

Risky Business: Managing Construction Project Risk with Bonds and Insurance

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Managing Risk

Prior to Construction

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Procurement and
Negotiation Phase

Statutory Requirements - Insurance

- ① Gov't Code § 2269.208 - A construction manager-agent ... shall maintain professional liability ... insurance in the amount of at least \$1 million for each occurrence.
- ① Local Gov't Code 271.904 - limits indemnity of A/E to Governmental Entity to comparative fault. Cannot request “defense” except on GL policy. Limited to the normal standard of care.

Before Construction

Contract negotiation phase

Insurance

- ◎ **First Party**
 - > **Builder's Risk:** the amount of the Contract Sum + C.O.
 - > **Installation Floater or Equipment Floater**
- ◎ **Third Party/Liability**
 - > **Commercial General Liability (CGL)**
 - > **Professional Liability**
 - > **Worker's Compensation/Employer's Liability**
 - > **Automobile**
 - > **Pollution**
 - > **Excess/Umbrella (Excess = same but more \$; Umbrella may provide additional coverage, see, e.g. slander)**

Statutory Requirements - Bonds

- ◎ Chapter 2253 Texas Government Code
- ◎ Requires Performance and Payment bonds
 - > Payment Bond if Contract Sum > \$50,000
 - > Performance Bond if > \$100,000
 - > Does Not Require Bid Bonds
- ◎ Why?
 - > Public Lands Not Subject to Lien
 - > Taxpayer Funds Require Security from Contractor Default

Payment Bond

- ◎ Solely for the Protect and Use of Beneficiaries who have a direct contractual relationship with the Prime Contractor or a subcontractor to supply public work labor or materials
- ◎ Must be written in the amount of the Prime contract (or Subcontract if provided by Sub for limited scope)

Performance Bond

- ◎ Solely for Protection of Owner/Governmental Entity Awarding the Contract
- ◎ Must be for full amount of contract
- ◎ Conditioned on Faithful Performance of the Work in accordance with plans, specifications, and contract documents
- ◎ Bond form Approved by Public Entity

Bond Forms

- ◎ AIA
 - › Contains language unfavorable to Owner
 - › Requires termination and payment of full contract balance
 - › Requires 2nd notice to cure - directed at surety
 - › 2 year Statute of Limitations (2253 is 1 year)
- ◎ EJCDC - essentially the same as AIA but it does enumerate Owner entitlement to damages - offset unclear
- ◎ Manuscript forms with modified General or Supplemental Conditions

Managing Risk

Construction Phase



A Balanced Approach to Construction Law.

Claims During Construction - Insurance

Typically **Builder's Risk**: applies until **Substantial Completion**.

- > Covers direct damage to building caused by fire, collapse, flood (sometimes)
- > Provides coverage for soft costs and delays
- > Usually not faulty/defective work, but probably the ensuing losses
- > E.g. Texas State Hotel, UT Golf Club; but see Shoal Creek Walk

Who buys?

- > Typically contractor but important factors: (a) ensuring policy doesn't lapse; (b) who will be liable for deductibles; (c) amount of deductibles.
- > Watch for waiver of subrogation in the contract. *See Temple EasTex, Inc. v. Old Orchard Creek Partners, Ltd.*, 848 S.W.2d 724, 730-31 (Tex. App.—Dallas 1992, writ denied).

Payment Bond Claims

- ⊙ No Obligation to Respond
- ⊙ Upon request – must provide copy of the bond
- ⊙ Monitor Payment Bond Claim Status
 - > May signal financial problems
 - > Foretell future performance issues
quality of work & delay

Performance Bond -

- ◎ Copy surety on correspondence addressing potential default
- ◎ Engage surety in event payment bond claims impact performance
 - > Assert pressure on contractor to address issue
 - > Project level meeting with counsel to address concerns
 - > Surety may help mediate dispute and stave off termination

Managing Risk

Disputes During
Construction

and

Post-Construction
Claims

Post-Construction Claims - Insurance

- ⊙ Limits of Insurance
- ⊙ Per Occurrence (CGL) or per Claim (E&O)
- ⊙ General aggregate
- ⊙ Products-Completed Operations (“completed ops”)
- ⊙ E&O policy: costs erode the limits (“wasting”)

Professional Liability

- ⦿ For architects, engineers, consultants, or other “professionals”
- ⦿ Damages arising out of professional services.
- ⦿ Ordinary standard of care (not heightened or contractually assumed liability)
- ⦿ Insures only the “professional” (no additional insured coverage)
- ⦿ Typically on a Claims-Made basis

CGL

- ⦿ Provides coverage for bodily injury or property damage caused by an *occurrence*.
- ⦿ An *occurrence* is an accident. An accident is not an intentional or deliberate act, but a deliberate act performed negligently if the effect is not intended, is an accident/occurrence. See, e.g. *Lamar Homes*.

CGL

What's covered?

- ⦿ Physical injury to tangible property, including all resulting loss of use of that property.
- ⦿ Purely economic damages are not covered.
- ⦿ A house built over a pipeline easement (now worthless) is not property damage.

CGL - triggering

- ◎ The “injury in fact” is trigger. *Don’s Building Supply, Inc. v. OneBeacon Ins. Co.*
- ◎ Trigger is when “actual physical damage to the property occurred.” That could be the day the work was negligently installed, the day of the first rain, or sometime later.
- ◎ Determines the policy implicated

CGL

Exceptions

- ◎ “your work”: excludes from coverage property damage performed by insured or on its behalf
 - › But see the “subcontractor exception”
- ◎ Contractually assumed liability
 - › *Gilbert v. Underwriters at Lloyds*, 327 S.W.3d 118 (Tex. 2010)
 - DART project. Gilbert had immunity. Negligence claims dismissed, leaving only breach of contract. No coverage because contractually assumed liability

CGL

◎ Contractually Assumed Liability

- *Ewing Construction v. Amerisure*, 420 S.W. 3d 30 (Tex. 2014)
- Ewing built tennis courts for school district, which quickly began to flake and crack. District sued for negligence and breach. Economic loss rule barred negligence, leaving only breach (good and workmanlike).
- Held: good and workmanlike does not enlarge duty to exercise ordinary care; coverage exists.

CGL

- ◎ Covers “physical injury to tangible property” or “loss of use of tangible property” (not defects)
- ◎ Accidents – not intentional acts
- ◎ That occur during the policy period (trigger)
 - › Make sure policies extend beyond substantial completion
- ◎ Always get named as an additional insured
- ◎ Don’t rely on the certificate

Triggering Surety's Performance Bond Obligations

- ⊙ Requires Default – Terms of Bond and Contract Documents Control
- ⊙ *Nova Cas. Corp. v. Turner Const. Co.*, 335 S.W.3d 698 (Tex. App.—Houston 14th, 2011)
 - › Termination not required to trigger performance bond obligation
 - › Standard language typically requires declaration of default, notice to cure, and termination to trigger
 - › Termination may not be best option
 - › Consider language triggering Surety obligations for uncured default short of termination – partial take-over or other relief

Surety Performance following Default

⊙ Take-over Agreement

- › Negotiate terms concerning accrued damages
- › Release of contract balance
- › Reservation of Rights

⊙ Denial of Performance

- › Contractor and additional surety defenses available
- › Litigation - Surety and Principal

Perfection of a Performance Bond Claim

- ⦿ No required notice
- ⦿ In event of abandonment or termination due to contractor default, performance bond obligations are triggered
- ⦿ Contract balance may be used to complete or paid to surety if surety accepts obligations to perform

Lawsuit on All Bond Claims

- ⊙ Must be brought in county where the project is located
- ⊙ Limitations period
 - › Performance bond - one year from date of final completion, abandonment, or termination
 - › *Hartford Fire v. City of Mont Belvieu*, 611 F.3 289 (5th Cir. 2010)

Questions?