NEC Secondary Option X13

Performance Bond

Presented by

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GVE CommercialSolutions

''Giving priority to your commercial success'

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About Us

GVE CommercialSolutions

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Our NEC capability has principally been acquired through practical application and experience within 'live' project environments assisting both contractors and subcontractors.

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- Commercial and contract management of projects,
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- Dispute avoidance and/or resolution.

For further information please see our website: www.gvecs.co.uk and follow us on LinkedIn

Reminder

Contract Assurance

Many construction projects have a potentially complex structure of contract relationships and multiple participants, with inherent commercial risks.

Specific contract tools are frequently used to safeguard against these risks by providing some form of assurance, including the following;

- Bonds,
- Guarantees,
- Warranties,
- Indemnities,
- Payment security,
- Third party rights,
- Direct agreements,
- Insurances.

Further reminder that these are specialised subjects.

Bonds

What are they?

Bonds are commonly used in the financial sector and are essentially a loan from an investor to a borrower.

A bond has an associated value and maturity date.

Interest is paid at regular intervals with the full bond amount re-paid upon the maturity date.

The value of a bond is determined by the following;

- The interest or 'coupon' rate,
- The expiry or maturity date,
- The credit rating of the borrower.

Construction Industry

Bonds used in construction are different to those used in finance.

They represent an undertaking by a bondsman, or surety, to make a payment in the event of contract action or non-performance.

There are various bonds used, including;

- Bid or tender bond,
- Defects liability bond,
- Off site materials bond,
- Adjudication bond,
- Advance payment bond,
- Retention bond,
- Performance bond,

The cost of the bond is usually borne by the contractor/supplier.

Performance Bond

Performance bonds are commonly used across many industries, including construction.

A performance bond is designed to cover the losses suffered by a beneficiary in the event of contractual non-performance.

The value of a performance bond is usually expressed as a percentage of the contract price, with 10% a common value.

There are essentially 3 'types' of performance bond as follows;

- Conditional, or default, bond,
- On-demand bond,
- Hybrid bond.

Performance Bond - Types

Conditional bond

This creates a 'secondary' obligation relationship, whereby the bond provider's liability is linked to a default under the primary contract.

This arrangement is essentially a performance guarantee.

On-demand bond

This creates a 'primary' obligation relationship, whereby the bond provider is directly liable to the beneficiary.

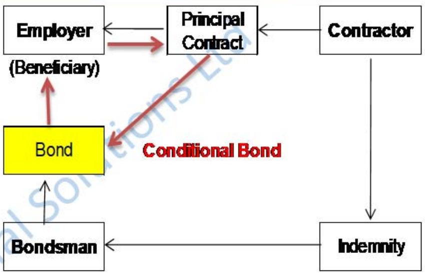
This bond type is less common in the UK and can be open to misuse.

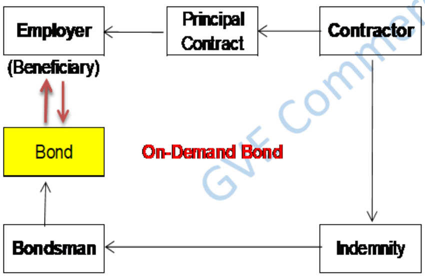
Hybrid bond

This is one based upon a 'primary' obligation relationship, but with certain conditional requirements.

Bond Relationship

Both on-demand and conditional bonds are 'ancillary' to the principal, or primary, contract.





The obligations under the on-demand bond, unlike the conditional bond, are not 'tied' to the principal contract.

A 'Guarantee'

This is essentially a contractual promise, which in this context promises that the guaranteed party, for example a Contractor under an NEC ECC form, performs their obligations under the contract.

A conditional bond is a form of guarantee, with the guarantor's obligations dependant upon the principle contract.

As a guarantee is a contract in it's own right, the requirements for forming a contract equally apply.

A guarantor may be released from its obligations where there is a material variation to the terms of the principal contract.

- Aviva Insurance Limited v Hackney Empire Limited [2012] EWCA Civ 1716.

Clause X13

NEC Suite

Secondary option X13 can be found in the following NEC forms of contract;

- Engineering and Construction Contract (ECC),
- Engineering and Construction Subcontract (ECS)
- Professional Services Contract (PSC),
- Professional Services Subcontract (PSS),
- Term Services Contract (TSC),
- Term Services Subcontract (TSS),
- Supply Contract (SC),
- Design Build and Operate (DBO).

The requirement for a performance bond is also provided under secondary option X4 in the following NEC forms of contract;

- Facilities Management Contract (FMC),
- Facilities Management Subcontract (FMS),
- Alliance Contract (ALC).

X13.1 – ECC Procedure

The amount of the performance bond is stated in Contract Data.

The form of the bond is set out in the Scope.

The bank or insurer providing the bond is required to be accepted.

The bond is to be given by the Contract Date, or within four weeks of the Contract Date.

If the bond is not given after the four week period, this can be notified as a default, which provides for a further four weeks to give the bond.

Upon the expiry of the 'additional' four week period, there is the right of termination at sub-clause 91.2.

Procedural Issues

Amount of the Bond

This may be for any value, although typically is set at 10% of the (predicted) 'contract sum'.

The amount is stated in (Sub)Contract Data;

If Option X13 is used	The amount of the performance bond is	

Cost of bond

Whether the cost of a bond is 'paid' under the contract depends on which form and main option is selected.

Under the ECC form, main options A and B allow for the cost to be included in the tendered total of the Prices.

Under the ECC form, main options C, D, E (and F) the cost is included within the Fee.

Form of the Bond

The form is 'set out in the Scope', which is provided by the Client / Contractor / Purchaser and determines whether the bond is an on-demand or conditional type.

The Association of British Insurers (ABI) published a 'Model Form of Guarantee Bond' for use in the construction industry.

The ABI form was published in response to;

- Criticism of archaic bond language used (re: Trafalgar House case),
- Recommendations in the 'Latham Report',
- Industry consultation and feedback.

The ABI and the Office of the Deputy Prime Minister recommend that on-demand bonds are avoided.

Acceptance of Bond Provider

Bonds are issued by a 'surety' provider, usually a bank or insurer.

A bond provider is required to be accepted.

A reason for non acceptance is that its commercial position is not strong enough to carry the bond.

The assessment would likely refer to the credit rating of the provider.

In the UK there are currently 12 credit rating agencies registered with the Financial Conduct Authority.

The credit rating agencies undertake qualitative and quantitative assessments of an organisation to 'score' their credit rating.

A rating score is assigned, typically using lettering, for example;
- AAA, AA, A, BBB, BB, B, CCC, CC, C, D.

Provision of Bond

Bonds may be given by the Contract Date, which is a defined term;

'The (Sub)Contract Date is the date when the (sub)contract came into existence.'

How do you know when 'the contract' came into existence?

- RTS Flexible Systems Ltd v Molkerei Alois Muller GMBH & Co (2010) UKSC 14 & 38,
- Balfour Beatty v Van Elle Ltd. (2021) EWHC 794 (TCC).

If the non-provision is treated as a default then a contractual option is the termination procedure.

If termination and 'damages' is not an adequate remedy then the court has the power to order specific performance.

- Liberty Mercian Ltd v Cuddy Civil Engineering Ltd and Cuddy Demolition and Dismantling Ltd [2013] EWHC 2688 (TCC).

Things to consider…

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Contract Date – when does this actually occur?

Provide for material variation or amendment of the primary contract for a conditional bond.

Include a clear expiry date and provision to make claims notified prior to this date.

Include details of any specific procedures to be followed.

State the maximum value and whether multiple claims can be made.

Beware if it provides for payment upon the decision of an adjudicator.

As the Scope can be changed, can the form of bond be amended?

Consider the use of 'contract assurance' measures with reference to a considered risk based approach rather than a 'tick box' exercise.

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