PP003 – Invoices for Supplemental Premiums

Introduction

Upon issuance of contract bonds, sureties will invoice a premium based upon the original contract price. By definition the bond covers the terms and conditions of the contract and therefore amendments to the contract by change order may provide increased exposure to the Surety. As a result, the Surety is entitled to charge an additional premium or refund the Principal if applicable. Therefore, once the final contract price has been determined, the original premium can be adjusted accordingly (plus or minus).

Background

Obligees, Principals and design professionals often question the manner in which the surety industry invoices supplemental premiums. On the anniversary date or at the conclusion of the work (whichever occurs first), the Surety will typically issue a supplemental invoice should either or both of the following circumstances be evident:

1. The contract price has increased by change order. In this case, the Surety will typically bill for the increment at the rate of the original premium charge.
2. A portion of the contract remains uncompleted at the anniversary date. The Surety will generally charge a renewal premium at the original rate for the unbilled amount of the contract.

SAC Position

When a Surety issues an invoice for a bond, the premium is calculated based on the Surety's total exposure to loss over time which is determined by the value of the contract and its duration. If the contract price or contract duration changes, the Surety Association of Canada (SAC) believes that sureties deserve to be fully and adequately compensated for any additional exposure they undertake. Conversely, Obligees should be refunded when contract price or duration decreases.

Summary

Since a bond, by definition, covers the terms and conditions of the contract, if the contract terms and conditions change (i.e. increased scope of work or the project has been extended beyond the contract anniversary date), the Surety is entitled to charge an additional premium. Sureties will be fair and equitable in their approach and should there be a reduction in contract price, a refund will typically be granted.

Sureties may differ in the manner in which they invoice renewals/supplemental premiums. As such, the Surety Association of Canada strongly encourages Principals to contact their broker should they have any questions regarding supplemental premium invoicing.

Glossary of Terms

Obligee

An individual or organization in whose favour an obligation is created and to whom a bond is given.

Principal

The individual or organization that bears the primary responsibility for fulfilling the obligation under the written contract referenced in the bond and that has the duty to perform for the Obligee's benefit.

Surety

The party to a surety bond who answers to the Obligee for the Principal's default or failure to perform as required by the underlying contract, permit or law.

This paper is intended to serve as a general guideline to assist members and other readers in responding to the issues discussed. Nothing contained herein should be construed as legal advice and readers are cautioned to consult with legal counsel for such advice.

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