

New AIA Bid, Performance & Payment

On May 25, 2010, the American Institute of Architects (AIA) issued a press release announcing that the new A310 Bid Bond form and the new A312

The A310 Bid Bond was last updated 40 years ago (1970) and the A312 P&P was last updated 26 years ago (1984). So, it was time for modifications

Performance & Payment (P&P) Bond forms would be made available in June of 2010.

On June 29, 2010, the National Association of Surety Bond Producers

(NASBP) presented a discussion and analysis of the new forms to its members, of which our firm is one of them.

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If you recall from a previous article and, maybe from personal experience, the surety industry, as a result of a few adverse court decisions, had issues with the previous payment bond, specifically the section that related to the 45 day response requirement. To address these concerns, on 5/21/2008, the AIA recommended amending the section in question.

The AIA has issued a Bond Form Commentary and Comparison to facilitate knowledge of and transition to the 2010 editions. This is an excellent guide and we highly recommend reviewing it. If you have trouble obtaining it, please contact our office.

Here are some of the main points, in our opinion:

A310 Bid Bond

- The new form added language that allows the project owner and contractor to extend the period of acceptance of the bid up to 60 days without obtaining consent from the surety. The surety's consent would be needed for longer periods.

The new form added language that, also, makes the form appropriate for subcontractors to use when a bid bond is required by a prime contractor.

A312 P&P Bond

- Users must be aware of the shortened time periods in the new forms, such as deleting the 20 day waiting period by the project owner before declaring the contractor in default and terminating the construction contract and

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BEYOND CONTRACT BONDS

Union Wage & Welfare Bond

Are you a union contractor and the union is requiring you to provide a surety bond guaranteeing that you pay the union benefits and/or wages as outlined in your collective bargaining agreement? Are you finding it difficult to obtain this bond?

It's true, most sureties will not entertain writing these bonds unless they are already writing your contract Performance & Payment bonds. Many of you, however, do not do public work or other projects that require you to be bonded. What are you to do?

Although most sureties have taken a hands off approach to these bonds because of the high loss frequency, there are a few markets that will consider writing them for financially qualified companies.

The underwriter would need to review CPA prepared business financial statements; personal financial statements of the owners and their spouses; a Letter of Good Standing from the union would be required if you are already a member of the union. The company, owners and spouses (in most cases) would also have to have a clean credit history and can provide verification of all liquid assets.

Some union's bond forms contain some onerous clauses so the surety will need to review the form. If the form is not acceptable to the surety, they may offer their form as an alternative.

If you find yourself in need of this bond, please contact our office and let us help you out. Any one of our surety professionals will be able to assist you.

Alert on New Proposed Revenue Recognition Rules

The Financial Accounting Standards Board (FASB) has proposed new revenue recognition rules that would significantly affect contractors and users of their financial statements.

On June 24, 2010, FASB issued its Exposure Draft. This Exposure Draft will substantially impact how contractors approach revenue recog-

inition. FASB has not yet announced when these new rules will take effect; however, comments on the proposed rules are due by October 22, 2010.

This information was obtained from the Construction Financial Management Association's website. Please go to their website for a comprehensive discussion of the matter

- www.cfma.org/fasb_rev_rec.

Please contact your CPA firm to ensure that they are abreast of this development, and please call us as well to discuss how this may impact the surety industry's analysis of construction firms' financial statements.

Fidelity Coverage – Do I Need It?

For all intents and purposes, John was the perfect employee. He was never out sick, hardly ever late, and always willing to “go the extra mile”. He performed his job in purchasing diligently and gained the trust of management and his co-workers.

Three years ago John ran into some financial difficulty. It seems his gambling losses were getting out of control. He rationalized that if he “borrowed” a few dollars from the company, he knew he would win big enough to pay back the “loan”. He came up with a scheme to establish a shell company, purported to be a supplier. Checks were mailed to the company’s PO Box and deposited into John’s personal account.

Before long John was accustomed to the extra cash flow and his intent of paying back the “loan” was long forgotten. The scheme went undetected for years before it was uncovered by a co-worker when John was on vacation, but not before the company had paid over \$500,000 to this fictitious company (and John).

Could this have been avoided, or at least could the company have been protected from this type of loss with the proper insurance coverage? The answer to both questions is yes.

Fidelity coverage, also known as Employee Dishonesty Coverage, is available as part of a Combination Crime Policy or as monoline coverage. The blanket form covers dishonest acts of all “employees” (as defined) unless specifically excluded. The

employer is protected for loss of or damages to covered property resulting directly from dishonest acts committed by an employee with 1) manifest intent to cause you to sustain a loss and; 2) who obtains a financial benefit. Both elements must be present for coverage to apply. For example, damaged caused by a disgruntled employee who sets fire to his employer’s property would not be covered because the employee did not realize any financial benefit. However, losses caused by an employee who diverted company funds to his own personal account would be covered.

It’s not just money and securities you need to be concerned about. Do you have a large inventory of merchandise, machinery or other equipment and supplies? Employees’ theft of these items can cause a firm thousands of dollars to replace. Although loss of property caused by a dishonest act of an employee is covered, the insurer will not pay for a loss that depends on inventory calculations to prove either the existence or the amount of the loss. This exclusion is referred to as the Inventory Shortage Exclusion. The purpose of the coverage is to cover employee dishonesty, not inadequacies or inaccuracies in the employer’s record-keeping system.

Proper controls are always the first line of defense. For this reason, all Fidelity Coverage is written with a deductible. These deductibles will range from as low as \$500.00 to tens of thousands depending on the amount of coverage and the adequacy of the controls. The general rule that we have

found most insurers to follow is a deductible in the amount of 10% of the coverage.

Dual responsibility of job functions provides a check and balance system that will usually catch most types of losses. But there are times when even the best controls fail. That’s when it’s comforting to know that there is a safety net in place in the form of insurance to protect the assets of the business that you worked so hard to build.

Who should carry this coverage? In our opinion, any business that has employees, even long-term trusted employees, should have Fidelity Coverage in place. You may say, “My employees are responsible people of the highest moral fiber” or “My key employees have been with me for many years.” The majority of losses are caused by those employees who have full access to the company’s assets, are trusted by management and are considered the ones least expected to cause a loss. You may consider these employees to be above reproach and always have the best interest of your company at heart. However, it’s not uncommon for these employees to run into some personal financial difficulty with nowhere else to turn. What might start out as the “temporarily borrowing” of small amounts can turn into a full-blown catastrophe for the company. Remember John? This was an actual case from one of our insurer’s claim files.

We are available to help you with this coverage. Contact one of our bond professionals for assistance.



LOOKING AHEAD

Contractor’s for Kids Event (CFK)

- **CFMA/CFK Annual Dinner Gala** Honoring Marc Herbst, LI Contractors Association Tues, October 19th, 2010 @ Crest Hollow Country Club, Woodbury, NY—Call 516-336-2451 for reservations. Proceeds to benefit Contractors For Kids
- **CFK Business Friends Networking Night**—Exclusively for Business friends of Contractor for Kids— Wed. October 20, 2010 from 6 to 8 PM at Governor’s Comedy Club located at 90 Division Ave., Levittown, NY. Go to the CFFK website—www.contractorsforkids.org—for information on how to become Business Friend or Family Friend of CFK.
- **CFK Annual Dinner Gala**—January 21, 2011 @ Crest Hollow Country Club, Woodbury, NY

Women’s Insurance Network of Long Island, Inc. (WINLI)

- **Annual Breast Cancer Walk**—join the WINLI and the Atlynx Team at Jones Beach on Sunday, October 17, 2010
- **Halloween Party**—Friday October 29, 2010 at Domenico’s of Levittown, Levittown, NY. Additional details and ticket information is available at the WINLI website, www.winli.org or contact Denese Thompson at 516-745-7504

CHANGE ORDERS AND BOND PREMIUMS

Does a Performance Bond cover change orders? It is a common question. While there may be instances when the surety may claim that a 'cardinal change' has been made to the original contract, basically that the surety never intended to bond such a project, the answer is often "yes".

This article's focus is not on the legal issues of a 'cardinal change'. Our focus will be on the more routine change order work and the additional bond premiums that are incurred as a result.

The bottom line is that the bond covers the contract and, therefore, the contractor is responsible for the additional premiums that are incurred as a result of a contract over-run on a bonded project.

For example, the AIA Document A312, a frequently used Performance Bond form, states in Section 1 that "The Contractor and the Surety, jointly and severally, bind themselves... to the Owner for the performance of the Construction Contract, which is incorporated herein by reference." The Construction Contract is defined in Section 12.2 as "The agreement between the Owner and the Contractor ... , including all Contract Documents **and changes thereto** (emphasis added)."

So, if there are change orders to the existing contract, the bond automatically

covers those change orders. The bond premium is calculated on contract price. Therefore, if the contract price increases, additional premiums are due. Conversely, if the contract price decreases, the contractor should be entitled to a return premium. As you will read, however, this may not always be the case.

Most sureties, but not all, will return the premium when a final contract price is lower than the original contract price, subject to certain minimum thresholds. However, there has been interesting case law where a court determined that the surety company was not obligated to return the premium. The contractor was awarded a \$2.5 million construction contract and paid the appropriate premium. The project was terminated (not defaulted) when it was 13% complete. The contractor sought the pro rata return of premium on theories of unjust enrichment and breach of implied contract. The contractor argued that once the project was terminated, there was no further risk under the bonds. The court found that the contractor received what it had bargained for – performance bonds for the full contract price, which put the surety at risk for the full amount of the contract and without which the contractor would not have been awarded the contract.

[Taken from www.constructionweblinks.com Bullard-Lindsay Contracting Co., Inc. v.

Universal Bonding Insurance Co.; Supreme Court, New York County; Index No. 122066/00; Justice Schoenfeld; January 2, 2002; *aff'd*, 303 A.D.2d 317, 755 N.Y.S. 2d 844 (1st Dept. 2003).

How is the premium calculated for an additional / over-run premium?

The Bonding company calculates the premium on the final contract price, then subtracts the premium that was paid based on the original contract price. Since many sureties have 'sliding-scale' rates, it is very important to perform the calculation this way. One cannot assume that the overall rate paid for the original bond will be the rate charged for the additional / over-run premium.

It is very important that the contractor factors in the additional premium that will be charged into the change order proposal. If the Project Owner does not want the additional work to be covered under the bonded obligation, it is important that they issue either a separate, unrelated, unbounded contract or purchase order for this work. However, if the Project Owner states that the change order work is part of the existing, bonded project, the bonding company will typically seek the additional premium for the additional work performed.

New AIA Bid, Performance & Payment Bond Forms

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shortening the notice period for a surety default under the bond from 15 days to 7 days.

- Claimants not in privity to the contractor no longer must provide the contractor with notice of non-payment then wait 30 days before sending notice to the surety and the owner. The claimant may provide notice to the contractor and submit a claim to the surety without the 30 day wait.

- In response to the surety industry's concerns with the previous edition of the payment bond, the new payment bond extends the period of time in which the surety must answer a payment claim from 45 days to 60 days. The new form, also, now states that a failure of the surety to answer within the time period is not a

waiver of the surety's and contractor's defenses to the claim, but it may entitle the claimant to attorney's fees.

- The new form added language that, also, makes the forms appropriate for subcontractors to use when P&P bonds are required by a prime contractor.

The AIA will provide an 18 month transition period during which time both versions will be available for use.

Because of the General Indemnity Agreement that you signed with your surety, you need to be cognizant of the terms and conditions of all bond forms, including these, that you and your surety will be bound by. So, please make it a point to review these forms.

OFFICE LOCATION

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BEWARE - INFORMATION TECHNOLOGY CAN INCREASE YOUR LEGAL RISK

In a recent article I read the hazards of some of the technology that we now take for granted was brought to my attention. Email, for example, has become the main mode of communication in almost every facet of our lives. Not only in our business, it has become the main source of communication in our personal lives. Arranging family gatherings, sending birthday greetings and not so uncommonly, emailing or texting your kids to come to dinner!

While email is an attractive medium for personal and business communication, it also can prove to be dangerous once a lawsuit or arbitration begins. When a suit is filed, one of the first things subpoenaed are the email records of both parties. Emails have emerged as the best source for finding a "smoking gun".

How many times have you dashed of an impulsive message to someone or made a personal attack against someone in a moment of anger? Email invites impulsive messages and casual candid comments. These types of responses can be extremely dangerous. Remember emails are not limited publications. They can be printed or easily routed to others. Even if you delete the damaging email, your company's exposure continues until the applicable statute of limitations expires or until your hard drive, all the recipients' hard drives and all the hard drives that routed the email are destroyed. Emails are recoverable. It is now common practice for lawyers to go after all communications, including emails, during the discovery phase of any lawsuit or arbitration proceeding.

There are steps you can take

to prevent these damaging emails from coming back to haunt you. Every written correspondence that leaves your office should be written as if it were going to be scrutinized by a judge and jury.

A mandate from the top to all employees and agents that the company has a zero tolerance policy against unprofessional emails may help. At minimum, an email policy forbidding personal emails and advising all employees that they have no right to privacy should be in place. If someone consistently ignores this policy, disciplinary actions should be implemented.

Email used correctly is a convenient tool that can provide instantaneous communications and immediate answers to a question you need answered. Just remember that it can also be your worst nightmare.

Letter From the Editorial Staff

This newsletter is designed with our readers in mind. All inquiries or suggestions regarding this or future newsletters are appreciated. Please send all inquiries to denese@esuretybond.com.

If you know anyone who you feel would like a copy of our newsletter, please let us know so that we can include them in our mailing list.

Check our website www.atlynx.com for past editions of our newsletter.

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