Marquette Law Review

Volume 10
Issue 3 *April 1926*

Article 5

Contract Bonds

W. Stanley Smith

CONTRACT BONDS

W. STANLEY SMITH*

CORPORATE SURETYSHIP was first given statutory recognition in Wisconsin in 1897, by the enactment of the law drafted by the then commissioner of insurance, and since that time such bond has been given full recognition by the courts and accepted by all departments of the government, and by individuals as the preferred surety where such security or guarantee is required.

Suretyship bonds cover the obligations of individual, partnership and corporate undertaking, and performance of duties as the guarantee of fulfillment, and in the business world constitute an essential factor of growing importance in giving to assumed obligations and undertakings a certainty therefore unknown.

Suretyship companies are placed under the supervision of the department of insurance under stringent regulations and statutory impositions, with such requirements of financial standing as will give to the guarantee furnished, the assurance of certainty. *Contractor's* or *builder's bonds* make up one of the most important forms of suretyship.

A *contract bond* is a guarantee of suretyship; its value depends upon the integrity, underwriting experience and financial strength of the guarantor or surety company. *Contract bonds* have been the rock upon which many companies have foundered.

Suretyship is a guarantee of indemnity in the event of loss upon the happening of unforeseen or unavoidable contingencies. If the guarantee of fidelity is insurance against human dishonesty, then suretyship is insurance against human fallibility.

A Surety Company is a guarantor or endorser, lending its name and credit to persons of responsibility in the carrying out by them of assumed obligations, believing them, from investigation, reputation, standing and ability, capable of carrying out their undertakings. In such guarantee or endorsement—while assuming a liability—the company does not expect to suffer loss, but for the premium charged for such accommodation, does stand to make good if such loss does occur, for the surety is the guarantor for performance according to specifications—material, worksmanship, etc. So that in the event of the default of the contractor the surety becomes liable either for the amount of the money loss—within the limits of the bond—or for the completion of the contract.

The *contract bond* is given by the contractor to the owner as the guarantee or indemnity contract when assuming construction for the

*Insurance Commissioner for Wisconsin.

performance of the contract according to the conditions and specifications.

The owner, under the provisions of the bond, is bound to the performance of certain conditions, such as payment of the contract price at specified times, etc. Default on the part of the owner releases the contractor from his obligation and the surety from its liability.

Distinct from the *contract bond* is the *completion bond* where the owner borrows money to finance the erection or construction, or where the owner is one to whom a lease has been given and who has contracted with the party granting him the least that he—the leasee—will erect a building or make improvements costing a certain sum; in such case the surety bond runs to the lender (lessor) granting the lease and guaranteeing to him the completion of the building or construction free from liens. The *completion bond* guarantees the owner's and not the contractor's financial resources; the loss here would occur by reason of the owner's default, not the contractor's. So that a *contractor's* and a *completion bond* on the same building or construction involve two separate risks.

The *contractor's bond* should run to the owner and should never be assigned to lenders, lessors, mortgagees or trustees and their rights cannot be protected by a contractor's bond given for the faithful performance of the building or construction contract. Under a *contract bond* the contractor is the principal, and under a *completion bond* the owner is the principal.

When we consider that the lowest bid is in fact and of itself a selection against the surety, and that to guarantee performance under a contract is more in the nature of an endorsement, it is not unreasonable the surety should demand and be given all the information given the banker to whom application for credit accommodation is made. The banker requires a detailed financial statement,—he considers carefully the prospective borrower's available assets, the character, knowledge and ability for performance of the borrower; he asks and receives all information as to the details of work to be undertaken, the work in hand and every possibility and all the factors making for accomplishment or possible failure. Why then should there, at any time, be objection to the surety's being furnished all the details and information before accepting the obligations of a guarantor, involving a possible even greater loss than can come to the banker?

The surety, if the company expects to successfully conduct the business of suretyship, requires many details, must know the applicant's financial standing—his available assets and by that is meant assets capable of being drawn on or readily converted into money—real estate, unimproved, lots or realty, and not readily convertible securities are here "frozen assets"—they are tied-up resources and in most cases can-

not even be used as collateral for loans; loans—borrowed money—may indicate a straining of credit and create a doubt of being able to weather the storm in a financial emergency. The certified check deposited with the bid may represent actual funds on deposit at the time, but can be no conclusive indication of ability for the future financing of the work to be undertaken, so that it is perfectly proper that the surety may want information of the arrangements for future financing, and that such proper and adequate arrangements have been made.

The surety has a right to know the applicant's experience, his business reputation, relationship with employees, the organization for carrying on the work, the equipment for the work to be done, and the many other details indicating forethought and ability to successfully meet emergencies. All these are things which any one would want to know were he to step in as a guarantor of another.

So there should be no objection, but the most open and cordial cooperation, for once there has been established the confidential relationship which should exist between the parties to such *contract bond* it becomes a valuable asset of the contractor and the best evidence of merit and reliability.

Partnerships and corporations are considered better risks than an individual. The death of an individual as principal may have serious consequences in the completion of the contract.

Too many contracts in hand may also become the subject of careful consideration and investigation—ambition to accept too many contracts may exhaust resources—the condition of the work on hand, how near completion, etc., all become factors, as does also the percentages retained until after the full completion of the work and its acceptance, are important considerations in the granting of bonds. Companies have suffered large and many losses from the inexperience of the bonded, in attempting new lines, such as road building, and on account of the bonding of newly or recently organized contracting firms and corporations. So that when we give consideration to the large amount of money involved in these bond guarantees, the nature and character of the investigations required to tread safely, we begin to realize how great has been the advance of these suretyship companies to be able as expeditiously as they do—to issue the *contract bonds* that constitute so essential a need in your business.

The business of suretyship demands COOPERATION.

There are a number of forms bearing close relation to the *contract bond* that are of greatest importance to the contractor—there is for example: the *bid or proposal bond*—a bond, the writing of which, requires the greatest care on the part of the surety and yet, often, of such need to the bidding contractor that it can safely be written only where there is the fullest information and the closest confidential relationship. Deal-

ing, therefore, with the same company and the same tried and true representative, means much to the contractor, here the relationship established by previous experience has frequently been the means of saving both parties from delay and loss.

Contractor's public liability covering personal injuries and accidents to the public caused by employees of the contractor or the employees of other contractors on the job, *contractor's contingent insurance* covering the contractor for liability growing out of the work, caused by persons other than his employees, *property damage insurance,* written only in connection with *public liability insurance,* (and of special importance in contract work such as sewer construction, road building, plumbing, painting, etc.), and not forgetting *fire insurance* on equipment, etc., make up the proper safeguards for the contractor and the cost of such protection is really a proper charge in computing the cost of construction. Sub-contractors should always be bonded in favor of the main contractor.

The surety company must necessarily exercise care in the acceptance of contract bonds, and at the same time the corporate surety should be selected because of its financial strength, underwriting experience, and integrity in dealing with its clients, because of its representatives' knowledge of the business, and because of the service which the company can render to the purchaser of the bonds. With the assured's integrity and capability established, a relationship of cooperation follows, which removes difficulties, and means profit for both parties to the contract.