



SAC Integrated Project Delivery (IPD) Performance Bond User's Guide

Surety Association of Canada
May 2020

The SAC IPD Performance Bond

The Unforeseen (and Perhaps Unanticipated) Challenges of IPD Contracts

The Challenge of Integrated Project Delivery

The American Institute of Architects (AIA) defines Integrated Project Delivery (IPD) as “a project delivery approach that integrates people, systems, business structures and practices into a process that collaboratively harnesses the talents and insights of all participants to optimize project results, increase value to the owner, reduce waste, and maximize efficiency through all phases of design, fabrication, and construction.” Quite a mouthful. And, while it sets out laudable objectives, it says little about how these objectives will be met.

From an owner's perspective it sounds attractive indeed. Unlike other traditional project delivery models (e.g., design-bid-build or design-build, construction management), in which the various project participants operate in self-contained silos, the IPD approach seeks to create a team approach all parties enter into a single contract where the decision making, the risks and the profits are shared. This will, in theory at least, eliminate the adversarial dynamic that can develop when each party pursues its own interests; and, hopefully, it will incentivize more cooperative and collaborative relationships.

Like any non-traditional project delivery approach, IPD presents a new set of challenges to the construction industry as it works to create a sustainable and workable model that puts the theory into practice. For the most part, these challenges arise from the relative newness of the modern IPD concept and the lack of any unified understanding as to what an “integrated” project delivery scheme would look like. As the model continues to evolve, we encounter numerous contractual arrangements that have been lumped under the IPD umbrella, each with its own set of contractual relationships, payment chains and reporting dynamics

This is compounded by the fact that most of the published information about IPD contracts is promotional in nature and offers few specifics, putting the emphasis on the “what” but saying little about the “how”.

IPD and the Risk of Contractor Failure

Nowhere is this information gap more evident than in the discussion surrounding risk mitigation and in particular, the risk of contractor (or other party) failure. In discussing the need for protection against that risk of contractor failure, the Surety Association of Canada (SAC) has found that IPD proponents will often dismiss these concerns. They point to the all-hands-on-deck approach of the IPD arrangement and suggest that this coordinated focus on the common interest diminishes any such risk to the point of being insignificant.

Over the years and decades, sureties have learned the hard way that project risk doesn't always originate within the four walls of the project itself. Many and perhaps most of the issues that give rise to contractor failure are business/finance related and may have little or nothing to do with our Principal's ability to successfully perform the work under any particular contract. We know, only too well that replacing a failed contractor mid-way through a construction project can be an expensive proposition. This begs the question: What will happen should a major participant in an IDP contract become insolvent?

Responding to this challenge, SAC has undertaken a comprehensive review of the complex inter-relationships between parties to IPD contracts. We have attempted to identify the points of vulnerability to that risk of failure of the project contractor and/or one of the other construction participants to the IPD team. The culmination of these efforts is a new performance bond template; a novel surety approach that, we believe, adapts our traditional products and processes to the unique dynamics of IPD contracts in Canada.

CCDC 30 – A New Standard Template for IPD Contracts in Canada

In January 2019, the Canadian Construction Documents Committee (CCDC) took a huge step toward bringing some consistency into the IPD space with the publication of *CCDC 30 – Integrated Project Delivery Contract*. This template document provides a broad, workable framework to accommodate the objectives of the IPD approach while providing the flexibility to allow participants to manage the project in accordance with its specific needs.



SAC's IPD bond template was created with the new standard contract in mind and much of the approach and terminology found in the new bond reflects the CCDC 30 protocols. However, before

contemplating how surety bonds will fit into the structure of an IPD Contract under CCDC 30, it's best to review the main features of the template contract document itself and identify what they would mean for mitigation against that risk of contractor failure.

Note that terms shown in **Bold** designate defined terms within the contract template.

Parties and Teams

In keeping with the core IPD principal of project-focused collaboration, all project participants are signatories to one **Contract**. The parties to the **Contract** are set out as:

- The **Owner**; purchaser of the construction services;
- **Consultant**; e.g. design professional, architect, engineer;
- **Contractor**; typically, a general contractor or construction manager;
- **Other Parties**; e.g. trade contractors, major suppliers;
- **Added Parties**; brought in after the **Effective Date**.

The parties to the **Contract** are collectively known as the **IPD Team**, while the **Consultant**, **Contractor** and **Other Parties** are identified as the **Design Construction Team**. Note that each member of the team may enter into separate contracts with subcontractors, suppliers, etc. Each party is responsible to manage and pay its respective subcontractors.

The oversight and management of the **Contract** is carried out under the auspices of two groups consisting of representatives of each member of the **IPD Team**.

The day-to-day management of the project is the responsibility of the **Project Management Team** (PMT) which consists of one designated representative from each signatory to the **Contract**. Project oversight is provided by the **Senior Management Team** (SMT) which is made up of one senior executive representative from each party to the Contract. The SMT provides the senior support and is responsible for executive decisions that will have a major impact on the project (e.g. termination).



Project Phases

Under CCDC 30, the project is carried out in four distinct phases.

Validation Phase:

This initial phase of the project would be analogous to pre-tender work in a traditional contract arrangement. During the Validation Phase, the PMT:

- Reviews and evaluates the work site.
- Establishes **Base Program** which sets out the Owners requirements regarding “...quality, quantity, functionality, aesthetics, sustainability and other requirements” for the project.
- Establishes the **Base Target Cost**, setting out the target cost of the design services and construction work, including appropriate contingencies and allowances to meet the requirements of the **Base Program**.
- Identifies the preliminary work groups.
- Prepares the **Validation Report** – a document that is roughly analogous to a tender document or RFP.

The **Validation Report** must be accepted in writing by the **Owner** before a notice to proceed can be issued by the PMT. Note that the **Owner** can terminate the **Contract** if it doesn't accept **Validation Report** (i.e. achieve Validation), or at any time before. As well, any other **Contract** participant can terminate their participation up until **Owner** accepts the **Validation Report**.

Among the key features of the **Validation Report** is the inclusion of supporting schedules A through E:

- Schedule A – Establishes the parameters for distribution of the **Risk Pool** amounts at the milestone points (see below for a discussion of **Risk Pool**).
- Schedule B - Sets out the **Allowable Costs** for each party.
- Schedule D – is the **Task Matrix** which describes the specific tasks that each party to the **Contract** is charged with. A work order of sorts.

Design / Procurement Phase:

As name suggests, it is during the **Design/Procurement Phase** that design is prepared to the standards of the **Validation Report**.

During this phase, the PMT carries out the procurement as well as refining the cost/task distribution/risk pool/scheduling as set out in GC 4.2.3 of the **Contract** template.

Construction Phase:

The **Construction Phase** commences upon a Notice to Proceed being issued by the PMT. Again, during this phase the **Design Construction Team** performs the **Work** to completion and commissioning.

Following completion of the **Work**, the PMT certifies **Substantial Performance of the Work** and determines the **Risk Pool** distribution for Members of the **Design Construction Team**; setting off any amounts for correcting defects, deficiencies and warranty items.

The PMT then hands off the completed project to the **Owner** along with required schedules, manuals, etc.

Warranty Phase:

The **Design Construction Team** remains responsible for warranty items. However, the costs for correcting defects and deficiencies will be part of **Reimbursable Costs**.

Regarding extended warranties, these are only covered in the traditional CCDC manner; i.e. the responsibility of the **Design Construction Team** is limited to obtaining the warranty from the warrantor for the benefit of the owner.

Payment

Each member of the **Design Construction Team** is entitled to payment by the **Owner** on a monthly basis for **Reimbursable Costs** which are made up of **Allowable Costs** (Schedule B) plus overhead as set out in the appropriate section of the **Contract**.

The profits for each party are paid into a **Risk Pool** that is established during the **Validation Phase**. The **Risk Pool** will be increased or decreased during the course of the project depending on certain mitigating factors; e.g. the addition of "**Added Value Incentive Items**" (change orders).

Portions of the **Risk Pool** may be paid out by the **Owner** at pre-determined milestones as set out in Schedule A – RISK POOL DISTRIBUTION. It's important to note that these **Milestone Payments** will only be permitted if the project is on schedule and within budget.

Default / Termination of Contract

In discussing contract termination, this can be applied to an individual member of the **Design Construction Team** or to the entire **Contract**.

A member of the **Design Construction Team** may be terminated for bankruptcy/insolvency or failing to perform its obligations under the **Contract**. The terminated party is entitled to its earned share of **Reimbursable Costs** and **Risk Pool**. If that terminated party has been "overpaid" in terms of **Risk Pool** distribution, other parties are entitled to recover. However, the **Contract** doesn't specify exactly how that is expected to happen.

It's extremely important to note that a member may only be terminated **by a unanimous decision** of the SMT.

In addition to the termination of individual members, the **Owner** may terminate the entire **Contract** if the **Design Construction Team** "... neglects to properly perform the **Design Services or Work** or otherwise fails to comply with the requirements of the **Contract** to a substantial degree". As is the case with the termination of a member, the **Design Construction Team** is entitled to recover its share of the **Risk Pool** earned, less any set offs for loss or damage incurred by the **Owner** and the amount of any overpayment.

Again, the **Owner** may terminate the **Contract**, or any party to the **Contract** may terminate its involvement at any time prior to the acceptance of the **Validation Report** by giving notice to all the other parties.

Bonds / Contract Security

The template document is silent on the form of contract security that would be required to protect owners, subcontractors and suppliers from the risk of failure of one or more of the parties to the **Contract**. The only reference to contract security is found in GC 10.2.1 which simply states that "***Any Contract Security required for the Project shall be specified in the Validation Report.***"

IPD proponents and participants have pointed out, with some justification, that the nature of the IPD beast should, in many ways, minimize or at least reduce the risk of a participant contractor failure. The built-in team structure requires all participants to be more directly involved with the overall progress, flow of funds and performance of individual contractors in real time. This collaborative approach will (or should) reduce the likelihood of a project spiraling out of control before a non-performing member is terminated. Again however, no amount of collaboration or teamwork will protect against a contractor who fails and is terminated due to insolvency, or financial distress.

As a general note, it would be well to remember that as is the case with any standard contract, CCDC 30 is itself a template that can and will be modified to meet the needs and objectives of the IPD project at hand. When assessing the project risk for an IPD contract with its non-traditional approach to the inter-relationships between the parties, the supplementary conditions may bear additional scrutiny. The **Task Matrix** (Schedule D) will be a key point of focus in coming to understand the individual and collective responsibilities of the IPD parties.

The Surety Association of Canada IPD Bond

Note that terms shown in **Red Bold** designate defined terms within the bond template.



The Approach

In developing a workable and responsive IPD performance bond, SAC took as its starting point the new standard wording that is prescribed for public contracts under the *Construction Act of Ontario* which came into force in 2018. This new form represents the state-of-the-art in construction performance security and includes several enhanced features (e.g. timelines, clarity around allowable coverages) not found in traditional surety bonds.

As discussed in more detail below, this standard template was then modified to respond to the IPD arrangement as set out in the CCDC 30 contract form. However, while the bond language is intended for use with the CCDC standard, it also seeks to be flexible enough for use with modified versions of this document and for other variations on the IPD theme. Note that where possible, it avoids references to specific provisions and terminology of CCDC 30.

In recasting the standard bond for use with IPD projects, it was necessary to examine some of the fundamental relationship and requirement dynamics that will give rise to performance and payment risk in the scenario created by the IPD model. This required answers to some basic questions:

- Who will be the “Principal” under the bond or put another way: whose performance will the bond guarantee? The IPD Team? The Design-Construction team? Individual participants/signatories to the IPD Contract? If the latter, which participants?
- What will be the Surety’s obligation(s) and to whom?
- Who will be the “obligee” or beneficiary of the protection under the bond? The Owner? The IPD Team or Project Management Team?
- From the perspective of our bonded Principal, what will be the “Contract Price”?
 - What should determine the Bond Amount? (50% of what?)
 - What would constitute “Contract Balances” at the time of default/termination?
- What will constitute a “default” or failure on an IPD project? Or, more to the point, what are the conditions that will trigger a call on the bond?
- What will be the mechanics by which the Surety discharges its obligations and recovers Contract Balances?

Principal / The “Bonded” Participant

Unlike the standard 2-party construction contract, the **IPD Contract** does not lend itself well to traditional surety protection. The SAC IPD Bond does not and cannot guarantee the performance of the aggregate obligations under the **IPD Contract**. There are simply so many parties that could be collectively and individually responsible for such obligations as to make any attempt to provide consolidated performance security unwieldy or even impossible. Not to mention the difficulties for the surety in underwriting such a multi-party guarantee.

In any event, an umbrella bond that applies to the entire project would not provide the security needed to provide the appropriate level of protection in the event of major contractor failure. The true exposure to loss in an IPD contract would be the failure of a key participant that can create a financial shortfall; depleting or even exceeding the available **Risk Pool** fund. Thus, the SAC IPD bond will be issued on behalf of individual participants and guarantee that the bonded Principal will “...promptly and faithfully (perform) its obligations under the **IPD Contract**...”.

As to which of the parties to the **IPD Contract** would be required to post a bond, that would depend largely on the nature of the project and be determined during the Validation Phase; probably driven by the Owner. We would expect that bonds would be required from major construction participants that could potentially pose a risk to the financial viability of the project should they fail. Depending on the project in question, it's likely that bonds would be required from the **Contractor** and the key trades such as mechanical and electrical contractors.

Obligee / Beneficiary – The Owner

The all-in-one contract along with collaborative decision-making process that defines the IPD arrangement creates some difficulties in guaranteeing the performance obligation of any individual IPD participant. Not to put too fine a point on it, but who receives the benefit of the guarantee? The defining feature of the IPD model is that all participants share the risks and rewards and the responsibility for management of the project falls to the PMT. Also, as discussed below, the termination of any participant, which is the trigger for a surety's liability, can only be enacted by unanimous decision of the SMT. Identifying either of these groups as the Obligee, neither of which is a legal entity unto itself, would create no end of problems in the administration of any claim.

It would seem that as the source of project funding and ultimate bearer of the financial risk of a cataclysmic event, the Owner would be the logical choice as obligee/beneficiary under the bond. The SAC IPD Performance Bond identifies the Owner as the sole obligee under the instrument.

In order to align the terms of the bond with the collaborative responsibilities assigned to the various teams under the **IPD Contract**, the Owner, under Section 11 of the bond, “*represents and warrants to the Surety*”, that they, the Owner, have “*...the requisite authority to make a demand on (the) Bond*”. Section 11 also allows the Surety to rely on this representation during the administration of any claim.

What is Covered and Not Covered? – The Surety's Obligations

The objective of the SAC IPD Performance Bond will be to protect the Owner from any increase in costs of completing the bonded **Principal's Work** under the **IPD Contract** following that Principal's default and termination under the terms of the **IPD Contract**. More specifically, the Surety will be responsible under the bond for:

- The actual direct cost to the Owner of completing the **Principal's Work** as specified in the **IPD Contract**, less the **Principal's Entitlement** (i.e. amounts that are due to the Principal under the **IPD Contract**; See Section 9 of the bond).
- Any PST/HST for which the Surety may be liable.
- The **Owners' Direct Expenses** as set out in Section 7 of the bond.

To provide more clarity, users should also understand what the bond **doesn't** cover:

- The bond will not provide any compensation to the other IPD parties for any additional costs they incur, nor will it compensate the owner for any additional costs incurred by other parties; other than those articulated above.
- Related to this, the bond will not “top up” the Risk Pool, that may have been depleted; either due to the termination of the bonded Principal or for other reasons.
- The bond will not compensate the Owner for indirect expenses, costs or damages as set out in Section 7.3 of the bond.

It should be noted that although there is no direct protection against the depletion of the Risk Pool funds, the bond will indirectly furnish some Risk Pool protection. By providing coverage of the Owner's costs as outlined above, the bond indirectly protects the Risk Pool which would have been reduced by these amounts had the bond not been in place.

The options for completing the **Principal's Work** following the Principal's default/termination are set out in Section 6 and it should be noted that these options are similar, but not identical to those offered under the *Construction Act of Ontario* performance bond and the standard CCDC document.

Under the traditional bond, a Surety is afforded the option of "remedying" or curing the underlying default and allowing the Principal to continue. In the IPD world, the Surety's liability can only be triggered once the Principal's right to continue has been terminated by the IPD team, making the Remedy option moot. The options available under Section 6.1 are:

- a) **Having the Surety Complete Principal's Work:** It's anticipated that this option would only be chosen in rare instances.
- b) **Surety Arranges for Bids from Replacement Contractors to Finish Principal's Work:** It's anticipated that the successful replacement contractor would enter into a completion arrangement where they would become part of the IPD Team in the same manner as their terminated predecessor. This is similar to Option 3 of the standard CCDC Performance Bond. Once this arrangement has been implemented, the Surety will pick up any financial shortfall subject to the terms of the bond.
- c) **The Flexibility Option:** Under this approach, The Owner and Surety work together to devise an arrangement to complete the **Principal's Work** "by any method that is agreed upon...". As in Option b) above, once this arrangement has been implemented, the Surety will pick up any financial shortfall subject to the terms of the bond.
- d) **The Payout Option:** Virtually identical to that found in the standard CCDC performance bond and the *Construction Act of Ontario* bond which allows the Surety to simply pay the Owner the lesser of the Bond Amount or the Owners' cost to complete the **Principal's Work**.

Default Trigger / Conditions Giving Rise to Surety's Liability / Principal's Entitlement

Under the SAC IPD Performance Bond, the Owner is entitled to make a written demand (the “**Notice**”) on the bond in the event of the **Principal's Termination** as defined in Section 1.1 of the bond. The Notice must be delivered to the Surety substantially in the form of Schedule A to the bond and confirm the conditions of the **Principal's Termination** which are:

- a) The Principal is bound to perform construction work under the **IPD Contract**; and,
- b) The Principal is in default of its obligation under the **IPD Contract** and that default as been declared; and,
- c) The Principal's right to continue its participation as party to the **IPD Contract** has been “properly terminated”.

A quick reminder about the concept of “termination” as applied in the IPD context and in the SAC IPD Bond. As discussed earlier, General Conditions 9.1 and 9.2 of the standard CCDC 30 template provide for two instances under which termination can occur:

1. A single member can have their right to participate in the IPD Team terminated by unanimous decision of the Senior Management Team; or,
2. The entire **IPD Contract** can be terminated by the Owner.

The SAC IPD Performance Bond responds only to the first of these scenarios and in fact, the second paragraph of the bond explicitly states that should the **IPD Contract** be terminated by the owner, the bond will be null and void.

In addition to the **Principal's Termination**, the bond identifies three other **Conditions Precedent** to a surety's liability in Section 8.

- A notice of the **Principal's Termination** has been provided to the Principal; and,
- The Owner and all other parties to the **IPD Contract** have performed their obligations under the **IPD Contract**; and,
- The Owner has agreed to make the **Principal's Entitlement** available to the Surety.

On that last point, the **Principal's Entitlement** is defined in Section 9 of the bond as the total amount payable by the Owner to the Principal under the **IPD Contract**, and other amounts to which the Principal would be entitled; less deductions for the **Owners Direct Expenses** under Section 7. This would include the Principal's share of any undistributed Risk Pool amounts at the end of the project. Under a traditional surety arrangement this would be analogous to "Contract Balances". However, that term is not appropriate in an IPD context.

It should be noted that these **Conditions Precedent** reflect those found in the traditional performance bond.

Contract Price / Bond Amount

The traditional contract surety approach is dependent on full clarity around two key concepts; the Contract Price, which in turn determines the Bond Amount. The **IPD Contract** tosses a monkey wrench into this arrangement as the shared cost and risk sharing arrangement means there is no "Contract Amount" per se.

Fortunately, the CCDC 30 template itself provides some guidance as to putting a number to our Principal's contractual obligations. Articles 4 and 5 of the Contract set out the parameters around the Risk Pool and Reimbursable Costs respectively. The details around these provisions are found in Schedules A and B.

From this, it would appear that the IPD equivalent of Contract Price for individual participants would be the sum of Reimbursable Costs and their share of the risk pool as properly amended under the terms of the **IPD Contract**. In determining an appropriate bond amount, it might be prudent to set this at 50% of this total, Or, as the Surety's exposure is limited to the cost of completing the Principal's Work, an Owner may wish to apply the 50% to the Reimbursable Costs as set out in Article A-5 (the Allowable Costs plus overhead) when setting the bond amount.



Other Features of the SAC IPD Bond

As mentioned earlier, the SAC IPD Performance Bond was taken from the standard wording prescribed under the *Construction Act of Ontario* and includes many of the enhanced features that are found in that wording. Among these enhancements:

- Fixed timelines that require a surety to respond to a **Notice** and deliver its response within specified, short timeframes. Upon receiving a **Notice**, the Surety must:
 - Provide the **Acknowledgment** of the receipt of the **Notice** within 4 business days of its receipt.
 - Propose a **Post-Notice Meeting** within 10 business days of the **Notice** and attend that meeting.
 - Within 20 business days of the receipt of the **Notice**, provide Owner with the **Surety's Position**.
 - Meet with the Owner (at Owner's request) to discuss status of **Investigation** within 5 business days of the Owner's request.

- More clarity around extent of coverage for Owner's default-related costs and the **Owner's Direct Expenses**, as well as protection against increased costs for time extensions. As discussed, these clarifications are found in Section 7 of the bond.

- Allowance for more communication between Owner and Surety; both before a **Notice** is given and after. The bond provides for:
 - A **Pre-Notice Meeting** between the Owner, Principal and Surety when problems begin to develop with the Principal's performance which in the Owner's opinion could lead to the failure and termination of the Principal right to continue. This meeting is optional and will take place at the request of the Owner.
 - A **Post-Notice Conference** that will take place between the Surety and Owner following receipt of the **Notice**. The purpose of this meeting will be to review the status of the project, identify any issues and where possible, eliminate or minimize any work stoppages or schedule slowdowns while the Surety conducts its **Investigation**.

- Flexibility in allowing an Owner to undertake measures following the **Principal's Termination Investigation**, while retaining its rights under the bond. This includes provisions for:
 - **Necessary Interim Work**; action taken to address emergency situations; specifically:
 - ◆ Ensuring public or worker safety.
 - ◆ Preserving existing work from damage or deterioration.
 - ◆ Complying with local laws and ordinances.
 - **Mitigation Work**; undertaken to ensure, inasmuch as possible, that the disruptions are held to a minimum and to mitigate the cost of completing the **Principal's Work**.

- Template schedules that provide guidance to the Owner and Sureties. This should bring more uniformity and certainty to the claim process and hopefully reduce delays caused by incomplete notices or responses. The bond includes three such schedules:
 - Schedule A – Provides the Owner with the format for submitting a **Notice** to the Surety that the Principal's right to continue has been terminated and calling on the Surety to act under the bond. The Schedule includes a check box Appendix that details any information submitted in support of the claim.
 - Schedule B – is completed by the Surety and sets out the form for the **Acknowledgement** of the **Notice**. The Schedule also begins the process of setting up the **Post-Notice Conference** and includes a check box Appendix detailing any additional information required to assist the Surety in its **Investigation**.
 - Schedule C – is executed by the Surety upon completion of its **Investigation** and provides the Owner with the **Surety's Position** regarding the Notice. As set out in Section 3.3 of the bond, the Surety will choose one of the three options available:
 - ◆ Accept liability under the bond.
 - ◆ Deny liability under the bond and provide the reasons for such denial.
 - ◆ Inform Owner that Surety is unable to determine liability and request any additional information needed to make such a determination.

Integrated Project Delivery is an innovative and commendable approach to the procurement and delivery of construction services. This creation of a collaborative working arrangement where all parties share in the risks and rewards, will almost certainly prevent the adversarial dynamic that can develop when each party is focused on protecting its own interests, often to the detriment of the other contracting parties.

That said, no contractual arrangement, no matter how well-intentioned or collaborative is risk free. Experience has shown that the risk of a major contractor insolvency or failure, if not adequately managed can have catastrophic consequences to the project and all of its participants. A surety instrument specifically created for use on IPD projects will go a long way to mitigating that risk.

For questions regarding this User Guide or the SAC IPD Performance Bond, please call (905) 677-1353 or send an email to surety@suretycanada.com.

