

PRACTICE

Understanding NEC4 option X4 on parent company guarantees



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KEY POINTS

- NEC4 option X4 on ultimate holding company guarantees provides the client with a potentially valuable form of contract security.
- Option X4 may provide assurance in the event of specific breaches of contract and enhance trust between the parties.
- Holding or parent company guarantees are a specialist form of document that require particular expertise when drafting.

provision for a performance bond, which is addressed under option X13 in other NEC4 forms.

Option X4 comprises two clauses, X4.1 and X4.2. The wording in NEC4 ECC is:

X4.1: If the *Contractor* is a subsidiary of another company, the *Contractor* gives to the *Client* a guarantee of the *Contractor's* performance from the ultimate holding company of the *Contractor* in the form set out in the Scope. If the guarantee was not given by the Contract Date, it is given to the *Client* within four weeks of the Contract Date.

X4.2: The *Contractor* may propose an alternative guarantor who is also owned by the ultimate holding company for acceptance by the *Project Manager*. A reason for not accepting the guarantor is that its commercial position is not strong enough to carry the guarantee.

It amends the previous NEC3 wording to clarify that in the event a guarantee is required, this does not necessarily need to come from the ultimate parent company. Instead, the guarantee may be provided by an intermediate holding company where its commercial position is strong enough to carry the guarantee, which more accurately reflects real-world scenarios involving PCGs.

Benefits of guarantees

A PCG is a form of security where the parent company of a contractor (or subcontractor, consultant, service provider or supplier) provides certain guarantees, which may be either performance

or financial, in relation to the contractual obligations of its subsidiary. The wording of the PCG determines what the parent company may be required to do with the form stated in the scope.

There may be various benefits of implementing option X4, including the following:

- Risk management – a primary purpose of option X4 is to mitigate the risk of contractor default providing an additional layer of assurance to the client.
- Financial security – in the event the subsidiary contractor faces financial difficulties or insolvency, the parent company may be legally obligated to step in.
- Enhanced trust – including a PCG within the contract can lead to enhanced trust and co-operation between the contracting parties.

Drafting considerations

Discussions often occur during the pre-contract stage (usually decided by the client) to propose the forms of contract security and assurance level required. This may include discussions as to the necessity of a PCG and the specific terms under which it will be provided. Considerations may include the scope of the guarantee, the obligations of the parent company and any conditions or limitations.

Due to the nature and importance of the document, a PCG should be prepared by a specialist to ensure it is enforceable and aligns with both parties' interests. The guarantee will usually be signed as a deed by the relevant parties. While option X4

Option X4 on ultimate holding company guarantees in the NEC4 Engineering and Construction Contract (ECC) and other NEC4 contracts (except short forms) is an optional procedure which enables parties to use a parent company guarantee (PCG) as a form of contract security. The wording is the same across the NEC4 suite except for the different parties and named roles. However, the Facilities Management Contract (FMC), Facilities Management Subcontract (FMS) and Alliance Contract (ALC) include

may provide significant benefits, there are important considerations to keep in mind, as follows:

- Parent company viability – the effectiveness of a PCG relies upon the financial integrity and stability of the parent company. Good practice for clients may involve undertaking due diligence to assess the parent company.
- Scope and limitations – the scope of the guarantee should be clearly defined including specifying which obligations are covered and any exclusions or limitations.
- Jurisdictional issues – a potential issue may be where the parent company is based in a different jurisdiction. The PCG should align with the law of the contract.
- Costs to draft – NEC contracts do not provide a standard template for PCGs although many clients have their own standard form for use. Where any bespoke amendments are required, additional legal costs may be incurred.

Conclusions

NEC4 option X4 can be a useful tool for managing risk and ensuring project continuity in the event of specific contractor defaults. A PCG provides for an additional layer of assurance for the client in relation to the contractor's performance.

However, careful consideration and meticulous drafting in conjunction with specialist professionals are essential to maximise its effectiveness and mitigate potential legal complications. When properly implemented, option X4 can serve as a valuable mechanism to safeguard project interests. ○