

Bonding and Insuring of Defence Construction Canada Construction Contracts

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Defence Construction Canada (DCC) - Who We Are

The mandate of Defence Construction (1951) Limited, also commonly known as Defence Construction Canada, is a Federal Crown Corporation that provides procurement, construction, professional, operational and maintenance services in support of the defence of Canada

The main beneficiary of these services is the Department of National Defence, however the Corporation also provides services to the Canadian Forces Housing Agency, the Communications Security Establishment Canada, Shared Services Canada, and Public Services and Procurement Canada

Bond Basics

What a bond is and isn't

- A bond is a written agreement in which one party (the Surety) guarantees that a second party (the Principal) will fulfill its obligations to a third party (the Obligee)
- The agreement commits that if the Principal defaults on its obligations, the Surety must complete the work for them or pay the completion costs to the Obligee
- A bond is not an insurance policy

Parties to the bond

- The **Principal** is the party who requests the Surety to issue the bond and whose obligations are guaranteed (Contractor)
- The **Obligee** is the party who requires the Principal to obtain the bond and who receives the benefit of the guarantee (Owner)
- A **Surety** is the party who issues the bond that guarantees the obligations of the Principal

Bond Basics

Key characteristics of construction bonds

- A construction bond is a three-party agreement between a Surety, Principal and Oblige.
- The bond is triggered when the Principal defaults on its obligation to the Oblige, unless the Oblige somehow caused the default.
- The bond pays for pure economic loss, meaning the cost of completing the Principal's obligation even if nothing is broken or destroyed.
- A Surety that pays out on a construction bond has the right to seek recovery from the defaulting Principal - the bond purchaser.

Bonding of Construction Contracts - Bid and Contract Security

The Bid Bond used on Defence Construction Canada construction contracts

- Its use is to guarantee that, if a bidding contractor is awarded a contract in response to a tender and then refuses to enter into the contract in accordance with the terms of the tender, the Surety will pay the owner the price difference between the dis-honoured bid and the next lowest bid up to the limit of the bond

Limit (\$) of the Bid Bond

- Not less than 10% of the bid amount to a maximum amount of bid security required with any bid being \$2,000,000
- Applicable taxes are not included in calculating the amount of the Bid Bond

Bonding of Construction Contracts - Bid and Contract Security

Purpose and function of the Bid Bond

- Ensures that the successful bidder will enter into the tendered contract
- Ensures that the successful bidder/contractor will provide contract security as specified in the tender documents (14 days after award in accordance with DCC General Conditions) and the Bid Bond is converted to contract security to bridge the time until contract security is provided (Performance, L&M bonds, cash security...)
- If the contractor meets the commitment to provide contract security, the Surety's obligations under the Bid Bond are at an end
- If the contractor fails to meet any of the obligations under the Bid Bond, the contractor is in default and the Owner can call upon the Surety to compensate for loss (up to the limits specified in the Bid Bond)
- Time limitations are stipulated in the Bid Bond (right to claim within 12 months of the date of the Bid Bond)

Bonding of Construction Contracts - Bid and Contract Security

The Performance Bond used on Defence Construction Canada construction contracts

- Its use is to guarantee that the contractor that has entered into a construction contract will perform all of its obligations under the contract

Limit (\$) of the Performance Bond

- Equal to and not less than 50% of the Contract Amount
- Contract Amount means the amount set out in the Contract to be payable to the Contractor for the Work, subject to the terms and conditions of the Contract
- Applicable taxes are not included in calculating the amount of the Performance Bond

Bonding of Construction Contracts - Bid and Contract Security

Purpose and function of the Performance Bond

- Generally, a Performance Bond constitutes a promise from the Surety to the Obligee that if the Principal defaults in the performance of a specific contract, so long as the Obligee has performed its obligations under the contract, then the Surety, usually subject to certain conditions, will be obliged to either remedy the default or complete the contract*
- On the construction site, a Performance Bond assures the Owner that contractual obligations to complete Work assigned to the bonded contractor will be completed in accordance with the bond conditions (which by reference include the contract terms and conditions).
- *Note on Federal/DCC contracts the option to put bids for completion to the Obligee is absent from the bond (i.e. not an option). The Surety is obligated to complete the work. CCDC bonds provide additional options to the Surety.

Bonding of Construction Contracts - Bid and Contract Security

The Labour & Material Payment Bond used on Defence Construction Canada construction contracts

- Its use is that it provides for payment of the bonded Principal's sub-contractors and suppliers should the Principal not make payments as required

Limit (\$) of Labour & Material Payment Bond

- Equal to and not less than 50% of the Contract Amount
- Contract Amount means the amount set out in the Contract to be payable to the Contractor for the Work, subject to the terms and conditions of the Contract
- Applicable taxes are not included in calculating the amount of the Labour & Material Payment Bond

Bonding of Construction Contracts - Bid and Contract Security

Purpose and function of the Labour & Material Payment Bond

- Refers to the contract between the Principal and the Obligee.
- Ensures payment by the Principal of lawful obligations to sub-contractors and suppliers on the contract.
- Intended to offer protection to the Principal's sub-contractors and suppliers in the event the principal fails to pay them.
- Provides the subcontractors and suppliers with an alternative to filing liens which cannot be registered against Federal Crown contracts.

Bonding of Construction Contracts - Bid and Contract Security

The Claimant's Payment Bond used on Defence Construction Canada construction contracts

- Its use is that it is provided by the Surety to the contractor and is used mainly as an alternative to withholding "earned but unpaid" monies from contractor's progress claim for those cases where DCC has received notices of claims from claimants. A claimant's payment bond protects registered claimants by ensuring that funds are available to them in the event the contractor refuses or is unable to pay.
- Normally this form of bond is not required when a Labour & Material Payment Bond has been provided by the contractor.

Triggering Bonds

Triggering the Bid Bond

- A Bid Bond may be triggered by the Principal's refusal to enter into the tendered contract
- To claim against the Bid Bond, the Surety must be formally advised that the contractor's bid is compliant, with no demonstrable, genuine and substantial errors and the contractor refuses to perform the work (prior to provision of a Performance Bond)

Triggering the Performance Bond

- A Performance Bond may be triggered by the Principal's default in the performance of the bonded contract
- To claim against the Performance Bond the Obligee must make the determination and a declaration (i.e. provide notice) of default to the Surety

Triggering Bonds

Triggering the Labour & Material Payment Bond

- A Labour & Material Payment Bond may be triggered by the Principal failing to pay on the accounts of its sub-contractors and suppliers, when due
- It is the responsibility of the claimant to pursue recourse through the Labour & Material Payment Bond directly with the Surety
- Notice of a claim must be given within a specified period - usually 120 days - after payment is due or some other defined event in the construction process

Insurance Basics

Insurance Defined

- Coverage by contract whereby one party undertakes to indemnify or guarantee another against loss by a specified contingency or peril

Parties to the insurance

- The **Insured** is the party who purchases the insurance policy from the Insurer (Contractor)
- The **Insurer** is the party who issues the insurance that is purchased by Insured (Insurance Company)
- The **Additional Insured** in Defence Construction Canada contracts is the party that is included under the coverage of the Insured as issued by the Insurer (DCC)

Insurance Basics

Key characteristics of construction insurance

- An insurance policy is a two-party agreement between an Insurer and an Insured.
- Construction insurance coverage is triggered only by accidental events.
- Construction insurance excludes coverage for completing construction contract obligations. Construction liability and property insurance policies provide no coverage for fixing or finishing defective or incomplete work or materials but instead cover only resulting physical damage to other items.
- An Insurer that pays out on an insurance policy has no right to recover against the Insured - the policy purchaser

Insuring of Construction Contracts

The Commercial General Liability Insurance Policy used on Defence Construction Canada construction contracts

- Its use is that it is provided by the Insurer to the contractor and includes, but is not necessarily limited to:
 - All premises, property and operations necessary or incidental to the performance of the Contract
 - Personal injury
 - Bodily injury and property damage on an “occurrence” basis
 - Broad Form property damage including loss of property
 - Removal or weakening of support of any property, building or land whether such support be natural or otherwise
 - Elevator liability, including escalators, hoists, and similar devices
 - Owner’s and Contractor’s Protective Liabilities
 - Blanket Contractual Liability
 - Completed Operations and Products Liability
 - Cross Liability - The insurance as is afforded by this policy shall apply in respect to any claim or action brought against any one Insured by any other Insured. The coverage shall apply in the same manner and to the same extent as though a separate policy had been issued to each Insured. The inclusion herein of more than one Insured shall not operate to increase the limit of the Insurer’s Liability

Insuring of Construction Contracts

- The policy shall be endorsed to include the following exposures or hazards if the Work is subject thereto:
 - Blasting
 - Pile driving and caisson work
 - Underpinning
 - Risks associated with the activities of the Contractor on an active airport demolition
 - Demolition
 - Marine risks including piers, wharves and docks
 - Radioactive contamination resulting from the use of commercial isotopes
- The insurance shall continue for a period of at least one year beyond the date of the Final Certificate of Completion
- The policy provides for limits of liability of not less than \$5,000,000 inclusive, for Bodily Injury and Property Damage for any one occurrence or series of occurrences arising out of one cause and not less than \$5,000,000 for personal injury
- The policy shall be issued with a deductible amount of not more than \$10,000 per occurrence

Insuring of Construction Contracts

The Builders Risk-All Risks or Installation Floater-All Risks Insurance Policy used on Defence Construction Canada construction contracts

- Builder's risk protects a contractor from a loss during a construction project due to weather, fire, accidents, material defects and poor installation or workmanship.
- Builder's risk will provide funding to repair, re-purchase or re-construct the covered loss for the benefit of all contractors working on the project.
- Builder's risk provides coverage for all parties that have an insurable interest in the project including the Owner, general contractor, and subcontractors.

Insuring of Construction Contracts

The Builders Risk-All Risks or Installation Floater-All Risks Insurance Policy used on Defence Construction Canada construction contracts

- Installation floater will protect a specific contractor from the loss of the material installed by that contractor.
- Installation floater provides coverage only for the policyholder.
- Installation floater doesn't provide coverage for any other party on a project site other than the contractor who purchased the installation floater.
- Most installation floaters are blanket for all work performed and not specific to any one project; it is, however, specific to the limits of the policy.

Insuring of Construction Contracts

The Builders Risk-All Risks or Installation Floater-All Risks Insurance Policy used on Defence Construction Canada construction contracts

- The builders risk and installation floater insurance expire when the building or structure is accepted by the Owner as complete
- The amount of insurance shall not be less than the sum of the contract value plus the declared value (if any) set forth in the contract documents of all material and equipment supplied by Canada at the site of the project to be incorporated into and form part of the finished work
- The policy shall be issued with a deductible amount of not more than \$10,000

Common Challenges with Bonding and Insurance

Bonding Challenges: Challenges based on understanding the Bonds

- As long as the Surety fulfills their obligations under the bond, the Surety's liability is limited to allowable damages sustained by the Obligee up to the face amount of the bond (sometimes called the bond's "penal sum").
- Recovery of any damages beyond the face amount of the bond can only be claimed from the defaulting Principal.
- If an Owner has no legal right to accept a particular bid from a bonded contractor, then the Surety has no obligation to pay on the bond if the contractor refuses to enter into the tendered agreement.
- An important concept to understand is that the Bid Bond is not in force until the tender is accepted.

Common Challenges with Bonding and Insurance

Insurance Challenges: Challenges based on understanding the Insurance Policies

- The Insured makes the decision to make a claim against the policy with the Insurer following an accidental event
- Maximum deductible amounts on larger contracts
- The role of the insurance broker
- Wrap-up Liability insurance

Questions?????

