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Eight Insights Into Contract Surety Claims

By David Kotnik of [Westfield](#)

As a financial product, surety bonds are underwritten to have zero losses paid by the carrier; but that doesn't necessarily translate to zero claims. Here are eight insights into contract bond surety claims.

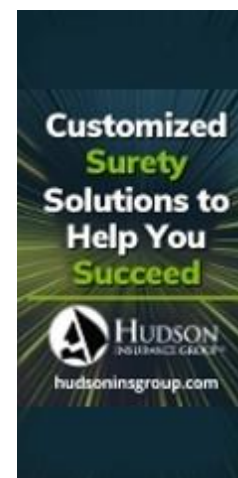
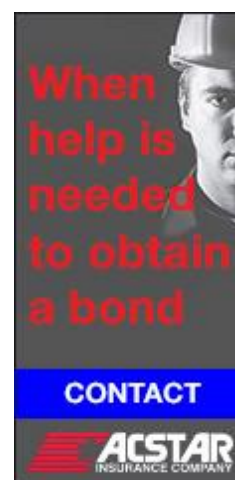
1. Surety claims usually don't turn into losses.

A very small percentage of surety claims, likely in the low single digits, actually turns into losses for a surety. (Claims are demands filed against a surety bond, typically by a subcontractor or obligee; losses are actual paid claims.)



The following example illustrates the difference between claims and losses. A landscaping contractor on a construction project in Florida purchased materials from 42 plant nurseries. When that contractor failed to make timely payment to the nurseries, each filed a claim with the surety.

The nurseries were proactively protecting their rights through the surety in the event the contractor ultimately failed to make payment. But those claims did not turn into surety losses because the contractor eventually paid the outstanding amounts due to the nurseries. So, essentially, 42 claims were filed against the surety; but not one turned into an actual surety loss.



2. Surety companies often mediate disputes to prevent them from becoming claims and losses. One reason claims rarely turn into losses is that sureties often find themselves mediating disputes between bond principals and potential claimants. The surety's goal is to get the parties to a common ground and, ultimately, resolve the conflict.

Mediation can serve as a useful tool because it causes parties to openly discuss their dispute so they can find common ground. Addressing conflicts openly and promptly can serve to avoid future litigation.

3. Bond principals are ultimately responsible for losses they cause a surety. A bonded contractor is obligated under an indemnity agreement to repay the surety for any losses the surety pays out on behalf of the principal.

In the example of the landscape contractor, if the contractor had not eventually made good on its obligations, then the surety company would have been obligated to pay the claims from the nurseries. (If that had happened, the surety company would then have sought to recover the losses from the landscape contractor.)

4. One bond can lead to numerous claims. The complexity of subcontractor relationships on a construction project can lead to multiple claims on one bond. Anybody that does work on a project could be a claimant on it.

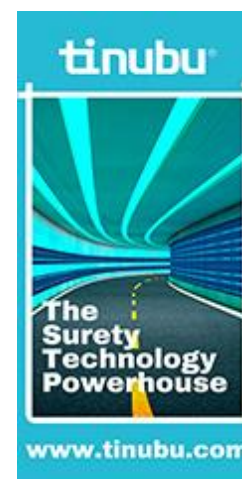
I've had instances (such as the nurseries discussed above) of dozens of claims made on a single bond. Think about a construction project with different trucks on the lot; each of those vehicles represents a subcontractor who could have a dispute with the contractor.

5. Typical contract bond claims are for nonpayment and nonperformance. A bond serves as a guarantee that a contractor will do the work in accordance with the project plans and specifications. Those working on the project, including subcontractors, suppliers, and laborers, also benefit from the bond's assurance that they will be paid for their work.

This allows the project owner, whether it's a state, city, private developer, or another entity, to know that it is protected from a contractor's failure to perform or pay its lower tiers. The surety would ensure that the project gets completed and make sure that everybody on the project gets paid.

6. It's instructive to consider the cause of claims. Surety claims typically are related to economics or performance. For example, an economically based claim could arise if a project owner doesn't pay the bonded principal, which then cannot pay its subcontractors.

Performance-related disputes involve how and when contracted work is done or not done. Performance issues generally fit into one of three categories: allegations of defective workmanship, failure to adhere to the schedule, and differences in contract interpretation. For example, an owner could make a claim if only 93 of 100 light fixtures were installed, or if the project were not finished on time.



Understanding potential reasons for claims can help all parties—principal, subcontractor, obligee, and surety—prevent them.

7. Character counts. Character is probably the most important component of any surety-principal relationship. The surety wants to know the bonded principal will be reliable, honest and fair. The surety also wants to trust that, if the project goes off course, the company will actively work to resolve the situation.

In the construction business, there are ways for people to avoid responsibility in these scenarios. For instance, bankruptcy laws can provide a convenient escape when people run into problems. Individuals with high character are less likely to run from their problems.

8. Communication matters. Whenever a contractor senses there is an issue with a project, it should move quickly to communicate with all involved. Swift action can prevent more complicated issues from cropping up and prevent parties from taking a hard-line regarding conflicts. Contractors are well served to proactively speak with their surety bond producer and surety and to engage other stakeholders such as the claimant, the owner, and their attorneys.



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