

**TENTH ANNUAL
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**TIPS FOR THE SURETY CLAIMS HANDLER:
SUGAR'S SAFE SEVEN**

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INTRODUCTION

Approximately thirty years ago, I first became involved in the business of suretyship. It has been interesting watching the evolvement of surety claims handling over that many years. It has occurred to me that there are certain steps that need to be taken by the surety claims handler in every instance. I have noted however, that there seems to be a trend in the industry to re-invent the wheel of claims handling.

Several years ago I became involved with a contractor that was being terminated. The man was extremely articulate, likeable and a great con-artist. I admit I was taken by his overall demeanor and before I knew it the surety was supporting this company without having followed some of the most basic claims handling check off items. Needless to say, surety had to bring in a new contractor to finish the job because Principal did not have the proper support staff to finish. We can all fall into this trap and that is why I have attached what I am suggesting are safe claims handling tips that need to be reviewed before financing the contractor.

TIP #1 - Do Not Support a Contractor Until You Have a Complete Understanding of The Contractor's Overall Financial Picture And The Cost to Complete For Both Bonded And Unbonded Jobs.

It is tempting to help a contractor get one job out of trouble but as experience tells us; one job is usually the precursor to the surety lending financial support to all the contractors jobs.

It is obvious to many of us why the cost to complete both bonded and unbonded jobs is critical. It is just as important to have an understanding of what kind of additional costs the surety will incur if they support a contractor. These include such terms as: outstanding bank loans, IRS liens, leases on equipment, factored accounts receivable, status of insurance premiums for liability, auto, and workmen's compensation. It is also important to have a handle on what types of law suits the contractor is involved with and any outstanding judgments that they may have against them.

After both of these matters (overall financial picture and costs to complete) have been explored, the surety will be well informed as to the real cost of financing a contractor.

Tip #2 Workman's Compensation Premiums: Liability or Asset?

In the past year we have had two occasions in a support situation where workman's compensation audits have shown the contractor to be in arrears; \$500,000 on one project and approximately \$300,000 on another project. If this had been known by the surety, the dollars may have been significant enough for the surety not to consider a support.

On the other hand, it is just as important to know if the workman's compensation audit will ultimately produce a refund. We had a recent audit produce a \$150,000 refund. The surety will want to consider this type of an asset in making its support decision.

Tip #3 Surety Support: Withholding Taxes.

Several papers have been given at our conference regarding this issue but it is wise to caution the claims handler at every opportunity of the bad consequences if the withholding taxes are not paid during the surety's support phase. Once the surety starts advancing payroll dollars to its principal, it needs to have an independent agent in the form of a consultant, its attorney or personal observation by the claims handler that the withholding taxes are being deposited at the bank. Do not depend upon the contractor depositing the taxes even if he has told you he has done it. We have found withholding taxes in drawers and dummied up tax receipts.

You may have personal liability for these taxes, interest and penalties.

Tip #4 Understanding the Competency of the Contractor's Field Staff and in House Accounting Staff Is Critical in Making a Decision to Support.

If the subcontractors and laborers are not being paid in a timely fashion, the ability to complete the project is severely impacted. Only by having a full understanding of the contractor's ability to keep track of its accounts payables and to handle its finances in an efficient manner will a support be appropriate.

If the field people are weak, have no scheduling abilities nor have a true understanding of the type of construction they are involved with, the surety can expect a very disgruntled obligee and the very real possibility of the contract schedule not being met. The worst scenario is having to rip out work that the surety has financed. Have the project manager/superintendent/foreman and a scheduler interviewed by a competent consultant. Support only if your Principal has competent field staff.

Tip #5 Have Security Agreement Signed Before Commencing Financing.

It is easier to pressure the indemnitors to get security agreements signed before surety commences financing.

The contractor knows that once the surety has spent its first half a million dollars that their bargaining position has increased.

The surety should retain an attorney who has obtained signed security agreements in the past. This experience should enable the surety, within a matter of days, to have all the security agreements drawn up and signed by the contractor/indemnitors. The surety that commences financing before having the security agreements signed usually finds itself in a weaker position to obtain the signed documents and will lose valuable assets.

Tip #6 Do Not Support a Roofing Contractor Until You Have Verified That The Roofing Manufacturers Warrantees Will Be Issued.

Even though the initial indicators may favor support, the claims handler must know that roofing contractors pose a unique problem. There have been many instances where sureties have supported roofing contractors only to discover that the roofing manufacturing guarantees and warrantees will not be issued. In many instances, if the surety has proceeded with financing the contractor all the new work will need to be ripped out to bring the roof into compliance with the roofing manufacturers requirements. This obviously results in delay, possible liquidated damages and a double dip on the cost to complete the contract.

Tip #7 Insurance Coverage During Termination.

When construction work is damaged during the interim period of principal's termination and a new contractor taking over the project, the question always becomes who is responsible for the damage. I suggest that a letter be sent to the obligees advising them to purchase adequate insurance to cover exposures during this termination period with all parties reserving their rights as to who is responsible for the additional insurance premiums.

The premium for the insurance will appear very reasonable in those situations where damage does occur and the property insurance carrier pays for it.

Conclusion

Reinventing the surety claims handling wheel is costly. Consideration of the seven tips will save the surety a lot of time, loss, cost and expense.

SUGAR'S SAFE SEVEN

1. Do not support a contractor until you have a complete understanding of the contractor's overall financial picture and the cost to complete for both bonded and unbonded jobs.
2. Workman's compensation premiums, liability or asset? Check out status.
3. Do not become personally liable for withholding taxes to the Internal Revenue Service. Setup a procedure to make sure the taxes are being paid when supporting a contractor.
4. It is critical to have a complete understanding of both the competency of a contractor's field staff and an understanding of the strength of the chief financial/comptroller/bookkeeper before you make a decision to support.
5. Get your security agreements signed before commencing financing (with the exception of possibly one week's look see payroll).
6. Support of Roofing Contractors: do not support until you have verified with the roofing manufacturers that the warranties will be issued.
7. Advise Obligees, in writing, of their need to purchase adequate insurance to cover exposures during the termination period.