



International Federation of Consulting Engineers
The Global Voice of Consulting Engineers

Guarantees, Bonds and Retentions relating to Professional Services

FIDIC Briefing Note

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Background

The international engineering federation FIDIC (the International Federation of Consulting Engineers) believes that its member associations and their members should strive to achieve the highest degree of quality and standards.

FIDIC has always had policy statements that it expects its members to follow to ensure high standards of service in the infrastructure industry. These standards are reflected in FIDICs contracts, policy work, events and committees.

Guarantees, Bonds and Retentions relating to Professional Services

Consulting Engineers in many countries are faced with a situation where they are often asked to provide earnest Money Deposit or Bid Bond or Guarantees while bidding for tenders of consultancy work floated both by public sector and private sector.

This creates a potential number of issues for engineers:

- It blocks cash/bank limits putting a strain on their cash flow and limits the ability to grow and improve performance.
- Being a knowledge industry, a consultant may often not have adequate assets to offer as security and can lose out of jobs which they are otherwise well equipped to handle.
- In countries where local banking sector is weak, clients often ask for bid bonds/guarantees to be issued by international banks which can cause complications
- At times of tightening capital markets banks are very selective in issuing bid bonds/guarantees, also the cost of issuing bid bonds/guarantees increases steeply pushing up costs
- It becomes extremely difficult for the consultants to retrieve the EMD/ Bid Bonds/ Guarantee for projects where the consultant is not awarded the tender.
- Call for EMD/Bid Bonds/ Guarantees is a procedure generally followed while inviting tenders for construction work or supply of plant and equipment/other materials etc and this condition is imposed to ensure that the tender is supported by an entity that has the resources to implement the job. Applying the same approach to "Consultants" is constraining because primarily a consultant is not a "Contractor" as the former provides services based on knowledge and experience and there is generally substantially more capital involved in the contracting side of projects

Bid or Tender bonds

In cases where Consultants are required to bid competitively, Clients sometimes require that a Tender Bond accompanies the bid. Ostensibly the purpose of this bond is twofold. Firstly, to ensure that a bidder does not change his mind and cancel his bid and, secondly, to exclude non-serious bidders.

As financial compensation does not help the Client towards his objective of securing a trusted Consultant to work with him on the project. Other methods such as pre-qualifications for a short list, followed by presentations and negotiations are more likely to succeed in securing for the Client a Consultant of integrity and trust.

Advance payment guarantees

Agreements may specify that an advance payment shall be made to the Consultant to cover heavy initial costs such as mobilisation, purchase of plant, computer equipment or travel and housing costs for staff. Advance payments are generally about 10 percent of the fee but they may be as much as 25% or 30% of the fee, and an Advance Payment Guarantee is usually required by Clients as a security to cover this payment. As this type of guarantee is linked to the advance payment, the amount of the guarantee should reduce in step with the repayment of the advance.

Retentions

The use of Retention of part of the Consultant's fee to supposedly ensure proper performance of the services under a consultancy agreement. On completion of the Agreement there is no further performance to guarantee and the Consultant will be already carrying liability for his performance.

Performance bonds

Performance Bonds, as their name implies, are designed to guarantee the proper and timely completion of the Consultant's duties under the Agreement.

The wording of such a bond is very important as it will specify the conditions under which the bond may be forfeit. Non-performance has to be established before the bond can be called.

The use of Performance Bonds of this type, in Consultancy Agreements, has over the last many years almost disappeared. They are however occasionally used in connection with Construction contracts, particularly in the United States. Performance Bonds are often issued by Insurance Companies.

"On-Demand" bonds

In recent years there has been increasing use of "On-Demand" Bonds under which a bank or other surety guarantees to make payment when so requested, without any necessity to prove lack of performance.

As the name implies an "On-Demand" Bond is given (normally by a bank) to a Client in a form which allows the Client to call the bond, and thus receive payment to the full value of the bond, whenever he (the Client) believes there to be lack of performance by the Consultant. The bank is obliged to honour the Bond as it is payable "On-Demand" and there is no redress. Clearly a Client will normally not take such action until all other means of settling the dispute have been exhausted and the Consultant will take all possible measures to avoid putting his Client into such a position. In addition, no Client will wish to be accused of, or earn a reputation for, unjust calling.

The use of "On-Demand" Bonds does not necessarily add to the likelihood of high quality performance and deprecates their use as they create a potentially confrontational situation which militates against successful co-operation between Client and Consultant. Misuse of such Bonds by delaying their release is counter-productive, as it causes severe problems, and economic difficulty and loss to the Consultant involved.

Cost

It is often overlooked that all bonds, but particularly "On-Demand" Bonds, are costly to acquire and set in place, and will therefore ultimately add to the price the Client pays for the Consultant's services. In exceptional cases the Consultant may also feel that there is additional risk associated with the project and for this reason may add to his price.

FIDIC recommends:

- In general, contract guarantees, such as Earnest Money Deposit, Bid Bonds, Performance Bonds and Retention Funds, serve little useful purpose under a consultancy agreement between a Client and a Consulting Engineer. They increase the overall cost without influencing the performance of the services. They should be avoided. Advance Payment Bonds are acceptable as they guarantee repayment of funds advanced by the Client.
- On-Demand Bonds are by their nature, one-sided and confrontational. FIDIC opposes the use of these bonds.
- A Client and Consulting Engineer should consider that the interposition of bonds between them is likely to have an adverse effect on the relationship between them which should be based on mutual trust and cooperation.
- However, if a Client is obliged by local law to require a Bid Bond, the conditions should not make subsequent failure to reach agreement a justification for calling the bond, as both Client and Consulting Engineer should be free to withdraw, if there are considerations that deter either from proceeding.

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Endnotes