Build momentum.

Insurance & Bonding 101

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HOLMES MURPHY

CONSTRUCTION

BUILD MOMENTUM

Contents

Insurance

Bonding

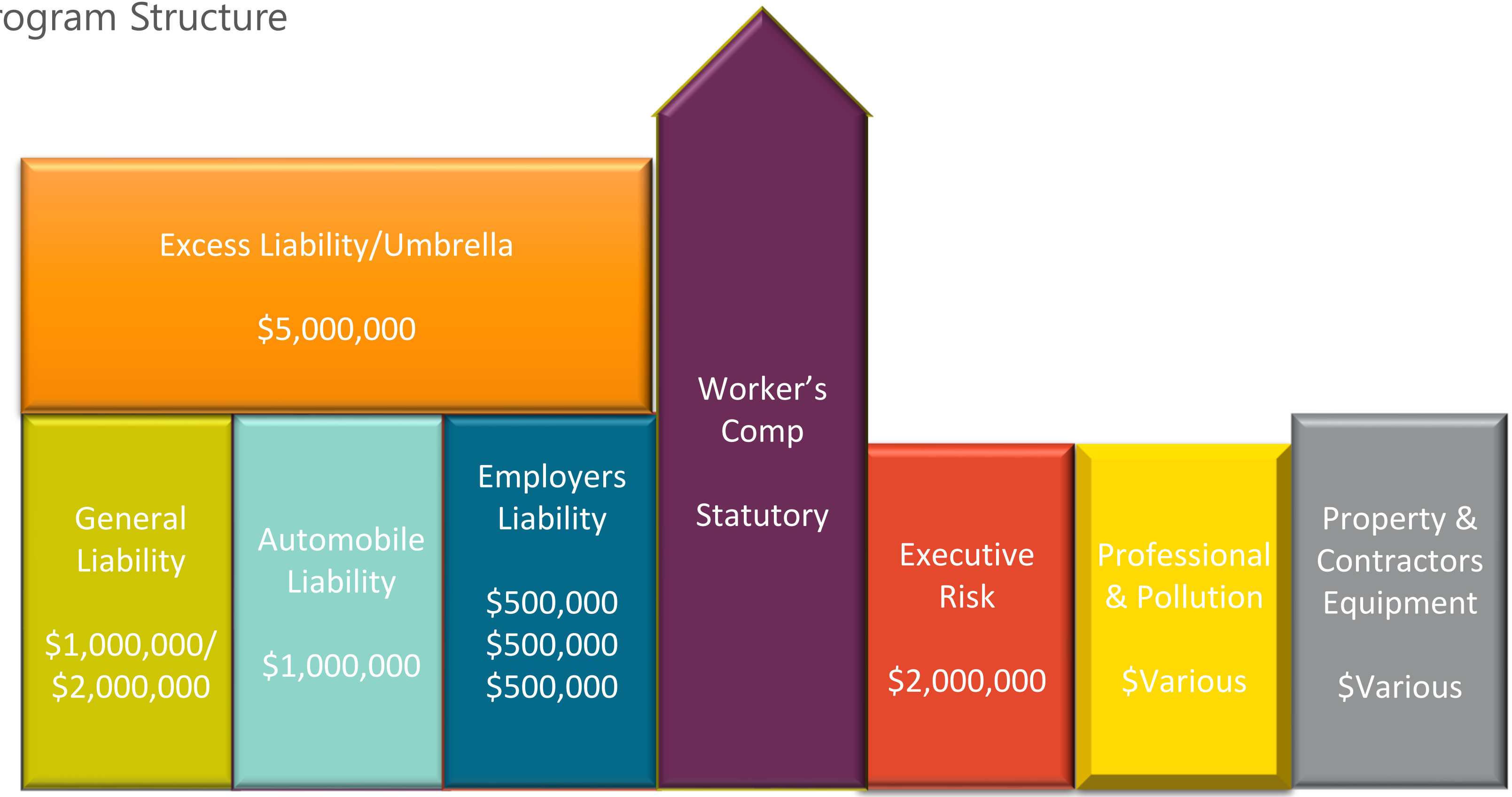
Insurance Basics

- **Insurance:** A contractual relationship when one party (insurer) for a consideration (premium) agrees to reimburse another (insured) for a loss to a specific subject (the risk) caused by a designated contingency (hazard or peril)
- **Primary Insurance:** The policy that responds first to an insured loss
- **Umbrella Insurance:** Coverage that applies when primary insurance has been exhausted
- **First Party Coverage:** Insurance applying to the insured's own property or person
- **Third Party Coverage:** Insurance applying to the risk of losses to third parties
- **Exclusion:** Policy provision referring to a hazard, peril, circumstance of property that is not covered by the policy
- **Subrogation:** The assignment to an insurer by terms of the policy or by law, after payment of a loss, of the rights of the insured to recover the amount of the loss from one legally liable for it

Policy Structure

- **Exclusion:** Narrows the scope of the coverage definition
- **Supplementary Payments**: Miscellaneous financial and other obligations paid by the carrier in regards to the investigation and resolution of claims
- **Who is an Insured:** Person or entities that are protected under the policy
- **Limits of Insurance:** Financial parameters of carrier obligations
- **Conditions:** The rights, duties and obligations of each party
- **Coverage Endorsements:** Enhancements and restrictions
- **Deductible:** The amount the insurer will deduct from the loss before paying up to it's policy limits

Program Structure



Worker's Compensation

- Policy which delivers no-fault statutory benefits prescribed in state law(s) to an employee (or the employee's family) due to a job-related injury (including death) resulting from an accident or occupational disease.
  - Every state's worker's compensation law contains an Exclusive Remedy provision that states the benefits provided by Worker's Compensation coverage are the sole remedy available to an employee injured on the job.

- Included under this policy is ***Employers Liability*** coverage. This coverage pays on behalf of the insured (employer) all sums that the insured becomes legally obligated to pay as damages and defense for work-related injury or disease <u>not covered</u> by the workers compensation law.
  - Employers Liability Claims are rare
    - Claim examples for Employers Liability:
      - Worker cuts off hand while working on metal press brake, sues the employer for lack of maintenance on the machine
      - Worker is seriously injured and his wife suffers a heart attack while caring for him

Worker's Compensation

- Limits are not stated on a Workers' Compensation policy as benefits are provided according to what is required by state law(s).
    - **Other States Coverage:** Expands the policy so that an injured employee can receive prescribed compensation benefits in states listed on the endorsement. However, coverage only applies to states so listed, and coverage cannot be extended in this manner to monopolistic fund states.
    - **Extraterritorial Coverage:** Most state WC laws are extraterritorial meaning the benefits extend to an employee who is injured while temporarily working outside of their normal state of employment.
    - **Monopolistic State Funds:** There are four (4) states where the state is the insurer and private insurance is not allowed: North Dakota, Ohio, Washington, Wyoming
- Employers Liability limits are typically shown:
    - Bodily Injury by Accident $500,000 Each Accident
    - Bodily Injury by Disease $500,000 Policy Limit
    - Bodily Injury by Disease $500,000 Each Employee

Worker's Compensation

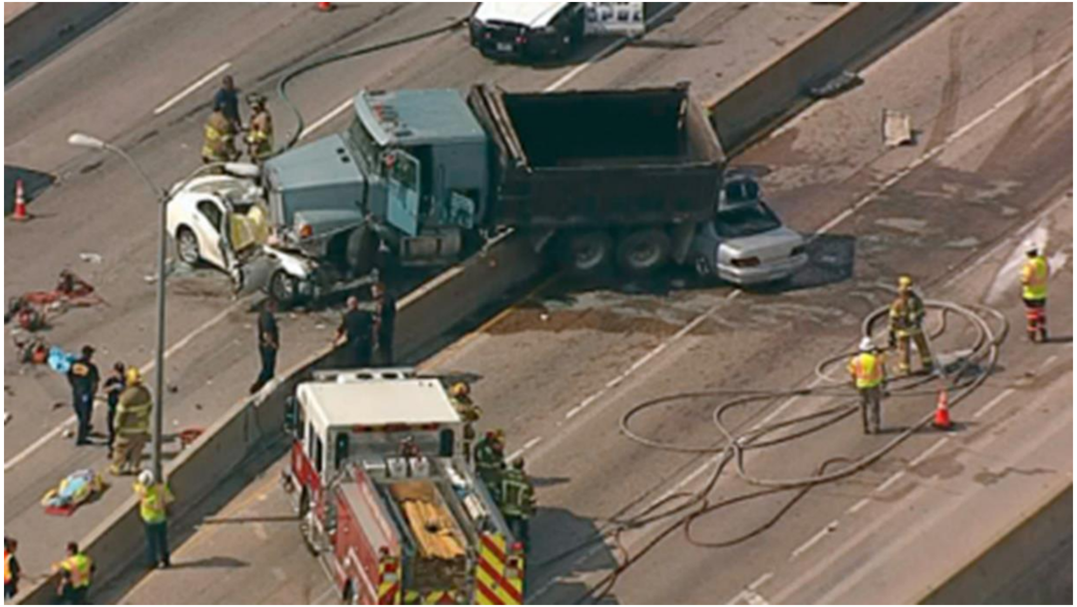
- Key modifications of a contractors Worker's Compensation policy include:
  - **Stop Gap Endorsement:** Monopolistic State Fund workers compensation policies do not provide Employers Liability coverage. A Stop Gap endorsement closes this coverage gap.
  - **Blanket Waiver of Subrogation Endorsement:** When required by written contract.
  - **USL&H Coverage:** Endorsement provided federally required WC coverage for certain maritime employments – generally, loading, unloading, repairing, or building a vessel or support facilities.
  - **Maritime Coverage Endorsement:** Provides common law require EL coverage for "transportation, wages, maintenance, and cure", owed by the owner to "masters or members of a crew". Also, seamen can sue the vessel owner for damages resulting from the ship not being seaworthiness.

Automobile

- **Liability and Physical Damage**

    - **Auto Liability:** Third party insurance protecting the insured against financial loss because of legal liability for automobile-related injuries to others or damage to the property of others by an auto.

    - **Auto Physical Damage:** First party insurance covering damage to owned, leased or rented vehicles.



Automobile

- **Auto Liability:** Limits are typically:$1,000,000 Combined Single Limit. This limit applies per accident regardless of the number of covered autos, claims, or vehicles that are involved. No aggregate limit applies to this coverage. Defense costs are covered and are outside of the policy limit of liability.

- **Medical Payments:** Optional coverage to pay for medical expenses caused by an auto accident regardless of fault.
- **Uninsured Motorist (UM) Coverage:** Coverage for named insured for Bodily Injury caused by a motorist that does not have insurance.
- **Underinsured Motorist (UIM) Coverage:** Coverage for named insured for Bodily Injury caused by a motorist who is not sufficiently insured
- **Auto Physical Damage** includes:
  - **Comprehensive coverage:** applies to all 1st party auto other than Collision. Includes theft, vandalism, collision with a deer, hail damage, etc..
  - **Collision coverage:** applies to all 1st party auto loss involving a collision with another vehicle or object. The only exception is a collision with an animal is considered a Comprehensive loss.

Automobile

- Key modifications of contractors' automobile policies include:
  - **Any Auto:** includes owned, hired and non-owned autos.
  - **Additional Insured Coverage:** Provides policy protection to indicated parties as required by written contract.
  - **Primary/Non-Contributory Language:** The contractor's policy must pay before other applicable policies (primary) and without seeking contribution from other policies that also claim to be primary (noncontributory).
  - **Waiver of Subrogation:** Waives insured rights to seek recovery from another party. Endorsement when required by written contract.
  - **MCS-90 Endorsement:** Government mandated coverage for haulers of hazardous materials.
  - **Automobile Broadened Pollution Coverage:** Endorsement responds to coverage required by MCS-90 Endorsement.

General Liability

- Insurance protecting commercial insureds from **third party** liability exposures other than automobile, pollution liability, professional liability

LIMITS	
EACH OCCURRENCE	$ 1,000,000
DAMAGE TO RENTED PREMISES (Ea occurrence)	$ 100,000
MED EXP (Any one person)	$ 5,000
PERSONAL & ADV INJURY	$ 1,000,000
GENERAL AGGREGATE	$ 2,000,000
PRODUCTS - COMP/OP AGG	$ 2,000,000
	$

Examples:

- Claimant is claiming mud on the road caused motor accident. Claimant alleges that contractor left material on the road causing physical damage and bodily injury.
- Subcontractor backed over claimant causing brain injury
- Trailer from subcontractor's truck came loose and went into oncoming traffic striking claimants vehicle.
- Claimant alleges respiratory issues after inhaling wood dust from grinding machines nearby.
- Claimant alleges mold got into their home from mulching operations nearby.

General Liability

- Key modifications of a contractors General Liability policy include:
  - **Per Project General Aggregate:** Provides a full policy General Aggregate limit for each construction project
  - **Additional Insured Coverage:** Provides policy protection to indicated party as required by written contract. Separate forms for Ongoing and for Completed Operations
  - **Blanket Waiver of Subrogation:** Insured waives rights to seek recovery from another party. As required by written contract
  - **Primary/Non-Contributory Language:** contractor's policy must pay before other applicable policies (primary) and without seeking contribution from other policies that also claim to be primary (noncontributory)

Umbrella/Excess

- Third party coverage is designed to provide protection against catastrophic losses. It generally is written over various **primary** liability policies, such as the business auto liability, commercial general liability and employers' liability.

    - Two alternative forms are available:
        - **Umbrella** policy may be broader than the underlying liability policies in certain areas.

        - **Excess Liability** policy is no broader than the underlying liability policies; its sole purpose is to provide additional limits of insurance

            - Regardless of form, seamless flow of coverage from the primary policies to the umbrella/excess policy is critical (concurrency).

Umbrella/Excess

- Coverage **does not** normally apply excess of the following coverage / policies:
  - Uninsured/Underinsured Motorist coverage
  - Medical Payments coverage (Auto and GL)
  - Personal Injury Protection (No-Fault)
  - Professional Liability
  - Pollution Liability
  - Aircraft Liability
  - Any other coverage or policy not listed in the schedule of "underlying insurance"

Umbrella/Excess

- Limits can range greatly depending on the insured's needs:
  - Size of Company – Revenue Size
  - States Worked in - IL, NY, CA are particularly litigious venues
  - Number of Autos and Size of Autos (more autos = more limits)
  - Net Worth of Company – need limits at least equal to retained earnings

- Typically, there is an Each Occurrence and Aggregate Limits such as:
  - $5,000,000 Each Occurrence Limit
  - $5,000,000 General Aggregate Limit
  - $5,000,000 Products & Completed Operations Limit

Professional Liability

- Third party coverage designed to protect traditional professionals (e.g., architects/engineers) and quasi professionals (e.g., real estate brokers) against liability incurred as a result of errors or omissions in performing professional services.

- Things to Consider:
  - Do you do Design-Build work?
  - Do you have any engineers on staff?
  - What does your website say you do?
  - Almost always excluded on your General Liability policy

- Although there are a few exceptions, most professional liability policies cover **economic losses** suffered by third parties, as opposed to bodily injury and property damage (which is typically general liability). Defense coverage is included in and not in addition to the limit of liability.

Contractors Pollution Liability

- Third party coverage designed to protect the contractor for *Pollution Conditions* that arise out of the contractor's construction operations.
    - Sample Policy Definition: Pollutant means any solid liquid, gaseous or thermal pollutant, including but not limited to smoke, vapors, odors, soot, fumes, acids, alkalis, toxic chemicals, hazardous substances, petroleum hydrocarbons, waste materials, including medical, infectious and pathological wastes, legionella, electromagnetic fields, mold matter and low-level radioactive waste material.

- Coverage Grant
    - The company will pay on your behalf, all sums that you are legally obligated to pay for bodily injury, property damage or CLEAN UP COSTS caused by an unexpected or unintended pollution condition and resulting from your operations as a contractor. Defense coverage is included in and not in addition to the policy limit of liability.

Contractors Pollution Liability Claim Examples

- Paving Contractor – After laying the “tack” coat of naphtha in preparation for the final coat of blacktop on a new road job, a heavy rain hit, washing the toxic material into a drainage ditch along the road and, subsequently, into a stream. The cleanup costs exceeded $150,000.
- A telecommunications contractor performed trenching to lay fiber-optic cable. The contractor crushed a sewage line causing sewer back-ups at several businesses. This resulted in lost revenue to area businesses and clean-up costs in the amount of $80,000.
- A drywall contractor working on a project to build a new multistory building nicked a water pipe with a drywall screw while working on the fourth floor. This caused a slow leak behind the drywall that went down to the first floor resulting in mold growth throughout the floors below. The affected drywall was removed and replaced, and the mold remediated at a cost of $200,000.

Contractor’s Equipment

- First party coverage – designed to protect against loss or damage to owned or leased/rented contractors equipment and tools used on the jobsite.

Certificates of Insurance

- A document issued by an insurance company or its representative (agent)
- Includes important coverage information
- A snapshot in time of coverages in place on the day it is issued
- Does not provide coverage

ACORD

CERTIFICATE OF LIABILITY INSURANCE

DATE (MM/DD/YYYY)

THIS CERTIFICATE IS ISSUED AS A MATTER OF INFORMATION ONLY AND CONFERS NO RIGHTS UPON THE CERTIFICATE HOLDER. THIS CERTIFICATE DOES NOT AFFIRMATIVELY OR NEGATIVELY AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW. THIS CERTIFICATE OF INSURANCE DOES NOT CONSTITUTE A CONTRACT BETWEEN THE ISSUING INSURER(S), AUTHORIZED REPRESENTATIVE OR PRODUCER, AND THE CERTIFICATE HOLDER.

IMPORTANT: If the certificate holder is an ADDITIONAL INSURED, the policy(ies) must have ADDITIONAL INSURED provisions or be endorsed. If SUBROGATION IS WAIVED, subject to the terms and conditions of the policy, certain policies may require an endorsement. A statement on this certificate does not confer rights to the certificate holder in lieu of such endorsement(s).

PRODUCER	CONTACT NAME:	
	PHONE (A/C, No, Ext):	FAX (A/C, No):
	E-MAIL ADDRESS:	
	INSURER(S) AFFORDING COVERAGE	NAIC #
	INSURER A :	
INSURED	INSURER B :	
	INSURER C :	
	INSURER D :	
	INSURER E :	
	INSURER F :	

COVERAGES CERTIFICATE NUMBER: REVISION NUMBER:

THIS IS TO CERTIFY THAT THE POLICIES OF INSURANCE LISTED BELOW HAVE BEEN ISSUED TO THE INSURED NAMED ABOVE FOR THE POLICY PERIOD INDICATED. NOTWITHSTANDING ANY REQUIREMENT, TERM OR CONDITION OF ANY CONTRACT OR OTHER DOCUMENT WITH RESPECT TO WHICH THIS CERTIFICATE MAY BE ISSUED OR MAY PERTAIN, THE INSURANCE AFFORDED BY THE POLICIES DESCRIBED HEREIN IS SUBJECT TO ALL THE TERMS, EXCLUSIONS AND CONDITIONS OF SUCH POLICIES. LIMITS SHOWN MAY HAVE BEEN REDUCED BY PAID CLAIMS.

INSR LTR	TYPE OF INSURANCE	ADDL INSD	SUBR WVD	POLICY NUMBER	POLICY EFF (MM/DD/YYYY)	POLICY EXP (MM/DD/YYYY)	LIMITS	
A	X COMMERCIAL GENERAL LIABILITY	Y					EACH OCCURRENCE	$ 1,000,000
	CLAIMS-MADE X OCCUR						DAMAGE TO RENTED PREMISES (Ea occurrence)	$ 100,000
	X Contr Liab per						MED EXP (Any one person)	$ 5,000
	X Policy Form/XCU						PERSONAL & ADV INJURY	$ 1,000,000
	GEN'L AGGREGATE LIMIT APPLIES PER:						GENERAL AGGREGATE	$ 2,000,000
	POLICY PRO-JECT X LOC						PRODUCTS - COMP/OP AGG	$ 2,000,000
	OTHER:							$
A	AUTOMOBILE LIABILITY	Y					COMBINED SINGLE LIMIT (Ea accident)	$ 1,000,000
	X ANY AUTO						BODILY INJURY (Per person)	$ 1,000,000
	OWNED AUTOS ONLY / SCHEDULED AUTOS						BODILY INJURY (Per accident)	$ 1,000,000
	HIRED AUTOS ONLY / NON-OWNED AUTOS ONLY						PROPERTY DAMAGE (Per accident)	$
	X Comp $1,000 X Coll $1,000							$
A	X UMBRELLA LIAB X OCCUR	Y					EACH OCCURRENCE	$ 10,000,000
	EXCESS LIAB CLAIMS-MADE						AGGREGATE	$ 10,000,000
	DED X RETENTION $ 10,000							$
A	WORKERS COMPENSATION AND EMPLOYERS' LIABILITY Y / N						X PER STATUTE OTH-ER	
	ANY PROPRIETOR/PARTNER/EXECUTIVE OFFICER/MEMBER EXCLUDED? (Mandatory in NH) N	N / A					E.L. EACH ACCIDENT	$ 1,000,000
	If yes, describe under						E.L. DISEASE - EA EMPLOYEE	$ 1,000,000
	DESCRIPTION OF OPERATIONS below						E.L. DISEASE - POLICY LIMIT	$ 1,000,000
A B	Leased/Rented Equipment Poll/Prof Liability Claims Made						Limit: Each Loss: Aggregate:	100,000 3,000,000 3,000,000

DESCRIPTION OF OPERATIONS / LOCATIONS / VEHICLES (ACORD 101, Additional Remarks Schedule, may be attached if more space is required)

Types of Bonds

- Contract Bonds – Bid Bonds, Performance Bonds, Payment Bonds, Warranty/Maintenance Bonds

- Commercial bonds – License & Permit, Wage & Welfare, Right-of-Way, Mechanic's Lien Bonds, Notary Bonds, Appeal Bonds, etc.

Types of Bonds

Contract bonds are a form of agreement that provides assurance for:

- Owners
- Lenders
- Contractors
- Subcontractors

Main types of bonds during the construction projects:

- Bid Bonds – guarantees contractor will enter into contract and furnish performance and payment bonds
- Performance Bond – guarantees the performance of the contract and underlying specs
- Payment Bond – guarantees payment for labor and material provided to complete the contract
- Warranty/Maintenance Bond – guarantees completion of any required maintenance work according to the contract – 1st year included with performance/payment bonds

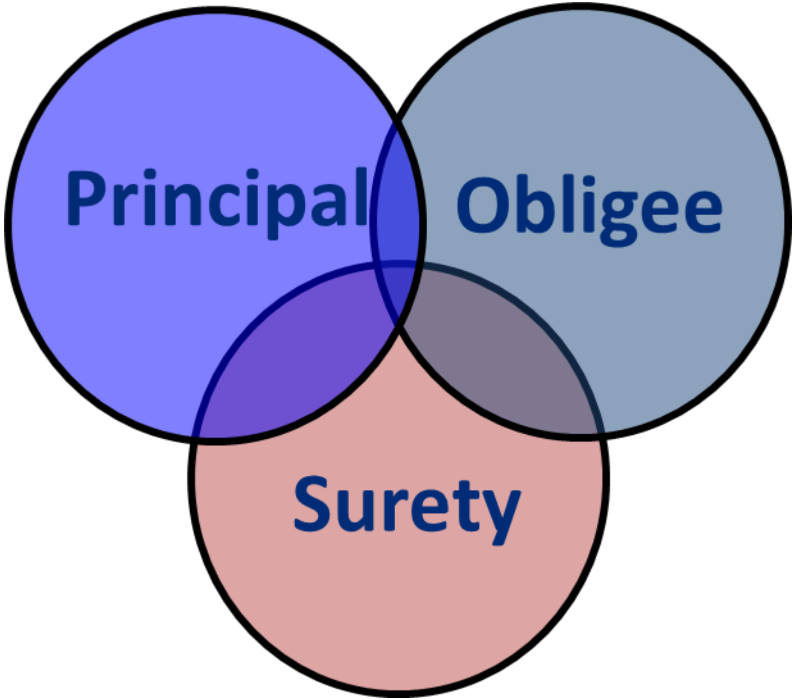
Surety vs. Insurance

Surety Bonds	Insurance
3 Party Agreement (Principal, Obligee, Surety)	2 Party Agreement (Insured, Insurer)
Premium is a fee for service provided	Premium based on expected loss
Covers default on underlying contract regardless of cause	Covers fortuitous loss subject to certain exclusions
Underwritten with no expected losses	Underwritten with loss expected based on class of insured and risk type
Surety can subrogate against principal for loss recoveries	Subrogation against insured would defeat the purpose of insurance
Risk transfer mechanism regulated by State Insurance Department(s)	

Three Party Agreement

A Bond is a three-party agreement between:

- Principal – the party required to provide the bond and paying for the bond
- Surety – the party issuing the bond
- Obligee – the party protected by the bond



Why Surety Bonds?

Most, if not all, public construction projects require bonds - Miller Act and Little Miller Acts

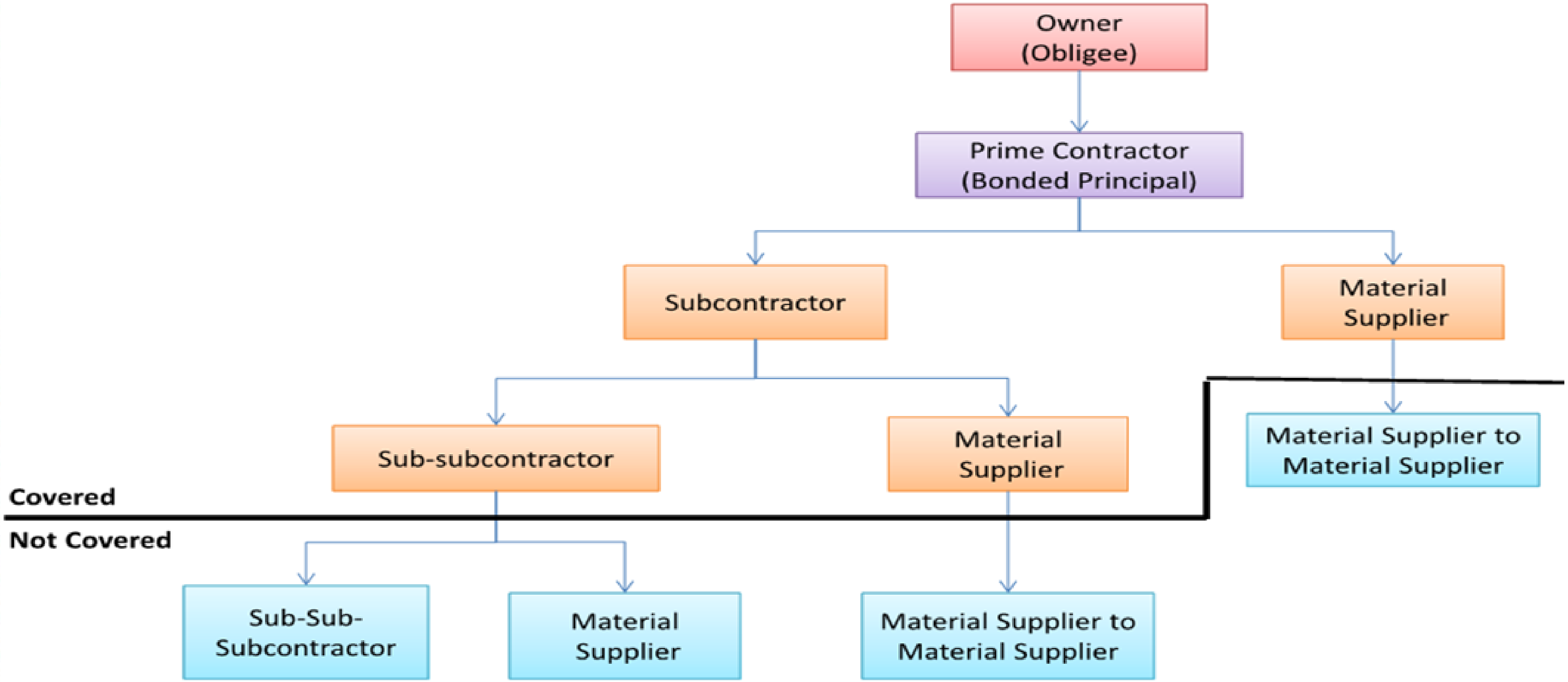
- Public entities want to ensure the projects get completed – protection of taxpayer $
- Bonds act as prequalification service for public entities
- Sovereign immunity - mechanic's liens cannot be filed on public projects

Some private project also use bonds to make sure their projects get completed. This is often required by the lender financing the construction costs.

Payment Bonds

- Sometimes referred to as material and labor bonds
- Almost always equal to 100% of the contract amount and issued along with a Performance Bond
- Payment bonds protect the Obligee against payment claims from Suppliers and Subcontractors
- Claimants file a payment bond claim in lieu of a mechanic’s lien on the property
- Limitation regarding the number of tiers covered
- Notification period for filling claims - 120 days in MN (same as lien period)
    - Not always the same in other states

Payment Bonds



Performance Bonds

Unlike a Payment Bond, which can protect several different parties, a Performance Bond is only for the benefit of the Obligee, against a failure of performance by the Principal.

- A performance bond comes into play when a bonded principal is in default and/or terminated.
- Almost always equal to 100% of the contract amount and issued along with a Payment Bond.
- The sureties prefer to provide the performance bond once the Contract is signed and executed.

The protection provided by a Performance Bond is a blend of the Subcontract, the bond and the law applicable to both contracts and bonds.

- Therefore, the Bond's process and procedures must be followed for the Performance Bond to function as intended.
- The termination of a contractor does not automatically mean the Surety will finance and complete the project.

Performance Bonds

Typically, the surety has a few options for to complete the obligation. This is often highlighted in the contract and/or bond forms. The most common options the surety has include:

- Work with contractor, with consent of project owner, to complete contract.
- Take over for contractor to complete contract through its agents or independent contractors
- Obtain bids/proposals from other qualified contractors acceptable to the Owner for contract completion
- Waive its right to the first three options and:
    - Determine what is owed to the owner and make payment
    - Deny liability in whole or in part citing reasons for denial.

Surety Bonding Underwriting Process

- Good character / reputation
- Financial strength
- Experience matching contract requirements
- Excellent credit history
- Business Relationships
    - Attorney
    - Bank
    - CPA
- Business Planning
- Necessary equipment / resources
- Indemnification / Guarantees

Surety Bonding Underwriting Process

- 3 years of CPA financials
  - Review quality / Good construction-oriented CPA
- Personal Financial Statements for Owners
- Completed Application
  - Background / Organizational Structure / Experience
- Internal Controls
  - Accounting Software / Job Costing / Reporting
- Work in Process Reports
- Bank Documents / Line of Credit / D&B Reports
- Continuity Plan
- Experience / Qualifications / References

Surety Bonding Underwriting Process

- **Analyzed** Working Capital & Equity
- Financial Ratios, Operational Performance and Trends
- WIP and Completed Contract Analysis
- Benchmarking & Credit Scoring
- Typical Bond Program Parameters
  - 10 to 20 times **analyzed** working capital and equity (typically includes bonded and unbonded backlog)
  - Single projects up to 2-3x largest completed project
- Bond rates range from 0.5% to 2%+ of contract value
- Broker Line of Authority

Surety Bonding Underwriting Process

- Bond request form
  - Owner, location, job description, bond form, contract amount, duration, L/D's, maintenance period, WOH, etc.

- Underwriter Review relative to the project:
  - Current backlog
  - Experience on similar projects
  - Job duration
  - Sub-contractors / Schedule of Values
  - Contract Terms
    - Default
    - Damages
    - Indemnifications
    - Maintenance / Warranty period

Subcontractor Default Insurance

What is Subcontractor Default Insurance (SDI)?

- An insurance policy which indemnifies the Project Owner and General Contractor for costs associated with Subcontractor default and adds value to the project as a risk mitigation method. Typically, these are rolling programs and cover multiple contracts. High limits and High deductibles.

Why was SDI created?

- Large General Contractors expressed concern with increasing risks of Subcontractor default, and their dissatisfaction with the structure and process involved with making claims against Subcontractor Surety Bonds. The idea is that the sophisticated GC can do a better job of prequalifying, selecting, and mitigating subcontractor risk and SDI aligns the incentive to do so with the lower cost of insurance coverage.

Subcontractor Default Insurance

Objectives of SDI?

- Control: puts control back in the hands of the GC project team vs. Surety Carrier.
- Coverage: provides consistent and efficient coverage.
- Cost: a cost-effective solution.
- Profit: by utilizing the GC's ability to prequalify, select, and mitigate subcontractor risk.

Why was would a Project Owner or Lender be Interested in SDI?

- Subcontractors will typically perform more than 75% of the work on a project.
- Subcontractors fail at a rate of over 90,000 firms per year.
- SDI generally carries a longer-term tail coverage for default.

Questions?
Observations?
Unique Experiences and Insights?

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Thank You.

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