

# Drafting a Takeover Agreement

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**Introduction** This article discusses the issues an owner, lender, completion contractor, and surety should consider when drafting a takeover agreement. Although each of these four main parties may share the basic goal of seeing the project completed in a timely and efficient manner, each has different interests to protect. As in any negotiation process, each party must be willing to give and take in the name of compromise. There are certain factors each party must consider and carefully weigh when negotiating the terms of a takeover agreement. Every project is unique and presents its own challenges. Still, all takeover agreements should include specific language:

- identifying the original owner-contractor agreement and the performance bond in question;
- confirming the contractor's default;
- setting forth the remaining scope of work;
- identifying the accurate contract price, plus the sum of monies previously paid;
- setting forth the payment provisions and timing, including a listing of outstanding retainage;
- confirming payment for any change orders;
- delineating responsibility for any liquidated damages;
- confirming the surety's right to receive the unpaid contract balance, including retainage;
- allocating responsibility for latent defects;
- establishing a new completion date;
- identifying the dispute resolution provisions that will now apply; and
- listing what work has been accepted to date.

Each of these issues has varying importance to the different parties involved. Below is a brief summary and checklist of the issues most relevant to each of the parties to a takeover agreement.

**Issues for the Owner to Consider** Generally, the owner's goal is to complete the project as quickly as

possible so it can repay its debt to the lender and begin to realize income. In light of the owner's dissatisfaction with the original contractor's performance (or lack thereof), it is imperative that the owner consider the following factors when negotiating a takeover agreement:

1. Will the surety undertake all uncompleted work, according to the project plans and specifications?
2. Will the surety remain responsible for any necessary corrective work (including that which will be unknown until construction recommences)?
3. Who will be responsible to pay for change order work subsequently performed by the completion contractor?
4. All pending change orders should be carefully analyzed, with appropriate credits and deductions so the adjusted contract sum accurately reflects the cost of the work performed by the original contractor.
5. There should be language in the takeover agreement preserving the owner's right to credits against the contract price up to and including the completion of all punchlist work.
6. The owner may want to fund monthly requisitions jointly from the unpaid contract balance and the surety's additional funds.
7. The owner may want to allocate more than the standard 10 percent to perform punchlist work, plus consider adding a separate line item on each requisition for the punchlist work.
8. The owner should address the surety's liability for latent defects, which may not be discovered until after completion of construction.
9. Depending on the facts and the owner's relative bargaining power at the time, the owner may consider waiving all or part of the liquidated damages (assuming such damages are recoverable under the performance bond) or reserve its rights with respect to some or all of those damages. Perhaps a compromise may be reached whereby the surety agrees to complete the project at an earlier date in exchange for the owner's waiver of liquidated damages.
10. The owner should seek to ensure that if issues develop during the completion of the project, all proper parties are bound to the same dispute resolution provisions.

**Issues for the Lender to Consider** Ordinarily, the project under construction is the lender's security for the loan. Many things can prevent the lender from realizing enough funds from the security to cover the amounts advanced. Because of this, in addition to sharing the owner's interest in a completed project, the lender typically has two primary concerns in connection with a takeover

agreement.

1. The lender needs assurance that a financially responsible party is obligated to pay for the cost to complete the project and remedy any defective construction and/or latent defects.
2. The lender also needs assurance that any continuing delay will not jeopardize the completion of the project.

**Issues for the Completion Contractor to Consider** The completion contractor should pay special attention to the following issues when it considers becoming a party to the takeover agreement:

1. Is the terminated contractor's default contested? If so, the completion contractor must weigh carefully the implications that the basis for the dispute between owner and contractor may have on its ability to successfully complete the project. Additionally, it should make provision for the cost and delay of any testing, discovery or other distractions, which may result from possible lawsuits between the owner and contractor.
2. Is the project public or private? Completing public work raises more issues than private jobs. Government contracts, particularly with federal agencies, can require the completing contractor to comply with a host of socioeconomic statutes and regulations, including, for example, the Buy American Act and Disadvantaged Business Enterprise obligations. A contractor unfamiliar with working with government agencies should investigate and account for such costs and obligations before entering into a takeover agreement for completion of a public project.
3. Are there concerns about the quality of the principal's work? Completion contractors do not want to be held responsible for the work of the terminated contractor. The takeover agreement should be as clear as possible with respect to who bears responsibility for hidden defects in the portion of the project already completed. For example, an agreement can contain a differing site conditions clause that transfers the risk of hidden defects to the owner. In the absence of such a clause, a contractor agreeing to perform work for a stipulated sum bears the risk of unforeseen difficulties absent some basis for relief, such as misrepresentation or breach of an implied warranty.
4. What is the completion contractor's scope of work? The completion contractor must ensure that the takeover agreement clearly delineates the scope of the work that it is required to perform. Otherwise, it may be surprised to discover that it is expected to perform work outside the scope of what it originally anticipated.
5. What are the expectations and limitations on utilizing existing subcontractors and suppliers? The completion contractor will likely be interested in employing some of the same subcontractors who were originally on the job because they are already familiar with the project. To avoid potential conflict after entering into the agreement, the completion contractor should ensure that the takeover agreement is clear regarding its rights or restrictions when employing these individuals.

6. Time for completion issues and the assessment of liquidated damages. The completion contractor will be particularly interested in the expected completion time of the project because it will be responsible for compliance with whatever completion schedule is negotiated by the owner and surety.
7. Liquidated damages: It is important that the completion contractor establish which party will be held responsible in the event of delays caused by latent defects, weather and other non-compensable but excusable delays.

**Issues for the Surety to Consider** While negotiating a takeover agreement, the surety's goals should be to: mitigate loss, preserve salvage, identify and preserve the principal's and surety's claims against the obligee and any third parties, reach agreement as to the actual scope of the surety's obligations to the obligee, and define the contractual terms that will govern the work. Additionally, as the surety investigates and negotiates its takeover agreement, it should try to determine whether the owner has fully complied with all duties owed to the surety and the original contractor. The following issues should be considered by the surety when negotiating a takeover agreement:

1. Will the owner agree to pay the contract balances to the surety, free from existing offsets or claims by the owner?
2. Can the parties agree on the details and existence of the original contractor's default? If a complete agreement cannot be reached, at a minimum it is important to attempt to identify and define the reasons for their respective positions regarding the obligee's declaration of default.
3. What is the expected timing for project completion? In addition to the completion date, the surety should seek to define and address the project schedule, mileposts and completion dates, any pending requests for time extensions, calculation of any delay, and the date by which the surety will recommence work on the project.
4. Existing and potential claims: The surety should seek to identify and resolve or preserve existing claims. Additionally, it is important that the dispute resolution procedures to be employed by the completing contractor, surety and obligee are clearly outlined and agreed upon. The parties should also specify the venue for any dispute proceedings and consider using additional dispute mechanisms. Finally, if relevant, the parties should consider whether to make any changes to an arbitration agreement, such as the number and qualifications of arbitrators, availability of discovery, and use of a reasoned award.
5. What is the scope of the contract, scope of work yet to be completed, and the percentage of completion? To ensure that it has an accurate picture of the scope of its work, the surety should obtain the following during the negotiation process: (i) a complete set of contract documents, drawings and specifications; (ii) all requests for information and responses; (iii) a set of approved as-built drawings as of the date of default; (iv) the obligee's opinion as to the percentage of completion; and (v) a clear understanding of the obligee's claims as to any nonconforming or defective work and how the obligee thinks such work should be corrected.

6. Are there any subcontractor and supplier issues? If so, how will they be resolved? The surety must determine the identity and existence of all its principal's subcontractors and suppliers; whether they have been paid through their last acquisitions; whether they have filed all necessary notices, and whether they have provided all necessary lien releases. To the extent the surety intends to use any of the existing subcontractors in the completion agreement, it should also consider whether the subcontractors have been approved by the obligee or if any pre-approval is required.
7. Prior to signing the takeover agreement, the surety should seek to resolve issues related to the use of the completing contractor, which in some cases may be the same as the original contractor. Although the owner may not be able to stop the surety from using the original contractor to complete the project, it often protests if the surety attempts to do so. This can cause delays in the completion of the project. To avoid this, the surety may consider hiring a consultant or contractor other than the original contractor, who will then subcontract some or all of the work to the principal. The surety also needs to agree with the owner regarding the process by which the surety's completing contractor will be paid; whether its subcontractors will require pre-approval by the obligee; and the identity of those persons the obligee will recognize as authorized to act for the surety or the completing contractor when processing and signing payment applications and making resolving RFIs and any claims, among other communications.
8. Limitation of liability. Absent a limitation of liability in the takeover agreement, if the surety elects to take over and complete the defaulted contract, it loses the benefit of its right to limit its liability to the penal sum of its bond. Also, despite the delay occasioned by the termination of its principal, the surety is usually subject to the contractual completion date. The surety should try to negotiate a specified cap on its liability, as well as an extension of the substantial completion date. The owner/obligee may be willing to grant such requests in exchange for the surety's commitment to complete the project, especially if there is a question as to whether the surety is in fact obligated to do so.
9. Government Contracts. When the contract involves a government entity, a takeover agreement may be the best option for a surety. Because the government often has the upper hand in terms of availability of legal (and other) resources, the best strategy for sureties is to preclude disputes through careful drafting of takeover agreements. All claims by a contractor against the government relating to a contract are covered by the Contract Disputes Act (41 U.S.C. § 605(a) (2010)) ("CDA"). Except as provided in the CDA, no contractor may bring an action directly on a claim against the U.S. Government in the U.S. Court of Federal Claims, notwithstanding any contract provision, regulation, or rule of law to the contrary. The CDA defines "contractor" as "a party to a Government contract other than the Government." The CDA also permits the contractor to appeal a contracting officer's decision to a board of contract appeals. The existence of the takeover agreement may be crucial to establishing the surety as a contractor for purposes of the CDA. Thus, it is commonly held that the surety's right to proceed under the CDA is reserved to claims arising under the takeover agreement. Notably, the surety does appear to have a right to sue the government for its overpayment to the contractor in violation of the original contract.



Takeover agreements can be equally important for projects with other public agencies, as they may be necessary to avoid the doctrine of sovereign immunity to any claims by the surety arising out of the project.

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