

Bonding

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Surety bonding is essentially an agreement between three parties whereby one party guarantees that another party will perform the work that is stated in contract to the best of his/her ability. It is a guarantee that the owner of a job will receive the quality and completion of work that he/she anticipates.

Depending on what type of business you are in, you may be required (by law) to obtain bonding before you can start work. For those of you who are not required to seek bonding, you may decide that the benefits of obtaining it are well worth the hassle. Whatever your case, there are many different kinds of bonds to choose from and each of them serves a different purpose.

The three most common types of bonds are:

1. Contract Bonds (Bid Bonds)
2. Fidelity Bonds
3. Miscellaneous Bonds

Contract Bonds/Bid Bonds

Most often used in the construction industry, bid bonds ensure owners that the contractor who is the lowest bidder on their job, can and will enter into contract at the tendered price. If the contractor fails to fulfill his/her obligations under the bid bond, he/she must compensate the owner for the difference between his/her bid and that of the next lowest bidder.

When applying for a bid bond, surety companies look at much the same characteristics in an applicant as a bank does when issuing a loan. First, the surety will conduct a review of the company's management performance. This will give the surety knowledge of the company's history, as well as provide information on whether the company is respected in the construction community. Next, the surety will examine the qualifications and background experience of the contractor's personnel. Finally, the tangible net worth of the contractor will be determined through financial statements and the net worth of its shareholders. This will help the surety determine whether the contractor will have the financial capacity to complete the project.

In addition to the basic criteria, when qualifying for a bond, surety companies also examine contract-related characteristics. These may include:

- Nature of the work - does the project fall into the contractor's range of expertise?
- Project location - is there more risk involved because of the project's distance or remote location?
- Completion date - will the long duration of the project create greater risk of the work not being completed?

- Legal conditions - are there any legal clauses stating what will happen under unusual situations?
- Communication - does the contractor exhibit good management skills including the ability to make accurate cost projections?

There are several reasons why a contractor should apply for bid bonds. First, bid bonds assure the business owner that the contractor is acting in good faith. Secondly, it guarantees the business owner that those who are bidding on his/her work have the financial and technical knowledge to complete the work. Finally, bid bonding reduces the demand that is placed on a contractor's assets and bank credit.

Since most surety companies use the applicant's work experience to determine whether or not he/she will qualify for bonding, it is not uncommon for new businesses to be denied. If you find your business in this situation, do not be discouraged. There are many smaller contracting jobs that do not require bonding. As you complete more jobs and prove your company's viability, you will build a name for yourself in the industry and will qualify for bonding soon enough.

Fidelity Bonds

Fidelity bonds insure a business owner financial coverage for losses caused by a dishonest employee. Under fidelity bonding the owner is covered up to the amount of the bond. The surety company will then seek reimbursement from the employee. There are several different types of fidelity bonds.

- Named schedule fidelity bond - This type of bond provides coverage over the employee(s) that are named on the bond. Coverage is available only when the employer's loss can be directly traced to the individual. There is no coverage for mysterious disappearances.
- Blanket position bond - Under a blanket position bond the employer has coverage over all of his/her employees. The bond automatically covers new employees and ceases the coverage of prior employees upon resignation or termination. The blanket position bond will cover each employee involved in an incident up to the coverage amount. For example, if you as an employer caught 10 dishonest employees and the bond amount was \$10,000, you would be eligible for \$100,000 in coverage. Unlike named schedule bonds, under a blanket position bond the employer does not have to prove which employee was responsible for the loss.
- Primary commercial blanket bond - This type of bond is similar to the blanket position bond except that the amount of the coverage is usually smaller. Where the blanket position bond will cover each employee up to the bond amount, the primary commercial bond will pay out the same amount regardless of how many employees are involved. For example, if there are 10 employees involved in a loss and the bond amount is for \$50,000, the employer is eligible for \$50,000. If there is only one employee involved however, the employer would still be eligible for \$50,000.

Miscellaneous Bonds

There are many types of bonds that have no category of their own. Though they fall under the broad heading of miscellaneous, surety companies still have to be sure that the applicants are fully qualified to perform the obligations of their contracts. Before issuing any of these types of bonds, the surety must know the applicant's education, training and related work experience. Financial information from the most recent fiscal year must also be provided. Some of the most common miscellaneous bonds are:

- License and permit bond - Certain industries lend themselves to areas where licenses and permits are required. Usually required by service firms, these bonds make the business owner financially responsible for any injury or damage caused to the public. Service firms who may require these types of bonds include electricians, gas stations, used car dealers and real estate agents.
- Customs and Excise Bond - These bonds ensure the federal government that taxes and duties will be paid by the bond applicant upon request. This type of bond allows applicants to run warehouses and import goods duty free. They also ensure that the operators will pay the federal government all required taxes. For example, under custom and excise, cigarette and alcohol manufacturers must make sure that their retailers are collecting taxes for their goods and that they are being received by government. The **Customs Bonded Warehouses Regulations** specify the requirements for the licensing and operation of a bonded warehouse. Contact Canada Border Services Agency for further information on this type of bond.
- Court Bond - This type of bond is required for litigation cases in the courts and is needed when a plaintiff claims that the property of the defendant is rightfully his. If the plaintiff is correct, he/she will gain custody of the property. However, if it is found that the plaintiff is not the true owner of the property, he or she must return the property or pays its value plus damages to the true owner.
- Performance Bond - Performance bonds guarantee the performance of the contracted work. If the owner of a job is not satisfied with the contractors work or feels that the contractor did not perform the level of work that was specified in the contract, he/she can look to the issuer of the bond for compensation.

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For further information regarding starting a business, contact the

Canada-Saskatchewan Business Service Centre

#2 - 345 3rd Avenue South

Saskatoon, Sask. S7K 1M6

Phone: **306-956-2323** Toll-Free: **1-800-667-4374**

E-mail: saskatchewan@canadabusiness.sk.ca

Web site: <http://www.canadabusiness.ca/sask/>

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