

Bid Bonds from Subcontractors – Why Not?

During the last couple of years and especially this year, subcontract failures are on the rise. With work going to contractors that are bidding with little to no profit there is simply no room for a bid or execution error these days. Unfortunately that is just

A trend that is unfortunately picking up steam is subcontractors failing or pulling off work before they sign subcontract agreements or post the required performance and payment bonds. This can have severe negative repercussions for the general

contractor. Replacements subcontractors may come in at a more expensive price putting additional pressure on already tight construction budgets and/or construction schedules can be impacted depending on how long it takes to find a qualified replacement contractor. While risks rarely can be eliminated entirely, a remedy that may help mitigate this risk is requiring subcontractors to post bid bonds.

are reviewing information. In addition the simple form they provide to bond agents, sureties, or subcontractors to complete asking about bonding abilities are little more than fluff as they are not binding commitments. An example of the wording that makes surety prequalification letters non-obligatory, and is in nearly all surety letters, is as follows:

“The agreement for bid bonds or performance and payment bonds is a matter between the contractor and the surety company. XYZ Surety Company assumes no liability as to third parties or to others, if for any reason, we do not execute said bond(s).”

If a general contractor would require a subcontractor to post bid bonds they stand a much better chance of getting a higher quality subcontractor. In addition, the general contractor would know that a surety guarantee is behind the bid and that they are aware of the project at bid time, not just when the subcontractor requests a performance and payment bond they hopefully can secure.

Additionally the general contractor in the request for bids could indicate acceptable surety parameters and then review the bid bonds that come in prior to committing to a subcontractor that cannot meet the requirements. Routine information reviewed by general contractors to determine

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surety acceptability includes the surety company’s AM Best rating and Treasury Listing. Normally a general contractor will require an A rated surety company as determined by AM Best. They will also routinely confirm

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a part of being in business and the impact of these errors can vary widely depending on the financial strength of the firm and whether it is an isolated problem or a business wide systemic issue.

Much work today is public or federally funded and requires the general contractors procuring the work to post performance and payment bonds. Even some commercial work is requiring the bonding of those general contractors that get selected to procure the work. Many of those general contractors in turn are requiring their subcontractors to post performance and payment bonds. This is prudent in today’s business climate as you simply do not know what firms are doing well or struggling. Long standing names in the industry are having issues just like lesser known firms.

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Why General Contractors Should Require Bid Bonds:

Historically general contractors have a prequalification package they send to interested subcontractors on an annual basis. In the dynamic environment we are in today a yearly review of qualifications is simply too long of a time period. Financial disasters can happen a lot quicker than general

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the surety treasury listing is greater than the value of the bond being issued for the subcontractor. There are other qualifying items a general can look to as well but these tend to be the most routine.

The general contractor would also have recourse against a subcontractor and surety company if a selected subcontractor does not enter into a subcontract. While it is hopeful the requirement of bid bonds would nullify the risk of a subcontractor not entering in to a contract the risk is still present. This risk however, should be significantly less than if a bid bond was not required.

This risk mitigation tool holds true for federal, commercial, and public work construction projects. On federal work some general contractors can be very dependent on teaming partners. If these teaming partners are critical to not only winning the contract but actually successfully performing the work you need to ensure they will actually enter into the subcontract. In addition, it is not unusual for a surety company to require a large teaming partner to bond back to the prime contractor. Requiring a bid bond at the time the teaming partner submits a proposal will enhance the chances that they will fulfill their pre-award obligation and enter into a subcontract.

If you do plan on requiring subcontractor bid bonds you need to be prepared for the subcontractors surety to request some basic information to underwrite the request. They would want to see copies of all potential bond forms being required (bid, performance, payment), understanding of the project financing, if the general contractor is/will be bonding the project, and a sample subcontract agreement that will be used.

Why Subcontractors Should Endorse Subcontracting Bid Bond Requirements:

As a subcontractor that qualifies for bonding you should look at a bid bond requirement as a positive sign. It should help reduce the amount of competition on a bid and more importantly remove from the pool of bidders lesser qualified firms that cannot get a surety to guarantee their work.

Subcontractors can get surety input early and potentially learn some valuable information from their surety partner. Some of the information your surety should be able to review and provide input/questions on include the bid bond, performance bond, and payment bond forms, terms, and conditions. These can vary widely and from time to time be very onerous on

the subcontractor and surety.

In addition the surety can review with you the scope of work, workmanship guarantees, efficiency guarantees, liquidated damage provisions, and indemnity provisions amongst other items. If there are terms and conditions being requested of you that are onerous this might be a more advantageous time to negotiate those terms than when you are being pressed to sign the contract. If terms are not negotiable at least you and your surety partner can make a go / no go business decision before wasting a lot of time, energy, and money putting together a bid.

While you should consult your attorney for more specific information, subcontractors still have the opportunity to pull out of bids that require bid bonds just like prime contractors. This is an important item as you don't want to feel boxed into a corner to take a job if you had a legitimate bid error.

For some time the very largest of general contractors have been requiring bid bonds on projects as a means of risk mitigation. These large firms have this requirement for a reason. While the thought of other general contractors requiring subcontractors to provide bid bonds may seem outside of the industry norm it can be a win-win for general contractors and subcontractors. ▼