Bonding: The Good, the Bad, and the Ugly-*Surety Bonds 101*

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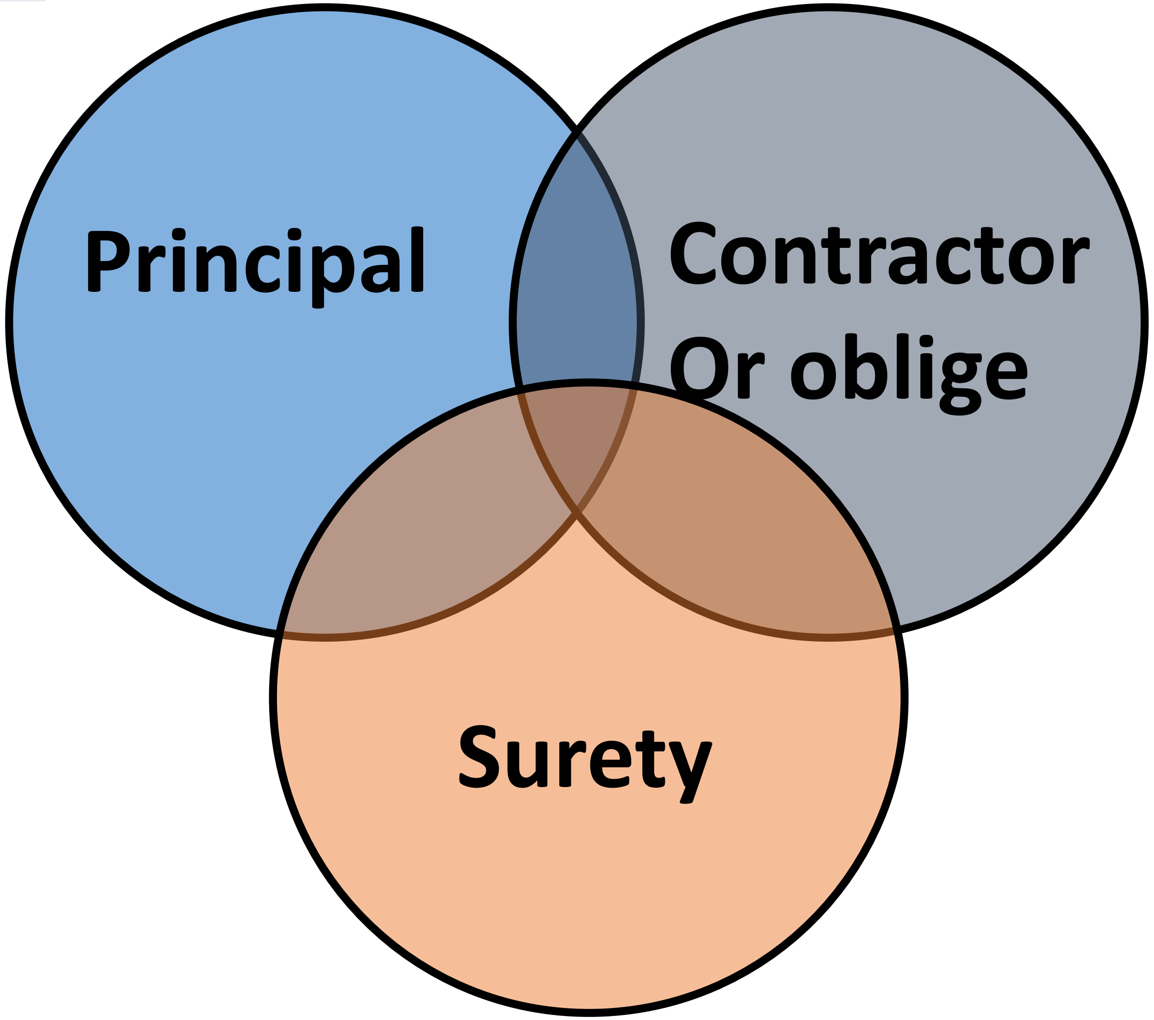
A Surety Bond is a two-party agreement

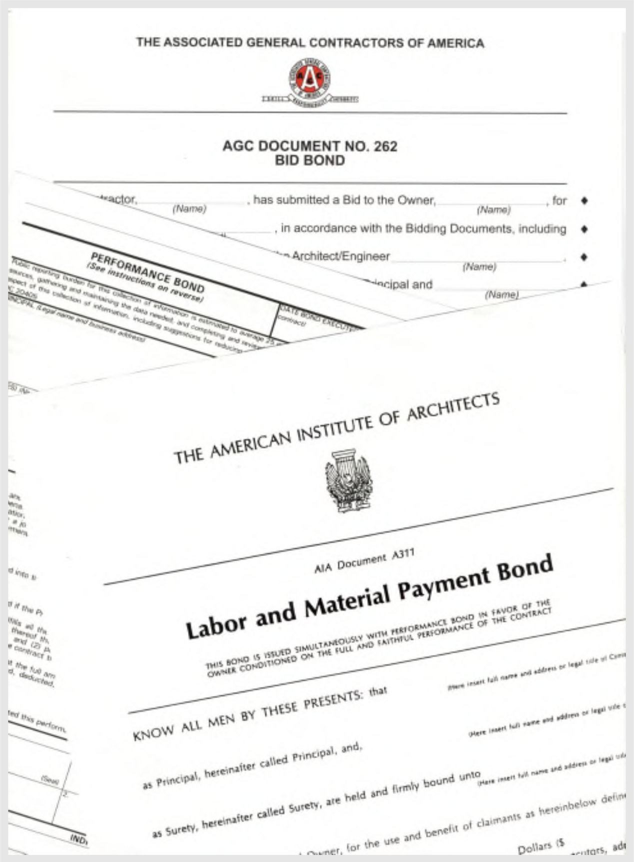
- True
- False

Surety bonding

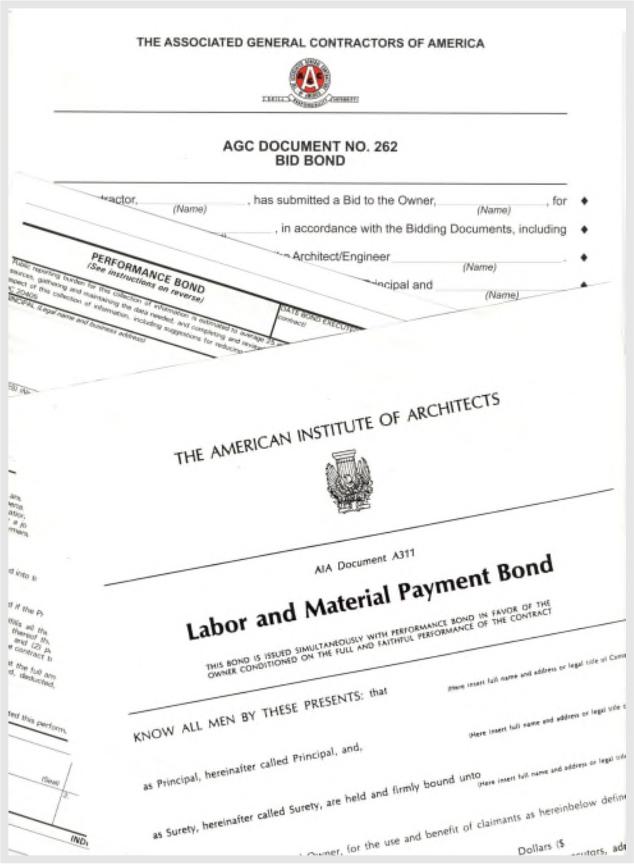


Imagine new possibilities.

Types of Surety Bonds



- **Bid Bond**
- **Performance Bond**
- **Payment Bond**



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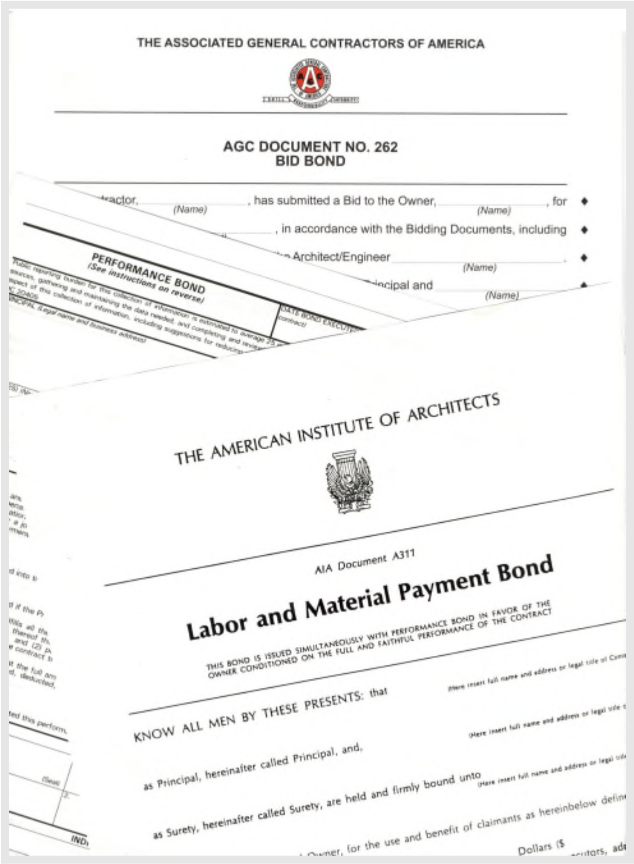


- **Bid Bond**
- **Performance Bond**
- **Payment Bond**
  - **Always get release from subs and material suppliers**

If an agency requires a payment and performance bond, it must also require a bid bond?

- True
- False

- The majority of states require bid, performance, and payment bonds, (for construction)
  - Performance and payment are normally 100% of the contract price
  - However, every state can set its own bid bond requirement and form of bid bond

A surety bond is the same as insurance?

- True
- False

- Insurance pays on behalf of you;
- surety bonds are a guarantee of payment to another party.

  - **The primary difference between a surety bond and insurance is that insurance will pay for losses in a claim, whereas a bonding company will guarantee your obligations are fulfilled.**

Why Bond

- Approx. 29% of contractors fail annually (pre-COVID)
  - Risk mitigation
    - Provide assurance to you that all parties involved will perform and meet financial obligations
- TxDOT– contractor with $300M in multiple contracts declared bankruptcy –
- Central TX Mobility Authority - $136M to add toll lanes found in default
- NC infrastructure contractor – defaulted on $15M project

Some general rules about bonds

- The liability of the surety is measured by the liability of the principle, the amount set forth in the bond, and cannot be exceeded
- A surety becomes a creditor of the principal discharging the obligation of the bond
- In cases of interpreting bond language formulated by a surety company, any language construction is strongly in favor of the oblige
  - In the case of a rider added to the bond, the rider is subject to the broadest interpretation of coverage – *Gulf Power Co., v. Insurance Co., of America, 443 So. 2d, 1141*
    - The owner argued that the increased amount to bond should be effective immediately, regardless of when claims may arise
    - Surety argued that claims against increased bond amount should only be allowed after the date of rider.
      - Surety lost

Benefits of Bonds

- Financial Security
- Construction Assurance

- *Benefits of Bonds*

Owner

- Qualified bidders
- Reduced risk of liens
- Timely project completion
- Defect protection

- *Benefits of Bonds*

Contractor

- Contract reviews
- Continuity plans
- Expertise
- Project qualification
- Private construction
- Lending institutions
- Subcontractor protection
- Technical, managerial, financial assistance

From a contractor’s financial strength perspective, is a bank’s letter of credit viewed the same as a surety bond?

YES

NO

Borrowing Capacity

Surety Bonds

- Issued on unsecured basis
- No direct effect on bank line of credit
- Credit enhancement

Letters of Credit

- Assets used as collateral
- Diminish existing line of credit
- Can affect cash flow

Duration

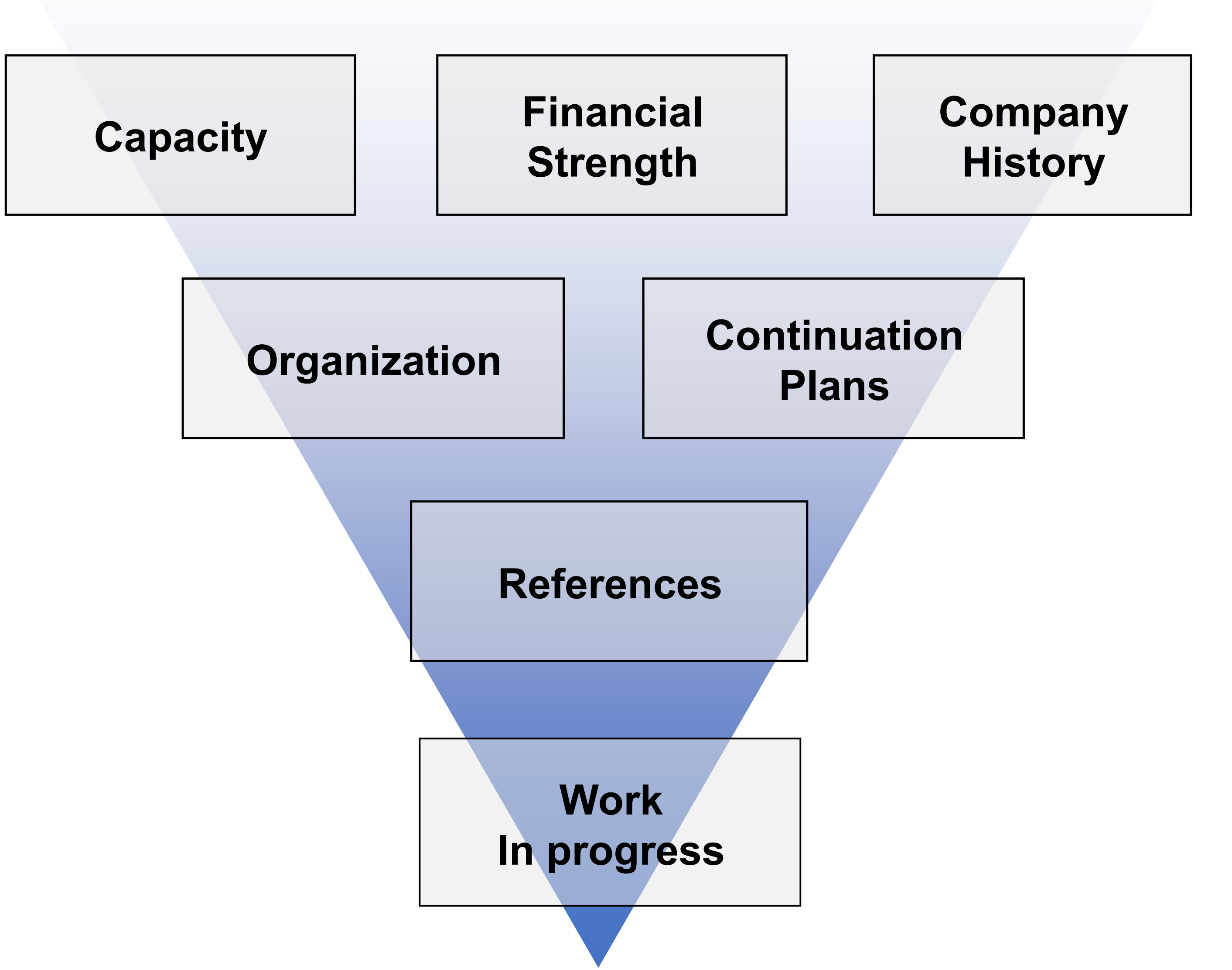
Surety Bonds

- Duration of contract
- Maintenance period

Letters of Credit

- Date specific
- Evergreen clauses

Prequalification



Prequalification

Capital

Capacity

Character

Capital

Financial statements

Working capital

Work-in-progress

Indemnity

Prequalification

Capital

Financial statements
Working capital
Work-in-progress
Indemnity

Capacity

Resumes
Contingency plan
Business plan- short & long term
Equipment

Prequalification

Capital

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Equipment

Character

Reputation
Relationships
References

Liquidated Damages

- While not part of P&P bonds, generally included with bonded projects and others:
  - Black's Law Dictionary defines it as follows:
- A provision, that determines in advance, the measure of damages if a party breaches the agreement
  - Will generally be upheld, unless, the agreed-upon sum is construed as a penalty, for one of the following reasons:

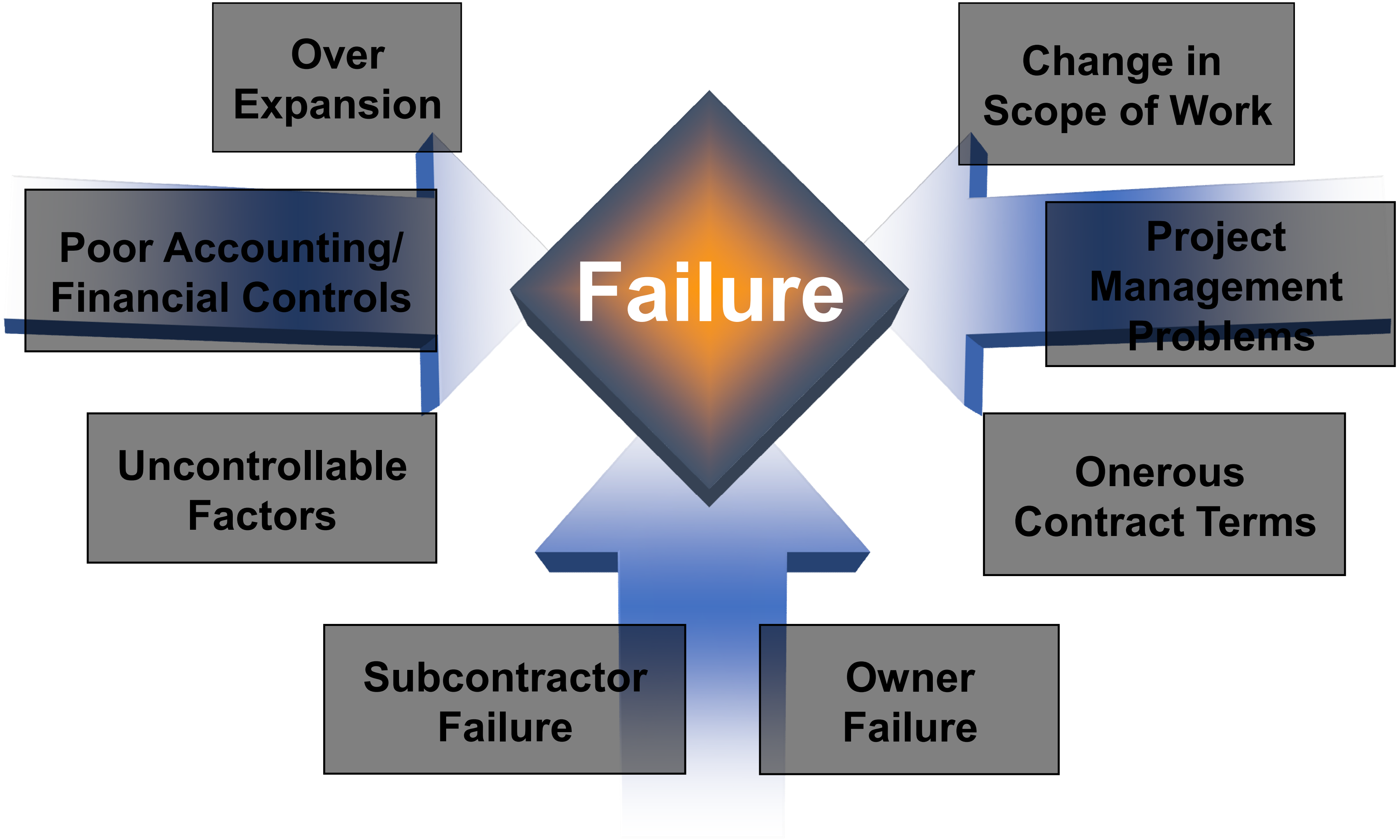
1. The sum grossly exceeds the probable damages from the breach
2. The same sum is made payable to a variety of other breaches
3. A mere delay in payment is listed among the events of default

- *Important points to remember when using liquidated damages for any solicitation (while these are FL cases, other jurisdiction courts have opined similarly*
  - In FL, enforceable as long as the assessment is not strictly a penalty, and
  - Actual damages are difficult to ascertain at the time of contracting
    - *Pembroke v. Caudill, 160 Fla. 948, So. 2d. 538*
  - Liquidated damages will not be assessed in addition to actual damages where only liquidated are provided for in the contract
    - *Hall Construction v. Beynon, 507 So. 2d. 1225*
  - Further, in light of liquidated damages, the owner is precluded from advancing evidence that actual damages were much greater
    - *Miami-Dade County v. Frank J. Rooney, Inc., 627 So. 2d, 367*
  - it is basic that "a party to a contract who agrees to a sum as liquidated damages cannot sue for actual damages".
    - *Waters v. Key Colony E, Inc., 345 So. 2d 367*

Contractor failures – it happens

- *Although prequalification greatly reduces the likelihood of contractor default, many things can cause contractor failure.*

Contractor Failure



LICENSED SURETY COMPANYS

In most states surety is regulated by the state insurance office

the contract should require issuing surety to be authorized by the state office to write bonds

state insurance offices are required to review the qualifications of the surety

also, require surety to be rated by AM Best (https://www.ambest.com/home)

Best is largest credit rating agency in the world specializing in Insurance

Fort Lauderdale required A+ rating

CONTRACT CHANGES

Changes happen

ALWAYS NOTIFY SURETY OF EVERY CHANGE – regardless of how minor it may appear

Employers Ins of Wausau v Construction Management Engineers, (FL)

- Principal failed to notify surety of changes increasing price
- Contract failure surety was not liable for amounts over original contract price

Equitable Fire & Marine Ins v Tierman Building Corp

- Bond-required changes to specifications have to be approved by surety in writing
- Principal/owner changed equipment specifications, without consent
- Surety was not obligated to cover damages or losses due to changes

Bank Letters of Credit

- Cash guarantee to owner
- Called on demand
- Payment to owner & loan for contractor
- No guarantee of project completion
- Irrevocable

What is the approximate cost of a bid bond

- $500.00
- 1% of the contract amount
- 2.5% of the contract amount
- No cost

What is the approximate cost of a performance bond?

- 1% of the contract value
- 3% of the contract value
- 7% of the contract value
- 10% of the contract value
- None of the above

Cost of Surety Bonds

- **Bid Bond** **No Charge**

Payment and Performance bonds

- *The typical price range for Performance & Payment Bonds is . 5% to 4% of the contract price. Usually, the rate is presented as a dollar amount per $1,000 of the contract price. For example, a $250,000 contract might cost $25.00 per $1,000 of the contract price, or 2.5%.*
  - riskier contractors are charged additional costs 1-1.5%

Letters of Credit

- 1% of contract amount covered
- Included in bid price

Imagine new possibilities.

Coverage

Surety Bonds

- 100% performance
- 100% payment
- 100% warranty (typical)

Letters of Credit

- Typically, 10% of contract
- No protection for unpaid subs

Claims

Surety Bonds

- Surety investigates claim of default
- Surety's options
- Surety pays rightful claims of certain parties

Letters of Credit

- Payable on demand
- Owner determines validity of claims by subs & suppliers

Conclusion

Informed

Decisions

On Risk

Management

Thank You

The Basics of Bonding

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