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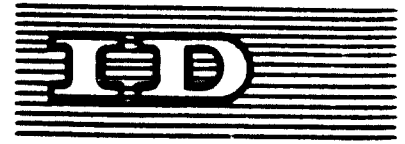
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Forms of Contract for Fertilizer Plants
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TYPE OF PERFORMANCE BOND THAT MIGHT BE INCLUDED IN
THE UNIDO MODEL FORMS OF CONTRACT * .

Note by the UNIDO Secretariat

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Types of Performance Bond

1. This note considers two alternative types of performance bond that might be included in the UNIDO Model Forms of Contract as Annexure XXII:

Type A. Performance Bond payable on demand to the PURCHASER.

Type B. Performance Bond payable after default by the CONTRACTOR has been proved to the Surety and after the Surety has taken all steps to fulfill specific performance of the contract.

2. The Expert Group Meeting is invited to consider the example of the form of these two types of Performance Bond provided in Annex A and B.

3. Type A - Performance Bond Payable on Demand-is a bond issued by a Bank/Bonding Company/Surety Company and which is payable on demand to the PURCHASER without any enquiry or reference to the reasons for calling the Bond. An example is provided as Annex A.

4. Type B is a Performance Bond issued by one of the same institutions which is payable after default by the CONTRACTOR has been proved to the Surety and after the Surety has exhausted all means to ensure completion of the CONTRACTOR's obligations. An example is provided as Annex B.

5. Some institutions are hesitant to issue Performance Bonds that require them to decide for themselves whether the PURCHASER's claim of a breach of contract or default by the CONTRACTOR is sufficient cause for payment on the Bond. These institutions prefer to make payment on the bond conditional upon either (a) the award of the competent court of law or (b) a decision by Arbitration proceedings.

Coverage of the Performance Bond

6. Practice as regards the amount of the Performance Bond required varies from country to country. In the United States, performance bonds of up to 100 per cent may be required on construction, engineering and plant contracts for the Government because it takes the view that the Bond must cover the need for the work to be completed by another CONTRACTOR if the principal CONTRACTOR defaults on his obligations.

Contracts in the private sector generally require performance bonds of up to 25 per cent. In Western Europe, practice varies from country to country; for construction and plant contracts a Performance Bond of substantially less than 100 per cent is usually deemed sufficient by the Government; and in the private sector Performance Bonds of less than 25 per cent are considered sufficient.

7. The construction of a fertilizer plant is an expensive and complex task. The interest of the PURCHASER is to obtain a completed plant that works satisfactorily. However, the PURCHASER will have paid as much as 75 per cent of the contract price before the plant is mechanically complete and 85 per cent before the Guarantee Tests are demonstrated. It is therefore suggested that a Performance Bond that will adequately protect the interests of the PURCHASER needs to recover 25 per cent of the cost of the plant. The Statement from the World Bank attached as Annex C supports this point of view.

Estimated cost of the Performance Bond

8. The maximum coverage that can be obtained through a Performance Bond and its cost varies with the type of bond required by the PURCHASER. In the case of a Bond Payable on Demand (Type A), the coverage obtainable in current practice could be up to about 25 per cent of the cost of the plant. The cost of this type of bond for a contract of three years duration has been estimated at between 3 and 5 per cent of the contract value.

9. In the case of the second type of Performance Bond, Type B referred to above, the coverage obtainable could exceed 25 per cent and the cost would be lower than for the Type A Bond for the same level of coverage. Furthermore the second type ensures that the PURCHASER can turn to the Surety providing the Performance Bond to first try to compel the CONTRACTOR to fulfill his obligations and failing this to arrange for alternative arrangements to complete the plant. The cost of this type of bond has been estimated at 2 to 4 per cent of the contract value.

Conolusion

10. The choice of which type of Performance Bond to use should be left to the PURCHASER. The immediate possibility of calling each type of Bond helps the PURCHASER to ensure that the CONTRACTOR pays urgent attention to fulfilling his obligations under the Contract at any time during its execution.

11. A Bond Payable on Demand (Type A) is simple and unambiguous as regards when and how it can be called. However, once the bond is called, it provides no further hold on the CONTRACTOR to meet his obligations under the contract. The amount received by the PURCHASER as a result of calling the bond may well be insufficient for him to make alternative arrangements with another contractor to ensure the fertilizer plant is successfully completed.

12. The Performance Bond of Type B is not payable on demand. It is more complex and the PURCHASER cannot be certain when he will receive a cash sum. Only after all efforts to complete the plant have been exhausted by the Surety, will the Surety pay a cash sum to the PURCHASER. Thus by introducing a third party it ensures that all efforts are made to complete the fertilizer plant successfully.

Advice requested from the Expert Group

13. The Expert Group is invited:

(a) To indicate whether the wording of the Performance Bonds (Types A and B) is suitable for international use;

(b) To suggest which type of Performance Bond should be included in the UNIDO Model Form of (i) Turn-Key contract and (ii) Cost Reimbursable Contract;

(c) To suggest the amount of the Performance Bonds that would be appropriate for incorporation in the UNIDO Model Form of (i) Turn-Key Contract and (ii) Cost Reimbursable Contract.

EXAMPLE OF A PERFORMANCE BOND

Type A. Performance Bond Payable on Demand

BY THIS BOND We ... (FULL CORPORATE NAME OF PRINCIPAL)
 whose registered office is at
 hereinafter called the CONTRACTOR and (FULL CORPORATE NAME OF THE BONDING
 COMPANY) whose registered office
 is at (FULL ADDRESS) hereinafter called
 the SURETY are held and firmly bound unto (FULL NAME AND TITLE OF THE
 OBLIGEE) for
 the payment of which sum the CONTRACTOR and the Surety bind themselves
 and their assigns jointly and severally by these presents.

Sealed with our respective seals and dated this day of
 197...

WHEREAS the Contractor by a Contract made between the PURCHASER of the one
 part and the CONTRACTOR of the other part has entered into a Contract
 hereinafter called the Contract (incorporated herein by reference) for
 the grant of license and technical know-how, supply of plant and equipment,
 and the construction, erection, commissioning and guarantee testing of an
 Ammonia and Urea Plant being the Works as therein mentioned in conformity
 with the provisions of the Contract.

NOW THE CONDITION of the above-written Bond is such that if the CONTRACTOR
 shall duly perform and observe all the terms provisions conditions and
 stipulations of the Contract on the CONTRACTOR's part to be performed and
 observed according by the CONTRACTOR the Surety shall satisfy
 and discharge the damages sustained by the PURCHASER thereby up to the
 amount of the above-written Bond then this obligation shall be null and
 void but otherwise shall be and remain in full force and effect but no
 alteration in terms of the Contract made by agreement between the PURCHASER
 and the CONTRACTOR or in the extent or nature of the Works to be built or
 constructed erected delivered and maintained thereunder and no allowance

of time by the PURCHASER under the Contract nor any forbearance or forgiveness in or in respect of any matter or thing concerning the Contract on the part of the PURCHASER shall in any way release the Surety from any liability under the above-written Bond and the Surety promises and shall be bound to pay to the PURCHASER, in satisfaction and discharge of the damages sustained by the PURCHASER, up to the amount of the above-written bond forthwith at PURCHASER's more notice stating that the CONTRACTOR has failed to fulfil its obligation under the Contract for reasons for which the CONTRACTOR is liable and without any objections and enquiry whatsoever regarding the grounds for non-fulfilment of obligations and without asking for any reason as to whether the amount is lawfully asked for by the PURCHASER or not, the entire amount or portion thereof, as mentioned by the PURCHASER in the notice. In any case, however, the Surety's responsibility under this Performance Bond is limited to (AMOUNT AND CURRENCY, WORDS AND FIGURES)

This Performance Bond comes into force from the Effective Date of the CONTRACT and shall be valid initially for a period of _____ months from the Effective Date of the CONTRACT to be extended in case the CONTRACTOR fails to fulfil his obligations under the CONTRACT for such periods as may be mutually agreed upon but not more than 6 (six) months at a time. The guarantee shall expire after fulfilment of the Final Acceptance of the Plant in terms of the CONTRACT, as would be jointly certified by the PURCHASER and the CONTRACTOR.

In the event of force-majeure, or in the event of recourse to arbitration according to the CONTRACT, the validity of this Performance Bond shall be extended, for a period to be mutually agreed upon, till the cause of force-majeure is over or settlement has been made through arbitration, but not more than 6 (six) months at a time.

This Performance Bond shall be in addition to and shall not affect or be affected by any other security now or hereafter held by PURCHASER on account of money hereby intended to be secured and the PURCHASER may, at its discretion, and without any further consent from the SURETY and

without prejudice to its rights against the Surety, may compound with, give time or other indulgence to, or make any other arrangement with the CONTRACTOR and nothing done or omitted to be done by the PURCHASER in pursuance of any authority or permission contained in this bond shall affect or discharge the liability of the Surety.

This Performance Bond is to be returned to the Surety after its expiry unless extended beyond the period stipulated in the Performance Bond for the reasons stated above.

The common seal of the (Institution) _____

EXAMPLE OF A FORM OF PERFORMANCE BOND

Type B. Performance Bond payable after default by the CONTRACTOR has been proved to the SURETY and after the SURETY has taken all steps to fulfil specific performance of the contract.

Name of Bonding/Surety/Guaranty Company

No: _____ (State Currency and Amount)

KNOW ALL MEN BY THESE PRESENTS THAT BY THIS BOND WE (legal name and title of Contractor together with address) as Principal, hereinafter called the CONTRACTOR

AND THE (legal name and title of Bonding Institution together with address) a Corporation created and existing under the laws of the State of and duly authorized to transact the business of Suretyship in (name of PURCHASER's country) as SURETY, hereinafter called the SURETY,

are jointly and severally held and firmly bound unto (legal name and title of PURCHASER together with address) as PURCHASER, hereinafter called PURCHASER, its successors and assigns, in the full and just sum of (words and figures) lawful money of (country name) for the payment of which sum well and truly to be made to the said PURCHASER, its successors and assigns whereof we the CONTRACTOR and SURETY bind ourselves, our heirs, executors, administrators, successors and assigns and each of us jointly and severally, firmly by these presents.

SIGNED, SEALED AND DELIVERED this day of A.D. 19

WHEREAS, the CONTRACTOR has entered into a written contract with the PURCHASER dated the day of A.D. 19, for the grant of licenses, technical know-how, Construction, Supply of plant, equipment and completion of erection, start-up, commissioning and conducting guarantee tests of an Ammonia and Urea Plant (enter location and other details of the specific plant) in accordance with the Specifications, Drawings and Plans submitted therefor which contract, Specifications, Drawings and Plans, are by reference hereto made a part of this obligation hereof (as fully and to all intents and purposes as though recited in full herein) and are hereinafter referred to as the Contract, and including for a period of year(s) from the date of acceptance by the PURCHASER, the remedying of any defects due to faulty materials and/or workmanship, and/or errors in the processes, and/or breach of specifications, and the payment for any damage to other work resulting therefrom, in accordance with the Specifications, Drawings and Plans forming part and parcel of this obligation.

AND WHEREAS the SURETY has agreed to execute these presents to secure the due performance on the part of the CONTRACTOR of the said Contract or as the same may be changed, altered or varied as hereinafter provided; AND WHEREAS the SURETY hereby waives notice of any variations, changes or additions made to the scope of the work to be undertaken pursuant to the CONTRACT or as to any extension(s) of time granted by the PURCHASER.

NOW, THEREFORE, THE CONDITION OF THIS BOND AND OBLIGATION is such that if the above bounden CONTRACTOR, its successors or assigns (et seqq.) shall henceforth and at all times faithfully and promptly perform or cause to be performed and fulfil all the undertakings, premises, covenants, terms, conditions and agreements stipulated in the said Contract in good

sufficient and workmanlike manner (on the CONTRACTOR's part to be performed and observed) during the original term of the said Contract as set forth and any extensions thereof that may be granted by the PURCHASER, with or without notice to the SURETY, and during the life of any guarantees and/or warranties specified in the said Contract, and shall also well and truly perform and fulfil all the undertakings, covenants, terms, conditions and agreements of any and all duly authorized variations, changes and additions to the scope of work and/or modifications of the said Contract, and shall furthermore also make good and reimburse to the PURCHASER all loss, damage and costs which the PURCHASER may sustain by reason of and/or incidental to the failure or neglect on the part of the CONTRACTOR to undertake the aforementioned obligations or if on default by the CONTRACTOR the SURETY shall make good, satisfy and discharge the damages sustained by the PURCHASER thereby up to the amount of this Bond, then this obligation shall be null and void, otherwise this Bond to be and shall remain in full force, virtue and effect in law;

Provided always and it is hereby agreed and declared that the PURCHASER may in its discretion at any time or times take and receive from the CONTRACTOR any security whatsoever and grant any extension of time thereon or on any liability of the CONTRACTOR to the PURCHASER;

Provided further and it is hereby agreed and declared that the CONTRACTOR and SURETY, their heirs, successors and assigns, or any of them, shall not be discharged or released from any liability hereunder nor shall such liability be in any way affected by any dealing or transaction or forbearance which may take place between the CONTRACTOR and the PURCHASER and it is hereby agreed that the PURCHASER shall not be required to give the SURETY notice of any such or of any default of the CONTRACTOR

such notice being hereby waived but upon request from the SURETY the PURCHASER shall furnish any information it may have at the time of such request;

Provided also further and it is hereby agreed and declared that any claim, suit or action by reason of any default shall be instituted against the SURETY before the expiration of two (2) years from the date on which final payment under the said Contract falls due and if this limitation is made void by any law controlling the construction thereof, such limitation shall be deemed to be equal to the maximum period of limitation permitted by such law or two (2) years whichever is the lesser;

Provided always and it is hereby agreed and declared that no right of action shall accrue upon or by reason hereof, to or for the use or benefit of any one other than the PURCHASER named herein or the heirs, successors, assigns, executors or administrators of the PURCHASER and the SURETY shall not be liable for a greater penalty than that specified in this instrument.

IN TESTIMONY WHEREOF, the said CONTRACTOR and SURETY each of them jointly and severally bound have caused these presents to be sealed under their several seals on the day and year first above written, the name and corporate seal of each of the said CONTRACTOR as SURETY being hereto affixed duly attested by the signatures of its undersigned Attorney-IN-FACT pursuant to authority of its governing body.

SIGNED, SEALED AND DELIVERED

in the presence of

Witness:

(CONTRACTOR)

(Seal)

Attest:

(Seal)

(SURETY)

(Seal)

Attest:

(Seal)

Countersigned:

STATEMENT ON WORLD BANK'S PRACTICE ON PERFORMANCE BONDS

prepared for

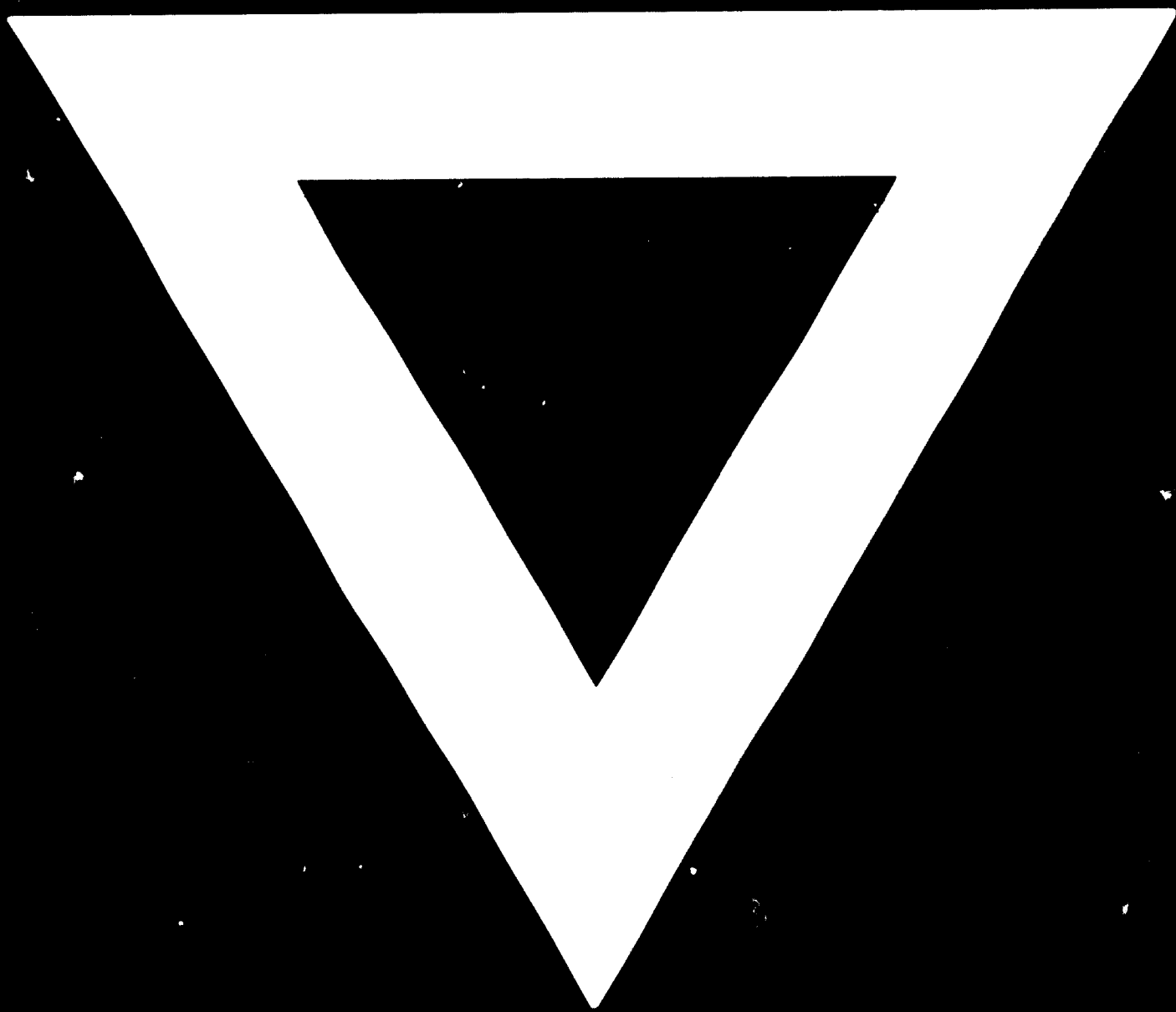
First Working Group on Contracts and Insurance for
Fertilizer Plants

Vienna, 14-17 February, 1978

The Bank's guidelines for procurement applicable to most contracts it finances require its borrowers to obtain security to ensure performance of contractual undertakings by contractors and suppliers in the event of default or failure to perform by them. Present requirements stipulate that the bidder should have the choice of selecting either a performance bond or a bank guarantee for this purpose. The reason the selection option is left to the bidder and not to the borrower is because of different business conditions in various countries. Thus while qualified North American contractors can usually obtain performance bonds with little difficulty, European contractors are usually unable to obtain this type of security and the reverse is normally true with respect to bank guarantees. The Bank's requirements were designed to avoid giving an unfair competitive advantage to certain contractors through mandatory stipulations concerning the form of security, and the solution adopted was to leave the choice of security with the bidder. There is no general rule as to the amount of security merely that it be appropriate to the contract in question, but since the bidder can select the type of security the decision was made that the amount of coverage should not be out of proportion to the type of security selected. As bank guarantees normally require a ten to fifteen per cent coverage, performance bonds need not cover more than 20 to 30 per cent of the contract value. It was also felt that the chances of failure increase as work progresses so that the greatest risk of failure is at the final stage of performance for which a 20 to 30 per cent value range would normally be sufficient. Where very large industrial projects are concerned the value of security required by the Bank's rule could, however, be much lower in order to attract sufficient competition.



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