

THE BOTTOM LINE



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E X C E L L E N C E I N S U R E T Y B O N D S

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What a Year 2001 was for the Surety Industry

2001 is finally gone. For the surety industry, 2001 couldn't have left soon enough. There were three events that have caused the surety industry to refocus and to begin to re-evaluate its book of business. These events were September 11, the collapse of Enron, and overall losses that have changed the surety marketplace from a "soft" market to a "hard" market.

SEPTEMBER 11, 2001

There was no way anyone could have ever imagined what happened on September 11. To think that there were more people lost on that one day than were killed in Pearl Harbor is still hard to understand.

For the insurance industry, September 11 will definitely be hard to forget. In a manner of a few hours, the insurance industry lost approximately \$100 billion dollars. As I am writing this I am amazed that any industry could lose that much in just over two hours. That is approximately \$50 billion dollars an hour, gone in a flash of an eye. Just think how much money your company makes in a year and you can plainly see that this event was a serious blow to the insurance industry. The surety industry is a small part of the insurance industry. As such, the surety industry is greatly affected by what happens in the insurance industry each year.

THE FALL OF ENRON

Enron, the energy giant, filed for Chapter 11 protection in December of 2001. Enron's sudden collapse will have global consequences for many banks and insurance companies who were involved in its energy trading and supply activities.

While at the time of this publication, the net effect has not yet been determined, here is what we do know at the present time:

1. There is potential liability to the surety industry of approximately \$1.5 billion dollars. To give you a little more prospective, the entire surety industry earns approximately \$3 billion dollars a year in revenues. Thus, Enron's collapse could cause the surety industry to shrink considerably.
2. There is a large amount of exposure on Enron, with 15 different sureties that may have potential losses. Some of these sureties are already reporting losses in excess of \$200 million dollars.

"SOFT" MARKET VS "HARD" MARKET

For the past several years, the insurance industry has been experiencing what industry people call a "soft market". When a soft market hits, many insurance companies and agents try to pick up market share by offering lower rates. As you have probably seen or heard, insurance prices were at an all-time low and were compared to prices back in the early 1990's. The insurance industry was trying to make money through investments as opposed to underwriting results. As the economy began to fall and losses mounted, insurance companies began to increase rates.

For the first time in many decades, surety companies are beginning to file new higher rates in hopes of recouping losses. In the past, surety companies did not raise rates since, in theory, there should never be a loss with proper underwriting and full indemnities from all stockholders, spouses and affiliates. This, of course, is only in theory. You only have to ask Amwest and Frontier to see that losses do occur in surety. These companies are either out of business or have been purchased because of financial distress.

Since the fourth quarter of 2000, the surety industry had begun to experience surety losses due to poor underwriting decisions, the slowdown in the economy and contractors' failures. The surety industry was in a "hard" market long before September 11. The surety industry will be trying to recover from these losses and other losses that have yet to be discovered.

The question now is what can be expected, from the surety industry for the upcoming year:

1. Increased rates on most accounts
2. Stricter underwriting guidelines
3. More collateral and escrow deals
4. An increasing number of contractors that won't be able to obtain a surety bond

Like most industries, the surety industry is having problems at the present time, but you can rest assured that these problems will quickly be addressed. Until then, be prepared for changes in 2002. If you have any concerns or questions regarding the change in the marketplace, please do not hesitate to call us for further information.

*"Famous
Quotes"*

*"The purpose of life
is to believe, to hope
and to strive."*

Indira Gandhi

*"When my enemies
stop hissing, I shall
know I'm slipping."*

Maria Callas

*"The greatest gift
that you can give
yourself is a little
bit of your own
attention."*

Anthony J. D'Angelo

*"The length of a
film should be di-
rectly related to the
endurance of the
human bladder."*

Alfred Hitchcock

*"Most of the impor-
tant things in the
world have been
accomplished by
people who have
kept on trying when
there seemed to be
no hope at all."*

Dale Carnegie

SAFETY AS A COMPETITIVE TOOL

"Our feelings are our most genuine paths to knowledge."

Audre Lorde

"The aging process has you firmly in its grasp if you never get the urge to throw a snowball."

Doug Larson

"No act of kindness, no matter how small, is ever wasted."

Aesop

"People forget how fast you did a job—but they remember how well you did it."

Howard W. Newton

"People and things do not upset us, rather we upset ourselves by believing that they can upset us."

Albert Ellis

"Nothing is a waste of time if you use the experience wisely."

Rodin

"Far away in the sunshine are my highest aspirations. I may not reach them, but I can look up and see their beauty, believe in them, and try to follow where they lead."

Louise May Alcott

In the last few years, when construction firms enjoyed unprecedented profitability, worker fatalities actually increased when compared to the period prior to the expansion. In 2000, there were 1,154 worker fatalities in the construction industry, according to the Bureau of Labor Statistics. In 1999, the number was 1,191. In 1998, the number was 1,174. The industry is losing five workers per working day! Some studies indicate that 180,000 construction workers are injured each year. The most common cause of fatalities and disabling injuries is falls from elevations.

One likely explanation for the increase during the period is that the economic expansion hid a lot of bad business practices. However, the current market should now eliminate some of the weaker competitors, Darwin's survival of the fittest.

It is the employer's responsibility to provide a safe workplace, to provide safe tools and equipment, and to enforce safety rules. Principals and other members of the management team may face personal liability and may even open themselves up to criminal charges in certain cases.

Construction has risks, but these risks can be managed when the entire organization is committed to safety. Top management must be committed to providing a safe workplace. In addition to the moral obligation to provide a safe workplace as a member of the human race, rest assured that it is good business. There is economic motivation in accident prevention.

Employees are any contractors' most valuable resource. They are what separate the successful firms from the unsuccessful ones. Every firm can buy material and equipment within a couple of percentage points from their competitors. It is the productivity of the labor force that makes the difference.

Employee morale is higher when they feel that their employer is concerned about their safety. Safety is not a necessary evil. It must be an integral part of the firm's operations. Would you expect an employee to be loyal, dedicated and productive for a firm that places little value on his or her life? Of course not.

There is tremendous savings realized from accidents that never occur. OSHA penalties can be severe. Plus, there are indirect costs of accidents that are not covered by insurance, such as loss of trained manpower, adverse publicity, certain legal expenses, and reduced employee morale. Another obvious benefit of fewer accidents is lower general liability,

workers compensation and auto insurance premiums.

The first step is to prepare a written company safety policy. While each company's plan will differ, the plan will address items such as the safety organization within the company, training, record keeping and reporting of accidents and conditions that might lead to accidents, and jobsite inspection.

A safety organization needs to exist within the company. A director of safety should be appointed and a safety committee should be established. The director must report directly to the President, COO or some other similar position. It is important that everyone within the organization knows that top management has given the highest priority to safety.

Statistics show that 85% of all construction job accidents are the direct result of unsafe acts; the balance, from unsafe conditions. As such, there must be a heavy emphasis on training. This includes regularly scheduled company safety meetings, guest speakers, video training, publications and new hire orientations. Personal protection, first aid training, and fire prevention need to, also, be included in the program. Also, keep in mind that multi-lingual safety programs need to be established to reflect the diversity of today's work force.

Like many other expense items, there should be a safety budget. A company safety program does cost money. There is a rule of thumb that a safety program for a firm with direct labor will cost 2.5 percent of direct labor expense. However, many General Contractors and other Prime Contractors have very little direct labor expense, yet they need to provide a safe workplace for everyone on their jobsite including their subcontractors. However, this expense should more than pay for itself.

As a result of the hardening of the insurance market, insurance will soon be a competitive tool. The firms with good safety records will have a marked difference in their insurance costs, making them more competitive than their less-safety focused competitors.

It is, also, important that accountability for safety exists. It is critical to establish a management system that:

- Establishes some measure to compare performance against, such as number of injuries, lost-time, workers' comp claims, etc.
- Measures an individual's performance against that criteria
- Rewards the desired performance

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SURETY BAD FAITH CLAIMS

In many instances, a Construction firm (known as the Principal in surety terms) or its Indemnitors may feel that its bonding company acted in bad faith in the handling of a particular claim situation. While everyone is entitled to their opinion, **legally**, claims with bad faith as a defense for not reimbursing the surety are usually not successful.

Bad faith does not mean bad judgment or a lack of diligence on the surety's part. Bad faith is not an error, and it is not negligence. One needs to prove malicious intent or motive to support such a defense of bad faith. Again, this is difficult, but not impossible, to prove.

As a general rule, surety companies do not want to pay claims, but they must pay and act upon valid claims. They do not want to write the check or seek a replacement contractor and then seek reimbursement from the construction firm, that in many cases is still their client. However, they must act. Failure to act and failure to honor valid claims could result in the suspension of their license by that particular State's Insurance Department. This could have devastating effects on a surety's operations. Plus, the surety must be concerned about its reputation. If it is perceived that they do not honor valid claims, project owners and other Obligees may refuse to accept bonds from that surety company. Obviously, this may, also, affect their operations.

We must look at the General Agreement of Indemnity (GAI) that is signed by every bonded construction firm. Most will agree that it is a one-sided document. However, it is the fundamental contract that outlines the relationship between the Surety and the

Principal and its Indemnitors. It defines the rights of the surety and the obligations of the Principal and its Indemnitors.

Typically, the Principal or its Indemnitors are required to reimburse the surety for any monies that it pays as a result of bonds issued for that Principal. They are also required to post sufficient collateral with the surety any time a potential loss occurs, even before the surety pays out any monies. The surety establishes a reserve for the loss, and it is this amount that they expect to be collateralized. The refusal to indemnify, hold harmless or exonerate the surety is a breach of the GAI.

This point is important because if the Principal posts sufficient collateral, then the surety will typically follow the Principal's defense. If the collateral is not posted, then the surety may settle the claim and the Principal and Indemnitors are ultimately responsible to the surety.

The Principal cannot control settlement without posting sufficient collateral. A Principal's dispute over whether a surety should pay a claim is not enough to support a defense of bad faith. As a general rule, a Principal cannot refuse to post sufficient collateral and then be successful in a claim of bad faith.

This is not to say that claims of bad faith are never successful. For instance, it might be successful if the surety fails to follow the terms of the bond or the surety fails to conduct an investigation. For readers that are interested in specific cases, please contact us.

"If you treat an individual as he is, he will remain as he is. But if you treat him as if he were what he ought to be and could be, he will become what he ought and could be."
Johann Wolfgang von Goethe

"The scientific theory I like best is that the rings of Saturn are composed entirely of lost airline luggage."
Mark Russell

"The greatest discovery of my generation is that a human being can alter his life by altering his attitudes of mind."
William James

"Decide what you want, decide what you are willing to exchange for it. Establish your priorities and go to work."
H.L. Hunt

"Life is not a problem to be solved, but a reality to be experienced."
Soren Kierkegaard

"He who thinks by the inch and talks by the yard deserves to be kicked by the foot."
Anonymous

SAFETY AS A COMPETITIVE TOOL

- Corrects problems- It is imperative that corrective action be taken when problems arise, not just at someone's annual review.

At the annual review, it is important to reward those individuals that meet and exceed the established objectives and to penalize those that do not. If their performance is so substandard, employment must be terminated. If not, a very damaging message will be sent to the other employees – safety is not that important at this firm. The firm should, also, consider implementing safety recognition programs and contests, maybe pitting one project's team against another.

Safety must be a major element in any

successful contractor's strategic plan. It must be a high priority of top management, and it must be viewed as something that is critical to the future success of any construction company, because it is.

The following websites have some useful information:

- www.agc.org -click on "Safety and Risk Management"
- www.asse.org (American Society of Safety Engineers)
- www.bls.gov (Bureau of Labor Statistics)
- www.osha.gov (Occupational Safety and Health Administration)

ACC's New Year's Resolution

While the surety industry has tightened to levels never seen before, we at Atlantic Coverage Corp. are committed even more to growth in 2002. In order for us to continue to grow, we are asking you, our clients and friends, to help us by providing us with information regarding the quality of service and things you would like us to improve upon. No matter whether your responses are positive or negative, it is extremely important that you be as truthful as possible, since we can only improve if we know what needs to be fixed. Please fax back your response to these important questions to (516) 682-5005, or you may e-mail Louis J. Spina directly at spina@esuretybond.com, or call him at (516) 682-5000 with any confidential responses. We can only improve with your help. Thank you in advance.

Contractors Name: _____

What are our strengths?

What are our weaknesses?

What do we need to improve upon?

Company News

Denese Thompson, Kathy Bellone and Nicole Gruter took time out to volunteer and raise money for Breast Cancer by participating in the Walkathon at Jones Beach. Laura Spina also participated in a Walkathon for Breast Cancer in Stony Brook.

Anthony M. Spina chaired a golf committee for the United Cerebral Palsy of Greater Suffolk. The golf outing was held on October 1, 2001 at the Huntington Crescent Club and raised over \$100,000 which will be used to provide family assistance and new wheelchairs to local children throughout Suffolk County.

Letter from the Editorial Staff

This newsletter is designed with our readers in mind. All inquires and ideas regarding this or future newsletters are appreciated. Please send all inquires to me at anthony@esuretybond.com. If you know anyone who you feel would like a copy of our newsletter, please let us know so that we can include them in our mailing list. Please let us know if you would like to receive this newsletter via e-mail.

Disclosure

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