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Performance Bonds

This is the generic name given to bonds which are sometimes called Guarantee Bonds or Deeds.

The use of Bonds of this kind is standard practice in the world of commercial contracting. They have long been established in public sector contracting for supplies, works and Part A services. Sometimes a general reference is made for example in relation to road works. The statement being that if the works are not completed on time, the contractor will have to pay a fine. This is one type of Bond. A Performance Bond is a form of guarantee for the purchaser that the provider will comply with all of the terms of the contract. Although there is no maximum amount set for the value of the Bond, in relation to Part B services this generally to a maximum of 10% of the total contract value, but there have been examples of bonds required to a value up to 40% of that value.

The Bond is in the form of money to be paid to the purchaser in the event that the contract fails. This is usually in circumstances where the provider (contractor) has breached the terms of the contract in some way. This breach of action will usually be dealt with by the courts and is a separate issue. But any court action is likely to take some time. Whilst this is happening the purchaser has a problem. This is that the contractor has been moved from the delivery of the service until the court action is completed, but the delivery of those services, which may be a statutory requirement, must continue. Linked with this is the cost of finding another contractor to take over the service including the potential cost of re-tendering for a new contractor to take over the future delivery of the service. The Bond is required to cover these additional costs.

There are now two options for providers to consider in setting up a Performance Bond:
a) through a bank – in principle a new bank account is set up over which the bank has control. Money to the value of the Bond is deposited by the provider in the account, usually from general, unrestricted reserves. The Bank guarantees payment of the Bond from this deposit should the needs arise. Banks operate the system in different ways, so it is essential that discussions are held with bankers at an early stage to ensure that the Bond can be put in place when needed. This approach was popular prior to the banking crash of 2008/9 when were prepared to will offer higher rates of interest for the funds. It is usual for these facilities to set up so that the Bond would be in place when tendering. The Bond itself, including the deposit of funds, to be arranged by the winning tenderer, prior to signing the contract;

b) through an insurance company – this is now usually the preferred method of setting up bonds of this kind. Arrangements can be made with some insurance companies to set up a Performance Bond by means of an insurance policy. This differs from an arrangement with a bank in that although this does not have the effect of placing a potential strain on general unrestricted reserves, there is a cost. This cost may be factored into the offer price in the tender.
In any case it is advisable that at an early stage, options with the bankers, insurance, brokers and with other bankers in order to find the most cost effective solution for the organisation and that this solution receives Board approval

In the event that the contractor finds itself in a position where the purchaser believes that there has been a breach of contract then the Bond will become payable, directly to the purchaser by the Bond holder. That is the bank or insurance company.

Some Part B providers have sought to have the provision of a Performance Bond removed from the tender requirements. This misses the point completely. The introduction of tendering means that providers are entering into commercial contracts with the public purchasers. These contracts are governed and regulated through the courts by contract law. For contractors to avoid triggering the payment of the Bond it is essential:

- to read and thoroughly understand every one of the terms of the contract, before signature. This means getting legal advice regarding the contract at a very early stage;
- to ensure that every member of staff involved in any aspect of the delivery of the contract understands ALL of the contract conditions, and abides by them at all times;
- that if a provider feels that there is any aspect of the contract with which they are unable to comply, then do not sign.

Commercial contracts and contractual terms are a new area for many Part B providers, an area where advice is absolutely essential for Trustees and Senior Managers. So although the performance Bond is a feature of the new world of procurement it is essential that management procedures are in place which will ensure that it is not triggered and that there is contract compliance by all involved at all times. The Bond will be triggered only if theiris a potential breach of the contract.

Some contracts ask for a "Parent Guarantee" or "Guarantee Bond". This is required in circumstances where a subsidiary of a company, organisation or holding company is submitting a tender. If an organisation is part of a structure of this kind then it is usual for the purchaser to ask that the main company/charity or holding company provides a Bond covering the contract being delivered. This type of Bond is usually for the full value of the contract, although this may change in some circumstances.

Lessons to be learned
If a purchaser asks for a Performance or Guarantee Bond, then that is what is required in order to progress successfully through the tendering process. Therefore to answer the relevant question in the tender document with an indication that a Bond of the types indicated above will NOT be available is likely to lead to exclusion from the process. Such an answer is also likely to raise questions as to the capacity of the tendering organisation to comply with the terms of the eventual contract.

Instruments of this kind cannot be set up quickly. This underlines the lesson that successful tendering requires a preparation period of some months. As a general rule, if the process for setting up a Bond is not in place when the tender documents are issued, then it is too late. TfC recommends a preparation period of 6 to 9 months before the issue of the tender if an organisation is to be successful.

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