

The Star

LEGALS



Kelly Stannard of MDA Attorneys feels on-demand bonds are a major threat to struggling building contractors.

Fairer alternatives to on-demand bonds needed to help distressed contractors

LEGALS WRITER

CONSTRUCTION projects are complex and risky. For this reason, the viability of the industry requires forms of securities, including on-demand bonds, says Kelly Stannard of MDA Attorneys.

Stannard says an on-demand bond is a contract between an employer under a construction contract and an independent guarantor (usually a bank) which allows the employer to demand the bond amount for immediate payment without needing to prove that he or she had suffered a loss. "Even if there are pending disputes between the employer and the contractor, the guarantor is obliged to pay the total guarantee amount to the employer unless there are exceptional circumstances. The guarantor will then recover the paid-out amount from the contractor," she explains.

"For employers, on-demand bonds are an ideal

form of security: they can be quickly enforced and their effectiveness is legally certain. But for contractors this form of security can lead to liquidation. There is clearly a need to develop alternative security options that are effective – and fair for contractors."

Stannard says because on-demand bonds allow for a "pay-now-argue-later" scenario, employers are increasingly abusing on-demand bonds to obtain cash quickly, instead of waiting for a long and expensive dispute to be resolved under the underlying contract. "Given South Africa's cash-strapped construction sector, at MDA Attorneys we are now seeing more cases where employers cash in on bonds even where they may not have actually suffered loss as a result of the contractor. This action provides quick cash flow for employers, but devastates the contractor's cash flow. The employer is paid immediately - but the contractor may not survive to argue later. Often the contractor

has a legitimate dispute that would have been won if dispute resolution proceedings were followed, making this situation severely prejudicial against for contractors."

Looking at alternatives, Stannard says in South Africa there is the "conditional bond" to consider. Here, the employer has to prove the liability of the contractor before cashing the bond. But employers seeking the speed and certainty of an on-demand bond are unlikely to accept conditional bonds.

"In the UK, a third type of bond has been developed: the adjudication bond. This is principally an on-demand bond, but the demand must be accompanied by an adjudicator's decision. The employer must have proven his or her case against the contractor and obtained a favourable adjudicator's decision before making any demands under the bond.

"This type of bond could offer a compromise that employers are willing to accept. As adjudicator's

decisions can be fairly quickly obtained, it upholds to some extent an employer's desire for a prompt remedy, while affording the contractor some fairness in that his or her argument will be heard by an adjudicator now rather than later."

Stannard points out though that the implementation and enforcement of adjudication bonds will not be without challenges. The underlying contract and the bond will need to "speak to each other" in respect of the adjudication provisions. Situations that may obstruct the effectiveness of the bond also need to be considered. "Adjudication may be impossible - if the contractor is liquidated, for instance - and there is also no legislation in South Africa to regulate adjudication. These problems could be addressed with the help of legal and financial professionals. But there is no doubt that the time has come to implement effective and fair alternatives to the on-demand bond," Stannard adds.