Bid Security

Surety Security for the Tendering Process

Two Simple Learning Objectives

A Multitude of Risk Management Rewards!

This module will assist you as a project owner to determine which surety instrument to use to manage the risk of contractor default at the bidding phase.

Upon completion of this module:

1. You will know what risk management tools are available from the surety industry to support the bidding process; and

2. You will understand what risks each of these tools are designed to address.

Surety Instruments: Risk Management Tools Available for Bidding Process

- Prequalification Letter
- Consent of Surety
- Bid Bond

Prequalification Letter

A Prequalification Letter…

- is not a bond, nor is it a legal commitment.

- is a letter from the surety to you, the project owner, confirming the ‘bondability’ of its contractor client. It typically means the surety is acknowledging their business relationship and familiarity with the contractor and they are willing to put this in writing.

A Prequalification Letter…

- is used in the ‘RF’ stage (e.g. request for qualifications, or request expression of interest); or any time the terms of the contract are unknown or have not yet been determined.
- is project specific.
- is not binding; i.e. the surety reserves the right to review the terms and details of the contract once these have been finalized.

What benefit is a Prequalification Letter to you?

- If you receive a Prequalification Letter, then you will have the comfort of knowing:
  - that the contractor has a relationship with the surety and;
  - that their surety has a sufficient level of confidence in that contractor's ability.

What else you should know...

- It does not provide any assurances other than the confirmation of the surety's confidence.
- Without the details of the contract, the surety will not be in a position to provide a firm commitment.

When should you request a Prequalification Letter?

- When you issue a Request for Qualifications (RFQ) or a Request for Expression of Interest (RFEI) before the terms of the contract are determined or finalized, then requesting a Prequalification Letter is an effective risk management tool that will demonstrate that the respondent is a worthy candidate for consideration.

A ‘what if’ scenario…

- If you request a Bid Bond or a Consent of Surety during the ‘RF’ phase of your project, contractors will be unable to produce these documents. Such documents require a firm commitment by the surety to guarantee the contractor’s compliance with the contract’s terms; a commitment that cannot be made before those terms are determined.

Consent of Surety

A Consent of Surety …

- is also commonly referred to as an Agreement to Bond.
- is not a true “bond” in that it is only executed by the surety; not the contractor.
- is indeed a legal commitment.

A Consent of Surety …

- Confirms to the contractor that should they decide to accept the job and execute the contract, they will be able to obtain performance bonds (or the final bonds which often include payment bonds) as per the terms outlined in the Consent of Surety.

What risk will a Consent of Surety manage?

- A Consent of Surety will provide assurance similar to that of a Bid Bond, in that once awarded the contract and once the contractor executes the contract,
  - the surety *will issue the required surety bonds for the contractor.*

What risk will a Consent of Surety NOT manage?

- However, there is no assurance that:
  - the contractor *will enter* into the contract, nor that;
  - the contractor will enter into the contract *at the price quoted* to you in the tendering process.

Understanding the risk…

- If you have concern regarding the surety's commitment to the contractor or the contractor's ability to perform the contract, then a Consent of Surety will alleviate that risk. A surety has no alternative but to issue the required surety instruments under its terms should the contractor execute the contract.

However!

- Risk related to the concern that an awarded contractor does not execute the contract <u>is not</u> managed by a Consent of Surety.
- Risk related to the concern that an awarded contractor does not guarantee the price provided <u>is not</u> managed by a Consent of Surety.
- These two risk factors are often misunderstood.

Final thoughts re Consent of Surety

- A Consent of Surety does not manage the same risks as does a Bid Bond. (Bid Bonds will be addressed next).

- A Consent of Surety provides protection against the risk that a surety might choose not to execute the performance and payment bonds – however, a surety's refusal to execute bonds should give a project owner pause for thought; and why?

Final thoughts re Consent of Surety

- For a surety to step back from this obligation to issue performance bonds, then it is very likely that new and significant information came to light between the bid phase and the award phase which led to this course of action.

Final thoughts re Consent of Surety

- And finally, in order to obtain a Consent of Surety, a contractor must submit to a surety's rigorous prequalification process under which the bonding company carefully reviews the contractors' operation, financial state, staff and history and determine whether the firm is qualified to perform your contract and carry out its work program. This usually includes a review of the terms of the contract.

Bid Bond

A Bid Bond ...

- is the most commonly used risk management tool at the tender stage.
- is a legal instrument enforceable by law.
- is a three party agreement with specific obligations required of each party.

A Bid Bond …

- provides assurance that the bonded contractor *is* qualified to carry out the job for which they have tendered.

What risk does a Bid Bond manage?

- A bid bond will provide assurance to you that, once awarded the contract,

  - the contractor *will enter* into the contract;

  - the contractor will enter into the contract *under the terms provided* to you during the tendering process; and

  -the contractor *will provide the required performance and payment security.*

What benefit is a Bid Bond to you?

- Bid bonds serve to bring accountability and integrity to the tendering process. They provide assurance from a third party that a bidder is not only qualified but will take their tendering obligations seriously and follow through on the tendering commitments. Contractors know that failure to do so will result in a claim against their bid bond for which they will be held responsible (corporately and personally) for reimbursing the bonding company.

What benefit is a Bid Bond to you?

- To be “surety secured” is one of the primary benefits of requesting bid bonds.

- In order to be surety secured, a contractor must submit to a surety’s rigorous prequalification process under which the bonding company carefully reviews the contractors’ operation, financial state, staff and history and determine whether the firm is qualified to perform your contract and carry out its work program. This usually includes a review of the terms of the contract.

What else you should know…

- Bid Bonds, provide an owner with prequalification assurance and go hand in hand with Performance Bonds and Payment Bonds, which provide security assurance.

What else you should know…

- One of the assurances that bid bonds provide is the guarantee that the successful bidder will provide the required performance bonds (and other required final bonds). Remember that performance bonds tie in to the construction contract. If there are concerns regarding the proposed contract provisions, this could impact whether Bid Bonds will be provided.

What else you should know…

- In order for a surety to provide a bid bond for a contract, the contractor must be prequalified and meet the surety's criteria to be bondable from a performance perspective.
- In order for a surety to provide a Bid Bond for a contractor, the contract must not contain onerous terms that would prohibit the issuance of a Bid Bond.

What else you should know…

- Borderline prohibitive terms in a contract could diminish the number of contractors who will qualify for a Bid Bond.

Let’s Summarize

A summary so far…

- A Prequalification Letter will allow you to identify the qualified parties with serious interest in your project before the contract terms and conditions are completely identified.

A summary so far...

- A Consent of Surety will allow you to be certain of the surety's commitment and assure that the surety will issue the performance and/or payment bonds. However it does not ensure that the contractor will enter into your contract under the terms of the tender.

A summary so far...

- A Bid Bond will provide you the most coverage. It will allow you to be certain, that once awarded the contract, the contractor will enter into the contract; they will enter into the contract at the price awarded; and the performance security (final bonds) will be provided.

Congratulations!

You have just completed the
Bid Security Module #1!

To see more Surety Learning Modules,
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