 2007 revision, known as the UCP 600, is available. The UCP is an international uniform set of

definitions and practice for letters of credit. Letters of credit may be controlled by the UCP, but in the event there no controlling provision in the UCP, each state's U.C.C. provision will control. The web site to order the latest revision of the UCP is www.ICCbooks.com.

Defenses to a letter of credit by the applicant are limited. Because the relationship between the issuing bank and the beneficiary is independent of the underlying contract, any dispute about performance or default is not a defense that prevents the payment of a letter of credit if the documents are properly presented prior to the expiration date of the letter of credit. The independence rule is supported by the UCP and the U.C.C. and is virtually accepted by all jurisdictions. The applicant's remedy would be against the municipality once the municipality has the money in hand after exercising their rights under the letter of credit.

The U.C.C. in some states and some courts have recognized a fraud exception to the execution on a letter of credit where the applicant can prove that there was fraud in the underlying transaction and there was no adequate remedy at law. *See Itek Corp. v. First Nat'l Bank*, 730 F.2d 19 (1984); *Southern Energy Homes, Inc. v. AmSouth Bank of Alabama, et al.*, 709 So. 2d 1180, 1183 (1998); U.C.C. §5-109). The fraud exception will allow the applicant to obtain an injunction to prevent payment. Only in limited cases can the issuer deny payment when the terms of the letter of credit are strictly complied with. The *Itek* case involved a complex transaction with the country of Iran in 1979 and the international political situation played a significant role in the decision. The discussion has been questioned and narrowed by subsequent decisions and commentators.

In *Foxboro Co. v. Arabian American Oil Co.*, 805 F.2d 34, 41 (1986), the court held that any injunction to prevent the payment of a letter of credit was not appropriate where the issue was the payment of money and that there was an adequate remedy at law available when the payment of money is at stake. Most commentators on letters of credit agrees that fraud claims should not become surrogates for breach of contract claims. In most cases, the real issue is the underlying contract dispute. *Southern Energy Homes, Inc. v. AmSouth Bank of Alabama, et al.*, 709 So.2d 1180 (1998). Some states may authorize a court to enjoin payment of a letter of credit if payment would facilitate a material fraud. *See California Commercial Code*, § 5-109(b). The UCP does not contain a fraud exception and courts will look to state law and the U.C.C. for guidance on this issue.

C. Practice Pointers

The expiration date in a letter of credit is the critical term or condition of a letter of credit and must be complied with. The majority of authorities indicate that there is no reasonable diligence rule or mailbox rule applicable to letters of credit so execution and presentation of the draft and documents must occur before the expiration date. *Consolidated Aluminum Corporation v. Bank of Virginia*, 544 F. Supp. 386, 393 (1982); UCP Article 6. Because the certainty of the letter of credit to the beneficiary and the issuer is vital, the letter of credit must be presented to and received by the issuer by the

expiration date. Always make sure that there is sufficient time between delivery and the expiration date to correct any errors in the documentation or deficiencies in delivery. Issuers are required to notify you within a few days of any defects in the documents. You need to leave enough time to correct any deficiencies. Letters of credit expire, unless stated otherwise in the letter of credit, one year after its stated date of issuance or if no date if issuance is stated then one year after it is issued. If the letter of credit states that it is perpetual, it will expire five years after its stated date of issuance. U.C.C, §5-106(c), (d).

Letters of credit should clearly indicate the choice of law, jurisdiction and venue obligations of the parties. The municipality will normally require in its RFP or in its form letter of credit that the issuing bank must be authorized to do business in the municipality's state and that the issuing bank will be required to submit to the municipality's jurisdiction and venue for resolution of any dispute. If there is no provision in the documents, the liability of a party is governed by the law of the state where the person is located. It is imperative that you specify dictate the choice of law in the letter of credit to prevent the possibility of having to enforce the letter of credit according to laws of another state. U.C.C. §5-116.

The literature indicates that 50% to 70% of initial presentations of documents to execute on a letter of credit fail. In light of the strict compliance requirements, you should make sure that you have the correct documents and the proper form of sight draft and the certification of default. Some banks have a preferred form of the sight draft and the certification of default. A generic form of a sight draft and certificate of default is attached to the materials. Always contact the bank to discuss the form and format of the letter of credit and certificate of default, preferred delivery method and to whom the document should be delivered.

The issue of minimum contacts and jurisdiction will give rise to disputes as well, and the authorities are split on the issue of whether a foreign bank that issues or confirms a letter of credit for the benefit of a resident of a state subjects themselves to jurisdiction. *See RZS Holdings, AVV v. Commerzbank, AG*, 279 F. Supp. 2d 716, 719 (2003) for a general discussion of this issue.

It is imperative that the municipality control the terms and conditions of the letter of credit to insure that the issuing bank has submitted to the jurisdiction of the municipality. The municipality must also be able to strictly comply with the terms and conditions of the letter of credit in the event it must execute on the letter of credit. Always verify that the precise language used in the letter of credit is then used in the sight draft and certification of default. Further, having the proper party sign the sight draft and certification of default is also important. Unless specifically required under a letter of credit, delivery by an overnight delivery service is probably the best choice, or if the issuing bank is local, personal delivery to the proper person is a better option.

PERFORMANCE/LABOR & MATERIAL BOND
CHECK LIST

1) _____ The surety company issuing the bond must be qualified to do business in the State of Maryland. This information may be verified in the Treasury Department Circular 570 (www.fms.treas.gov/c570), or by calling the Recording Department of the Clerk of the Court at 240-777-9470.

2) _____ The Attorney-in-Fact on the bond must be properly authorized to bind the surety as of the date of the bond. This authorization may be documented by a Power of Attorney submitted with the bond, or the Attorney-in-Fact must be registered with the Circuit Court for Montgomery County, Maryland. This information may be verified by calling the Recording Department of the Clerk of the Court at 240-777-9470.

Contact Person:_____ Date:_____

3) _____ The obligee of the bond must be "Montgomery County, Maryland."

4) _____ The bond's choice of law provision must be the State of Maryland and the choice of venue provision must be Montgomery County, Maryland.

5) _____ The correct names and addresses for the parties must be shown clearly on the bond.

6) _____ The bonds must be properly signed by a corporate officer, and corporate seal applied, delivered, and witnessed.

7) _____ The date on the bond must be left blank. It will be filled in by the Office of Procurement staff upon execution of the contract.

8) _____ Verify that the Power of Attorney's dollar signature authority is at least equal to or more than the bond amount, that the Power of Attorney is for the same company that issued the bond, and that the Power of Attorney is attached to the bond.

9) _____ Check for expiration dates of the bond, if any. Make sure that a Performance Bond runs through the term of the contract or maybe renewed annually. Make sure that a bid bond is sufficient to meet the requirements of the solicitation and that it covers the time between opening of bid to award of the contract.

10) _____ Confirm that the written and numerical dollar values are correct and are consistent with the value of the contract.

11) _____ Make sure that separate forms are used for Labor and Material Bonds and Performance Bonds.

12) _____ Refer all questionable bonds/powers of attorney to the Office of the County Attorney.

FOR PERFORMANCE BONDS ONLY

13) _____ Check procedural requirements for surety to remedy contractor's default. (If the condition for the surety's obligation is anything other than "contractor's breach of any terms of the contract" or words to that effect, refer the bond to the Office of the County Attorney.

14) _____ Make sure Performance Bond requires surety to be bound by <u>all</u> terms and conditions of contractor performance, including time to complete, liquidated damages, warranties, and other clauses that protect the County's interests (it is not sufficient that the surety is bound to "complete the project").

_____ _____
Procurement Specialist Date

PERFORMANCE BOND
(95% of the Contract Sum)

_____, as surety ("Surety"), and _____, as principal ("Contractor"), enter into and execute this bond ("Performance Bond"), and bind themselves in favor of the Montgomery County Government, as obligee ("Owner"), in the initial amount of $_____(ninety-five percent (95%) of the Contract Sum or such greater amount as the Contract Sum may be adjusted to from time to time in accordance with the Contract between the Contractor and Owner) (the "Penal Sum").

WHEREAS, the Contractor has executed a contract with the Owner dated _____ (the "Contract") for construction of the XXXXXXXXXXX XXXXXXXXX XXXXXX Project in Montgomery County, Maryland (the "Project") and,

WHEREAS, the Owner has required the Contractor to furnish this Performance Bond as a condition to executing the Contract with the Contractor;

NOW THEREFORE, the Surety and the Contractor, both jointly and severally, and for themselves, their heirs, administrators, executors, successors and assigns agree:

1. **CONTRACT INCORPORATED; SURETY AND CONTRACTOR BOUND FOR FULL PERFORMANCE.** The Contract is incorporated by reference and made a part of this bond. The Surety and the Contractor are bound for the full performance of the Contract including without exception all of the Contract Documents (as defined in the Contract) and all of their terms and conditions, both express and implied.

2. **OWNER'S AFFIDAVIT OF CONTRACTOR BREACH OR DEFAULT.** If the Owner shall provide to Surety the written affidavit of the Owner stating that the Contractor is in breach or default of the Contract, and that such breach or default remains uncured by the Contractor, then upon delivery of such affidavit to the Surety in the method for providing notices as set forth in Paragraph 7 below, Surety must promptly notify the Owner in writing which action it will take as permitted in Paragraph 3.

3. **SURETY'S OBLIGATION UPON DELIVERY OF OWNER'S AFFIDAVIT OF CONTRACOR'S BREACH OR DEFAULT.** Upon the delivery of the Owner's affidavit of breach or default by the Contractor as provided in Paragraph 2 above, the Surety may promptly remedy the breach or default or must, within ten (10) days, proceed to take one of the following courses of action:

a. **Proceed Itself.** Complete performance of the Contract including correction of defective and nonconforming Work through its own contractors or employees, approved as being acceptable to the Owner, in the Owner's sole discretion, provided, however, that Owner's discretion to approve Surety's contractor will not be unreasonably withheld as to any contractor who would have qualified to offer a proposal on the Contract and is not affiliated (as defined in the General Conditions of Contract) with the Contractor. During this performance by the Surety the Owner will pay the Surety from its own funds only those sums as would have been due and payable to the Contractor under the Contract as and when they would have been due and payable to the Contractor in the absence of the breach or default not to exceed the amount of the remaining Contract balance less any sums due the Owner under the Contract. During this performance Surety's payment bond must remain in full force and effect; or

b. **Tender a completing contractor acceptable to Owner.** Tender a contractor, approved as being acceptable to the Owner (in the Owner's sole discretion), together with a contract for fulfillment and completion of the Contract executed by the completing contractor, to the Owner for the Owner's execution. Owner's discretion to approve Surety's completing contractor will not be unreasonably withheld as to any contractor who would have qualified to offer a proposal on the Contract and is not affiliated (as defined in the General Conditions of Contract) with the Contractor. Owner's discretion to approve Contractor as the completing contractor, however, shall be in Owner's sole subjective discretion. Upon execution by the Owner of the contract for fulfillment and completion of the Contract, the completing contractor must furnish to the Owner a performance bond and a separate payment bond, each in the form of those bonds previously furnished to the Owner for the Project by the Contractor. Each such bond must be in the Penal Sum of the full cost to complete the Contract. The Owner will pay the completing contractor from its own funds only those sums as would have been due and payable to the Contractor under the Contract as and when they would have been due and payable to the Contractor in the absence of the breach or default not to exceed the amount of the remaining Contract balance less any sums due the Owner under the Contract. To the extent that the Owner is obligated to pay the completing contractor sums which would not have then been due and payable to the Contractor under the Contract (any sums in excess of the then remaining Contract balance less any sums due the Owner under the Contract), the

Surety must pay to the Owner the full amount of those sums at the time the completing Contractor is tendered to the Owner so that the Owner can utilize those sums in making timely payment to the completing contractor; or

c. **Tender the Full Penal Sum.** Tender to the Owner the full Penal Sum of the surety bond. The Owner will refund to the Surety without interest any unused portion not spent by the Owner procuring and paying a completing contractor or completing the construction contract itself, plus the cost allowed under Section 4, after completion of the contract for fulfillment and completion of the Contract and the expiration of any applicable warranties; or

d. **Other Acts.** Take any other acts mutually agreed upon in writing by the Owner and the Surety.

e. IT SHALL BE NO DEFENSE TO SURETY'S OBLIGATION TO UNDERTAKE ONE OF THE PRECEDING COURSES OF ACTION THAT THE CONTRACTOR CONTENDS THAT IT IS NOT IN BREACH OR DEFAULT OF THE CONTRACT, OR THAT THE NOTICE OF BREACH OR DEFAULT WAS DEFECTIVE, OR THAT THE CONTRACTOR HAS RAISED ANY OTHER CLAIM OF DEFENSE OR OFFSET, PROVIDED ONLY THAT SURETY HAS RECEIVED THE AFFIDAVIT OF THE OWNER AS SPECIFIED IN PARAGRAPH 2.

4. **SURETY'S ADDITIONAL OBLIGATIONS.** In addition to those duties set forth herein above, the Surety must promptly pay the Owner (i) all losses, costs and expenses resulting from the Contractor's breach(es) or default(s), including, without limitation, fees, expenses and costs for architects, engineers, consultants, testing, surveying and attorneys, plus (ii) liquidated or actual damages, whichever may be provided for in the contract, for lost use of the Project, plus (iii) reprocurement costs and fees and expenses, plus (iv) costs incurred at the direction, request, or as a result of the acts or omissions of the Surety; provided that in no event shall Surety's liability exceed the Penal Sum of this Bond.

5. **SURETY'S WAIVER OF NOTICE.** The Surety waives notice of any Modifications to the Contract, including changes in the Contract Time, the Contract Sum, the amount of liquidated damages, or the Work to be performed.

6. **NO THIRD PARTY BENEFICIARIES.** The Surety provides this Performance Bond for the sole and exclusive benefit of the Owner and, if applicable, any dual obligee designated by attached rider, together with

their heirs, administrators, executors, successors and assigns. No other party, person or entity has any rights against the Surety.

7. **METHOD OF NOTICE.** All notices to the Surety, the Contractor or the Owner must be given by Certified Mail, Return Receipt Requested, to the address set forth for each party below:

SURETY:

Name: _____
Attention: _____
Street: _____
City, State, Zip _____

CONTRACTOR:

Name: _____
Attention: _____
Street: _____
City, State, Zip _____

OWNER:

Montgomery County Government
Bruce Johnston, Chief, Division of Capital Development
101 Monroe Street, 9th Floor
Rockville, Maryland 20850

with a copy to:

Office of the County Attorney
John Markovs, Associate County Attorney
101 Monroe Street, Third Floor
Rockville, Maryland 20850

8. **STATUTE OF LIMITATIONS.** Any statutory limitation, which may be contractually superseded, to the contrary notwithstanding, any action hereon may be instituted so long as the applicable statute of limitations governing the Contract (including any warranty period) has not run or expired or within three (3) years following Final Completion of the Contract (including any warranty period) and acceptance of the Work performed under the Contract by the Owner, whichever is longer.

9. **RECITALS.** The recitals contained in this Performance Bond are incorporated by reference herein and are expressly made a part of this Performance Bond.

10. **GOVERNING LAW.** This Performance Bond shall be governed by, and construed in accordance with the laws of the State of Maryland without regard to its conflict of laws provisions.

11. **VENUE.** In the event any legal action shall be filed upon this Performance Bond, venue shall lie exclusively in the Circuit Court for Montgomery County, Maryland.

Contractor	**Surety**
_____	_____
(Typed Firm Name)	(Typed Firm Name)
_____	_____
(Seal)	(Seal)
By:	By:
_____	_____
(Signature)	(Signature)
_____	_____
(Printed Name)	(Printed Name)
_____	_____
(Title)	(Title)
_____	_____
_____	_____
(Address)	(Address)
_____	_____
(Date of Execution)	(Date of Execution)

END OF DOCUMENT

PAYMENT BOND

(95% of the Contract Sum)

_____, as surety ("Surety"), and _____, as principal ("Contractor"), enter into and execute this bond ("Payment Bond"), and bind themselves in favor of, the Montgomery County Government, as obligee ("Owner") in the initial amount of $_____ (ninety-five percent (95%) of the Contract Sum or such greater amount as the Contract Sum may be adjusted to from time to time in accordance with the Contract between Contractor and Owner) (the "Penal Sum").

WHEREAS, the Contractor has executed a contract with the Owner dated _____ (the "Contract") for construction of the XXXXXXXXXX XXXXXXXXX XXXXXX Project in Montgomery County, Maryland (the "Project") and,

WHEREAS, the Owner has required the Contractor to furnish this Payment Bond containing the terms and conditions set forth herein as a condition to executing the Contract with the Contractor;

NOW THEREFORE, the Surety and the Contractor, both jointly and severally, and for themselves, their heirs, administrators, executors, successors and assigns agree:

1. The Contract is incorporated by reference and made a part of this Agreement. The Surety and the Contractor are bound for the full performance of the Contract including without exception all of the Contract Documents (as defined in the Contract) and all of their terms and conditions, both express and implied, and, without limitation, specifically including Contractor's obligation to pay for labor, materials, services and equipment provided in connection with the Contract performance;

2. For purposes of this Payment Bond, Beneficiary is defined as a person or entity who has actually provided labor, material, equipment, services or other items for use in furtherance of the Contract, labor and material being construed to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment directly applicable to the Contract and having:

a. a direct contract with the Contractor; or

b. a direct contract with a subcontractor or sub-subcontractor of the Contractor; or

c. rights, under the laws applicable in Montgomery County, Maryland, to file a lien, a claim or notice of lien, or otherwise make a claim against the Project, the Site, or against funds held by the Owner, if the Project is, or were, subject to such filing.

3. The Surety is not obligated hereunder to a Beneficiary other than a Beneficiary having a direct contract with the Contractor unless such Beneficiary has given written notice of its claim to the Contractor and the Surety within the longer of:

a. ninety (90) days after such Beneficiary provided labor, material, equipment, services or other items for use in furtherance of the Contract; or,

b. the period of time under the laws applicable in Montgomery County, Maryland for (1) filing of a lien, claim of lien, or notice of lien, if the Project is, or were, subject to such filing, or (2) otherwise making a claim against the Project or against funds held by the Owner; stating the amount claimed and identifying, by name and address, the person or entity to whom such labor, material, equipment, services or other items were provided.

4. In no event is the Surety obligated hereunder for sums in excess of the Penal Sum.

5. Upon receipt of a claim from a Beneficiary hereunder, the Surety must promptly, and in no event later than thirty (30) days after receipt of such claim, respond to such claim in writing (furnishing a copy of such response to the Owner) by:

a. making payment of all sums not in dispute; and,

b. stating the basis for disputing any sums not paid.

6. No action shall be commenced by a Beneficiary hereunder after the passage of the longer of one (1) year following final completion of the Contract (including any warranty period) and acceptance of the Work performed under the Contract by the Owner or any limitation period provided under the laws applicable in Montgomery County, Maryland.

7. The Surety waives notice of any Modifications to the Contract, including changes in the Contract Time, the Contract Sum, the amount of liquidated damages, or the Work to be performed.

8. All notices to the Surety, the Contractor or the Owner must be given by Certified Mail, Return Receipt Requested, to the address set forth for each party below:

SURETY:

Name: _____
Attention: _____
Street: _____
City, State, Zip _____

CONTRACTOR:

Name: _____
Attention: _____
Street: _____
City, State, Zip _____

OWNER:

Montgomery County Government
Bruce Johnston, Chief, Division of Capital Development
101 Monroe Street, 9th Floor
Rockville, Maryland 20850

with a copy to:

Office of the County Attorney
John Markovs, Associate County Attorney
101 Monroe Street, Third Floor
Rockville, Maryland 20850

9. The recitals contained in this Payment Bond are incorporated by reference herein and are expressly made a part of this Payment Bond.

10. This Payment Bond shall be governed by, and construed in accordance with the laws of the State of Maryland without regard to its conflict of laws provisions.

11. In the event any legal action shall be filed upon this Payment Bond, venue shall lie exclusively in the Circuit Court for Montgomery County, Maryland.

Contractor	**Surety**
(Typed Firm Name)	(Typed Firm Name)
(Seal)	(Seal)
By:	By:
(Signature)	(Signature)
(Printed Name)	(Printed Name)
(Title)	(Title)
(Address)	(Address)
(Date of Execution)	(Date of Execution)

END OF DOCUMENT

LETTER OF CREDIT
CHECK LIST

1) _____ The issuer/bank issuing the letter of credit must be qualified to do business in the State of Maryland. This information may be verified through the Maryland State Department of Assessment and Taxation.

2) _____ The letter of credit should have a date of issue or effective date on its face.

3) _____ The beneficiary of the letter of credit is "Montgomery County, Maryland."

4) _____ The correct names and addresses for the parties must be shown clearly on the letter of credit and indicate where the certification of default and sight draft should be sent in the event of default.

5) _____ The letter of credit must be properly signed by a corporate officer, and corporate seal applied, delivered, and witnessed.

6) _____ The expiration date must be filed in and must be beyond the final completion and acceptance date of the contract.

7) _____ Make sure that the issuer has submitted to jurisdiction and venue in State of Maryland and Montgomery County and to the contract dispute resolution process.

8) _____ Make sure that a letter of credit amount is sufficient to meet the requirements of the solicitation.

9) _____ Confirm that the written and numerical dollar values are correct and are consistent with the value of the contract.

10) _____ Make sure the letter of credit is irrevocable.

11) _____ Make sure that there is a form sight draft and certification of default from the issuer.

12) _____ For questionable letters of credit. Refer the letter of credit to the office of the County Attorney.

13) _____ Check procedural requirements for letter of credit to remedy contractor's default. (If the condition for the issuer's obligation is anything other than "contractor's default of any terms of the contract" or words to that effect, refer the bond to the Office of the County Attorney.

14) _____ The County must have the original letter of credit.

15) _____ The letter of credit must be subject to the ICC Uniform Customs and Practice for Documentary Credits, 2007 Revision.

_____ _____
Procurement Specialist Date

PMMD-94 Rev 12/04

<<Date>>

BENEFICIARY:
MONTGOMERY COUNTY, MARYLAND
C/O CHIEF DIVISION OF TREASURY
255 ROCKVILLE PIKE
ROCKVILLE MD 20850

APPLICANT:
<<Company Name>>
<<Address>>
<<City, State, Zip Code>>

IRREVOCABLE LETTER OF CREDIT

STANDBY LETTER OF CREDIT NO: <<00000>>

CURRENCY/AMOUNT USD – << xxxxxxxxxx >> Dollars <<($00,000.00)>>

ISSUE DATE: <<xxxxxx, xxxx>>
EXPIRATION DATE: <<xxxxxx, xxxx>>

WE, <<Bank Name,>> A FEDERALLY INSURED BANK, HEREBY ESTABLISH OUR IRREVOCABLE LETTER OF CREDIT IN FAVOR OF MONTGOMERY COUNTY, MARYLAND, (BENEFICARY) FOR THE "ACCOUNT PARTY" OF <<Company Name>>.

WE ARE INFORMED THAT THIS IRREVOCABLE LETTER OF CREDIT IS ISSUED TO SECURE PERFORMANCE BY THE ACCOUNT PARTY OF ITS OBLIGATION UNDER SECTION C, NO. 35 OF THE AGREEMENT BETWEEN THE ACCOUNT PARTY AND THE BENEFICARY DATED <<xxxxxx, xxxx>>.

WE AUTHORIZE THE BENEFICIARY TO DRAW ON THE ISSUER UP TO AN AGGREGATE AMOUNT OF <<xxxxx xxxxx>> UNITED STATES DOLLARS (U.S. <<$00,000.00>>).

THIS IRREVOCABLE LETTER OF CREDIT IS NOT TRANSFERABLE.

THIS IS AN INTEGRAL PART OF L/C NO. <<0000>>.

EACH DRAFT MUST STATE THAT IT IS DRAWN ON IRREVOCABLE LETTER OF CREDIT NUMBER <<0000>> AND BE ACCOMPANIED BY A WRITTEN STATEMENT THAT (1) THE ACCOUNT PARTY HAS NOT PERFORMED ONE OR MORE OF ITS OBLIGATIONS UNDER SECTION C, NO. 35 OF THE AGREEMENT BETWEEN MONTGOMERY COUNTY AND <<COMPANY NAME>>, AS SUCH AGREEMENT MAY BE AMENDED FROM TIME TO TIME.

THE AMOUNT OF EACH SUCH DRAFT MUST BE ENDORSED ON THIS IRREVOCABLE LETTER OF CREDIT. THIS IRREVOCABLE LETTER OF CREDIT MUST BE ATTACHED TO THE DRAFT WHEN THE CREDIT AVAILABLE HEREUNDER IS EXHAUSTED.

WE ARE AUTHORIZED TO ACCEPT ANY STATEMENT FURNISHED HEREEUNDER AS BINDING AND CORRECT WITHOUT INVESTIGATION OR RESPONSIBILTY FOR THE ACCURACY, VERACITY, AND CONCLUSIVENESS OF VALIDITY OF SAME OR A PART THEREOF.

THIS IRREVOCABLE LETTER OF CREDIT IS EFFECTIVE AS OF <<INSERT DATE>>.

THIS IRREVOCABLE LETTER OF CREDIT IS VALID FOR A PERIOD OF ONE YEAR AND SHALL BE AUTOMATICALLY EXTENDED FOR SUCCESSIVE ONE YEAR PERIODS, UNLESS WE NOTIFY YOU AT LEAST NINETY (90) DAYS PRIOR TO THAT DATE IN WRITING BY REGISTERED MAIL TO THE DIRECTOR OF PROCUREMENT, 255 ROCKVILLE PIKE, ROCKVILLE CENTER, SUITE 180, ROCKVILLE, MARYLAND AND A COPY TO THE COUNTY ATTORNEY, 101 MONROE STREET, ROCKVILLE, MARYLAND, 20850, THAT WE ELECT NOT TO RENEW THIS LETTER OF CREDIT.

WE HEREBY AGREE THAT DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS AND CONDITIONS OF THIS IRREVOCABLE LETTER OF CREDIT WILL BE HONORED UPON PRESENTATION TO THE ISSUER.

IF ANY ACTION OR PROCEEDINGS INITIATED IN CONNECTION WITH THIS IRREVOCABLE LETTER OF CREDIT, AND/OR ANY AMOUNT OR OBLIGATIONS ARISING HEREUNDER, THE VENUE SHALL BE MONTGOMERY COUNTY, STATE OF MARYLAND.

THIS IRREVOCABLE LETTER OF CREDIT IS SUBJECT TO AND SHALL BE GOVERNED BY THE LAWS OF THE STATE OF MARYLAND AND COMPLIES WITH MARYLAND CODE ANN., COMMERICAL LAW ART., SECTIONS 5-101 et seq.

_____ _____

(AUTHORIZED SIGNATURE) (DATE)

_____

(PRINT NAME)

_____

(TITLE)

THIS CREDIT IS SUBJECT TO THE "UNIFORM CUSTOMS AND PRACTICES FOR COMMERCIAL DOCUMENTARY CREDITS" PROMULGATED BY THE XIII CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE (INTERNATIONAL CHAMBER OF COMMERCE BROCHURE NO. 600, 2007 REVISION).

MERCANTILE POTOMAC VALLEY BANK

March 8, 2004

BENEFICIARY:
MONTGOMERY COUNTY, MARYLAND
C/O CHIEF DIVISION OF TREASURY
255 ROCKVILLE PIKE
ROCKVILLE MD 20850

APPLICANT:
[redacted]
14815 DOVER ROAD
ROCKVILLE, MD 20850

IRREVOCABLE LETTER OF CREDIT

STANDBY LETTER OF CREDIT NO: 497

CURRENCY/AMOUNT USD – [redacted]

ISSUE DATE: [redacted]
EXPIRATION DATE: [redacted]

WE, [redacted], A FEDERALLY INSURED BANK, HEREBY ESTABLISH OUR IRREVOCABLE LETTER OF CREDIT IN FAVOR OF MONTGOMERY COUNTY, MARYLAND, (BENEFICARY) FOR THE "ACCOUNT PARTY" OF [redacted].

WE ARE INFORMED THAT THIS IRREVOCABLE LETTER OF CREDIT IS ISSUED TO SECURE PERFORMANCE BY THE ACCOUNT PARTY OF ITS OBLIGATION UNDER SECTION B, NO. 1 OF THE AGREEMENT BETWEEN THE ACCOUNT PARTY AND THE BENEFICARY DATED [redacted]

EACH DRAFT MUST STATE THAT IT IS DRAWN ON IRREVOCABLE LETTER OF CREDIT NUMBER [redacted] AND BE ACCOMPANIED BY A WRITTEN STATEMENT THAT (1) THE ACCOUNT PARTY HAS NOT PERFORMED ONE OR MORE OF ITS OBLIGATIONS UNDER SECTION B, NO.1 OF THE AGREEMENT BETWEEN MONTGOMERY COUNTY AND [redacted], AS SUCH AGREEMENT MAY BE AMENDED FROM TIME TO TIME.

THE AMOUNT OF EACH SUCH DRAFT MUST BE ENDORSED ON THIS IRREVOCABLE LETTER OF CREDIT. THIS IRREVOCABLE LETTER OF CREDIT MUST BE ATTACHED TO THE DRAFT WHEN THE CREDIT AVAILABLE HEREUNDER IS EXHAUSTED.

WE ARE AUTHORIZED TO ACCEPT ANY STATEMENT FURNISHED HEREUNDER AS BINDING AND CORRECT WITHOUT INVESTIGATION OR RESPONSIBILTY FOR THE ACCURACY, VERACITY, AND CONCLUSIVENESS OF VALIDITY OF SAME OR A PART THEREOF.

THIS IRREVOCABLE LETTER OF CREDIT IS EFFECTIVE AS OF [redacted].

THIS IRREVOCABLE LETTER OF CREDIT IS VALID FOR A PERIOD OF ONE YEAR AND SHALL BE AUTOMATICALLY EXTENDED FOR SUCCESSIVE ONE YEAR PERIODS, UNLESS WE NOTIFY YOU AT LEAST NINETY (90) DAYS PRIOR TO THAT DATE IN WRITING BY REGISTERED MAIL TO THE DIRECTOR OF PROCUREMENT, 255 ROCKVILLE PIKE, ROCKVILLE CENTER, SUITE 180, ROCKVILLE, MARYLAND AND A COPY TO THE COUNTY ATTORNEY, 101 MONROE STREET, ROCKVILLE, MARYLAND, 20850, THAT WE ELECT NOT TO RENEW THIS LETTER OF CREDIT.

702 Russell Avenue ▪ Gaithersburg ▪ Maryland 20877 ▪ 301.963.7600 ▪ www.potomacvalleybankmd.com
Affiliate Mercantile Bankshares Corporation ▪ Member FDIC ▪ Equal Housing Lender

MERCANTILE POTOMAC VALLEY BANK

WE HEREBY AGREE THAT DRAFTS DRAWN UNDER AND IN COMPLIANCE WITH THE TERMS AND CONDITIONS OF THIS IRREVOCABLE LETTER OF CREDIT WILL BE HONORED UPON PRESENTATION TO THE ISSUER.

IF ANY ACTION OR PROCEEDINGS INITIATED IN CONNECTION WITH THIS IRREVOCABLE LETTER OF CREDIT, AND/OR ANY AMOUNT OR OBLIGATIONS ARISING HEREUNDER, THE VENUE SHALL BE MONTGOMERY COUNTY, STATE OF MARYLAND.

THIS IRREVOCABLE LETTER OF CREDIT IS SUBJECT TO AND SHALL BE GOVERNED BY THE LAWS OF THE STATE OF MARYLAND AND COMPLIES WITH MARYLAND CODE ANN., COMMERICAL LAW ART., SECTIONS 5-101 et seq.

(AUTHORIZED SIGNATURE) (DATE)

(PRINT NAME)

SENIOR VICE PRESIDENT
(TITLE)

THIS CREDIT IS SUBJECT TO THE "UNIFORM CUSTOMS AND PRACTICES FOR COMMERCIAL DOCUMENTARY CREDITS" PROMULGATED BY THE XIII CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE (INTERNATIONAL CHAMBER OF COMMERCE BROCHURE NO. 500, 1993 REVISION).

702 Russell Avenue ▪ Gaithersburg ▪ Maryland 20877 ▪ 301.963.7600 ▪ www.potomacvalleybankmd.com
Affiliate Mercantile Bankshares Corporation ▪ Member FDIC ▪ Equal Housing Lender

BANK OF IDAHO

IRREVOCABLE STANDBY LETTER OF CREDIT

Beneficiary: Office of Procurement
Montgomery County Government
Attn. [redacted]
Contract No. [redacted]
255 Rockville Pike, Suite 180
Rockville, Maryland 20850-4166

Applicant: [redacted]

Amount: Not to exceed US [redacted]
Contract: Department of Liquor Control Technology Systems, Contract No. [redacted] between Montgomery County, Maryland, and [redacted].

Gentlemen:

We hereby issue in Beneficiary's favor for the account of [redacted] (Applicant), our Standby Irrevocable Letter of Credit in the amount of [redacted] available and payable no later than the end of the 7th business day upon presentation of Beneficiary's sight draft (s) in any amount not exceeding the credit hereby established accompanied by this Irrevocable Letter of Credit and the following:

A- Beneficiary's statement certifying that (a) [redacted]. is in default of its obligation in its payment to subcontractors, including labor and materials delivered under contract No. [redacted] and that (b) the amount of the sight draft does not exceed the sum due Beneficiary under said contractual agreement.

B- Beneficiary's signed statement describing the sum due beneficiary.

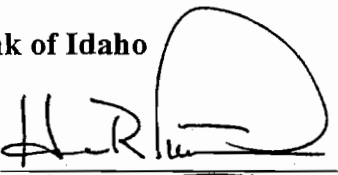
We hereby promise to Beneficiary that any drafts drawn in compliance with the terms of this Irrevocable Standby Letter of Credit will be duly honored if presented to us in person, certified mail at the following address: Bank of Idaho Trust Department, 399 N. Capital, Idaho Falls, ID 83402, or through the banking process in due course during the term of this letter of credit.

The release date of this Irrevocable Standby Letter of Credit will be upon the Final Acceptance Payment, which is anticipated to be approximately November 1, 2005.

This Irrevocable Standby Letter of Credit is, unless otherwise expressly provided, subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision), International Chamber of Commerce Publication No. 500.

Date: July 26, 2004

Bank of Idaho

By: 

[redacted]

Vice President & Trust Officer

SIGHT DRAFT

Montgomery County, Maryland
(Place of Drawing)

DATE: February 16, 2007

AT SIGHT PAY TO THE ORDER OF: Office of Procurement
Montgomery County Government
(Beneficiary Name)

$ [redacted]

[redacted] U.S. DOLLARS

DRAWN UNDER BANK OF IDAHO IRREVOCABLE STANDBY LETTER OF CREDIT ATTACHED HERETO, FOR APPLICANT, [redacted]

TO: BANK OF [redacted]
TRUST DEPARTMENT
[redacted]

Office of Procurement
Montgomery County Government
Beneficiary Name

By: _____
[redacted] Director
Office of Procurement
Montgomery County Government
Authorized Signature

Date: _____

By: _____
[redacted] Director
Department of Liquor Control
Montgomery County Government
Authorized Signature

Date: _____

ENDORSEMENT

Pay to the Order of the Office of Procurement, Montgomery County Government.

Office of Procurement
Montgomery County Government

By: _____ _____
[redacted] Director Date
Office of Procurement
Montgomery County Government
Authorized Signature

By: _____ _____
[redacted] Director Date
Department of Liquor Control
Montgomery County Government
Authorized Signature

Office of Procurement
Montgomery County Government
255 Rockville Pike, Suite 180
Rockville, Maryland 20850-4166

CERTIFICATION OF DEFAULT

The undersigned, authorized representatives of the Office of Procurement, Montgomery County Government (the "County") hereby certify that

a. [redacted] is in default of its faithful performance under Contract No. [redacted] and

b. The amount of the Sight Draft does not exceed the sum due Beneficiary under said contractual agreement; and

c. The sum due the Beneficiary is $[redacted]

Office of Procurement
Montgomery County Government

By: _____ _____
[redacted] Director Date
Office of Procurement
Montgomery County Government
Authorized Signature

By: _____ _____
[redacted] Director Date
Department of Liquor Control
Montgomery County Government
Authorized Signature