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—Richard Brown, 2018 Craft Professional of the Year, Gaylor Electric


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—Richard Brown, 2018 Craft Professional of the Year, Gaylor Electric

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SPECIAL SECTION: CONTRACTORS’ GUIDE TO SURETY BONDING

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Changing of the Guard
Lynn Schubert Retires From SFAA After 22 Years of Service

In 1996, the Surety Association of America, SFAA’s predecessor, set a vision to further enhance its mission by promoting and preserving the use of surety and fidelity bonds. Historically, the organization had focused mainly on providing statistical and actuarial materials for its members and regulators, gradually adding services such as bond form review, advocacy and promotion.

That’s when the talents of Lynn M. Schubert came in. As the first woman to head a national insurance trade association, Schubert has served as president of SFAA for the past 22 years, forever changing the industry for the better. During her dedicated years of leadership, Schubert transformed the organization to meet the needs of its members in the modern world.

Schubert passionately promoted the industry through the Surety Information Office, SFAA communications, various publications, federal and state-level advocacy, legal advocacy, developing strategic partnerships, and testifying before Congress and state legislatures on the benefits of bonding. She also was a founding member of the International Surety Association, a confederation of associations from around the world specializing in surety bonds.

In 2018, Schubert was elected to the National Academy of Construction. She is a recipient of 2017 Trending 40’s Top Association CEOs, the 2015 Martin J. Andrew Award for Lifetime Achievement from the American Bar Association Fidelity & Surety Law Committee, the Women Builders Council 2008 Champion Award, and the 2008 Private Sector Leadership Award of the Jamaica Business Resource Center for work in leading the surety industry in efforts to assist women and minority contractors to become bondable businesses.

A frequent international lecturer on the topics of fidelity and surety bonds, procurement, and diversity and inclusion, Schubert received her undergraduate degree in business administration from East Carolina University and her law degree from the University of Notre Dame.

Thank you for your service, Lynn!

Lee Covington Takes the Helm

Lee Covington assumed the role of SFAA president on Oct. 1. Previously, he served as general counsel and senior vice president, governmental affairs for the Insured Retirement Institute, leading its federal and state legislative and regulatory initiatives since 2009.

His focus on insurance law began in 1993 in Little Rock, Arkansas, where he rose to become the deputy commissioner of the Arkansas Insurance Department. Covington honed his leadership skills as the director of the Ohio Department of Insurance from 1999 to 2002, where he served on the National Association of Insurance Commissioners Executive Committee, and then moved to positions of influence on the national stage in Washington, D.C.

Covington serves on the board of the Griffith Foundation for Insurance Education and is a member of the editorial review board of the Journal of Insurance Regulation. He began his legal career as law clerk to U.S. District Judge Jimm L. Hendren.

Welcome, Lee!

Lauren E. Pinch
Editor-in-Chief
Hudson Insurance Company is part of Hudson Insurance Group, a specialty insurance group that writes business on an admitted basis through Hudson Insurance Company and on a non-admitted basis through Hudson Specialty Insurance Company and Hudson Excess Insurance Company. Hudson offers a wide range of property and casualty insurance products to corporations, professional firms and individuals.

Hudson Surety is comprised of an experienced group of underwriters with deep industry knowledge that enables us to offer creative, personalized solutions to our clients. We work closely with select agents throughout the United States to provide superior service.

Hudson Surety provides surety bond products for standard contract surety, commercial surety and specialty contract surety. We have the expertise to work with all types of contractors and the financial strength to grow with our valued principals.

**CONTRACT SURETY**
Regional knowledge of the construction marketplace has been an important element of our underwriting approach. Our contract underwriters work closely with our agency partners to understand our customers’ needs in order to develop a surety program that supports their plans. Our client base consists of general contractors, as well as many specialty trade contractors.

**COMMERCIAL SURETY**
Exceptional customer service and a broad appetite for both standard and non-standard risks have driven the success of Hudson’s transactional commercial surety business. Our products include all types of license and permit bonds, custom bonds, public official bonds, court bonds and miscellaneous commercial bonds.

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For contractors that may not fit the underwriting criteria of the standard surety market, we offer an alternative solution utilizing tools such as collateral and funds control. We support the bonding needs of the contractor until they qualify for our standard surety program and participate in the SBA Surety Bond Guarantee Program.
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Liberty Mutual Surety, a business unit of Liberty Mutual Insurance, is the second largest surety in the United States and a leading surety globally. We are continually expanding our global presence by establishing offices and issuing bonds worldwide. We have the capacity, capabilities and professionals to underwrite all types and sizes of contractors and corporations.

As of July 1, 2018, our combined U.S. Treasury Listing is in excess of $1.7 billion, which is among the highest in the industry. With more than 40 U.S. field offices and dedicated surety staff in 14 countries, we have the ability to arrange issuance of bonds and guarantees in more than 40 countries worldwide.

Liberty Mutual underwrites all types of regional, national, multinational and global contractors. Our surety operations provide program capacity for all size contractors, and for well-capitalized construction, manufacturing and supply risks. In collaboration with other Liberty Mutual units, we also can provide you with comprehensive property and casualty coverage, ensuring that all aspects of your projects are protected.

When you choose Liberty Mutual, you’ll work with one company to cover construction risks from start to finish. Choose a company that you can trust, choose Liberty Mutual Surety.

For more information, contact your independent agent or broker, or visit libertymutualsurety.com.

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libertymutualsurety.com
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We have the value-added services to help make it happen.

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For more information, contact your agent or broker or visit www.LibertyMutualSurety.com.
Nationwide® represents a wealth of experience in surety and specialty liability insurance ranging from management liability to cyber and professional liability. Our surety operation specializes in both commercial and contract surety bonds. We pride ourselves on developing a close working relationship with our agents, brokers and principals in order to ensure a consistent underwriting approach to mitigate losses.

Our expertise allows us to be innovative. Our relationships allow us to understand the needs of your business. The result: unique surety and insurance products, and an analytical approach unrivaled by any other firm. We offer comprehensive surety bond solutions, including 50-state capacity and a flexible, multi-tiered rating plan, and we continue to add products each year.

When you work with us, you know you are working with a strong and stable carrier. Nationwide is a Fortune 100 company that the U.S. Treasury listed and approved with a T-listing in excess of $1.1 billion¹, and it is one of the largest in the industry. Add to that an A.M. Best Rating of A+ (Superior), FSC XV² and an S&P A+ rating³, and you can be sure you're working with one of the most financially stable companies in the industry.

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COMPANY HIGHLIGHTS

- Nationwide® is U.S. Treasury listed and approved with a T-listing in excess of $1.1 billion, one of the largest in the industry¹
- A.M. Best Rating of A+ (Superior), FSC XV²
- 50-state capacity
- Flexible, multi-tiered rating plan
- National organization offering a full range of surety products to meet all needs, from small to middle markets and large national firms.

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2. Affirmed July 2017
3. Affirmed July 2017
Strength. Stability. Solutions.

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We’re professional. We’re experienced. With our extensive underwriting knowledge, we are skilled in tailoring unique surety solutions as well as forging strong and lasting surety relationships. Let us create the bond solution that will work for you.
Old Republic Surety’s ultimate goal is your success. We’ve been in the surety industry long enough to know that it’s the human element of underwriting that you need, not an algorithm or machine. Our relationships aim for successful, profitable outcomes for both our appointed agents and their contractor clients. Our president can visit with you on a jobsite, and our business development and marketing departments can willingly share strategies to help you grow. That’s in addition to the incredible underwriting talent we have throughout the country. We are here for you—to help agents and contractors succeed.

CAPACITY
Old Republic Surety is well positioned to assist large and middle-market contractors with bond programs based on flexible, commonsense underwriting. We write contract bonds, bid bonds, performance and payment bonds, and maintenance bonds in all 50 states. Your business’ strengths are unique to you and deserve the consideration we’ve been trained to provide—your success will never be determined by a computer program with Old Republic Surety as your surety partner.

STANDARD BOND PROGRAMS
Need help setting up a standard bond program? Having a standard bond program in place offers contractors a more nimble approach to bidding on projects and turning them into profitable outcomes. Prequalification can give a contractor the opportunity to expedite the bond portion of the bid process.

Understanding the bonding process is an essential element of a contractor’s growth. If you need help positioning yourself with the right process in place, Old Republic Surety can help.

CONTRACT BONDS FOR GROWING CONTRACTORS
We’ve got a bonding option for smaller, growing contractors through our FastBond program. Based mostly on credit score, our FastBonds not only offer a quick, flexible answer for a smaller bond, but they also open the door for small contractors wanting to grow.

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Brookfield, WI 53005
Alan P. Pavlic
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PRODUCT HIGHLIGHTS
The FastBond program is designed for contractors who may need their first bond, or who only have occasional bond needs.
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• All construction trade
Some of your toughest challenges are ahead. We’re a surety partner that will be with you from start to finish - even through the tough stuff. Let’s do this!
Executive Insights

How can a construction company mitigate risk when getting ready to apply for a surety bond?

**MICHAEL P. CIFONE**  
SENIOR VICE PRESIDENT, SURETY UNDERWRITING  
Hudson Insurance Group  
On a daily basis, construction companies are confronted with risks associated with their labor force, subcontractors, contract terms, weather and unforeseen conditions. The ideal surety candidate has the ability to identify risks and manage them effectively. Once a risk is identified, the contractor has the option to avoid, eliminate, reduce or accept it.

The surety understands the risks surrounding the construction industry. When contractors are looking for surety support, they should demonstrate their knowledge of the risks and their plan to manage these risks. A long-range plan provides a good starting point for the contractor to address issues related to growth initiatives, succession planning, training and mentoring, and equipment and financing needs.

The daily risks associated with onerous contract terms, labor shortages, subcontractor defaults and equipment failures are best mitigated by a contractor with the proper management team operating with a practical long-range plan.

**HENRY W. NOZKO, JR.**  
PRESIDENT, SURETY UNDERWRITING  
ACSTAR Insurance Company  
Unforeseen project conditions can blow up a project’s cost. Estimating errors and omissions in drawings and contract documents could lead to cost overruns. Natural disasters and defective materials or equipment can crush the success of a project. Labor stoppages from work disputes or jurisdictional disputes can eradicate estimated profits. Funding shortfalls and litigious owners could kill a project. It is impossible for a contractor to control all of these factors; however, through risk mitigation, successful outcomes are greatly enhanced.

Vigorously renegotiate onerous contract terms and conditions. Secure insurance coverage for a particular project exposure in addition to simply purchasing required insurance. Confirm that adequate project financing has been secured. Negotiate extensions to labor agreements where the absence of such could give rise to work stoppages. Require bonds from critical subcontractors and suppliers. Research the litigation history of your customers.

**MIKE SANDERS**  
SENIOR VICE PRESIDENT, UNDERWRITING  
Old Republic Surety Company  
The individual a contractor selects as its agent for surety bonds has a tremendous impact on the contractor’s ability to obtain the most beneficial surety bonding program possible. Look for a bond agent who:

- understands the contractor’s business, goals and plans for the future;
- asks a lot of probing questions;
- gives you their undivided attention and really listens to your story;
- will respectfully challenge scenarios relative to both their business operations and to the surety bonding process;
- can access multiple surety companies to more effectively choose the company and the underwriter that best fits their surety needs; and
- finds value in building the relationship between the contractor and the underwriter. An agent demonstrating these traits will be most effective in presenting a contractor to a surety underwriter in the most favorable manner.

What top qualities should a construction company look for in a surety bond producer?
Can’t fit your contractor’s bond into an express program?

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nozkojr@acstarins.com

Henry Nozko III
nozk03@acstarins.com

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What clauses should bond producers and construction companies be on the lookout for in contracts?

Bogda M. Clarke
Associate Vice President, Surety Claims
Nationwide

Heightened risks from onerous contract provisions pose a threat to subcontractors from project delays wholly unrelated to their work. If the subcontractor has agreed to broad language obligating it to meet the project schedule as it may be revised and updated, coupled with “no damage for delay” language and clauses allowing the general contractor to supplement the subcontractor’s workforce, the subcontractor’s risks may skyrocket. A general contractor that has fallen behind in its work may seek to avoid its own liquidated damages exposure through contract provisions allowing for schedule compression and acceleration, causing inefficiencies to subcontractors and back-charge exposure to the subcontractor. Consequential damage exposure, without limitation in the subcontract, also may be unreasonably high. Subcontractors must not agree to clauses that unfairly expose their companies to ruinous consequences for project delays and disruptions for which they may not have been responsible.

Brian Smith
Contract Underwriting Officer
Liberty Mutual Surety

Contract provisions important to a contractor’s risk assessment include liquidated/consequential damages, default, payment terms, change orders, no damage for delay, final payment, warranties and hold harmless/indemnity. Key questions include:

• Are liquidated damages reasonable or capped? Is there a mutual waiver of consequential damages?
• Is there reasonable time to cure? Does the termination for default provision provide adequate notice to the contractor and surety?
• Is payment contingent upon receipt of financing?
• Are change order procedures clearly defined?
• In addition to time extensions, is the contractor compensated for job costs that were unforeseeable or due to owner delays?
• Does receipt of final payment waive all claims?
• Can extended warranties pass through to suppliers/manufacturers?

Steve Dorenkamp
Vice President, Claims Manager
Merchants Bonding Company

Our advice is: Always read your contract and, where appropriate, seek the input of your surety to help you avoid onerous bond language. Here’s a quick list of clauses to be aware of:

• Damage clauses, including liquidated, actual, consequential and efficiency;
• subcontract flow-down provisions;
• indemnification clauses;
• environmental indemnification clauses;
• differing site condition clauses;
• warranty, venue and jurisdiction provisions;
• attorney fee provisions; and
• statute of limitation waivers.

In each of these cases, the goal is to limit the risk to what a contractor and its surety should truly be responsible for and not force them to take on unnecessary risks. Your professional surety agent and surety underwriter should be able to assist you with identifying onerous contract language, allowing you to modify it and right-size your risk.
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Executive Insights

What clauses should bond producers and construction companies be on the lookout for in contracts?

CARL G. CASTELLANO
VICE PRESIDENT, CONTRACT SURETY
Philadelphia Insurance Companies

Cardinal rule No. 1: Read the contract and associated documents. Clauses, such as those outlined below, will be favorable for one party but not favorable for others. Beware of:

- Sole discretion to default/terminate
- Cross default language
- Consequential damages in general and especially if unspecified and uncapped
- Indemnity, particularly those in which the indemnitor assumes obligation for damages caused by indemnitee.
- Unreasonable liquidated damages
- Pay if paid clauses, where enforceable
- Long-term warranties, which continue to be the obligation of the contractor instead of a manufacturer
- Expanding coverage to such areas as personal injuries and copyright infringements
- If the project is bonded, clauses that could cause greater loss to a surety

How should a construction company prepare for its first meeting with a surety bond producer?

ROBERT E. SHAW
PRESIDENT
Skillings Shaw & Associates

The first meeting is about the bond producer and contractor learning more about each other’s goals, businesses and history, as well as identifying steps to meet the contractor’s business surety goals.

Bring all information, statements and reports, such as financial statements, résumés of key employees, trade references, recommendations and other pertinent documents requested by the bond producer.

The producer will explain for whom he or she works, how surety companies underwrite bonds, how bond rates work, how to request a bond, the importance of a good accountant, why bond underwriters care about construction accounting and bank support, the general surety marketplace, and how producers can coach contractors to attain higher levels of surety capacity.

He or she will explain how bonds are underwritten based on character (of the contractor), capacity (the expertise and experience of a contractor to handle a project) and capital (the financial strength of the contractor and its indemnitors).

Why is it important for contractors to choose a law firm experienced in surety bonding?

MICHAEL C. ZISA
PARTNER
Peckar & Abramson

When a contractor selects a law firm to defend or prosecute a claim against a performance or payment bond, it is essential to select a firm that not only understands the complexities of construction law but also has a true understanding of the legal and practical issues affecting sureties.

I regularly see well-seasoned construction lawyers who miss significant opportunities for their clients because they do not understand or appreciate the intricacies of surety law.

They do not understand the terms of the performance or payment bond and how those terms impact the contractor’s and surety’s right and obligations, which can result in costly consequences.
YOU NEED AN ARBITRATOR WHO UNDERSTANDS CONSTRUCTION.

WE HAVE THE EXPERTISE.

The AAA® Construction Industry Panel of Arbitrators and Mediators is composed of highly-qualified, diverse, and experienced construction attorneys and industry professionals. Our Construction Mega Project Panel of top construction arbitrators—rated by counsel for mega projects—based on their credentials and experience provides for disputes arising out of significant construction and infrastructure projects. When resolving your dispute requires construction industry expertise, trust the American Arbitration Association® and the International Centre for Dispute Resolution®.

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Executive Insights

How are surety bond companies keeping up with increased demand within the construction industry?

RICHARD BARNETT
SENIOR VICE PRESIDENT, SURETY DIRECTOR
Chubb Insurance

Investing in people remains a top priority. Contractors should make sure they are working with a seasoned surety that is not only deep in talent, but also consistently hires and trains new entrants.

Similarly, contracts and bond forms are getting more complex, particularly for large or privately financed projects. These require experienced and responsive legal resources to identify the inherent risks and potential solutions.

The surety industry is not immune to the need to improve efficiencies through technology. Best-in-class sureties are regularly investing in their platforms to enhance real-time access to information and timely decision-making.

With a growing and changing market, face-to-face interaction is as important as ever. A surety needs to be available to its clients to clearly understand their needs as well as their strategy to address risk.

Finally, there is no substitute for working hard and smart. Demands are great on contractors, requiring heavy investments of time and pursuit costs.

MICHAEL GROMAN
VICE PRESIDENT, INTERNATIONAL CNA Surety

On a pure capacity point of view, the availability of capital has been robust given the continued run of excellent industry results. Many established sureties have continued to leverage more of their own internal capital, and that of the reinsurers, by taking higher net retentions and placing higher excess of loss limits on top, translating into higher program capacity. Some sureties have adapted to the growth challenges by flattening their organizational oversight and moving more authority to the field.

Alternative surety solutions, such as expedited dispute resolution clauses and partial liquidity bonds, have grown in usage as contractors and sureties strive to meet the requirements of owners and lenders in the new public-private partnership models.

Lastly, more established sureties are going above and beyond the extension of surety credit by providing legal review to help avoid onerous contract terms, providing benchmarking tools for clients, and sharing their claims team insights on best practices.

BRAD GIBSON
VICE PRESIDENT, SURETY
Marsh & McLennan Agency

The surety industry as a whole managed to weather the recession fairly well and losses fell significantly short of expectations.

The profitability of the product has paved the way for an influx of capital and resources into the industry, which has made it possible for existing sureties to increase capacity.

Surety capacity is readily available from sureties, often at multiples of what they could accommodate just a few years ago.

Smaller sureties that cannot compete on large bond programs have adapted by offering up “bonded only” programs. A strong construction market yielding better profit margins has allowed sureties to extend more credit than they once would for a given balance sheet.

Underwriters are becoming more adept to get past the numbers to underwrite individual projects that create a stretch. Overall, an unprecedented amount of surety capacity is available to accommodate the growing demand. An open and proactive approach to communication with your surety is the key to accessing it.
WITHOUT THE RIGHT SUPPORT, YOUR PROJECT WILL GO NOWHERE FAST.

Every project needs design, balance, and support. To bring projects the surety support they need, turn to Philadelphia Insurance Companies. PHLY has recognized expertise in contract and commercial surety bonds, from performance and payment bonds to subdivision, service contract, license and permit, court, probate, and more. PHLY’s value is measured by the strength of relationships with its partners. When you’re ready to move your project forward, you need to be sure. Be PHLYSure.

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Executive Insights

What advice do you have for contractors considering making a claim on a surety bond?

MICHAEL BOMBA
DIRECTOR AND COUNSEL, CONTRACT DOCUMENTS & RISK MANAGEMENT
AIA Contract Documents

A payment bond is separate from the contractor’s agreement for the project and it often includes separate obligations the contractor must satisfy when a contractor is considering making a claim. Accordingly, a contractor should be aware of the terms of the bond at the outset of the project and thereafter be careful to ensure that it satisfies all the conditions in the bond. A failure to meet all the required conditions could result in the surety not being obligated to make a payment.

Particular attention should be given to the bond’s notice requirements. If a contractor fails to provide notice to the surety of a claim on the bond within the time period required, the contractor could lose its right to payment.

Additionally, many payment bonds require the contractor to provide adequate supporting information in order for the surety to consider the claim as proper. Failure to do so also could put the contractor’s claim at risk, or at the very least delay any payment being made by surety.

How should alternative dispute resolution provisions be approached upfront in construction contracts?

MICHAEL A. MARRA
VICE PRESIDENT, CONSTRUCTION DIVISION
American Arbitration Association

Construction firms and their lawyers carefully evaluate the business terms in their contracts, but they often reflexively insert a boilerplate arbitration clause. This oversight may jeopardize the inherent benefits of arbitration and could result in a more expensive, disruptive and inefficient proceeding.

Arbitration is a creature of contract, enabling the parties to tailor the process to fit their needs and bypass litigation procedures. If you do not take advantage of this critical distinction, you may be relegated to a more cumbersome and costly proceeding.

It is vital to give upfront consideration to the details of the procedures most suitable to any likely disputes under a contract and not simply hope for the best once hostilities have arisen. Parties to a contract should evaluate their specific project and potential disputes to determine if a simple arbitration clause found in most industry form documents is sufficient for their project or if further customization is needed.

Are you ready for revenue recognition?

JACK CALLAHAN
PARTNER - CONSTRUCTION INDUSTRY LEADER
CohnReznick

The new revenue recognition standard is now due for implementation. Despite the long lead time and delays, we find the construction industry is generally not ready.

Construction CFOs must have their game plan in place or risk the consequences of last-minute issues that may be costly, time-consuming and will pull much-needed resources from other areas within their organization.

As you prepare for this year’s financial statement audit, meet with your accountants to discuss the five-step process that needs to be put in place. It’s important to be certain that you are in a position to gather the information needed to make legal, accounting and engineering judgements required to properly support your financial statement assumptions.

Review your accounting software systems to assure that you have the capabilities to assemble the required financial information. Have you addressed key issues, including software, job tracking, contract analysis, point-in-time testing and others?
YOU’RE NUMBER 1, DOESN’T MEAN YOU STOP BUILDING.

You get to the top by outworking, outthinking and out delivering any and all challengers. You live at the top by never forgetting how you got there.

At NHC, we continually rise to the occasion for our customers with more options, stronger negotiating power and the right terms and conditions to meet their needs.

Sure, we’re proud to be America’s number one provider of surety bonds. More importantly for you, we fully intend to keep building on it.
S since 1998, the surety industry has protected more than $9 trillion in contract and commercial surety exposure, including $600 billion in 2017 alone. The direct premium written increased from $5.9 billion to $6.2 billion in 2017. The industry premium has more than doubled during the past two decades—up from $2.9 billion in 1998.

Approximately $25 billion in losses were paid out, and another $50 billion in loss adjustment, underwriting and general expenses were incurred since 1998. The continuing low loss ratio signals that the adherence to underwriting criteria and prequalification, along with a greater emphasis placed on efficiency regarding expenses, remain strong factors in the industry’s growth.

**Big Contractors Do Fail**

The collapse of the U.K. construction giant Carillion PLC sent shockwaves through the global markets and prompted an immediate reminder that big contractors can fail.

As a multinational construction company and facilities management provider, Carillion PLC employed 43,000 individuals worldwide and held approximately 450 governmental contracts across the U.K. ministries of education, justice, defense and transportation. The company held operations in Canada, the Middle East and the Caribbean, and was a large construction services provider for the Canadian government.

In 2016, Carillion boasted £5.2 billion ($7.3 billion) in sales and a market capitalization of nearly £1 billion ($1.4 billion). The trouble for the company began due to losing money on big contracts and running up massive amounts of debt to offset its losses. Industry analysts argue that Carillion overreached and took on too many risky and unprofitable contracts, while it reportedly faced payment delays from contracts in the Middle East that have now been disputed.

In 2017, Carillion issued three profit warnings within a span of about five months and had to write off more than £1 billion ($1.4 billion) from the value of some of its contracts. In January 2018, the construction giant folded under more than £1.5 billion ($2.1 billion) in outstanding debts, which left U.K. taxpayers, and as many as 30,000 subcontractors and suppliers, to bear the cost of this insolvency. In Canada, four of Carillion’s companies were granted protection from...
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creditors under the Companies’ Creditors Arrangement Act.

Construction is risky business. Research conducted by BizMiner between 2014 and 2016 indicates that 29.3 percent of U.S. contractors fail. That is more than one in four construction companies.

Most companies perform more than one job at a time. It is not uncommon that the loss that causes the collapse of a company is not the job being performed for a public entity, but rather one of its other projects.

The Canadian Centre for Economic Analysis reported that non-bonded construction firms are 10 times more likely to suffer insolvency at any given point in time, making the current situation in the U.K. possible.

**Comprehensive Protection**

Surety bonds protect not only governments, taxpayers and workers, but also private owners and lenders from unforeseen issues that arise during construction.

Compared to other risk mitigation tools, surety bonds provide additional benefits. For example, a letter of credit may provide financial compensation to a state or local government if a contractor defaults, but in a small amount. It almost never accounts for 100 percent of the project costs.

The biggest issue with using letters of credit or similar tools is that no one is responsible for completing the contract (and paying subcontractors and workers) in the case of default. By contrast, sureties enable the hiring of replacement contractors (or re-rebidding of the contract) and assume responsibility to save projects. Subcontractors can claim directly on the surety.

Sureties pay billions of dollars a year in claims. During the last 15 years, surety companies paid nearly $12 billion to complete construction contracts and pay subcontractors and suppliers what they were owed. These numbers do not include the significant amount of money sureties spent to finance troubled contractors so they could complete contracts and avoid the trouble caused to owners and subcontractors by a default.

In the wake of the Carillion collapse, one thing is certain: Surety bonds from licensed surety companies remain the smartest risk management tool for the construction industry.

Since 1998, the surety industry has protected more than $9 Trillion in contract and commercial surety exposure.

**Public-private Partnerships**

P3s are the collaboration of public entities and private enterprise to design, finance, construct, operate and/or maintain many types of public infrastructure projects. Sectors that have traditionally and successfully employed the P3 project model include transportation, water and wastewater infrastructure, courthouses, prisons, hospitals and schools.

P3s are not merely the private financing of public works. At its core, the P3 arrangement aims to harness private sector technology and its access to capital in order to solve a public infrastructure need. Once delivered, the private entity may then operate the project and attempt to recoup its investment through concessions or fees.

Historically, P3s have been employed to a much greater extent outside the United States. Here in America, P3s are a more recent phenomena compared to conventional public projects financed with public funds. While domestic experience with P3s may be limited, the current level of interest in P3s is high (and growing) at both the state and federal level.

While the P3 arrangement transfers certain construction and financial risk to the private partner, the risk of project delivery still must be properly managed. Delayed infrastructure can critically impair the portion of society that depends on it.

Public entities in the United States understand the importance that surety bonds play in the transfer and management of construction risk. As a result, surety bonds have been required for more than a century to assure contract performance and payment for the nation’s public infrastructure projects.

The Surety & Fidelity Association of America has gathered data from its member surety companies that have underwritten surety bonds on P3s in the United States. A non-exhaustive list includes more than $15.87 billion
in bonded P3 projects during the last five years alone.

The decision to require surety bonds is often dictated by legislative mandate; however, individual risk management also impacts bonding strategy. For instance, the state of Virginia does not currently have a P3 law that requires bonding, yet the recently awarded $984 million “Transform 66” P3 project to improve I-66 into an inter-modal/multi-modal corridor was bonded, as was $2.1 billion in P3 tunnel upgrade projects in the cities of Portsmouth and Norfolk.

Absent legislative authority, state and local governments may not ordinarily have the power to encumber public property with a private partner’s lease or license, or to commit public funds to repay a private partner. Moreover, existing procurement codes typically address public works projects that involve contracts directly between a public entity and a contractor improving property. Investors also prefer to have clear legal authority to enter into a P3.

Given these factors, states with an interest in obtaining private investment for infrastructure projects have been moving to enact P3 laws in recent years. As the P3 market evolves, the legislatures are recognizing the value of bonding to secure these P3 projects. In the last five years, 20 states have enacted P3 laws and all of them include a bonding component.

Bryan Surcouf is communications manager and Devin Girardi is a surety analyst at The Surety & Fidelity Association of America. For more information, visit surety.org.

P3s Secured With Surety Bonds in the Past Five Years

- $815 million State Highway 288 toll lane expansion and interchange upgrades in Harris County, Texas
- $899 million Rapid Bridge Replacement program, replacing 558 structurally deficient bridges throughout Pennsylvania
- $648 million I-77 express toll lanes project in North Carolina
- $803 million U.S. 181 Harbor Bridge Replacement between the Nueces Bay Causeway and State Highway 286 in Texas
- $540 million, 142-mile San Antonio Waters System - Vista Ridge regional supply project in Texas
- $916 million South Mountain Freeway (Loop 202) project in Arizona
- $2 billion Purple Line (light rail) in Maryland
- $763 million, 2,510-foot twin tower Ohio River Bridges project at East End Crossing in Indiana
- $430 million Portsmouth Bypass in Ohio
- $834 million Northwest Corridor express lanes expansion project to I-75/I-575 in Georgia
- $2.32 billion I-4 reconstruction project in central Florida
- $1.3 billion University of California, Merced 2020 campus expansion project
- $513 million Long Beach Civic Center development project in California

Other Large P3 Projects Secured With Surety Bonds During the Past 15 Years

- $903 million Claude “Bud” Lewis Carlsbad Seawater Desalination Plant in San Diego County, California, the largest and most advanced desalination facility in the nation
- $362 million Presidio Parkway Doyle Drive Concession in San Francisco
- $1.64 billion Eagle P3 FasTracks Light Rail project in Denver
- $1.814 billion I-595 Corridor roadway improvements in Broward County, Florida
- $914 million Miami Port Tunnel Project, expanding access between the Port and mainland Florida
- $2.047 billion North Tarrant Express Highway construction project (segments 1 and 2), expanding road and bridge capacity in and around the Dallas-Fort Worth area of Texas
With bonding being integral to public and commercial construction projects, the ability to obtain bonds is the lifeblood of many construction firms. Yet, when they hear the word “bond,” contractors may grimace or, worse, elect to pass on an otherwise attractive revenue opportunity by avoiding projects that require bonding. They have heard rumors of, or may have experienced firsthand, an underwriting process that can seem arduous and intrusive.

The fact is, establishing and maintaining a bonding relationship requires a significant investment of time and resources. This is driven by the surety’s need to thoroughly vet a contractor’s qualifications before extending surety credit. After all, the surety is generally an unsecured creditor, holding only a signed promise from the construction firm and, often, its owners personally, to protect it from loss in the event of a contract default. And bond premiums average only a fraction of bonded liability, leaving little room to pay claims before a surety finds itself unprofitable.

The flipside of that coin is that the ability to obtain bonds dramatically increases the potential of a contractor to grow and earn higher profit margins on construction projects by weeding out unqualified competitors that might otherwise land contracts at unreasonably low prices. In performing this valuable screening function, sureties serve as an ally for well-run, well-financed construction companies that qualify for bonding support.

Further, once approved for bonding, a contractor enhances its negotiating position by demonstrating to prospective project owners and others that it is stable and has been thoroughly prequalified, carrying the surety’s seal of approval.

Finding the Right Partner
The key to successfully navigating the bonding process is to first

Embrace the Bonding Process and Your Business Will Thrive

BY DANNY McNALLY
Win more than the job. Win their trust.

We know that obtaining surety bonds can be a lot of work.

Rather than dreading the bonding process, we’ll help you embrace it. With FCCI Insurance Group surety experts on your side, we’ll support you through the entire process – helping to grow your business.

Show your customers that your business is one they can trust. Find an agent near you at www.fcci-group.com.

Treasury listing more than $50M.
Rated A (Excellent) by A.M. Best.
FCCI Surety for contractors. Founded by contractors.
partner with a professional surety bond producer who is in tune with the local surety and construction market. Much like a CPA, attorney and banker, the bond producer should be considered a vital member of the contractor’s advisory group. They should invest the time to learn about the contractor’s operation, business plan and goals, and help design a roadmap that will enable the contractor to attain those goals. A good resource for contractors to locate a qualified surety bond producer is the National Association of Surety Bond Producers.

The primary objective of the professional surety bond agent is to help the contractor build and maintain a profitable business. He or she will begin by assisting the contractor in assembling and reviewing underwriting information, including organizational charts, résumés of the owners and key personnel, business and continuity plans, financial statements, schedules of contracts in progress and recently completed, and documentation on established lines of credit.

Based on the findings of this review, the agent will determine which surety company is best suited to meet the needs of the contractor and prepare a formal submission to the surety.

The agent will work with the surety company underwriter to establish single project and aggregate work program limits, which provide a responsible framework for the contractor to operate within based on experience and other factors, including financial and human resources as well as available equipment.

**Agents and underwriters can provide an independent perspective.**

**Increasing the Chances of Success**

While helping establish and maintain a bonding facility is the first step in the bonding process, it is by no means the only service provided by the professional surety bond agent or the surety underwriter. This surety team is well-equipped to serve as an invaluable resource and business partner for the contractor, providing referrals to accountants, attorneys and bankers who specialize in construction accounting, law and lending. Working together, this advisory group can greatly increase the contractor’s chance of success in business, while identifying and addressing potential threats and weaknesses that could negatively impact the operation.

Contractors should keep in mind that it is not always in their best interest for the surety agent or underwriter to approve a request for bonding. One of the most important services they can provide to a contractor is to push back, ask questions and even decline bonding in cases where they perceive an unusually high level of risk (such as onerous contract provisions) or a poor fit between the contractor’s experience or resources and the project for which bonding is being requested. Agents and underwriters can provide an independent perspective, helping mitigate risk, avoid potential pitfalls and ensure the long-term viability of the contractor.

In the case of a mature construction firm, owners often struggle to identify an exit strategy that will enable them to transition ownership of the business while protecting their legacy and ensuring the livelihood of the valued employees who helped build the company. Surety agents and underwriters can work with the owners of the business and their trusted team of advisors to establish a business succession plan that serves the interests of all parties without jeopardizing the company’s bonding capacity.

In summary, there is no question that establishing and maintaining a surety program requires a substantial commitment of time and resources. However, by embracing the bonding process—rather than avoiding or agonizing through it—contractors will be rewarded with a business that is robust, and they will come to recognize their surety agent and underwriter as vital members of their advisory team.

Danny McNally is surety manager for the Southeast region of FCCI Insurance Group, Lawrenceville, Georgia. For more information, call (800) 226-3224, ext. 5231, email dmcnally@fcci-group.com or visit fcci-group.com.
KNOWLEDGE AND SUPPORT ARE ALWAYS AN ADVANTAGE.

CNA Surety stands alongside contractors and subcontractors at every step of the bonding process to help them better manage their risks. Through our strong relationships with brokers and independent agents located in all 50 states, Puerto Rico and Canada, we offer a full range of products, including Bid, Performance and Payment bonds for contractors, as well as Commercial bonds for customers ranging from individuals and small businesses to Fortune 1000 companies. All backed by the financial strength of the CNA Insurance Group and highly rated for financial strength by all the major independent rating agencies.

To learn more, contact your independent agent or visit www.cnasurety.com.
The type of surety bond with the greatest impact on small contractors and their business goals is a contract bond.

Contract bonds can be further broken down into public and private sector construction bonds.

Set-asides and Performance Bonds
The U.S. Small Business Administration can limit competition for certain contracts via small business set-asides.

Competitive set-aside projects are typically less than $150,000 and can be open to any small business or limited to small businesses that participate in SBA contracting assistance programs.

Sole source set-aside contracts are not competitively bid. This usually happens where only a single business can fulfill the requirements of a contract. Some set-asides are for small businesses.
in certain categories, such as 8(a) Business Development, HUBZone, Women-owned Small Business and Service-disabled Veteran-owned.

Federal and state governments have regulations that require a performance and payment bond for each contract exceeding a certain specified amount called the bond threshold.

For federal (Miller Act) projects, the threshold amount is $150,000. For state (little Miller Act) projects, the threshold varies from state to state but is typically less than $100,000. These relatively low thresholds result in a large amount of federal and state construction projects to be bonded.

These projects are generally competitively bid, and the lowest qualified bidder receives the contract award. When small contractors get qualified with an acceptable surety, they can enter their bid and compete for public sector construction work.

Federal and state governments also frequently have regulations that require a certain percentage of work to be performed by certain contractor groups that meet specified requirements. Some of these specified groups include women and minority business enterprises and disadvantaged business enterprises.

For example, the United States Department of Transportation established a DBE program through the Safe, Accountable, Flexible, Efficient Transportation Act that provides opportunities and increases participation for state and local transportation agencies that receive financial assistance from the U.S. DOT.

At the state level, the Maryland General Assembly enacted legislation in 1978 to create an MBE program that requires state agencies to make every effort to achieve an overall goal of 29 percent MBE participation on the total dollar amount of all procurement contracts.

Licensing and Lien Bonds
In the private sector, there is no requirement for the use of contract bonds on construction projects. Yet, many private owners choose to require contract bonds on their projects to protect their interests in the event of contractor failure.

Another type of surety bond that small contractors are required to have are license and permit bonds, also known as compliance bonds. These bonds are required by most states and some local governments and guarantee that a contractor will comply with the state and local government rules and regulations regarding the required contractor license.

This type of bond does not help generate revenue for small contractors similar to the required contract bonds for public work, but without these licenses, the contractor cannot legally perform the work in the jurisdiction of the local government that is requiring the compliance bond.

Finally, small contractors sometimes require miscellaneous bonds, such as a release of lien bond. A release of lien bond allows a discharge of a lien filed on real estate.

This type of bond is not often needed, but it can be very important to the contractors involved because it can allow them to continue to work on the job while the dispute is being resolved.

Don Smith is a bond manager for Liberty Mutual. For more information, email surety@libertymutual.com or visit libertymutualsurety.com.
Today’s global economy contains increasing levels of uncertainty, where even best-in-class construction companies can be impacted by changes in the surety marketplace unrelated to their own financial and operational performance.

John Alberici, chairman of Alberici Construction Company, once said, “The price of gasoline has nothing to do with whether you’re a good driver or not.” That sentiment argues for construction CEOs, CFOs, COOs and owners to prioritize and invest some of their valuable time in their surety relationships.

The following list outlines some things to do (and not do) that can assist in maintaining stable, adequate surety capacity to support a business plan.

**A Surety Best Practices Checklist for Busy Contractors**

**BY MICHAEL ANDERSON**

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<th><strong>DO:</strong></th>
<th><strong>DON’T:</strong></th>
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<tr>
<td>• Communicate. Anticipate the questions a surety may ask.</td>
<td>• Sit on bad news. Experienced surety underwriters can deal with bad news, but a surprise can put support on hold.</td>
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<tr>
<td>• Seek the surety’s input when finalizing a business plan, particularly if it involves pursuits in new markets or sectors.</td>
<td>• Forego the broader perspective underwriters may have for what has worked and what has not worked in other comparable construction company business plans.</td>
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<td>• Outline the core elements of the company’s culture that will attract and retain the highest quality talent. Regularly review and update the firm’s continuity plan.</td>
<td>• Presume that the surety only underwrites financial results and projections. Underwriters look at the whole picture of how a contractor’s management team plans for and executes on its objectives.</td>
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<td>• Utilize the surety’s claim department staff as a second set of eyes on contract terms or pending disputes.</td>
<td>• Bypass the surety’s claim team as a resource. Their time and expertise are part of what surety premiums pay for.</td>
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<td>• Ensure the broker has communicated an active backup plan in case changes outside of the firm’s control affect its current surety program.</td>
<td>• Allow a disruption to the surety program from events beyond the firm’s control that may impact the surety’s ability to be responsive to the company’s needs.</td>
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<td>• Maintain a general knowledge of the factors that are driving conditions in the surety marketplace.</td>
<td>• Ignore that macro conditions in the surety industry factor into strategic decision-making for the surety, just as construction industry conditions do for contractors.</td>
</tr>
<tr>
<td>• Ask the surety about its business plan, financial results and changes in risk appetite. Develop relationships with both local decision-makers and those in the home office.</td>
<td>• Disregard that surety relationships are a two-way street. The business plan and objectives depend on stable, responsive support and the relationships that underpin it.</td>
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CPA, Partner - Construction Industry Leader
Jack.Callahan@cohnreznick.com
732.380.8685
Surety credit is the most efficient source of contingent capital a contractor can use in its business. The word credit has its roots in the Latin words “credo” and “creditus,” which mean to believe and to trust. Creditus is earned through proactive communication and delivering on promises (by all parties).

Surety support is an outcome of a contractor’s good business performance, but it is achieved by treating the surety as a partner with a vested interest in the company’s success along the way. The time involved to do this can be managed efficiently. With the backing of a stable surety, willing to provide and expand its support based on credo (and not just numbers), a contractor will wield a competitive advantage.

Michael Anderson is senior vice president of American Global LLC. For more information, visit americanglobal.com.

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<th>DO:</th>
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<td>• Understand how the broker is communicating with the surety.</td>
<td>• Assume the company is being presented to underwriters in the manner it would like, or be reticent in asking to review one of the broker’s submissions on the company.</td>
</tr>
<tr>
<td>• Work with the surety broker to develop an analysis of the WIP schedules provided to the underwriter.</td>
<td>• Forget that the WIP schedule is the only forward view financial information provided to the surety. It can be used to maximize the support the underwriter offers.</td>
</tr>
<tr>
<td>• Understand the credit model components the surety uses to determine the pricing and level of surety support extended to the firm.</td>
<td>• Pass up an opportunity to improve the reporting of projections and results to emphasize the factors critical to the surety’s analysis of the firm.</td>
</tr>
<tr>
<td>• Have an objective method for determining the value the surety broker is delivering to the team. Employ it on a regular cycle.</td>
<td>• Be satisfied with transactional and service excellence. If the broker is not assisting both the top and bottom lines, then he or she is costing the company money.</td>
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There is an enormous amount of risk in construction. At Marsh & McLennan Agency (MMA), our surety brokers build and maintain a strategic partnership with their clients. Our mission is to create a surety relationship that will enable our clients to be competitive, meet business plan objectives, and take advantage of opportunities for growth and profit.

To learn more about how MMA and its regional partner agencies can help you find Surety Bonding, visit MMA-MidAtlantic.com.

WORLD CLASS. LOCAL TOUCH.
Congress is seeing the midterm elections through without a significant new infrastructure spending bill in play. However, the current House and Senate conference on the transportation appropriations for fiscal year 2019 indicates that Congress will reject the president’s recommendation to significantly cut discretionary spending for transportation, which instead is headed for another boost next year.

Both the House and Senate bills provide $46 billion for the Highway Trust Fund, which is a $1 billion increase over FY 2018. Each chamber wants to provide additional spending for highway and BUILD grants, previously known as TIGER grants. The conference committee just needs to agree on the amounts.

Federal Change Orders
Congress enacted H.R. 4754 to address the slow approval of change orders and the resulting lack of timely payments to contractors. The new law requires that for every solicitation for a contract to be awarded to a small business, the prospective bidders must be provided with the federal agency’s policies or practices for compliance with the Federal Acquisition Regulations on Requests for an Equitable Adjustment (REAs) when a change order is issued. The FAR requires the agencies to respond to REAs in “the shortest practicable time.”

If the agency does not have a policy or information on its past practices regarding REAs, then it must start collecting that information for a three-year period. The agency must collect data on whether it responded to a REA within 30, 60, 90, 180 or 360 days from receipt of the REA, or whether the agency responds to REAs after the completion of the contract.

Gathering information on federal agency practices is a good first step to address compliance with FAR rules on change orders.

Federal Bond Thresholds
Congress failed to pass H.R. 4486, which would have exempted the Miller Act bond thresholds from the required indexing for inflation for all federal acquisition thresholds. The bill passed the House but stalled in the Senate. The Miller Act bond threshold is scheduled to be reviewed in 2020 and could be increased from $150,000 to $200,000.
Ask your surety agent about the common sense power of Merchants’ quill.
According to the data compiled by The Surety & Fidelity Association of America, the federal government’s exposure to loss from default would increase by $300 million annually, and subcontractors would be working on larger jobs without payment protection.

**Federal TIFIA Policy**

At several Senate committee meetings, concern was expressed over a “Dear Colleague” letter from the Federal Transit Administration that suggested that loans under the Transportation Infrastructure Financing and Innovation Act program would be treated as part of the federal funding in a project rather than as the state or local match. This would be a significant change in policy, and some argued that the TIFIA law is clear that such loans are not federal funding because the states repay the loans with local funds. If the FTA proceeds with this new policy, there may be fewer applications for TIFIA loans.

**Federal Permitting Decisions**

Twelve federal agencies signed a memorandum of understanding to work together under an executive order that President Trump issued in 2017 and to reach environmental and other permitting decisions within a goal of two years. A single agency would take the lead and set the time frame for major projects that require an environmental impact statement. The MOU is intended to create best practices for agency cooperation and does not give project sponsors any new recourse or remedies.

**State Budgets**

This was the second of a two-year session for most states, the majority of which focused on their FY 2019 budget. Several states had heated battles while others needed one or more special sessions to finish their budgets. Colorado, Delaware, Georgia, Iowa, Kentucky, Massachusetts, Mississippi and Missouri enacted infrastructure spending packages this year.

**State P3s**

State legislatures remain interested in public-private partnerships. New Jersey enacted a law that grants broad authority to the state, local governments and school districts to use P3s; however, these entities must utilize a project labor agreement and pay state prevailing wages. The new law also includes a provision that requires the general contractor, construction manager or design-build team to post a performance bond and a payment bond that comply with the Little Miller Act.

Missouri expanded its existing P3 law for the Highways and Transportation Commission to allow political subdivisions to use P3s and to allow the commission to use P3s for stormwater facilities and systems.

Delaware and Vermont enacted laws to enable the use of P3s. Delaware’s new law allows county and municipal governments to enter into P3s for public lands through a lease, concession agreement, easement or license agreement. Vermont enacted a pilot project to permit the use of P3s for transportation projects.

Michigan created a new Infrastructure Council to develop a multiyear plan for asset management in the state. The council has a broad mission, including reviewing funding and financing models, best practices and impediments to delivery.

A P3 bill for public buildings recently was introduced in Ohio, and a bill for P3s for virtually any kind of public works projects was introduced in Pennsylvania. These bills could move later in the fall.

**State Retainage**

Retainage got more complicated in Rhode Island and Vermont. Under prior law in Rhode Island, retainage was released when the public entity accepts the project. The new law allows retainage to be released at substantial completion, except for the following amounts: 0.5 percent for unknown or foreseeable defects that may become known in the first year after substantial completion; 2.5 percent for incomplete, incorrect or missing deliverables; 150 percent of the reasonable cost to complete or correct incomplete or defective work items; and an amount for the reasonable value of claims and any costs, expenses and attorneys’ fees incurred as a result of the claims if permitted in the construction contract for the person seeking the payment of retainage.
In Vermont, a new law prohibits a contracting entity or contractor from withholding as retainage any amount due and owing for materials delivered to the construction project and that are covered by a manufacturer's warranty or graded to meet industry standards, or both. The new law applies to public and private construction.

**State Bond Thresholds**
Rhode Island and Vermont also considered, but did not make significant increases to, the state bond threshold. In Rhode Island, legislation that would have allowed payment and performance bonds to be waived for projects up to $250,000 was rejected as way to cut costs in the state budget.

Vermont considered a proposal from its state transportation agency raising its bond threshold to $1 million so small contractors could participate in paving projects under Indefinite Delivery Indefinite Quantity contracts. After discussion in the legislature raised the possibility of unpaid suppliers and unqualified contractors, the agency withdrew the recommendation in favor of further study of the issues.

**Construction Manager At-risk**
A new law in California now authorizes counties to use the construction manager at-risk method for any kind of infrastructure project, including, but not limited to, buildings, utility improvements associated with buildings, flood control and underground utility improvements, and bridges (but excluding roads). The project cost must exceed $1 million. Existing law requires the construction manager at-risk to possess or obtain sufficient bonding for the construction services portion of the project.

Lenore Marema is vice president of government affairs for The Surety & Fidelity Association of America. For more information, visit surety.org.
It’s all over the headlines: The construction industry is booming, but qualified labor is in short supply. For those in the surety industry, the ripple effects from construction growth come with the same rewards and challenges. While these industries are growing, unemployment is at all-time lows and talent is at a premium.

Specifically, construction employment has reached the highest levels since the beginning of the recession in 2008, and the surety industry is battling with every other financial services opportunity for the best candidates. Filling the skills gaps as baby boomers head into retirement and adopting new, updated recruiting practices to attract talent are among the top challenges for leaders in both industries.

The Talent War Up Close
In August, construction added 23,000 jobs and, according to an industry survey, would have added more if enough people were available to fill the positions. Through the first quarter of 2018, employers have been looking to fill an average of nearly 225,000 construction jobs each month, according to the Bureau of Labor Statistics. The 2018 Insurance Industry Employment and Hiring Outlook Survey expects more than 13,000 jobs will open before the year is out. The Surety & Fidelity Association of America reports that property and casualty insurance, which includes surety, will see more than 400,000 retirements during the next five years.

In general, short-term solutions to the talent war have included companies recruiting professionals to move from job to job, trading one company for another for gains in salary or position. The growth has amplified the need with teams that are already lean and doing more with less. Forbes calls it “an insatiable appetite for fully baked candidates” (i.e., employees who have immediately transferrable skills and can hit the ground running). The talent pool for candidates like these is small and usually expensive.

One of the big problems for construction and surety is that the extraordinary opportunities and benefits of these careers aren’t common knowledge. Jobs within the construction industry simply aren’t attractive to millennials, who have been groomed to work elsewhere.

And, a career in surety has often been one that college graduates luck
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into by happenstance rather than by intention. They have not heard of surety, this niche subset of property and casualty insurance, and it takes special effort to learn about it before a young person can truly understand the opportunity.

The message that needs to be conveyed is that construction and surety careers offer steady employment, high wages and plenty of room for career advancement.

Innovation and Communication
To do battle in this war for talent, industry associations are already working with federal and state governments to find ways to increase the available labor force, take advantage of the skills and experience of retirees who still want to contribute, attract young people by selling the lifetime rewards and benefits of careers in surety and construction, and provide the education and training they will need to be successful.

Locally, chambers of commerce, businesses and associations are collaborating to find funding and work with community colleges, universities and vocational programs.

For companies, successful talent management strategies include the following:

• Enhancing campus recruiting and expanded internship programs.
• Improving diversity, which is important for more successful recruiting and retention. Companies with diverse workforces have a proven competitive advantage with greater measures in productivity, engagement and service.
• Creating more mentorships and avenues for young people to job shadow and experience a day in the life. Specifically in construction, there are also initiatives that target parents and teachers to make them aware of employment opportunities.
• Rethinking traditional work environments. Focus on a great culture with open collaborative space, technology for remote offices to work together, flexibility to balance work hours and home life, and opportunities for employees to stay healthy and give back to the community.

Surety & Fidelity: Careers That Make a Difference

The Surety & Fidelity Association of America is launching a new campaign called “Surety & Fidelity: Careers That Make a Difference.” The effort includes recruiting tools, educational materials and online resources to help surety companies communicate the benefits of being in this industry.

Of special note is the SFAA Foundation (the association’s educational arm) and its Surety & Fidelity Industry Intern and Scholarship Program (SFIISP). Through the SFIISP, the Surety Foundation provides awards of up to $5,000 to outstanding underrepresented students to support their studies and to encourage their consideration of the surety and fidelity industry as a career choice.

The strength of the surety bonding and construction industries is their people. While construction and surety may not seem like a typical career choice, these jobs are perfect for those who want to help build and guarantee an investment in the future, as well people looking to do exciting and meaningful work with nationwide or even global opportunities. Together, the industry can change the headline from “Today’s Talent War” to “The Hot Jobs of Tomorrow.”

“I enjoyed the work and office environment. As an intern, I felt like I was treated more as an equal employee than a temporary person. I enjoyed being a part of meetings, given the opportunity to complete real work and seeing the end results of what I had done,” says Nia Gumbs, 2018 SFIISP Intern.

Larry Taylor is president of Merchants Bonding Company and chair of the Surety & Fidelity Association of America Board of Directors. For more information, visit merchantsbonding.com.
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SPECIAL SECTION:
CONTRACTORS’ GUIDE TO SURETY BONDING

Surety Program Considerations for Contractor Ownership Transitions

BY DAN PANEK

Today, most contractors are facing the reality that a significant percentage of their management teams will hit retirement age during the next five to 10 years. After years of dedicating their time, energy and resources toward building a successful operation, the principals of construction firms must deal with the challenge of perpetuating their company. Who will carry on their legacy, and what’s the best way to structure the transition of ownership?

Transition Options
It seems that fewer contractors have children or other family members interested in going into the business. At the same time, owners typically want to benefit from the equity that they’ve built up in their business.

Some may simply wind down the operation: complete the remaining work, sell the equipment and walk away with the proceeds. However, for most, this option won’t generate a sufficient return.

Selling the company outright may seem like a logical choice, but there is still the challenge of finding a suitable buyer willing to pay the right price. Nor does this option guarantee that the company will continue to operate in its current form and with its employees protected.

During the past few years, two ownership transition options have gained increased attention: employee stock ownership plans and private equity investment. Both potentially address perpetuation of an organization; however, their structures can vary greatly, as can their impact on the company’s balance sheet. This, in turn, can have unforeseen consequences on the contractor’s surety credit.

Private equity investment involves the contractor being purchased by an investment management company. Private equity firms raise the necessary funding through outside investors, and the acquisition is often structured as
a leveraged buyout. The existing executive team typically remains involved in running the day-to-day operations, with investor oversight and ultimate control.

The firm uses its financing, strategic planning and management resources to help improve performance and returns. Once this objective has been achieved, investors often will look to capture a return on their investment through a sale of the company.

An ESOP is a vehicle by which a firm’s workforce gains an ownership interest in the company. The company sets up a trust fund into which it contributes shares or cash to buy existing shares. A contractor can then reward employees with stock ownership through various means.

When participating employees retire or otherwise leave the company, their shares are bought back at market value. An outside valuation must be done annually to determine the shares’ market price.

A benefit of an ESOP is that ownership and control stay within the organization. ESOPs can help preserve the company culture and encourage employees to focus on the organization’s performance.

Surety Challenges

ESOPs and private equity investments give the departing owners a built-in market to sell their shares. With that said, both methods can create challenges from a surety perspective.

The debt required to finance both transactions appears on the contractor’s balance sheet, whether financed institutionally, by outside investors or through the departing shareholders. This liability can heavily leverage the company and negatively impact its tangible-equity position, pushing what was previously a very strongly capitalized company into a weak equity position.

Any excess cash in the company is usually contributed to the transaction, significantly reducing working capital. This new debt generally will need to be serviced regardless of whether the contractor is profitable.

The extent to which the transaction is funded by shareholder or “friendly debt” may give the contractor the ability to mitigate the financial impact some in the surety's eyes. Flexible payment terms can be established in the event that earnings do not keep pace. The notes can be subordinated to the surety, allowing it to consider all or a portion of the debt as equity.

The formulas used to annually value company shares can be aggressive, sometimes increasing the share price as much as 50 percent in any given year. These outside valuations are based on how the company itself performs, but also include other factors such as market comparisons with economic data and valuations of publicly traded companies.

The result can be an inflated share price even in years where a contractor generates minimal profits or retained-earning growth. These annual, accelerated share price increases can significantly increase the eventual repurchase price of future departing shareholders beyond original expectations and possibly result in additional debt needed for the transaction.

With both ESOPs and private equity investments, the compensation paid to departing shareholders can include warrants or “earn outs” that vest at a future date. The value of this deferred compensation is based on annual share price evaluations. The company remains responsible for absorbing the resulting deferred compensation, which can be substantial if third-party valuations result in the share price outpacing earnings. Any deferred compensation needs to be structured so that meaningful financial targets must be hit before the target price can be paid out.

Transferring ownership of an organization is never an easy decision. Often, the impact on surety credit is the last thing considered when structuring ESOPs and private equity investments. Important transactions such as these should be vetted with the surety before it is too late in the process.

If the proposed structure restricts the ability to continue with the same surety program, the return assumptions to justify the transaction could be dramatically altered. Surety firms should be seen as partners and can be valuable consultants. Establishing expectations early on as to what the balance sheet should look like post-transaction can prevent difficult discussions later regarding bonding limitations.

Dan Panek is regional AVP/underwriting director for CNA Surety. For more information, visit cnasurety.com.
Public-private partnerships are becoming an important way to deliver large infrastructure projects in the United States. Most of these projects require surety bonds due to their size, complexity and scope of work.

The U.S. construction market continues to provide an excellent source of opportunities for domestic and international companies. According to the American Society of Civil Engineers, the United States will need to invest $4.59 trillion by 2025 to improve the nation’s overall grade of D+ for infrastructure. As such, the repair and rebuilding of highways, bridges, airports, rail systems and tunnels are the present focus for state and government agencies.

While the U.S. Department of Transportation defines P3s as “contractual agreements formed between a public agency and a private sector entity that allow for greater private sector participation in the delivery and financing of transportation projects,” the reality is P3s differ significantly from sector to sector and from project to project.

Many states are still debating whether P3s are the right delivery method for large, complex projects, though 33 states have passed legislation allowing the use of them for public projects.

Still, some states lack the technical capacity and expertise to consider such deals.

Balancing Risk
A P3 project can be delivered in different ways, including design-build (DB), design-build-finance (DBF), design-build-finance-maintain (DBFM) and design-build-finance-maintain-operate (DBFMO). Each has one common element: P3 projects pose greater risks for private contractors.

Contractors, which ultimately will handle the design and construction, may assume additional risk exposures in P3 projects depending on the delivery method of the P3 and whether it is DB, DBF, DBFM or DBFOM. By transferring more risk to the contractor, it may possibly reduce public entities’ own financial exposure. The bottom line is that the private sector and public entities need to find a balance of risk and responsibilities.

P3s require the involvement of large companies that have the expertise, capabilities, capital base and surety bonding support to undertake these projects. Many large P3 projects have been completed with the involvement of foreign contractors through their U.S. subsidiaries. These foreign companies have a large presence in the United States, as well as the resources, experience, capabilities and equity to participate in these P3 projects. P3s are common in other parts of the world, particularly in Europe, Asia, Latin America and Canada.

Engaging the surety early in the process is very important for a successful financial close and bonding support.
Gaining Support and Financing

It is crucial to understand what is expected from the partnership. Preparing bids for P3 projects can take years and millions of dollars in investments. Detailed contract agreements are necessary, and early involvement of the surety is key.

Support from public officials is also paramount when it comes to P3 projects. Public officials need to be fully on board with the project because ultimately they must protect the best interest of the taxpayers. The public could very well influence public officials to terminate negotiations with the private sector.

Educating the public, as well as legislatures and state agencies, about the benefits of P3s is essential for a successful financial close of a P3 project. Most large-scale transportation P3 projects are eligible to participate in the Transportation Infrastructure and Innovation Act program (TIFIA loans) and Private Activity Bonds (PABs).

Recent U.S. P3 transportation projects were funded through a combination of public and private funds (e.g., through TIFIA loans, PABS and private equity from investment partners).

Overall, approximately $11 billion in PABs and approximately $27 billion in TIFIA loans have been issued to date. In the end, the availability of funds through TIFIA, PABs and private funds will ultimately benefit taxpayers and resolve significant state budget restrictions for new infrastructure investments.

There is no one size fits all for the delivery of a P3 project, but states certainly can learn from each other through the process and past P3 jobs.

Ultimately, a successful P3 requires efforts from public officials, the public and private sectors, and state and federal government agencies.

Martino Sessa is associate vice president and head of international reverse flow surety for Nationwide, New York. For more information, email martino.sessa@nationwide.com.
The Power of Arbitration: Five Negotiation Strategies to Ensure a Better Dispute Resolution Process

BY MICHAEL R. POWELL


Some would argue that the real success of a project depends on the mechanisms in place to deal with disputes likely to rise during the construction phase.

In 2017, an American Arbitration Association survey asked construction lawyers how often their clients are involved in the development of a contract’s dispute resolution provisions. The answer: Clients were only “significantly or always involved in the process” 30 percent of the time.

So where can a contractor provide advice and consultation?

Consider subcontractor default insurance contracts, many of which contain a standardized arbitration clause for coverage disputes. Several points in these types of arbitration clauses leave the door open for negotiation and improvement.
1. Locale
When an arbitration clause does not specify where the arbitration will take place, the parties are given an opportunity to agree on the locale. However, to the extent the parties are unable to agree, the ADR forum or arbitrator will likely make that determination.
Therefore, it is important that the parties specify, pre-dispute, where the arbitration will take place. Further, the choice of the place to arbitrate may be construed to imply a choice of the applicable procedural law, which in turn may affect questions of procedure, court intervention and enforcement.

2. Qualification of Arbitrators
Unlike court, where parties have no say in the appointment of their judge, arbitration clauses can specify that the arbitrators have a certain type of construction background or expertise. It’s worth mentioning here that not all arbitrators are attorneys or retired judges. Non-attorney construction industry professionals serving as arbitrators may seem like a new phenomenon to those who entered the construction practice in the last 10 years. However, AAA construction panels have included architects, engineers, general contractors and subcontractors for more than 90 years. In fact, today there are approximately 300 industry professionals on the AAA’s national construction roster.

3. Duration of Arbitration Proceedings
A frequent complaint of clients in an arbitration hearing is that everyone is making money except them. It may not be enough to simply rely on the arbitration process to provide a speedier method of resolving disputes.
An emerging trend in arbitration clause drafting is to include timelines for the completion of an arbitration.
However, it is important to suggest deadlines that are realistic because failure to meet specified deadlines could jeopardize the enforceability of the arbitration award. The uncertainty pre-dispute is that the parties do not know what the scope of a potential claim may be.
Here, a “time is of the essence” provision, where the arbitration hearings shall take place within 90 days of filing and award rendered within 120 days, may be acceptable for a small project, but completely unrealistic for a multi-million-dollar project.

4. Discovery
Discovery is one of the most expensive and time-consuming portions of the arbitration process and, unbeknownst to many, the amount and scope of discovery can be controlled through a clause in the contract. In addition, the process can be limited by agreement of the parties at any time up to and including the preliminary hearing.
Under most ADR forum rules, arbitrators are authorized to direct a pre-hearing exchange of documents and witness lists, but the limitations can be unpredictable. In this instance, the parties may want to provide for a more tailored discovery program in their arbitration clause.

5. Confidentiality
While ADR forums and arbitrators adhere to certain standards concerning the privacy or confidentiality of the hearings, parties might want to impose limits on themselves as to how much information regarding the dispute may be disclosed outside the hearing. Except when required by law, parties to a contract can contractually limit parties or arbitrators from disclosing the existence, content or results of an arbitration unless they have the prior written consent of all parties.
The true power of arbitration lies in the ability of the participants to take advantage of all available strategies and techniques to ensure the right arbitral process for their dispute. Whether the parties are in arbitration or court, the benefits are only achieved if all the players know and understand the rules, policies and procedures.
Contractors also should be mindful that not every dispute requires legal action or a legal decision. Interestingly, this might explain why there is a noticeable increase in the enrollment of industry professionals in alternative dispute resolution training classes. Such a proactive part on contractors to better understand dispute resolution systems will certainly ensure that they are better prepared to handle potential disputes.

Michael R. Powell is vice president of the construction division at the American Arbitration Association, Los Angeles, and serves as liaison for the AAA’s National Construction Dispute Resolution Committee. For more information, visit adr.org.
The Miller Act requires contractors on federal construction projects over a certain threshold to furnish performance and payment bonds, providing a remedy to subcontractors and suppliers on the project to seek recovery for nonpayment.

Because subcontractors and suppliers cannot assert a lien on federal property, the Miller Act payment bond is their sole remedy.

Therefore, the Miller Act is highly remedial in nature and “entitled to a liberal construction and application in order to properly effectuate the congressional intent to protect those whose labor and materials go into public projects,” according to Clifford F. MacEvoy Co. v. United States (1944.)

However, there are limits embedded in the statute, such as time limitations, notice requirements and identification of eligible claimants.

In addition, the operation of the Miller Act may be affected by the operation of other federal statutes. Recent cases illustrate the interplay between the Miller Act and the Federal Arbitration Act, which establishes a framework for the enforceability of arbitration that was agreed to by the parties and is an expression of strong federal preference for arbitration.

So what happens when the contractor and subcontractor are arbitrating a payment dispute pursuant to the arbitration clause in the subcontract, and the subcontractor also has sued the surety under the Miller Act? Can the Miller Act action be stayed until the resolution of the arbitration, even in light of the liberal construction of the Miller Act?

Recent cases addressing this issue reflect the prioritization of the Federal Arbitration Act over the Miller Act.

Recent Cases
In United States ex rel. Debra’s Glass, Inc. v. The Insurance Company of the State of Pennsylvania (June 13, 2018), a payment dispute arose between the prime contractor and subcontractor...
on a federal project. The prime contractor invoked the arbitration clause in the subcontract and filed a demand for arbitration. Subsequently, the subcontractor commenced an action against the payment bond surety seeking recovery under the Miller Act. The surety filed a motion to stay pending arbitration.

The court noted the long history of cases in which arbitration (under the Federal Arbitration Act) was prioritized over the Miller Act and stays were granted.

The court also noted the common questions of fact between the Miller Act suit and the arbitration and the risk of inconsistent outcomes. The court granted the stay through the completion of the arbitration.

In United States ex rel. Red Hawk Contracting, Inc. v. MSK Construction, Inc. (May 8, 2018), a subcontractor on a federal project in North Carolina brought claims against the prime contractor and Miller Act surety, alleging that it had not been paid in full. The prime contractor moved to stay the action pending arbitration in South Carolina pursuant to the subcontract's arbitration clause.

After determining that the Federal Arbitration Act was applicable, the court concluded that the dispute fell within the scope of the arbitration clause and granted a stay pending arbitration.

With respect to the Miller Act claim, the court concluded that the surety's liability would rely on common issues of fact to be settled during arbitration. Therefore, the court concluded that the stay applied to the Miller Act claim as well.

In the 2018 case United States ex rel. Harbor Construction Company, Inc. v. T.H.R. Enterprises, Inc., a subcontractor on a federal project claimed that it was not paid in full. It commenced an action against the prime contractor and Miller Act surety. The prime contractor moved to compel arbitration pursuant to the dispute resolution provision in the subcontract and to stay the action pending arbitration.

The court granted the motion to compel arbitration. In considering the motion to stay, the court considered whether the Miller Act claim weighed against it and noted the long line of decisions that stayed Miller Act claims pending arbitration.

The court granted the motion to stay. However, concerned that in apparently trying to balance the remedial nature of the Miller Act and the policy preference for arbitration, the court limited the stay for a period of six months so that arbitration could not be used as a delay tactic.

A final example is United States ex rel. Bay South Limited, Inc. v. International Fidelity Insurance Company. In this 2017 case, a subcontractor on a federal project sued the prime contractor and Miller Act surety alleging that it had not been paid in full. The contractor and surety moved to stay the claims, pending arbitration.

The subcontractor argued that the arbitration provision in the subcontract operated as an improper waiver to bring a civil action under the Miller Act.

The court disagreed and concluded that the applicable Miller Act provision regarding the enforceability of a waiver does not restrict arbitration of Miller Act claims once a suit is filed.

The court also noted that the legislative history of the provision was clear that it was not intended to be a statutory preclusion of arbitration.

As to whether the Miller Act claims were within the scope of the subcontract's arbitration provisions, the court concluded that reference to arbitration being conducted in accordance with Construction Industry Arbitration Rules indicated that the arbitrator would decide the scope or the arbitration agreement. (The rules give the arbitrator power to determine his or her jurisdiction.)

The court granted the motion to stay the Miller Act claims pending arbitration.

Thus, an arbitration clause in the subcontract will be enforced in light of the policy preference for arbitration under the Federal Arbitration Act. The Miller Act is for the protection of subcontractors and supplier and is construed liberally.

However, there are limits. With respect to arbitration, courts typically stay a Miller Act lawsuit pending the outcome of arbitration.

Note, this is not a waiver of Miller Act rights, but merely a means for the parties that agreed to arbitrate their disputes to do so, before taking what are often the same issues regarding payment to court.

Robert J. Duke is general counsel of The Surety & Fidelity Association of America. For more information, email rduke@surety.org.
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