

## Contract Security

The purpose of contract security is to guarantee that the contractor will:

- perform and complete the work according to the contract requirements
- discharge lawful obligations and satisfy lawful claims against the contractor
- ensure that subcontractors discharge their lawful obligations and satisfy lawful claims against them.

### Requirements

Contract security is normally required in construction contracts when the contract amount is expected to be \$100,000 or over.

### Forms of Contract Security

For all construction contracts where contract security is required, the contract security can be:

- a performance bond **and** a labour and material payment bond each in an amount of 50% of the amount payable under the contract:

The performance bond shall be in a form approved by the Federal Treasury Board issued in favour of the GNWT and from a company whose bonds are acceptable to the GNWT;

The labour and material bond payment bond shall be in the standard construction document form CCDC 222 of the Canadian Construction Document Committee, issued in favour of the GNWT and from a company whose bonds are acceptable to the GNWT.

or

- a security deposit in an amount, equal to 10% of the contract amount (normally the 5% bid security plus an additional 5% security) for construction contracts and **at least** 10% for other contracts

### ***Performance Bonds***

A *performance bond* is a surety bond, provided by the contractor, that guarantees completion of the work according to the terms of the contract. Any breach or failure on the part of the contractor to complete the work according to the terms of the contract in its entirety will entitle the GNWT to be indemnified by the bonding company for any loss suffered. For example, the bonding company will be liable for all excess costs of completion of the work, up to the face value of the performance bond.

When the contractor is declared by the GNWT to be in default under the contract, the GNWT has the option to take the work away from the contractor.

The bonding company's obligations under the performance bond are as follows:

- When the work is not taken away from the contractor, the bonding company must remedy the default of the contractor.
- When the work is taken away from the contractor and the GNWT directs the bonding company to complete the work, the bonding company will complete the work according to the terms of the contract. If a contract is formed for the completion of the work, that contract must be between the contractor and the bonding company. The selection of the completing contractor will be subject to the approval of the GNWT.
- When the work is taken away from the contractor and the GNWT, after reasonable notice to the bonding company, does not direct the surety to complete the work, the bonding company will assume the financial responsibility incurred by the GNWT for the cost of completion in excess of the money available to the GNWT under the contract.

The bonding company is not entitled to either the contractor's

holdback or earned, but unpaid, progress money to which the contractor may have been entitled to at the time of the contractor's default. Upon satisfactory completion of the work, the GNWT may, however, pay this money to the surety, provided that they are not required for the purposes of the contract.

The limitation period for the GNWT to initiate a legal action against the surety for failing to fulfil its obligations under the performance bond must be no later than two years after final payment is due under the contract.

There are strict time limits for making a claim under a performance bond. Therefore, Project Officers and Managers are advised to maintain contact with the bonding company whenever there is cause for concern regarding the contractor's performance. Once the contractor has defaulted on its obligations under the contract, no unilateral actions may be taken by the GNWT. The GNWT must inform the bonding company, in writing, of its intentions with regard to the continuance of the contract and obtain the concurrence of the surety in respect to further action.

### ***Labour and Material Payment Bond***

A labour and material payment bond is a surety bond, provided by the contractor to guarantee payment of the lawful accounts of certain persons, firms, or companies (*claimants*) who have not been paid, in connection with obligations performed under the contract.

Labour and material includes water, gas, power, light, heat, oil, gasoline, telephone service, or rental of equipment that is directly applicable to the contract. Rental of equipment does not include rent applied towards the purchase of the equipment.

Any unpaid account that represents a capital expenditure, overhead, or general administration costs incurred by the contractor in performing the contract is not recognized by the labour and material payment bond.

Check the bond itself to determine what these limits are.

Under the labour and material payment bond, a *claimant* has a direct contract with the contractor **or any subcontractors** for labour, material, or both that are used or reasonably required for use in the performance of the contract. The Federal Bond form is different from the CCDC Bond in that it covers sub-subcontractors as well as subcontractors.

A claimant who does not have a direct contract with the contractor may claim under the payment bond as long as the following conditions are respected:

- The creditor of a subcontractor (sub-subcontractor) of the contractor (claimant) must notify the contractor of its entry into a contract with the subcontractor.
- The notice must indicate the work, the nature of the contract and the name of the subcontractor.
- The notice must be given before the creditor performs any work or supplies any material. Note that an employee of a subcontractor is not required to give notice to the contractor.

All claimants under a labour and material payment bond must give written notice, by registered mail, to the bonding company (surety) and to the contractor (principal) of their unpaid accounts. These notices must state with substantial accuracy the amounts claimed and must be received within specified time limits; otherwise, the claims will be disallowed under the terms of the bond.

A notice of claim for work performed or material supplied under the contract must be given within 120 days after the date on which the claimant performed the last of the work or supplied the last of the material for which claim is made.

A notice of claim for a holdback must be given within 120 days after the claimant should have been paid in full under the contract.

The surety's maximum liability is the amount specified in the bond, and that amount is reduced by any payments properly made under the bond.

The surety is not entitled to claim any contract money. However,

the GNWT may pay to the surety any contract monies not required for the purposes of the contract to compensate the surety for fulfilling its obligations under the bond. This payment must not be made until the surety has paid all valid accounts of claimants under the payment bond.

If a claimant has not been paid, as provided for under the terms of the contract, within 90 days after the date on which the claimant performed the last of the work or supplied the last of the materials, the GNWT may sue on the payment bond.

The Project Officer should ensure that a copy of the labour and material bond is posted on the work site and must make information regarding the bond available to subcontractors and employees upon request.

### ***Security Deposits***

When contract security is required, the contractor may, in lieu of a performance bond and a labour and material payment bond, provide a security deposit.

When a security deposit is delivered, it must be, in the amount of 10% of the contract price for construction contracts and **at least** 10% for other contract types. The deposit must be either a certified cheque, bank draft, a bank *Letter of Irrevocable Guarantee or Standby Credit*, or such other security considered acceptable by the GNWT. The security deposit will be payable to the Government of the Northwest Territories.

Effective August 4, 2010 the GNWT will accept contract security from approved “micro” lenders. Currently the only approved “micro” lender is the NWT Metis-Dene Development Fund Ltd. (MDDF). The GNWT will accept Letters of Irrevocable Standby Credit from the MDDF as security in amounts not to exceed \$300,000.

Security deposits must be handled as follows:

- certified cheques, cash or bank drafts must be forwarded to Finance personnel for depositing into the GNWT GL2014 account

- *Letters of Irrevocable Guarantee or Credit* must be retained in a fireproof safe for the duration of the contract

## Return of Contract Security

Performance bonds and labour and material payment bonds are retained on file and are not normally returned to the contractor because at the completion of the contract they have no value.

If the contract security is a security deposit, it will be generally returned with the interim certificate of completion payment. However, any portion of the security deposit which is required for the purposes of the contract (e.g., funds required for deficiencies, claims by subcontractors for non-payment, unfinished work.) may be retained.

*Irrevocable Letters of Guarantee or Credit* must be returned to the contractor upon completion of the contract or upon expiration, if so provided.

## Changes in the Contract Security

A performance bond refers to a specific contract. Therefore, any changes to the contract that materially or substantially affect the risk of the bonding company, may release the bonding company of its obligations under the bond unless the surety is notified.

What constitutes a material change or a change that would materially or substantially affect the surety's risk is not clearly established. However, the following are guidelines for what is considered material and prejudicial to the risk of the surety:

- changes involving additional work (one large change or a series of small ones) where the contract price is substantially increased (15% of original contract price)
- changes in the terms of payment
- changes in the work that involve the contractor or one of the subcontractors doing work in which they are inexperienced
- substantial changes that shorten or lengthen the time for

completion of the work

- stop work orders

The bonding company's consent must be obtained for any change that materially or substantially affect its risk. If there is a question about whether or not the proposed change is material, the surety should be notified of the change and asked their opinion. If, in their opinion, the proposed change is substantial, their consent and that of the contractor must be obtained.

