The form of performance securities in construction which is appropriate to a project will depend on the risk, scope, effect and duration sought to be protected against. It is not feasible to provide security against each risk that may arise, the cost would be excessive, and insurance can provide against many of the associated risks.

Bonds

i. Advance Payment Bond

This will be given where the employer has made a payment to the contractor in advance of having work completed to the value of payments made in order to cover the risk of contractor insolvency or default. An advance payment bond would be appropriate where the employer is providing monies to cover cost of mobilisation, equipment or purchase of materials. The bond will usually reduce over the period of the contract as deductions are made as works are carried out. The bond should be made repayable in full in the event the contract is terminated.

ii. Performance Bond

Performance bonds are widely used in the construction industry as a means of protecting employers against non-performance or financial default by the contractor. Performance bonds from the contractor will usually be required. They will generally be for between 10 and 15% of the Contract Price. The bond will typically remain until the end of the defects liability period but may be extended. *Clarington Developments Limited v HCC International Insurance Company Plc*[1] cast uncertainty over a form of wording widely used in performance bonds, dismissing an employer's application to enforce the bond, noting that the employer had first to exhaust the dispute resolution procedures under the building contract to crystallise the amount to which the employer was entitled. It is unclear what is now required to make a call on a performance bond and whether dispute resolution mechanisms are to first be exhausted.

iii. Retention Bond

The building contract will usually provide for deduction of an agreed percentage of each contract payment (usually 3-5%) as an ongoing security for the employer against default by the contractor. Once the works are substantially or practically complete, it is common for half of the amount retained to be repaid to the contractor, with the balance retained by the employer during the defects liability period (which usually lasts for around 12 months). In order to secure release of the entire retention fund upon substantial or practical completion of the works, the contractor may offer a retention bond to the employer. Retention monies, unless there are provisions in the contract to the contrary, can be applied by the employer against discharge of any outstanding obligations under the building contract; the employer is not confined to applying retention monies only in respect of outstanding defects.

Parent Company Guarantee (PCG)

Typically, PCG's will be utilised where the counterparty is a Joint Venture, or a special purpose vehicle incorporated for delivery of the particular project. They are a simpler form of security for a contractor to provide. The security consists of a guarantee by the parent of the performance of the contractor's obligations. A PCG may apply for the period of limitation under the building contract and provide security in respect of latent defects until years following expiry of the performance bond.

Collateral Warranties

These will generally be built into appointments and construction contracts. They offer an added layer of protection to the employer against non-performance of the key counterparties. Employers can obtain collateral warranties from subcontractors who have been engaged by the contractor or create a contractual commitment to third parties with an interest in the works being designed and constructed,

[1] [2019] IEHC 630.

such as funders, purchasers, tenants and management companies. The form of warranty will vary depending on the beneficiaries. Often, Funders will require more detailed direct agreements with the main contractor on significant developments. Warranties will need to be accompanied by copies of the underlying contract or appointment, and evidence of the insurances required to be maintained.

Where there is performance security required, it is quite usual for the Employer to have the entitlement to withhold payment, of all or a proportionate part, of monies due until the relevant bond, PCG or collateral warranty has been provided.

<u>Insurance</u>

A major challenge facing contractors, consultants and employers currently is obtaining Professional Indemnity (PI) Insurance. In the short term, this is causing significant delays for a number or projects in the construction industry but in the long term, this may leave owners and employers without recourse for design related latent defects.

i. PI Market

It used to be the case that contractors and design consultants could obtain €6.5 million each and every claim policy coverage easily.

Following the 2017 Grenfell Tower fire demand for PI policies in the construction sector has grown. There have been a number of changes to the market in recent years; withdrawal of some providers, introduction of widespread exclusions in relation to fire safety and cladding, increase in demand for information required by insurers in relation to works, trend towards a more onerous risk allocations in building and services contracts increasing liability beyond "reasonable skill and care", increase in premiums and "any one claim" cover being replaced with "aggregate" cover. Each of these has led to PI policies becoming more difficult to obtain.

Maintaining PI cover continues to be a requirement for consultants providing design and professional services on a project and over the last number of years it has also become a standard requirement for contractors and subcontractors as design responsibility is usually assumed by a number of parties engaged on a project. Further, the introduction of BCAR (Building Control Amendment Regulations), Completion certificates and Ancillary Certificates supports the view that PI cover for contractors and subcontractors is now a must.

ii. "**Any One Claim" or "Aggregate Cover"**

"Any one claim" provides cover up to a stated limit for each individual claim made during the period of insurance whereas an "Aggregate" policy allows for cover up to a stated limit for all claims made in the period of insurance. Difficulty may arise with aggregate cover as the PI policy effectively covers all projects on which the consultant, contractor or sub-contractor is engaged. If insurance claims reach the policy threshold within the period of insurance, an employer could be in a position where there is no further cover available to meet their claim.

iii. Impacts

Renewing current policies is proving difficult. The level and type of cover previously maintained by consultants, contractors and sub-contractors may either be unavailable or available at a significant increase in premium. As the cover held can be mandated by contracts or collateral warranties previously entered or currently in negotiations, issues may arise where the policies cannot be obtained. It may be prudent to allow for some flexibility on the type and level of insurance within a contract such as the maintenance of insurance subject to it being generally available in the market as failure to maintain agreed insurances will be a breach of contractual obligations.

Employers should be mindful of the impracticalities and implications in seeking an absolute commitment from a consultant, contractor or sub-contractor to maintain a specific level and type of PI Insurance for a required period. It is for the benefit of all parties that appropriate cover is maintained so allowing for a degree of flexibility would be a proactive step in the right direction.

Where the PI insurance market does not improve, we will see transactions costs and negotiation duration increase as employers and funders may continue to hold out for higher levels of PI cover. Further, there is a risk of long term ownership in building increasing with the result that latent defect rectification cannot be funded through recourse to insurance.

iv. Latent Defects Insurance (LDI)

This is a form of no fault cover that indemnifies the costs of rectification of certain defects in buildings. It is not a complete substitute for PI insurance and the extent of LDI cover will vary from policy to policy. It is usually arranged for a 12 (twelve) year period and will protect against defects that occur in the post construction phase of a building. By removing uncertainty surrounding litigation and safeguarding against a situation where litigation is not possible or feasible, LDI can be an effective tool for risk management and asset protection. Majority of claims can be caused by faulty materials or workmanship as opposed to effective design or specification and would therefore not be covered by PI. LDI is a “strict liability” policy whereas PI needs to be a proven “legal liability” resulting from a breach of professional duties.

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