



# PERFORMANCE BONDS WORK FOR YOU



**SURETY**  
ASSOCIATION OF  
**CANADA**  
YOUR BONDING RESOURCE

**SURETY BONDS**  
Protection against the risk  
of contractor default

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Construction is a virtual minefield of risk and the default of a contractor on any project can be devastating, as well as expensive. As a prudent construction purchaser, you have chosen to shield yourself from that risk by purchasing the most effective and widely used form of protection against the risk of contractor default: Surety Bonds.

The Surety Association of Canada is pleased to provide some insights and tips to ensure that expectations are met should you ever have to call on a performance bond. More than simple risk transfer products like insurance, or bank instruments, surety bonds promote accountability and professionalism among all the stakeholders in the construction community. The following comments apply only to standard performance bonds and not other forms of bonds, such as labour and material payment bonds.

When a surety company issues a performance bond, it provides two very important services that protect construction purchasers from the risks of contractor default:

## **Pre qualifying the contractor:**

Giving assurances that the contractor has the financial and operational capability to carry out the terms of the contract, both at the bid stage and at the time of contract award; and,

## **Providing Protection:**

Backing up the pre-qualification assurance with its own assets. If a bonded contractor defaults and a valid claim is advanced, the surety will respond by remedying the default, completing the contract or arranging for completion of the contract, subject to the terms and conditions of the bond.

The surety will promptly investigate the facts of any declaration of default and will propose practical and often creative solutions. Usually, mitigation proposals will be presented in order to facilitate completion of the contract and to protect the rights of all parties. The surety will provide protection from loss in situations where the contractor is in default of its contractual obligations, is rightfully terminated by the owner and is unable to honour its financial obligations.

Please note that the surety's exposure will be limited to the penal sum of the bond. Surety bonds have been an effective risk management resource in the North American construction industry for generations. They are relied upon, and in many instances mandated, by public and private industry participants.

The Surety Association of Canada endorses and encourages the use of standard CCDC (Canadian Construction Documents Committee) bond forms. The Surety Association of Canada also endorses and encourages the use of its own industry standard bond forms (SAC Bond Forms). The use of non-standard bond forms may expose you as a user to unknown and unnecessary risks and consequently this practice is strongly discouraged.

## HOW THE SURETY IS ABLE TO ASSIST PRIOR TO A DEFAULT

The surety company has an interest in seeing both you and its contractor client succeed and is often willing to use its experience and resources to facilitate discussion of problems and avoid a default.

A surety company will respond under a bond in the event the bonded contractor defaults, and the default has been declared with a formal written demand to the surety.



However, giving a surety company early warning of a problem often allows a surety to contribute informally to a solution before the problem becomes a default.

Surety companies have extensive experience in dealing with many different kinds of contracts and in solving problems that can arise in construction. Surety companies pre-qualify and monitor the overall health of a client contractor's organization, a process that quite often leads to a long term relationship between a surety and its contractor client. This means that surety companies can often make a positive contribution to resolving performance problems that could potentially lead to a breakdown on a project.

If you encounter a serious problem with the performance of a bonded contractor that you believe has the potential to lead to a default, advise the surety company. At your request, the surety will discuss the concern with you, and attempt to arrange and participate in a meeting or conference call with you and the contractor with a view to finding a solution.

Even though this meeting or conference call is not actually required under the contract or under the bond, it can often allow frank discussion and lead to solutions that can then be formalized within the contract provisions or, if necessary, with the surety company.

## WHAT TO EXPECT WHEN A BONDED CONTRACTOR DEFAULTS



If you encounter a contractor default that is serious enough that you have decided to advance a claim to the surety company under the performance bond, you are required to promptly provide the surety company with written notice of the contractor's default and make a clear and unequivocal demand on the bond.

It is very important, before making demand on the surety, that you have carefully complied with the obligations that you have negotiated and agreed to with the contractor, especially in providing the contractor with notice of the

default and allowing the contractor to respond to the notice or remedy the default within any time periods allowed in the contract.

It is essential that you have acted in accordance with the terms of the formal contract to which the bond relates and have kept the surety fully informed of any changes to the contract terms. This will ensure that the surety's ability to act under the bond in the event of a default is not made more difficult by unexpected changes in the contract terms of which the surety has no prior knowledge. These changes may include over paying the contractor, over certifying the value of the work, making significant changes in the contractor's scope of work which dramatically affect the value and/or the duration of the work, and lastly, completing the defaulting contractor's work without the surety's involvement, any of which may cause the surety a proper reason to decline to respond to a default.

When a demand is made on a performance bond, the surety company will promptly begin an investigation to ensure that the conditions of the bond have been satisfied. The surety company will be focusing on the terms of the contract, the conduct of the parties, and the condition of the work. The surety company's obligations under the bond are conditional upon a default by the principal contractor.

If it is determined that the declaration of default is not justified then the surety company will have no obligation under the bond, at least for that default.

The surety company will need your cooperation and assistance in obtaining copies of contract documentation and access to the work site

in order to clearly understand the contract requirements and evaluate the situation in a timely manner.

Some situations are relatively simple and clear, and in these situations a surety company will in all likelihood be able to complete their investigation and provide a response within a short period of time. In other situations though, especially if the problems leading to the declaration of default and the demand on the bond have been evolving over a long time or are complex, the time it will take the surety to investigate will be longer.

Delays and work stoppages usually increase costs, and the surety company will expend its best efforts to investigate and provide you with a response to the formal demand under the bond in a timely manner in order to avoid or minimize downtime and additional costs. As suggested earlier, advising the surety company of serious performance concerns relating to the bonded contractor before a default is declared can sometimes help reduce the investigation time in such situations.

## WHAT TO EXPECT FROM THE BONDING COMPANY

When a surety company receives a demand from you under the bond it will:

- 1 Promptly acknowledge the notice and request assistance from all affected parties in obtaining information and access to the work site as necessary;
- 2 Begin an investigation promptly following receipt of the demand on the bond, or as soon as is practical in the circumstances;
- 3 Attempt, with the cooperation of all affected parties, to conclude its investigation as promptly as possible and provide a response outlining its position under the bond. If the investigation cannot be completed in a time frame that is reasonable in the circumstances, then at your request the surety company will provide you with a written update on the status of this investigation and its best estimate of when the investigation will be concluded;
- 4 When the investigation is complete and it is determined that the conditions of the bond have been met, the surety company will work with you to implement a solution. The range of solutions available will depend on the specific requirements of your project, the form of the bond itself and options outlined within the bond.

In the interval when the surety company is investigating, there are often opportunities to mitigate and reduce costs and risks. Usually you are in the best position to identify these opportunities and to act on them quickly for the benefit of all parties. Where you feel it is necessary or advisable to incur costs or expenses during this interval that will reduce the ultimate cost, including steps to protect or preserve contract work from damage or deterioration, interim insurance coverage, site security, or even limited work to avoid delay, notify the surety immediately.

It is usually possible to reach an understanding with the surety company quickly about what steps are reasonable and how costs and expenses can be controlled during this interval. Provided they are documented and reasonable, costs and expenses incurred will be considered by the surety company in the calculation of the amount that the surety company will fund under the bond in the event the conditions of the bond are satisfied

## WHAT CAN BE DONE TO MAKE THE PROCESS MORE EFFECTIVE

As a party to the bond, you are an important participant in the claims process. Your knowledge of the project history, the documents and the project 'routine' can be valuable to a surety company as it moves through its investigation toward implementing a solution. You can help streamline the process and minimize delays in a few ways:

### Communicate:

- Respond to routine requests by the surety company to complete and return "contract status reports" with information about the progress of a contract.
- Inform the surety company when you are concerned about serious problems in a bonded contractor's performance, and where you are concerned that a default might occur. The sooner a surety company is aware of problems, the more effective it can be in helping you resolve them and prevent further deterioration.
- If a default is declared, notify the surety promptly and make a clear and unequivocal demand on the bond.

### Cooperate:

After a demand is made on a bond, work with the surety company or its representative to ensure access to required contract documentation, knowledgeable people and the work site itself. This helps the surety to learn your side of the story first hand and allows it to be more effective in addressing complex issues or discrepancies.

## Provide Documentation:

The surety company or its representative will need to review the contract documents and related material. It will assist greatly if you would forward copies of basic documentation along with your demand on the bond, or promptly on request. The documents most commonly required are:

- The signed bond;
- The signed contract, including general and supplementary conditions, amendments and relevant specifications and drawings;
- All approved and submitted contract schedules;
- All approved and pending change orders or contract amendment requests;
- All progress billings (contractor invoices) and payment certificates or approvals;
- A summary of all payments made including the date of each payment.
- Correspondence, meeting minutes and other documents relating to the default.

## Keep Expectations Realistic:

Widespread endorsement and continued use of surety bonds over many years and through many economic cycles may be the best evidence that surety bonds work, and work well. A surety company will work diligently to minimize delays and to enable the project to be completed within a reasonable time after a default. Where schedule requirements have become impossible to accomplish, or where events have already overtaken people's hopes and expectations, surety companies are committed to working with you cooperatively and constructively to implement reasonable solutions.

Construction defaults by their very nature are extremely frustrating and stressful experiences. Surety bonds can help you minimize this stress and make the best out of a bad situation but they are not a "miracle solution". A bonding company will try to keep delays to a minimum and ensure that the project is delivered as the contract set out, but they cannot be expected to accomplish six months work in two weeks or take a job that has been deteriorating for months and put it back on schedule overnight. Your understanding and cooperation will go a long way toward a satisfactory outcome.

The construction process is complex, and even the most experienced and well-qualified contractors can experience problems. Surety bonds give you peace of mind that you and your organization are not taking an unnecessary risk, and that should something happen there are resources and experienced professionals standing behind the bond.



If you need more information or have questions, please contact the  
**Surety Association of Canada:**

**Phone:** 905-677 -1353

**Fax:** 905-677 -3345

**Email:** [surety@suretycanada.com](mailto:surety@suretycanada.com)

Or visit our website at [www.suretycanada.com](http://www.suretycanada.com)

Note: The above information is intended to assist bond users in utilizing performance bonds and as such none of the comments should be construed as legal advice, be deemed to define or alter a surety's or contractor's obligations or liabilities beyond that set out in the bond instrument itself or is necessarily representative of the position or approach of any or all members of the Surety Association of Canada.