
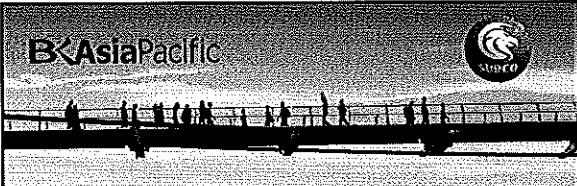


**BK Asia Pacific** 



**BK SURCO TRAINING  
BONDS, GUARANTEES  
&  
WARRANTIES**

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**BONDS, GUARANTEES & WARRANTIES**

**BK SURCO Training**

BK SURCO LTD is a Joint Venture of BK Asia Pacific Limited and SURCO Ltd.

BK is well known in Hong Kong as Contracts and Commercial Consultants that have for several years run training courses and workshops for construction professionals and contractors covering a variety of modules ranging from EOT and Prolongation to the Valuation of Variations, Sub-Contracting and Dispute Resolution.

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SURCO Ltd is the training company of the Chartered Institute of Civil Engineering Surveyors in the UK and is perhaps the UK's leader in providing structured commercial and contract management training course for Engineers, Surveyors and other Construction Professionals made up of a series of different modules ranging from Tendering and Estimating through Commercial Awareness and the New Engineering Contract to Dispute Avoidance and Resolution for some of the largest construction companies and employer organizations.

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Through BK's Joint Venture with SURCO their respective training courses have been combined and are being adapted to suit other jurisdictions and the international construction market and are being conducted throughout Asia, including Hong Kong and elsewhere in China.

BK SURCO's series of training seminars and workshops are running throughout June, July and August 2010. The current programme has been widely circulated but should details of the current programme be required please contact [plai@bkasiapacific.com](mailto:plai@bkasiapacific.com)

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**BONDS, GUARANTEES & WARRANTIES**

Programme

- The purpose of bonds and guarantees
- The different types of bonds and guarantees
- Sources of bonds and guarantees
- Most common types of bonds and guarantees
- Unfair calling & insurance
- Uses & abuses
- Case Study – Incheon Airport, Korea
- The use of warranties
- Case Law

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**BONDS, GUARANTEES & WARRANTIES**

The Purpose of Bonds & Guarantees

- To protect the client from the effects of a failure of the contractor to meet his contractual obligations.
- Primary aim is to provide the client with recourse to a third party for the completion of the contract and/or financial compensation for the costs, up to an agreed limit

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**BONDS, GUARANTEES & WARRANTIES**

**The different types of bonds and guarantees**

- **Tender bonds or guarantees** – used to ensure that tenderers are submitting bona fide tenders & any costs resulting from the contractor subsequent withdrawal will be covered up to the stated amount by the third party issuing the bond.
- **Performance bonds or guarantees** – are the most frequently requested types their purpose being to ensure satisfactory performance by the contractor or, failing this, to protect the client from losses incurred as a result of the contractor's non-performance. The usual values are 5 or 10% of the contract sum.

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**BONDS, GUARANTEES & WARRANTIES**

**The different types of bonds and guarantees (contd)**

- **Advanced payment bonds or guarantees** – used to allow the client to get protection on early financing of the project by advancing early payment to allow a contractor to fund early purchase of materials and equipment.
- **Maintenance bonds or guarantees** – may be used instead of retention monies to ensure that once construction work has been completed the contractor will fulfill his obligation throughout the maintenance period, or that losses incurred because of his failure to do so will be recoverable by the client.

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**BONDS, GUARANTEES & WARRANTIES**

**The different types of bonds and guarantees (contd)**

- **Retention bonds or guarantees** – may be given instead of retention monies being held throughout the contract period or against the early release of the retention element.
- **Parent Company Guarantee** – a guarantee usually obtained from the ultimate holding company of a financially stable company

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# Bonds, Guarantees and Warranties

**BONDS, GUARANTEES & WARRANTIES**

Main sources of Bonds and Guarantees are:

- Individuals – for Personal Guarantees
- Holding Companies – for Parent Company Guarantees
- Banks – primarily for On-Demand or Non Conditional Bonds
- Surety Companies – for Conditional Bonds
- Distinctive types of bonds available:
  - On-Demand Bonds, or
  - Conditional (Default) Bonds

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**BONDS, GUARANTEES & WARRANTIES**

On-Demand bonds or guarantees are generally very simple and will give the client a very strong position when a dispute arises as a bank that will normally issue such instruments will pay the sum on first demand as long as the demand has been made in accordance with the conditions stated.

A bank will therefore feel obligated to pay out without question on an on demand bond.

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**BONDS, GUARANTEES & WARRANTIES**

In

*Edward Owen Engineering Ltd*

-v-

*Barclays Bank International (1978)*

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**BONDS, GUARANTEES & WARRANTIES**

**Conditional or Default Bonds**

- A default bond is a contract of guarantee (or suretyship) where the surety contracts to make good any proven loss to the client as a result of the contractor's failure to perform.

**Retention Bonds**

- An alternative to cash retention.
- Points to note when providing a retention bond.

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**BONDS, GUARANTEES & WARRANTIES**

**Retention Bonds (contd)**

- (i) Ensure that the overall value of the retention bond is no greater than 5% of the contract value;
- (ii) Ensure that the bond reduces by 50% at practical or substantial completion;
- (iii) Ensure that the value of the bond builds up in the same way as a cash retention would – otherwise the full value of the retention bond will be available to the client from day one;
- (iv) Note that if a contractor is asked for both performance bond and a retention bond there is likely to be some overlap.

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**Unfair calling**

- Bank issued performance guarantees carry the risk of calls being made which the contractor may consider unjust – unfair calling. It is possible to insure against this risk in the private insurance market although the premiums required can be high. It is also possible to insure against a valid calling but at an even higher premium.
- Singapore's Progressive Approach to protect against unfair calling.
- Samwah Asphalt Premia Pte Ltd v Sum Cheong Piling Pte Ltd – Court of Appeal Singapore (December 2001)

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**BONDS, GUARANTEES & WARRANTIES**

**Cost of a Default Bond**

- Premiums are in the order of 0.5% to 1% of the bond value.

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**BONDS, GUARANTEES & WARRANTIES**

**Other Pitfalls to avoid**

- Don't agree to the provision of any form of bond without clearance.
- Refuse to provide On-Demand bonds out of hand citing Group protocol as prohibiting acceptance. Offer a Default Bond instead subject to agreement from the surety.

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**BONDS, GUARANTEES & WARRANTIES**

**Case Study – Incheon Airport, Seoul, Korea**

- Three bonds provided. Two surety bonds by Zurich Insurance – a performance bond and a maintenance bond both valued at 5% of the contract value.
- The third bond was an on-demand advanced payment guarantee of 20% of the contract sum issued by the Hong Kong Bank against the local loan facility.
- Failure to include a reducing formula in the advanced payment guarantee.
- A dispute regarding claims and performance resulted in the advanced payment guarantee being called in.

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**BONDS, GUARANTEES & WARRANTIES**

The Use of Warranties

- In the absence of third party rights, warranties are used to establish a direct contractual relationship
- Collateral warranties, or duty of care agreements, give one party a binding undertaking from the other.
- The term "collateral" is used as the agreement usually sits alongside another contract.  
Beoco -v- Alfa Laval Company (1988)
- Owner relied on a collateral warranty given by the subcontractor relating to design and performance

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**BONDS, GUARANTEES & WARRANTIES**

Case Law

Importance attached to the wording of the bond

- Trafalgar House Construction -v- General Surety and Guarantee Co Ltd (1995)

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**BONDS, GUARANTEES & WARRANTIES**

In this case the wording of the bond in so far as material was:

*'.....If the subcontractor shall duly perform and observe' (all the terms of the subcontract) ... 'or if on default by the subcontractor the surety shall satisfy and discharge the damages by the main contractor...' (up to the amount of the bond) 'then the obligations shall be null and void but otherwise shall be and remain in full force and effect...'*

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**BONDS, GUARANTEES & WARRANTIES**

The wording of an on demand bond therefore has to be quite specific such as:

*"We undertake to pay the said amount on your written demand in the event that the supplier fails to execute the contract in perfect performance..."*

Dragages et Travaux Publics (HK) Limited -v- Citystate Insurance Limited (2001)

The Hong Kong Court of Appeal held that the bond was a conditional bond and the judgement provided some useful guidelines

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**BONDS, GUARANTEES & WARRANTIES**

An employer is obliged to account to the contractor for any overpayment in the event of a call on the bond

- Spiersbridge Property Development Ltd -v- Muir Construction Ltd – Scottish Court of Session (March 2008)

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**BONDS, GUARANTEES & WARRANTIES**

Conclusion

- Remember the pitfalls and what to watch out for before committing to the provision of any form of bond.
- In particular, and with respect to performance bonds as the most common type of bond, the evidence that has been presented can only lead to one conclusion for the contractor and that is a surety issued performance bond is evidently advantageous and less risky than alternatives and in addition aids the contractor's cash flow as it places no restrictions on the assets of the company, nor its overdraft facilities.

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