

**Insurance & Bonding 101**



**Tim Nierman**, Construction Insurance Executive for Parker, Smith & Feek

**Ben Wolfe**, Contract Surety Bonding Executive for Parker, Smith & Feek

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**Parker, Smith & Feek Profile**



**Founded** - 1937, Seattle, Washington

**Ownership** - Privately held S-Corporation

**Offices** - Bellevue, Washington and Anchorage, Alaska

**Annual Sales** - \$300 million in policy premiums. Ranked in Top 100 US Insurance Brokers. \*

**Insurance Companies** - Over 300 national and international insurers represented

**Employees** - 185 salaried staff. No commissioned salespeople.

\*Business Insurance, July, 2008

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**Agenda-  
Construction Insurance**



- Concept of Insurance
- Types of Insurance on Construction projects
- OCIP/CCIP
- Coverage for Consideration

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## Construction Insurance An Overview



### Concept of Insurance:

- Two party contract

Method to transfer risk from one party to another

Insurance company indemnifies insured after loss

Actuaries calculate probability of loss to create rates

Underwriting Considerations;

- Industry Experience/expertise/Geographic Location
- Loss Control/ Safety
- Loss experience

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## Construction Insurance Property Insurance on Construction Projects



### Builders Risk

- Designed to cover the project while under construction.
- Typically owner purchased so contractor needs to review carefully to protect their interest. When appropriately placed, provides coverage for all parties. Owner/GC/Sub-contractors.
- Installation Floater (similar to Builders Risk) will be used by sub-contractors when installing highly valued equipment such as Compressors, Generators, or other machinery not covered by a builders risk policy.
- There are no uniform Builders Risk coverage forms. Important to review this coverage on each project.
- An extremely important coverage to get losses off General Liability policies and as a 1<sup>st</sup> party coverage, losses are paid quicker and people are back to work sooner.

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## Construction Insurance Property Insurance on Construction Projects



### Contractors Equipment

- Contractors Equipment policies cover all types of owned or leased equipment used to move and lift objects, build, erect, and excavate in all types of environments. Covers direct physical loss of or damage to equipment at a job site, in a storage yard or in transit.
- Examples of contractors equipment include; Cranes, Excavators, job trailers, Drilling rigs, lifts, Compressors & Misc. tools.
- Special endorsements needed when working from barges, cranes and underground.
- Earth Movement & Flood Coverage can be included
- Contractors Equipment coverage forms all differ, so it important to review this coverage.

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**Construction Insurance**  
**Liability Insurance on Construction Projects**

**General Liability/ Umbrella Excess Liability**

- Designed to provide coverage for Bodily Injury or Property Damage to a 3<sup>rd</sup> party.
- Construction Liability exposures;
  - Premises/operations - Job-site, Contractors office, etc
  - Products/Completed Operations- Work Performed, Fabricated materials
  - Contractual Liabilities - What is agreed to in a construction contract. (Liability insurance is not as broad as the construction agreements!)
  - Independent Contractors- damage as a result of subs work.
- Umbrella/Excess Liability- is way to increase Liability protection limits for both General Liability and Auto Liability.

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**Construction Insurance**  
**Liability Insurance on Construction Projects**

**Professional Liability**

- Designed to cover negligence, errors & omissions in the performance of professional services on a construction project. e.g. *Architects, Engineers, Construction Managers, Land Surveyors. Anybody providing consultation for a fee should have coverage.*
- Coverage includes legal defense costs, resulting judgments, including court costs, up to the coverage limits on your policy. Most professional liability policies cover economic losses suffered by third parties
- Design/Build Construction- Both parties need to be insured for professional Liability even if contractor plans to sub the design to your other team member. Does Design team member have adequate limits? A project specific program should be reviewed in these situations.
- Express Warranties or Guarantees Exclusion- An obstacle for those involved in D/B Construction. Is a level of LEED Certification or other Green building performance being guaranteed?

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**Construction Insurance**

**Contractors Professional Liability**

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## Construction Insurance Liability Insurance on Construction Projects



### Pollution Liability

- Designed to cover bodily injury, property damage to a 3<sup>rd</sup> party and resulting 'loss of use' of property as a result of pollution incident.
- Pollution Incident defined- Discharge, Dispersal, Release, or Escape of any solid, liquid, gaseous containment or pollutant including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.
- Coverage includes claims expense, (investigating, defending & settling a claim) clean-up costs, and compensatory damages or legal obligations from the BI/PD.
- Mold coverage- once difficult to procure can now be added to most policies along with lead-based paint. Asbestos coverage available, but still costly.
- Pollution Legal Liability (1<sup>st</sup> party coverage) for owned locations. Something of consideration for contractors.

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## Construction Insurance



### Sample Pollution Conditions on a Jobsite

- Use of chemicals (air, soil, groundwater)
- Use of materials which "off gas" (fumes)
- Portable AST's/refueling/use of equipment
- Demolition/renovation activities which disturb asbestos or lead based paint
- Mold
- Site grading/preparation work
- Use of petroleum compounds - Drilling, excavation, dewatering ops
- Transportation exposures
- Misclassification of construction debris
- Incomplete/improper HVAC hookup

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## Construction Insurance



### OCIP/CCIP's (Wrap-ups) Project Specific Insurance

- **Concept** - Usually intended for large projects in which the Owner or Contractor place a single Insurance program intended to cover most all parties on a construction site.
- Coverages can be tailored to the need of the project but will typically include: On-site General Liability, On-site Workers Compensation, (not in WA), Umbrella/Excess Liability.
- **What falls outside the OCIP coverage?** - Off-site activities for GL & WC. Auto Liability, Contractors Equipment, Professional/Pollution Liability, Builders Risk.
- **Benefits** – **Claims resolution**- derived from emphasis on safety, loss control, claims management, reduction in litigation between insurers and combining smaller insurance programs into one large one. Streamlining project management under a single authority provides; administration ease, strong recording keeping and Less 'proof of insurance' follow-up with subs and Ins agents.
- Contractor Concerns- Limits, Deductibles, Coverage
- Contract revenue performed under a WRAP are not attributable to the Contractor's General Liability policy reducing the sales or payroll projection.

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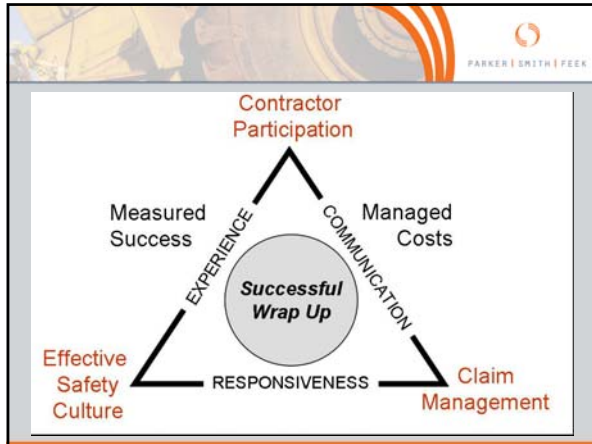
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- Construction Insurance**  
Coverage for Consideration
- Workers Compensation- USL&H, Defense Base Act, Jones Act.
  - Crime Coverage- EE Dishonesty, Forgery or Alteration, etc
  - Management Liability-
    - Fiduciary Liability-
    - Directors & Officers Coverage
    - Employment Related Practices Liability- 3<sup>rd</sup> Party coverage.

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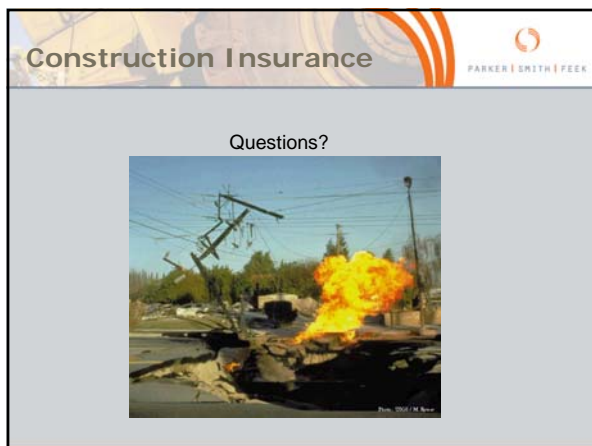
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## Agenda Part 1



### Concept of Surety:

- Two party contract
- Three party agreement
- Rights and Benefits of all parties (through Suretyship)
- Insurance vs. Surety
- Applicable example

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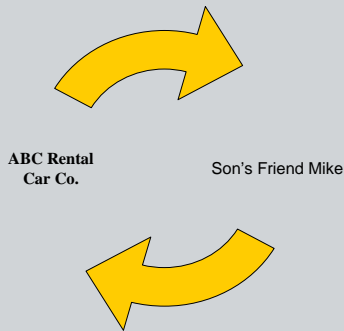
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## Two-Party Contract



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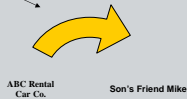
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## Two-Party Contract



1. Rental company will rent a safe car to Mike.



1. Mike will pay for car.  
2. Mike will return car with no damage.

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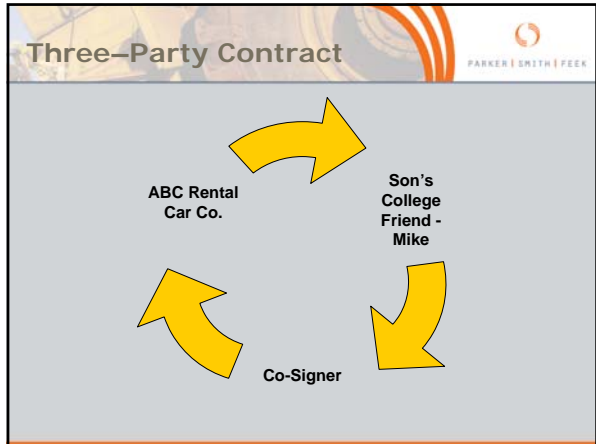
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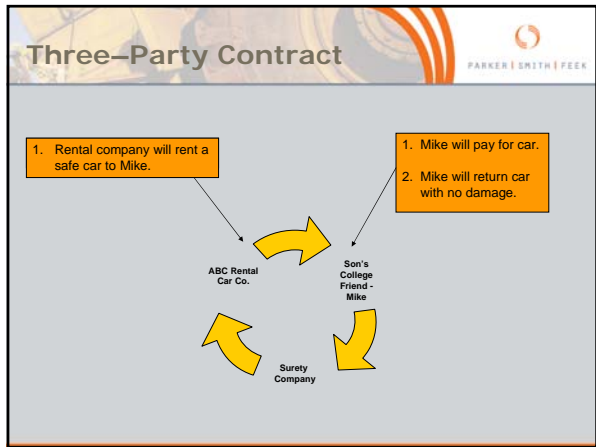
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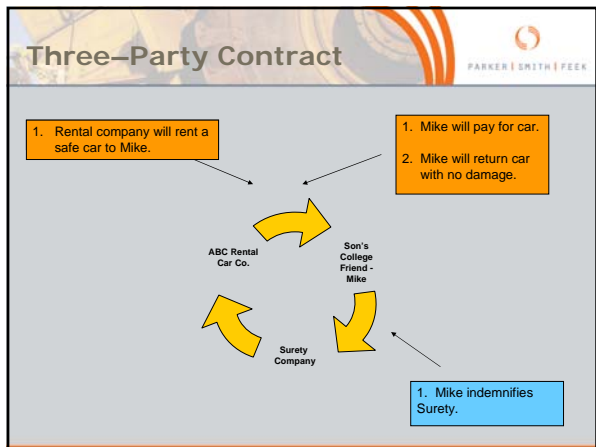
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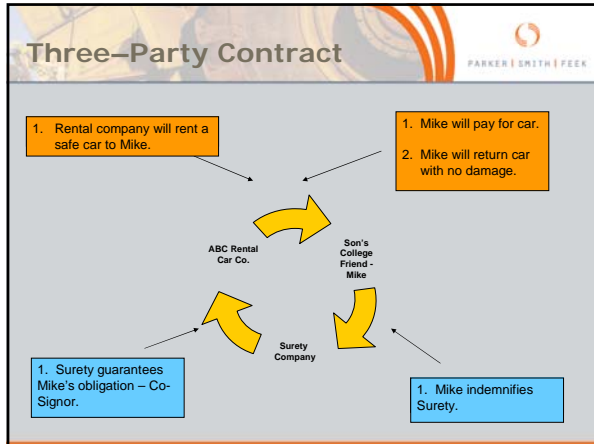
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### Principals of Suretyship

**Definition:** *One who has become legally liable for the debt, default or failure in duty of another.*

**Three Party contract:**

- **Principal:** Contractor is known as this within a bond.
- **Surety:** Underwrites risk; guarantees project to the owner
- **Obligee:** Bond guarantees performance and payment to this party; can be the owner of the project or a prime contractor.

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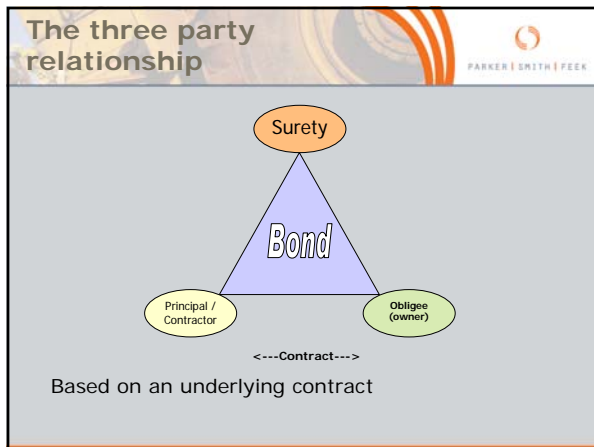
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## Basic types of Construction Bonds



- **Bid Bonds:** Guarantee that the contractor will provide a performance & Payment bond if low.
- **Performance & Payment Bonds:** Usually combined into one form which guarantees that the contractor will complete the job in accordance with their contract and that they will pay their subs and suppliers.

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## Bid Bond



Principal: ABC Contractor  
 Surety: Travelers  
 Oblige: XYZ School Dist.  
 Project: Big Box School



**BID BOND** Farmington Casualty Company  
 One Tower Square 3PB, Hartford, CT 06183

Bond No. \_\_\_\_\_

KNOW ALL MEN BY THESE PRESENTS,

That we, ABC Contractor, as Principal, hereinafter called the Principal, and Travelers Casualty and Surety Company of One Tower Square 3PB, Hartford, CT 06183, as Surety, hereinafter called the Surety, are held and firmly bound unto XYZ School District, as Oblige, hereinafter called the Oblige, in the sum of \$100,000.00, to the payment of which we will jointly be bound, the said Principal and the said Surety, bond ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

WHEREAS, the Principal has submitted a bid for Big Box School Building Project

NOW, THEREFORE, if the Oblige shall accept the bid of the Principal and the Principal shall enter into a Contract with the Oblige in accordance with the terms of such bid, and give such bond or bonds as may be specified in the bidding or Contract Documents, with good and sufficient surety for the faithful performance of such Contract and for the proper payment of labor and material furnished in the prosecution thereof; or in the event of the failure of the Principal to enter such Contract and give such bond or bonds, if the Principal shall pay to the Oblige the difference not in excess of the penalty hereof between the amount specified in said bid and such larger amount for which the Oblige may in good faith contract with another party to perform the work covered by said bid, then this obligation shall be null and void, otherwise to remain in full force and effect.

Signed and sealed this \_\_\_\_\_ day of \_\_\_\_\_

By: \_\_\_\_\_ (Seal)  
 Witness: \_\_\_\_\_  
 Travelers Casualty and Surety Company (Seal)  
 By: \_\_\_\_\_ (Seal)  
 Witness: \_\_\_\_\_  
 Attorney-in-Fact

Printed in cooperation with the American Institute of Architects (AIA) by Travelers Casualty and Surety Company of America. The language in this document conforms to the language used in the ConsensusDocs Bid, Payment and Performance Bond.

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## Payment & Performance Bond



Principal: ABC Contractor  
 Surety: Travelers  
 Oblige: XYZ School Dist.  
 Project: Big Box School

**PERFORMANCE AND PAYMENT BOND** Farmington Casualty Company  
 One Tower Square 3PB, Hartford, CT 06183

Bond No. \_\_\_\_\_

KNOW ALL MEN BY THESE PRESENTS, THAT

We, ABC Contractor, as Principal, hereinafter called the Principal, and Travelers Casualty and Surety Company of One Tower Square 3PB, Hartford, CT 06183, as Surety, hereinafter called the Surety, are held and firmly bound unto XYZ School District, as Oblige, hereinafter called the Oblige, in the sum of \$100,000.00, to the payment of which we will jointly be bound, the said Principal and the said Surety, bond ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

WHEREAS, the Principal has entered into a written contract with the Oblige, dated the \_\_\_\_\_ day of \_\_\_\_\_, in and to the effect that the Principal shall perform the work which is herein set forth and which is hereinafter described in this instrument, and the Surety has agreed to furnish a bond in the sum of \_\_\_\_\_ to guarantee the performance of such contract; and

NOW, THEREFORE, the Surety hereby certifies to the Oblige, that it is a duly licensed and authorized surety company under the laws of the State of Connecticut, and is authorized to issue such bonds, and that it is a member of the American Institute of Architects (AIA) and is bound to the same extent as if signed at length herein.

AND WHEREAS, the Surety hereby certifies to the Oblige, that it is a duly licensed and authorized surety company under the laws of the State of Connecticut, and is authorized to issue such bonds, and that it is a member of the American Institute of Architects (AIA) and is bound to the same extent as if signed at length herein.

PROVIDED, HOWEVER, that no action, suit or proceeding shall be had or maintained against the Surety on this instrument unless the same be brought or instituted and process served upon the Surety within two years after completion of the work specified in said contract, whether such work be completed by the Principal, Surety or Owner; and that if any maintenance bond provided in the contract for which said Surety is liable, an action for maintenance may be brought within two years from the expiration of the maintenance period, but not afterwards.

IN WITNESS WHEREOF, the said Principal and Surety agreed and sealed this instrument this \_\_\_\_\_ day of \_\_\_\_\_

By: \_\_\_\_\_ (Seal)  
 Witness: \_\_\_\_\_  
 Travelers Casualty and Surety Company (Seal)  
 By: \_\_\_\_\_ (Seal)  
 Witness: \_\_\_\_\_  
 Attorney-in-Fact

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**Principles of Suretyship Continued**



- The *Surety* provides credit in the form of a bond. The surety is indemnified by the *Principal* against loss.
- The *Obligee* (owner or upstream contractor) has assurance that their obligation will be met and gets a prequalification that the *Principal* can complete the job.
- *Principal* is granted credit and is responsible for fulfilling their obligation to both the *Obligee* and the *Surety*.

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**Principals of Suretyship**



- **Rights/Benefits of all parties:**
- **Surety** company is indemnified by principal
  - Premium is earned
  - Indemnity – security against loss or damage
    - If there is a claim – Surety Company will “subrogate”
- **Obligee** has assurance obligation will be fulfilled; company is pre-qualified
  - Surety writes check, finishes job, or rebids if obligation not fulfilled
- **Principal** gets surety's pre-approval and legal defense (good faith)

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**How surety is different from insurance**



If the principal does not perform and the Surety is obligated to act, the surety has the right of *indemnification*. Similar to a bank loan.

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**Insurance vs. Surety**  PARKER | SMITH | FEEH

Surety Bonds	Traditional Insurance
3 – Party Agreement	2 – Party Agreement
Risk Transfer	Risk Transfer
Protect Obligee	Protect Insured
Regulated by State Insurance Departments	Regulated by State Insurance Departments
No exception of loss	Calculated pooled risk
Project Specific	Term Specific
Penal Sum	Policy limits

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**Insurance vs. Surety**  PARKER | SMITH | FEEH

- Like bank credit:
  - for the principal to use our name as a guarantee – or a “co-signer”

Visa		Surety Bond
Charge dinner	→	Execute a bond
Pay the balance	→	No claim
Pay interest/annual fee	→	Pay the premium
Don't pay balance	→	Claim
Collections	→	Subrogation, etc.

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**Indemnity**  PARKER | SMITH | FEEH

- Types:**
  - Applications
  - General Agreement of Indemnity

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**Indemnity**

- **Determining Who Indemnifies**
  - Organizational Structure
  - Personal Indemnity

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**Part 2**

Agenda:

- The 3 C's of Surety.
- Basic understanding of financial statements.
- How to obtain a bond.

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**The 3 C's of Surety**

**Character**

"The moral and ethical nature of an individual or business entity."

- Honesty and integrity
- Personal and business record
- Trade payment record
- Sense of commitment

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## Capacity



"The contractor's ability to perform a project successfully."

- Prior experience and performance record
- Organization and Management
- Plant and Equipment
- Contractor's backlog



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## Capital



"The measure of a contractor's financial ability to assume the risks of business activity."

- Equity
- Working capital
- Cash flow
- Bank Line

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## Defaults



In case of default the surety has the option to remedy

- Pay penal sum
- Fund the contractor
- Hire another contractor to complete the job

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## Reading and Understanding Financial Statements



### Types of CPA reports

- Audit
- Review
- Compilation



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## Financial Analysis



### What's important?

- Profitability
- Working capital
- Equity
- Quality of Accounts Receivable
  - Aging of receivables
- Work in progress schedule

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## Key Financial Ratios



- Current ratio
- A/R turnover
- Working capital to backlog
- Net worth to backlog
- Debt to worth
- Net income to sales



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## How to obtain a bond



- Bonding Companies need to understand the project that is bidding. The more detailed info delivered to your broker, the easier the process.
  - Sub-breakdown vs. self performed work.
  - Quality of subcontractors / bonding back subs...
  - Scheduling.
  - Cash flow (front-end loading bid, material payment billed and collected before payment...).
  - Liquidated Damages.

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## Additional Criteria



### Industry-standard Submission Requirements

- 3 years of CPA Audited or Reviewed financial statements with supporting Work in progress schedules.
- Bank line of credit
- Contractors questionnaire
- Personal financial statement

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## QUESTIONS / DISCUSSION



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