TRANSACTIONS AND TRIALS

BERMAN AND SABLE NEWSLETTER

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Transactions and Trials *continues into its third year with information on commercial law topics we hope you will find interesting and useful. Customarily, at about this point, there should appear the legal disclaimer. Here it goes. "Reading this Newsletter may cause heartburn, nausea, sleeplessness, and an uncontrollable urge to keep repeating the phrase, " That's ridiculous".*

THE "UNBONDING" OF CONSTRUCTION BONDING

By Michael P. Berman

The construction field is made up of "tiers" of relationships. The aim is to keep the tiers separate to avoid incurring an unwanted liability to a party in a different tier, while being able to communicate to the party in another tier what the job is and how and when it is to get done. The usual sequence is: Owner, General Contractor (GC), Subcontractors (Subs), and Suppliers of materials to Subs (Suppliers).

In almost all government projects (where the government is the Owner), and in many private projects, the GC is required to deliver a bond to the Owner assuring the Owner that the GC will finish the job (performance bond) and a bond assuring the Owner that the Subs will be paid (payment bond). The Owner wants the Subs paid so they won't put a lien on the project for nonpayment. In government jobs, a Sub is not permitted to "lien" the project, so the law protects Subs by giving them a bonding company to look to for payment in the event the GC does not make payment from the monies the GC received from the Owner.

Question! What if the GC fails to complete the job? Since the GC put up a payment bond, any Subs who didn't get paid for the work (assuming the work was done properly, and assuming the Owner paid the GC for the work done by the Subs) can look to the payment bond company for payment.

What about the Owner? Who finishes the job? The Owner looks to the company who issued the performance bond assuring that the GC would finish construction of the project. It's that simple! Not exactly. Now the performance bond issuer must decide what to do.

The performance bond issuer a/k/a "Surety" has many possible moves. The Surety can:

- **PAY** the amount of the performance bond to the Owner and tell the Owner to get another GC. In this scenario the Surety is "off the hook", but it paid out a lot of money;
- **PROCURE** (tender) a new GC to finish the construction and pay the new GC any

(Continued on page 2)

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amounts charged by the new GC in excess of the balance of the original contract with the Owner (there is almost always an excess);

- **COMPLETE** the construction itself by hiring its own workers. This choice subjects the Surety to liability beyond the bond amount and/or beyond its ability to get payment under the original contract. This may seem like an undesirable alternative, but if there is very little work left under the contract compared to the unpaid balance, or if there is a great deal of work left and the Surety can limit its losses, this alternative may be a viable one;
- **FINANCE** or fund the old GC and keep them on the job. Many times this is the best alternative since the old GC is most familiar with the project and the Surety does not have to pay for the learning curve of a new GC, or;
- **DO NOTHING**, let the Owner hire a new GC, and be liable to the extent the Owner has to pay more to complete the job than the original contract price with the old GC.

In making its decision the Surety must consider the size of the project, the uniqueness of the construction, the balance of the work to be completed, the cost to complete the project, the balance of the original contract price to be paid, the maximum exposure under the amount of the bond (the "penal sum"), the number of Subs, the availability of materials, and many other factors. Making the best decision is definitely an art form, but the "painting" doesn't always come out

BERMAN AND SABLE NEWS!!!

Congratulations: Alena Gfeller and her husband Charles welcomed a bouncing baby boy, Charles Robert, on July 4, 2000.

We are proud to announce that we are now a supporting member of the Construction Institute, University of Hartford, active on the Marketing, Education and Program Committees.

We are also proud new members of the Associated Builders and Contractors, active on the Education and Business Development

BRAVE NEW WORLD (IN THE LEGAL SYSTEM??)

By Steven A. Berman

Sweeping changes are being proposed with respect to fundamental aspects of our legal system. Among the changes which business people will see are the Uniform Electronic Transactions Act and broad revisions to the Uniform Commercial Code.

For almost 1,000 years our legal system has been based on a **"signed writing"**. The Statute of Frauds, which dates back to the English legal system of the 1400s, requires that certain contracts be in writing to be **enforceable**. Typically, contracts which have a duration of more than one year or which involve an amount of $500.00 or more must be in writing to be enforceable. The Statute of Frauds applies to virtually every contract. Moreover, many of our statutes relate to **written agreements** or **signed documents**.

The Uniform Electronic Transactions Act ("UETA") would globally replace the requirement for "a signed writing" with the term **"an authenticated record"**. An authenticated record is any record which is retrievable in perceptible form which can be authenticated. Needless to say, this leaves the field wide open. Certainly, **e-mails** or even **voice mails** could fill the description.

What is even more dramatic under UETA is the concept of **"electronic agents"**. This is the present day version of R2D2! Simply put, if one computer is programmed to place an order when inventory gets down to a certain level and another computer, at a vendor's shop, is programmed to receive and fill the order, these **two computers can now enter into a binding contract**! The contract would bind the "principals" for whom these computers are acting as agents in the same way as a human agent has been able to bind a human principal for hundreds of years.

Along with UETA are sweeping changes to the Uniform Commercial Code. The Article of the UCC which is undergoing the greatest overhaul is Article 9 – Secured Transactions. It is under this Article of the UCC that almost every lien that does not involve real estate is taken.

(Continued on page 3)

Not only does the UCC also adopt the concept of "an authenticated record" in lieu of a writing, but other changes are taking place which make the **taking of a lien much easier than under present law**. Most notable among these changes is a much simplified filing system. Under present law any lender who wishes to take a lien (or any business which will sell to a questionable customer and want to retain a lien in the items sold) must file a UCC-1 Financing Statement in each jurisdiction where any collateral is maintained. In some states (Massachusetts being one) the filing of a UCC-1 Financing Statement at the Secretary of State's office is not enough. Filings must also be made at the county level. If the debtor has collateral in multiple states then a filing must be made in each state and in each applicable location within the state.

Under the new law, which will be introduced into the Connecticut Legislature during the coming session, **only one UCC-1 filing will be necessary**. That filing need only be filed in the office of the Secretary of State in the state of formation of the debtor (i.e. the state of incorporation or the state where the LLC is organized). This would be true regardless of where the collateral is kept.

For banks and other companies who extend credit secured by almost any non-real estate collateral, this makes the UCC-1 filing much simpler. Not only is one filing location all that is necessary, but it will be no longer necessary to track the location of the collateral as it may move from time to time. This will also make the UCC search process much easier as only the state of formation of the debtor need be searched.

Other broad changes included in the revised Article 9 are the coverage of additional types of collateral. For example, **deposit accounts, commercial tort claims, health care receivables will now be under Article 9** and the process of taking this type of collateral will be defined and simplified. Additionally, if the secured party has a blanket lien in the debtor's assets, the UCC-1 Financing Statement can simply say "all assets" although the security agreement still must describe collateral, at least by category.

The uniform effective date for the Article 9 revisions is July 1, 2001. It is anticipated that by that date all states will have enacted the revisions. There is a 5 year transition period during which existing liens will remain valid but new liens must be taken under the new rules. Although, during the transition period, some elements of secured lending will be more complicated, after the transition period the process will be greatly simplified.

OUT OF STATE BUSINESS OPERATIONS: "COVERAGE IS WHERE THE RISK IS!"

By Robert J. Caffrey

Your business is located in Connecticut. You purchase your commercial general liability and business risk insurance through a Connecticut insurance agency. The policy covers all your business facilities, some of which are located in other states.

Even though you have business operations in other states, because the contract was entered into in Connecticut, through a Connecticut agent, and you are a Connecticut company, common sense dictates that Connecticut law will control how your insurance policy is applied, doesn't it?

Although common sense might dictate that result, the Connecticut Supreme Court has decided otherwise. In most instances, your policy will be controlled by the law of the state where your business facilities (the "risks") are located. In Reichhold Chemicals, Inc. v. Hartford Accident and Indemnity Company, 252 Conn. 774 (2000) decided in May of this year, the Connecticut Supreme Court expanded upon an earlier decision it made on this issue in 1997. The Court's position is that the state where the facility, or more specifically the risk, is located will control how the provisions of your policy are applied. The only exception is if another state has an "overriding policy based interest in the application of its law".

The Reichhold decision means that if your company has business facilities in four different states, for example Massachusetts, New York, Connecticut and New Hampshire, your responsibilities and available coverage under a single policy may vary, depending upon the state where the "risk" exists. The availability of insurance coverage could be different, even if an identical accident occurred in each of the four locations. The location of the "risk" makes it important that you understand each state's rules on two key issues: (1) what's covered and

(Continued on page 4)

what's not; and (2) your duties and responsibilities under the policy and the insurance companies.

1. What's covered and what's not

Although most insurance policies have standard language that is used in almost all states, what the language does and doesn't cover can vary. As contracts, insurance policies are analyzed in each state according to that state's laws for understanding and applying contracts. Thus, what the language of the policy covers and doesn't cover can change depending upon the state that you are in.

Although a loss might be covered under Connecticut law, the Reichhold decision means that this is no guarantee that it will be covered if it occurred at a business facility in another state. Examples of situations where coverage could vary from state to state include: alleged assaults by employees; conduct which either infringes, misappropriates or compromises the copyright, trade mark or, intellectual property of another business; what conduct constitutes a negligent as opposed to intentional act; what types of events constitute "accidents" and "damages"; and finally, who is covered under the policy and who isn't!

To understand your risk, the best course of action is to be proactive. Businesses with operations outside of Connecticut should, at a minimum, obtain an analysis of the local law to identify any significant differences from Connecticut law. This can prevent the potential financial disaster created by a significant loss which is not covered by insurance.

2. Duties and responsibility of the insured

Although insurance policies have standard provisions requiring you to notify the insurance company of a claim or loss, what these provisions actually "mean" can differ from one state to another. All policies require you to notify the insurance company of events or incidents that might trigger insurance coverage. What the notice must contain and when it is required, however, is not uniform. Also, the impact of providing "late" notice to the insurance carrier varies.

In some states, late notice will not affect insurance coverage unless the insurance company proves it was damaged. In other states, late notice will not affect insurance coverage so long as the insured demonstrates that the insurer suffered no damage.

There are, however, notable exceptions to these rules. In some states late notice is an absolute bar to insurance coverage. In New York, for example, failure to give timely notice to the carrier can eliminate insurance coverage altogether, even if the policy would apply if the notice had not been late.

The situations under which an insured "possesses" notice of a claim or loss also varies from state to state. Thus, in one state an unsupported customer's threat to sue, without an actual letter from a lawyer or a lawsuit, may not trigger the notice provisions of a policy. Under another state's law, however, this simple event might require that the insurance company be notified. The failure to do so could have extreme consequences.

The Reichhold decision involved a commercial general liability or business policy. The decision is broad enough, however, to apply to other types of insurance policies, such as employment related practices policies, directors' and officers' coverage, and other types of insurance coverage involving your business operations in other states.

Competing in today's business environment requires greater involvement in the economy on both a regional and national basis. For insurance coverage purposes, however, the benefits of doing business in other states must be assessed, as is any other business opportunity, as a combination of both potential gain and risk. The

IN MEMORIAM

Berman and Sable regrets to announce the death of our Senior Counsel, I. Milton Widem, on September 9, 2000. He will be missed, and this issue of *Transactions and Trials* is dedicated to his memory.