Colombia Compra Eficiente

Procurement Processes' Guarantees Guide

I. Table of content

II. Introduction 2

III. General aspects of the guarantees in public procurement 2

A. Types of guarantees and coverage 2
B. Must all state contracts be covered by a guarantee? 2
C. Which risks must be covered with guarantees in the Procurement Processes? 3
D. How to enforce the guarantees? 4

IV. Insurance contract 4

A. Parties and beneficiary 4
B. Characteristics of the insurance contract in Procurement Processes 5
C. General conditions of the insurance contract 6
D. Statute of Limitations of the insurance contract 6
E. Third party liability 7
(i) Conditions of the third party liability insurance policy 7

V. Stand - alone trust fund 8

A. What is the guarantee trust fund agreement? 8
B. What condition must have the goods or rights transferred to the stand - alone trust fund that serves as guarantee 9
C. What are the collective investment funds? 9
(i) Which are the securities that can make up the collective investment funds? 10
(ii) What is construed as participations in collective investment funds? 10
D. Real estate in guarantee trust funds 10
E. Aspects that must be included in the guarantee trust fund agreement 11
F. Registration of the guarantee trust fund agreement 12
G. What is the guarantee certificate? 12

VI. Bank guarantees and stand - by letters of credit 12

A. Which requirements must be met by the bank guarantees? 13
B. How to enforce a bank guarantee or stand - by letter of credit? 13
C. Extensions and partial payments 14

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II. Introduction

One of the objectives of the public procurement system is the Risk management. Article 17 of Decree 1510 of 2013 establishes that the State Entity must assess the Risk that the Procurement Process represents for the compliance with its goals and objectives.

The guarantees are instruments for the coverage of some common Risks in Procurement Processes. The objective of this guide is to define guidelines and to guide the State Entities in the characteristics of each one of the classes of guarantee established in the contracting regulations, their differences and the aspects to be considered in the Procurement Processes subject to Decree 1510 of 2013.

The capitalized expressions utilized in this document must be construed with the meaning set forth in Decree 1510 of 2013. The terms defined are utilized in singular and in plural as required by the context in which they are utilized. The terms that have not been defined below must be construed according to their natural and obvious meaning.

III. General aspects of the guarantees in public procurement

In the planning of the Procurement Process, the State Entity must identify the guarantees to be requested according to the object, the value, the nature and the obligations of the contract.

A. Types of guarantees and coverage

The bidders or contractors, to guarantee the compliance with their obligations with the State Entities in Procurement Processes, can grant, at their election, any of the following guarantees: (i) insurance contracts, (ii) guarantee trust funds or (iii) bank guarantees or stand - by letters of credit.

The sufficiency and the validity of the guarantees must be those established in articles 118 to 125 of Decree 1510 of 2013.

B. Must all state contracts be covered by a guarantee?

Certain Risks identified by the State Entities can be covered through any of the instruments of guarantee described above.

In the selection modalities of direct contracting and minimum amount as well as in the contracting of insurance, the State Entity must justify the need whether or not to demand the setting up and posting of guarantees.

In the other selection modalities the bid bonds and performance bond are mandatory. The third party liability guarantee is mandatory in the work contracts and in those that due to their object or nature the State Entity considers that it is necessary, because of the Risks of the contract.

C. Which risks must be covered with guarantees in the Procurement Processes?

As a function of the phases of the Procurement Process, the Risks that must be covered by guarantees are:

1. **Selection**: The bidder must give a bid bond covering the following events:

   - The failure to extend the term of the guarantee when the term for the awarding or execution of the contract is extended, provided that said extension does not exceed three (3) months.
   - Withdrawal of the offer after the expiration of the term to submit it.
   - The failure to execute the contract without just cause by the successful bidder.
   - The failure to set up the contract's performance bond by the successful bidder.

2. **Contracting and performance:** In this phase the guarantee must cover the Risks derived from the non – performance of the contract. This guarantee can cover all or some of the following covers according to the conditions of the contract's object**:**

   - Good management and the correct investment of the down payment.
   - Return of the prepayment.
   - Contract performance.
   - Payment of salaries, legal benefits and labor settlements.

In addition to the performance bond, the State Entity may request a third party liability insurance for those contracts in which the performance of the purpose involves a risk of causing damages to third parties.

In the case of the labor liabilities' payment coverage, the guarantor has the obligation to pay the settlement of such damages to the extent that the wealth of the insured State Entity is affected, namely, the cover cannot be affected to pay the labor liabilities that the contractor has failed to comply if the contractor's employee have not filed claims with the State Entity.

3. **Obligations subsequent to the execution**: In this phase, the Risks covered are those that occur after the termination of the contract and its covers are:

   - Stability and quality of the works.
   - Quality of the service.
   - Quality and correct operation of the goods.

The purpose of the service quality coverage is to cover the damages derived from the deficient provision of the contracted service that arise after the termination of the contract and that are derived from the following events: poor quality or the insufficiency of the products delivered pursuant to a services' contract and poor quality of the service provided, taking into account the conditions greed in the contract. If the lack of quality occurs during the performance of the contract, the cover that must be affected is not this one but the performance bond.

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The service quality cover is applicable both in successive performance contracts, for example housekeeping and catering contracts, and in instantaneous performance ones, such as contracts to make designs. This cover operates once the term performance cover concludes.

The purpose of the quality and correct operation of goods' guarantee is to cover for the State Entity the damages attributable to the contractor by the deficient quality of the goods that the State Entity receives pursuant to a contract. Examples of events that may affect this cover include the poor quality or the technical deficiencies of the goods or equipment provided by the contractor or the failure to comply with the technical standards of the good or equipment.

D. How to enforce the guarantees?

According to Decree 1510 of 2013 the guarantees that back the compliance with a contract can be enforced when there is a default, attributable to the contractor, of the obligations agreed that lead to the declaration of default, the forfeiture of the contract, the imposition of fines and the enforcement of the penalty clause.

If there is default, the State Entity must issue an administrative act that so declares. In the sanctioning or enjoining administrative proceedings the State Entity must involve the contractor and the insurer of the contract. When the guarantee is a stand - alone trust fund, bank guarantee or stand - by letter of credit, it is not necessary that the State Entity involved the trust company or the issuer in the sanctioning or enjoining proceedings.

In the case of plural bidders such as consortia, joint ventures or promises of a future company, the guarantee must cover all of its members. Likewise, the notification of the default must involve all of its members.

IV. Insurance contract

The insurance contract contained in an insurance policy can only be subscribed by insurance companies under the oversight of the Financial Superintendence. In consequence are not insurance contracts the sureties or other instruments issued by general bond companies and other entities not subject to said inspection and oversight.

The State Entity must verify that the policy and its general clauses do not include exclusions or limitations of liability that are not acceptable and that the covers, coverage, term and insured value are as required.

A. Parties and beneficiary

The parties to the insurance contract in the Procurement Processes are:

1. Policyholder / Secured Party: is the bidder and/or contractor the obligations of which are guaranteed because of the filing of the offer and/or celebration of a contract with a State Entity.

2. Insurer: is the insurer entity under the oversight and control of the Financial Superintendence to which the bidder and/or contractor passes the Risk. When several insurers assume one same risk in a joint manner in favor of one same insured, all the entities assume the contractual position of insurer[1].

The State Entity is the insured and beneficiary, but it is not a party.

B. Characteristics of the insurance contract in Procurement Processes

1. Indemnification Principle: the insurance contract cannot be the source of enrichment for the State Entity, because its purpose is only to compensate the damages caused, however, in the case of the bid bond, the State Entity can receive the insured value in full even if the damages caused are not in the same proportion.

2. Independence of the covers: the covers of the policy are independent and autonomous in the Risk that they cover and in the insured value. The insurer cannot utilize the amount of one of the covers to settle or indemnify a different Risk .

3. Exclusions: The State Entity can only admit the following exclusions; if other ones are agreed, they will have no effects.

    - Acts of God, namely, the force majeure or fortuitous event, the act of a third party or the exclusive blame of the victim.
    - Damages caused by the contractor to the goods of the State Entity not deployed to the contract.
    - Undue or inadequate use, or lack of preventive maintenance , to which the State Entity is obliged.
    - The normal wear suffered by the goods given because of the guaranteed contract as a consequence of the lapse of time.

4. Irrevocability and non - termination due to the lack of payment of the premium: The automatic termination due to lack of payment of the premium and the revocation thereof is not applicable to the insurance policies in state contract .

5. Inadmissibility of opposition of the exceptions: The insurers cannot oppose or defend themselves against the claims made by the State Entities arguing the conduct of the policyholder, as it is the case of the inaccuracies or reticence in the information in the purchase of the insurance.

6. Inapplicability of the proportionality clause: the proportionality clause is the clause by virtue of which the insurer only pays the insured value in full in the events in which there is total loss; hence, it pays only a part of the insured value in cases of partial loss. This clause cannot be included in insurance contracts for state contracts and if it is included, it has no effect whatsoever.

[1] The coinsurer answers only for the part of the risk that it assumed; in other words, there is no joint and several liability between the coinsurers. By virtue of the foregoing, in a coinsurance scenario, the insured or beneficiary who wishes to enforce the guarantee must notify all the insurers involved and claim from each one of them their part of the settlement.

For example: in a state contract covered with an insured value of 100 million pesos, if there is clause of proportionality and a partial loss takes places which corresponds to a default of 70% of the contract, the insurer shall only have the obligation to pay a maximum settlement of 70 million, an amount proportional to the loss. This clause is not applicable in insurance contracts for state contracts.

7. Contract assignment: when the contractor has failed to comply with the contract can assign it to the insurer so it can comply with the contracted purpose as alternative to the payment of the damages. In this event, the guarantor can continue with the execution of the contract in his capacity as assignee thereof for which it is indispensable to establish the guarantees set forth in the contract.

C. General conditions of the insurance contract

The general conditions of the insurance contract contained in an insurance policy are as follows:

- The name or corporate name of the insurer.
- The name of the policyholder: is the person that enters into the insurance contract with the insurer.
- The names of the insured and of the beneficiary or the manner to identify them, if the same are different from the policyholder.
- The precise identification of the thing or of the person in respect of which the insurance is contracted.
- The term of the contract, stating the start and end dates and time or the manner to determine them.
- The insured amount or the manner to determine it.
- The premium or the manner to figure it up, as well as the manner of payment.
- The Risks that the insurer assumes.
- The dare in which it is issued and the signature of the insurer.
- All other particular conditions agreed by the contracting parties.
- The insurance application duly sighed by the policyholder.
- Annexes, exclusions, definitions and in general all the general conditions that may have been agreed in the insurance contract .

When the foregoing conditions do not appear in an express manner in the insurance contract contained in an insurance policy, the conditions applicable to the contract are those that the insurance company has deposited before the Financial Superintendence for the type, cover, modality of the contract and type of risk.

D. Statute of limitations of the insurance contract

The administrative act that declares the noncompliance must be firm before the statute of limitations of the action of the insurance contract. The statute of limitations is ordinary or extraordinary. The ordinary one is of two (2) years as from the moment in which the State Entity learns or should have learned of the fact. The extraordinary one is of five (5) years as from the date in which the loss occurred.

E. Third party liability

This guarantee covers the damages that the State Entity may suffer derived from the third party liability arising from the acts, occurrences or omissions of its contractor or of the subcontractors. This Risk can only be covered by insurance policies.

The State Entities must demand in the work contracts and in those that because of their purpose or nature are necessary, the purchase of the third party liability insurance policy.

Decree 1510 of 2013 demands a number of requirements that must be met by the third party liability insurance in favor of State Entities:

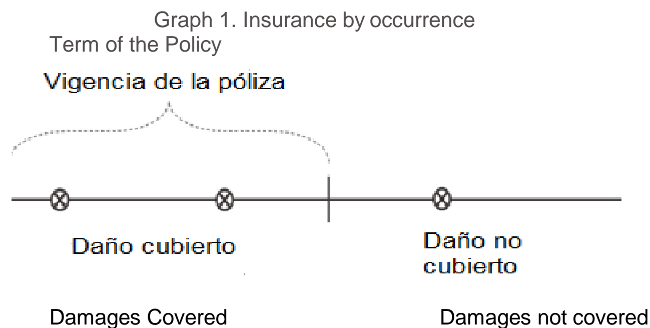
- Basic Coverage of premises, work and operations.
- Consequential damage and the loss of profit.
- Non – pecuniary Damages.
- Liability arising from acts of contractors and subcontractors, excepting that the subcontractor has its own third party liability insurance, with the same covers herein required.
- Express coverage of employer's protection, covering the damages caused by work accidents suffered by the employees in the service of contractor in the discharging of their duties.
- Express coverage of owned and not owned vehicles covering material damages, the bodily harm and / or the death caused to third parties with owned and not owned vehicles in the service of the insured entity in the ordinary course of its activities.

(i) Conditions of the third party liability insurance policy

a. The State Entity must appear in the insurance policy as insured and beneficiary. This dual capacity allows the entity to have protection when a third party files a liability claim under its contract (insured) or when the same entity suffers damages due to an event, conduct or omission of the contractor and must claim as victim the respective damages (beneficiary).

b. Decree 1510 of 2013 states that the third party liability insurance in favor of State Entities must be given under the modality of occurrence, and therefore the damage suffered by the victim must occur during the term of the insurance policy, although the claim is made later, provided that the statute of limitations has not operated.

Graph 1. Insurance by occurrence



2 Are those that affect the internal and personal sphere of the victim.

c. The third party liability insurance must be in force throughout the entire period of execution of the contract. The prescription of the rights of the insured starts on the moment in which the victim makes a judicial or extrajudicial damages claim; as from that moment, the insured has two (2) years to file the claim with the insurer.

d. It is not appropriate to agree franchises, mandatory coinsurance and any other form stipulation that implies the assumption of part of the loss by the insured entity. The franchise is a fixed limit below which only the insured is answerable.

e. The deductible is a sum or percentage of participation of the insured in the loss suffered by it. Decree 1510 of 2013 establishes that it is forbidden to agree deductibles of more than 10% of the amount of each loss and under no circumstances it can be of more than 2.000 SMMLV.

f. The setting up of insurance mandatory by the contractor such as the one related to the management of labor risks, does not release the contractor from establishing the third party liability insurance policy; in this case, the employer's coverage.

V. Stand - alone trust fund

A. What is the guarantee trust fund agreement?

It is a contract entered into by the bidder, contractor or a third party as settlor, with a trust company to transfer the ownership of one or more goods or rights with which a stand - alone trust fund is established, in order to guarantee with them or with the produce thereof the obligations of the bidder or contractor with the beneficiary State Entity. In the stand - alone trust fund the goods or rights are kept apart from those of the trust company and of other trust businesses so they can serve as guarantee.

When there is a default of the bidder or contractor the State Entity must declare it, for which it must follow the procedure established by the law. Once the State Entity completes this procedure it proceeds to the enforcement of the guarantee through the mechanism of execution of the guarantee set forth in the same commercial trust contract.

Are parties of the guarantee trust fund agreement:

1. The settlor, who enters into the trust contract of with a trust company and by virtue of said contract transfers or delivers the good or the right to establish the stand - alone trust fund that serves as guarantee for the creditor, namely the State Entity. In the case of guarantee trust fund agreements in favor of a State Entity, the settlor is the bidder in the selection stage or the contractor with which the State Entity has entered into a un contract and the obligations of which are secured with the guarantee trust fund. A third party can also contribute assets as settlor to a stand - alone trust fund to guarantee the obligations of the bidder or contractor.

2. The trust company is the financial services' company duly authorized by the Financial Superintendence and subject to its inspection and oversight, which acts as the spokesperson of the stand - alone trust fund.

The guaranteed creditor or beneficiary of the guarantee trust fund agreement is the State Entity, in favor of which it is entered into.

B. What condition must have the goods or rights transferred to the stand - alone trust fund that serves as guarantee?

The goods or rights that are transferred to the stand - alone trust fund must offer to the State Entity a suitable and sufficient support for the payment of the guaranteed liabilities, and therefore the State Entity and the trust company must review the legal and commercial conditions of the goods or rights offered according to the provisions of article 141 of Decree 1510 of 2013.

Are only acceptable as guarantee in favor of a State Entity the stand alone trust funds made up by the following goods and rights:

1. Securities that can be part of the collective investment funds, or the individual participation of the contractor in the funds. The State Entity acknowledges for the purpose of the calculation of the amount of the guarantee up to ninety per cent (90%) of the amount of said securities.

2. Real estate free of liens or encumbrances with a value of more than 2.000 SMMLV, that generate income in one (1) year for an amount of more than 0,75% per month of the realizable value according to appraisal made by an expert. Such income cannot be on the charge of the guaranteed contractor and must make part of the stand - alone trust fund. The State Entity will acknowledge, for the purposes of the calculation of the amount of the guarantee up to 70% of the amount of the appraisal of the real estate in trust.

C. What are the collective investment funds?

Are mechanisms or vehicles for the capture or management of sums of money or other assets, made up with the contribution of a plural number of determinable persons, resources that are managed in a collective manner by a trust company to obtain economic results that are also collective.

These funds are of two types depending of the manner of redemption of the investments (participations) of the persons in them:

- Open: Are those in which the participations can be redeemed at any time, without prejudice to having minimum permanence covenants included in its rules.

- Closed: Are those in which it is only possible to redeem all the participations at the end of the term set forth for the fund.

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(i) Which are the securities that can make up the collective investment funds?

Are the securities that can make up the collective investment funds of the monetary market according to article 3.2.1.1.1 of Decree 1242 of 2013, to wit:

i) Securities of a credit contents, namely, those which contain obligations to pay money in legal tender or unit representative of legal tender, registered with the National Securities' and Issuers' Registry –RNVE–, rated by a company legally qualified for those purposes with investment grade as a minimum; or,

ii) Public debt securities, issued or guaranteed by the Nation, Banco de la República (Central Bank) or by the Financial Institutions Guarantees' Fund –FOGAFIN–, which do not require to be rated.

To establish the amount of the guarantee on these assets the State Entity and the trust company must valuate these investments taking into account the risk of the issuer of the asset, its term, expiration, volatility and other conditions that allow establishing the amount thereof at market prices.

(ii) What is construed as participations in collective investment funds?

The participations are the contributions that a person has in collective investment funds represented participation rights.

The amount of the participations of an investor depends of the valuation of the securities that make up the portfolio of the collective investment fund, and, therefore, to know the amount of the participation, it is necessary to establish the value of the fund according to the methodology established by the Financial Superintendence. The State Entity must request from the trust company that manages the investment fund the information of the value of the investment fund's portfolio and of the participation of the guarantor to be able to establish the guarantee.

The participations that can be contributed to the stand - alone trust fund of a guarantee trust fund agreement to cover obligations of bidders or contractor of a State Entity are those that correspond to collective investment funds of the monetary market described above.

D. Real estate in guarantee trust funds

According to article 656 of the Civil Code, real property or farms or real estate are the things that cannot be transported from one place to another, such as the lands and mines, and that are permanently adhered to them, such as the buildings, the trees. The trust companies must order, on the charge of the trust fund, the appraisal of the properties and their updates, under the criteria of short – term realizable value. The State Entity can recognize up to 70% of the value of the real estate to take the guarantee.

The income refers to the returns, the gains, the benefit or the profit derived from the real property. The notion involves the income or benefits from lease contracts, leases by public deed, usufructs, income by production and concessions of space.

The income in guarantee trust fund agreements for state contracts must meet the following conditions:

- Come from real property.
- Not to be in the charge of the bidder or guaranteed contractor.
- To make part of the stand - alone trust fund.
- To generate income in one year for a sum of more than 0,75% per month of the price of realization of the appraisal.

E. Aspects that must be included in the guarantee trust fund agreement

1. The settlor must be the bidder or contractor or a third party willing to guarantee the obligations of the bidder or contractor and has the power to do so.

2. The contracting State Entity must be the guaranteed creditor beneficiary of the stand - alone trust fund.

3. The obligation of the trust company to carry out all acts required for the conservation of the goods in trust, or the adoption of the measures necessary so those who have such obligation guarantee the conservation.

4. The duty of the trust company to make in a periodic manner, or to order the assessments and appraisals of the goods that make up the stand - alone trust fund to see to the sufficiency and suitability of the guarantee.

   The bidder or contractor has the obligation to pay the cost of the appraisals, without prejudice to the withholdings made by the trust company of the periodic income produced by the goods of up to three per cent (3%) of the appraisal of the good or security, in the proportion and for the purposes set forth in article 145 of Decree 1510 of 2013.

5. The trust company must give notice to the State Entity and to the settlor within the first three (3) days after the date in which it has learned of the insufficiency of the stand - alone trust fund for the payment of the guaranteed liabilities and demand from the settlor the replacement or increase or of the goods in trust for the sufficiency of the guarantee.

6. The obligation of the settlor to replace or increase the goods in trust within thirty (30) calendar days after the demand made by the trust company.

7. The procedure to be followed for the replacement of goods or for the incorporation of new goods into the stand - alone trust fund.

8. The procedure to be followed to enforce the guarantee in case of default of the guaranteed liabilities.

9. The obligations of the trust company, including those of custody and administration of the goods, periodic verification of the value of the stand - alone trust fund, rendering of periodic accounts and reports.

10. The manner in which the payment in kind with the goods in trust proceeds, for which it is necessary that more than one (1) year has lapsed since the date in which the State Entity requested the trust company to enforce the guarantee and it has not been possible to realize the goods in trust. The State Entity must receive the payment in kind for fifty per cent (50%) of the updated appraisal, without prejudice to it seeking the payment of the damages that were not integrally paid.

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F. Registration of the guarantee trust fund agreement

The guarantee trust fund agreement is subject to the registration the subject matter of law 1676 of 2013 about chattel securities with the Confederation of Commerce Chambers, only when the underlying asset of the stand - alone trust fund is made up by participations in the collective investment funds. The guaranteed creditor must make the registration required according to the provisions of article 40 of the aforementioned law.

When the stand - alone trust fund is made up by securities that cannot make up the collective investment funds of the monetary market, the guarantee trust fund agreement must be registered only before the commerce chamber.

Likewise, when the stand - alone trust fund is made up by real property, it is necessary to record the guarantee trust fund contract in the commerce chamber, as well as the registration in the office of registration of public and private instruments that corresponds according to the nature of the good.

G. What is the guarantee certificate?

Is the certificate that the trust company issues in the name of the State Entity evidencing:

1. The sufficiency of the guarantee.
2. The financial statements of the stand - alone trust fund.
3. The procedure in case of enforcing the guarantee.
4. The guaranteed risks.
5. The precedence of the State Entity for the payment.
6. The mechanisms that the trust company can use to enforce the guarantee without affecting the sufficiency thereof.

VI. Bank guarantees and stand - by letters of credit

The bank guarantees and the stand - by letters of credit are irrevocable and unconditional commitments assumed by a financial entity to pay a given sum of money.

The issuer financial entity cannot include in this type of guarantees conditions, prior judicial proceedings or exceptions for the payment the foundation of which is the contractual relationship between the State Entity and the contractor.

The commitment of the issuer is to pay on first demand of the beneficiary of the guarantee, and therefore it is not necessary that the State Entity proves that the default has effectively occurred, but before enforcing this type of guarantees, the State Entity must carry out the procedure established by the law to declare the non – compliance in respect of the bidder or contractor.

A. Which requirements must be met by the bank guarantees?

1. An authorized financial entity must issue the guarantee. In Colombia are empowered to issue bank guarantees the following entities qualified by the Financial Superintendence: a) the banks[3], b) the financial corporations[4] and c) the commercial financing companies[5]. On the other hand, only the banks and the financial corporations are authorized to issue stand - by letters of credit[6].

2. The guarantee must be effective on first demand of the State Entity.

3. The guarantee must comply with the standards of the Financial System's Organic Statute and its regulatory provisions. The issuer financial entity is the principal responsible to verify the compliance with these conditions.

4. The guarantee must be irrevocable. The clauses that indicate in any way that the guarantee can be revoked are not acceptable. If the guarantee does not indicate that it can be revoked, it is construed that it is irrevocable.

5. The guarantee must be sufficient, that is to say, it must cover the minimum values the subject of articles 118 to 125 of Decree 1510 of 2013.

6. The issuer must have waived the benefit of excussion, which is the benefit that the guarantors have to make the enforcement first against to the main debtor and then to the guarantor[8]. For this waiver to operate, it is necessary that the guarantee states that the issuer waives the right of excussion.

B. How to enforce a bank guarantee or stand - by letter of credit?

The State Entity must enforce the guarantee by means of a letter addressed to the issuer, in which it states that the bidder or contractor failed to comply and that it demands the respective payment, accompanied by the firm administrative act that declares the noncompliance. For the collection it is not necessary to furnish the original document in which the guarantee is contained.

The State Entity must check that the manner in which it requests the payment meets the procedure established in the text of the guarantee and attach, if necessary, the documents required for the collection such as those that accredit the legal representation of the State Entity.

The enforcement of the guarantee must be made within the term of validity established. In this type of instruments are usual the clauses that indicate that the expiration of the term of the guarantee also means the expiration of the opportunity to enforce it. In consequence, the State Entity must verify that the

3 Item l, number 1 of article 7 of the Financial System's Organic Statute.

4 Item k of article 12 of the Financial System's Organic Statute.

5 Item g of article 24 of the Financial System's Organic Statute.

6 Decree 923 of 1997.

7 Article 2.1.12.1.1 of Decree 2555 of 2010 states the obligations that can be covered by bank guarantees and some exceptions that do not apply to the state contracts.

8 Article 2.383 of the Civil Code.

enforcement is made in a timely manner within the term established by the issuer. If the guarantee is not enforced within the term established, the obligation of the issuer or guarantor is extinguished.

C. Extensions and partial payments

The State Entity must verify in the text of the guarantee admitted the extensions and the manner in which those extensions operate. If the guarantee or stand - by letter of credit does not state that it can be extended, then the guarantee ends upon its expiration, unless the issuer expressly accepts its extension.

On the other hand, in this type of guarantees it is possible to include clauses that state that the guarantee is extended unless the issuer communicates to the beneficiary its intention of not extending it beforehand. In this case, if the issuer communicates to the State Entity that the extension does not operate, the guarantee expires and the State Entity must request to the contractor to recompose the guarantee.

The bank guarantees or stand - by letters of credit *must* not include limitations to request partial payments. Colombia Compra Eficiente recommends to the State Entities to demand that the text of the guarantees allows them to enforce it in a partial or total manner as required by the State Entity. If the guarantee document has no limitations for the partial payment, the State Entity may enforce the total or partial amount of the guarantee in any event of default.