PP002 – Waiving Final Bonds

Introduction

From the outset of a project, owners recognize the importance of requesting security, in the form of a bond, from contractors to ensure their performance under the contract. However, upon award of the contract, this security is sometimes waived by the owner and it is this practice that gives rise to concerns.

Background

Owners inure substantial value from a Surety's prequalification process. It is a service unique to suretyship and sets surety bonds apart from other forms of contract security. However, the waiving of final bonds (Performance and Labour and/or Material Payment bonds) by some owners once the contract has been awarded, appears to be more of a cost savings attempt rather than a risk mitigation mechanism.

SAC Position

Surety bonds provide an excellent risk management tool and Sureties provide valuable services through all stages of a project – not just prequalification at the tendering stage. The Surety Association of Canada (SAC) strongly recommends that Obligees obtain final bonds for the following reasons:

Final bonds = guaranteed performance

With final bonds in place, the Obligee is protected against loss arising from the contractor's inability to fulfill its contractual obligations. This guarantee is back stopped by the Surety. Without final bonds in place, the risk of project failure and financial loss are borne by the Obligee.

Final bonds = on-going monitoring

Sureties monitor a bonded contractor's entire work program on an on-going basis. Recognizing that one project could have impacts on other projects, this allows the surety to foresee potential problems and mitigate these issues before any impact is realized on the bonded project.

Final bonds = subs and suppliers being paid

A Labour and Material Payment bond ensures the payment to subs-trades and suppliers in the event of a general contractor's default. More importantly, it removes the administrative burden of responding to calls and emails from unpaid sub-trades and suppliers demanding payment for work or materials. If no bond is in place, the owner will be responsible for managing the process of distributing holdback monies among valid lien claimants.

Summary

By waiving final bonds, Obligees fail to take full advantage of the many benefits provided by surety bonds. While the surety prequalification process is very effective at eliminating unqualified contractors from the bidding process, circumstances can arise during the course of the contract which are beyond the principal's control. These additional external risks can also play into the contractor's inability to complete a contract leading to a default.

Potential losses incurred by the Obligee as a result of the default can be managed effectively through surety bonds which help the Obligee to protect their investments. Obligees should be aware that prequalification fees may be charged by the surety in cases where final bonds are waived. A Surety expends most of its underwriting efforts and incurs most of its costs during the prequalification stage and therefore, deserves to be compensated for its services if final bonds are waived after the tender bonds have been provided.

Glossary of Terms

Final Bonds

Performance Bonds and/or Labour and Material Payment Bonds.

Obligee

An individual or organization in whose favour an obligation is created and to whom a bond is given.

Principal

The individual or organization that bears the primary responsibility for fulfilling the obligation under the written contract referenced in the bond and that has the duty to perform for the Obligee's benefit.

Surety

The party to a surety bond who answers to the Obligee for the Principal's default or failure to perform as required by the underlying contract, permit or law.

This paper is intended to serve as a general guideline to assist members and other readers in responding to the issues discussed. Nothing contained herein should be construed as legal advice and readers are cautioned to consult with legal counsel for such advice.

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