



*Guidance*

# **Contracting in industrial sectors**

**Principles for general contract clauses**

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If legal advice is required, it is recommended the reader consult a lawyer.

#### *Acknowledgements*

*This guidance has been produced by the Internal and Industrial Market Task Force of EFCA, under the Chair of Hubert LABOURDETTE.*

*Thanks go also to Jan BOSSCHEM, Kari HARSUNEN, Valentin HUEBER, Loïc CHAPON, Mika LAURILEHTO, Patrick VAN DE VELDE, Silvio VENTURA and Enrico VINK (FIDIC).*

Publication date: May 2014

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## **Why this guidance?**

Objectives of the document are:

- to clarify the scope of services that the engineering consultancy company provides;
- to improve the understanding of conditions and terms of the relationship between engineering consultancy companies and buyer;
- to inspire seller and buyer to focus on scope of work and the final result of the project.

## **How to use it?**

The document is a “toolbox” addressed to different stakeholders.

This guide outlines areas of importance in relationships and contracts between engineering consultancy companies and buyer to create a win-win situation.

- it aims to acquaint the reader with the fundamentals governing the contractual relationship between engineering consultancy firms, contractors and partners;
- it identifies contractual principles and conditions that can be used as a reference for engineering consultancy companies when reaching an agreement.

The document does not constitute a legal advice, nor does it constitute binding guidelines or binding recommendations.

## Recommendations about scope of work and contractual object

### 1. Scope of work and project definition

This guidance focuses on engineering consultancy services for industrial products.

Cf. the European standards:

EN 16310:2013	Engineering services - Terminology to describe engineering services for buildings, infrastructure and industrial facilities
EN 16311:2013	Engineering services - Terminology to describe engineering services for industrial products

### 2. Obligations of means

Obligation of means is the commitment of the seller to put in place all available expertise, team or tools to achieve the best possible result. It is a commitment without guaranteeing the outcome.

Obligation of result on the other hand is the commitment to reach a well-defined result and to take all necessary actions as long as the goal is not reached.

#### **Principle**

Contracts in the industrial engineering consultancy sector generally involve an obligation of means.

### 3. Incentive mechanisms

The use of incentives aims at developing a “win/win” cooperation between engineering consultancies and industrial stakeholders, through sharing proportionally both losses AND benefits.

Incentive mechanisms can be based on pre-determined targets and agreed upon rules of application.

#### **Principle**

The use of incentives for both parties in a contract to reach well defined results can provide a common goal and balanced platform for supplier and client. If an engineering consultancy firm is subject to penalties by the client on some key benchmarks, then a parallel system of bonuses could be applied if the firm’s performance exceeds the client’s expectations.

#### 4. Contract period extension

The project schedule is to be defined and agreed between the client and the engineering consultancy firm. Major changes due to external or internal circumstances may change the conditions of terms during the project and need to be defined in agreement with supplier and buyer.

Main schedule milestones are defined as well as the (technical) content of each milestone.

The client and engineering consultancy firm contractually establish the client's and other parties' schedule for submittals (e.g. conditions, decisions, reference documents ...).

##### **Principle**

Extension of time, changes in resources or fee is often appropriate or necessary to apply in order to meet changed internal and external circumstances.

- "force majeure"
- client or third party delay
- major modification of the mission.

#### 5. Liquidated damages

Liquidated damages can be part of an engineering consultancy contract but it is in the interest of both parties that clear rules of application are to be specified.

##### **Principle**

Stakeholders should carefully consider when liquidated damages are agreed upon and whether this should be the last remedy or not.

Liquidated damages can be capped, either in terms of absolute value or in terms of a % limit of the engineering consultancy contract value. The purpose, effect or cost of this measure needs to be evaluated before the project starts.

Liquidated damages' amount is proportionate to the impact of the delay on the overall project (e.g. 1% per week).

Liquidated damages linked to partial or final delivery from the consultant can be appropriate if the time for delivery is critical. The time for partial delivery could e.g. be critical if other suppliers to the client are dependent on the delivery from the engineering consultancy firm and a delay in delivery therefore could incur extra costs for the client. On the contrary, if other suppliers are not dependent on the delivery from the engineering consultancy firm, this indicates that the time for partial delivery may not be critical.

## **I. Terms and conditions of invoicing and payment**

### **1. “Cash neutral”**

Manpower – and thus salary costs – is the largest costs for an engineering consultancy firms. Salaries are paid monthly and negative cash is therefore most disruptive for the industry. It is advisable to take this into account to achieve a cash neutral approach in the payment plan and minimizing unnecessary risk of financing costs in the project.

#### **Principle**

The firm and the client have an interest to mutually recognise and commonly act in the spirit of the principle of being “cash neutral”.

Various alternative arrangements are possible:

- advance payment with supplementary invoicing of adjustments at the end of the month,
- deposit or initial down payment to establish a “cash neutral” situation.

In any case, it is necessary to work in full transparency with the client and to make use of simple simulation tools.

### **2. Invoicing and Terms of payment**

Two practices:

- The use of advance invoicing can help to achieve a neutral relationship in delivery/payment.
- Minimize unnecessary time slack in transactions through, for example, the use of pre-approved payment plans and prioritising payment similar to delivery of service.

#### **Principle**

The use of “cash neutral” principles for invoicing and payment creates a balanced contract for partnership where delivery and payment are equally important and the parties have equal respect for each other. Based on these principles it is advantageous to clearly define the process and time for invoicing and payment in the contract between the parties.

As soon as the milestones are met or the dates according to the payment plan are reached, payment by the client will be made.

In common understanding and in support of the partnership the terms of payment are to be agreed in the spirit of being a preferred supplier or a preferred client.

**Principle**

For intellectual services (as opposed to the supply of materials) that are mainly based on monthly salary costs, this is an important issue. It's an indication of the need for an effective cash flow.

**3. Modifications**

To get things done you have to place an order. The same goes for changes in a project.

Nothing can be done by the engineering consultancy firm without previous client approval and acceptance of the schedule and payment conditions.

Modifications are:

- all changes, additions or reductions that impact on the engineering consultancy's firm assignment as defined in the contract;
- any external event that impacts on the cost, the schedule and/or the quality of the project.

**Principle**

Modifications need to be in the form of a written agreement between the engineering consultancy firm and the client, indicating:

- the nature of the change;
- the consequences of these changes on the firm's assignment - including remuneration, the project budget and deadlines.



## II. Risk management and liabilities

### 1. Risk management

The pattern of risk management approach is:

*Risk identification* ⇔ *Risk limitation and allocation* ⇔ *Risk evaluation*.

Parties have to take into consideration that the allocation of certain risks towards the engineering consultant is not acceptable regardless of the potential financial gain.

Rational criteria for risk allocation are:

- 1 Who can best control the events that may lead to the risk occurring?
- 2 Which party can best manage the risk if it occurs?
- 3 Which party should carry the risk if it cannot be controlled?
- 4 Is the premium charge by the transferee reasonable and acceptable?
- 5 Is the transferee likely to be able to sustain the consequences if the risk materializes?

The engineering consultancy firm and the client should jointly implement a risk management programme (from identification to evaluation and allocation).

#### **Principle**

Risks should always be minimized and insured if possible. Costs of unnecessary risk will harm the project.

Risks, insurance and costs should be balanced and calculated in the project.

Engineering consultancy firms should carefully consider accepting to be responsible for risks that they have no control over, or to be liable for losses which they will not be able to meet. They should be fairly remunerated for their ability to control both project risks and those activities they are responsible for.

## 2. Liabilities

The professional liability of the engineering consultancy firm is often limited to an amount related to the overall remuneration received for the assignment, regardless the nature of the damages or the legal basis.

Engineering consultancy firms should carefully consider accepting to be liable for indirect or consequential damages. The length of the liability period (start and end) shall be clearly defined.

The engineering consultancy firm is responsible for fulfilling all regulatory obligations inherent to their professional activity as applicable at the date of the contract signature.

The engineering consultancy firm and the client need to evaluate risks and allocate responsibilities between client and engineering consultancy firm.

### **Principle**

The contracts usually contain a limitation of liability for the engineering consultancy firm.

The period of liability should be clearly defined in the contract between the parties.

The limitation may cover the performance of remediation services in case of proven error for a limited period of time.

## 3. Insurance

The engineering consultancy firm should be appropriately insured for possible liabilities the engineering consultancy firm may incur in pursuing its business activities. The most important insurances in this regard is the professional indemnity insurance. Another important insurance is an insurance for general liability according to law. It may also be appropriate for the client to take out additional insurances.

### **Principles**

Engineering consultancy firms shall have and maintain professional indemnity insurance that covers the agreed limitation of liability.

An engineering consultancy firm often also need insurance for the liability the engineering consultancy firm may have according to national law.

The engineering consultancy firm and the client need to discuss whether the client needs to take out an own insurance to meet certain risks in the project or to complement the insurance of the engineering consultancy firm. The parties may also need to discuss whether the limitation of liability in the professional indemnity insurance of the engineering consultancy firm should be altered, for example with regard to the scope or complexity of the assignment.

### III. Intangibles

Intangibles are about:

- Intellectual Property Rights
- Intellectual property rights are legally protected rights, for example copyright or patent. An owner of an intellectual property right to, for example, works or to an invention has certain exclusive rights to use the protected object(s). The owner of an intellectual property can allow another party to use such works or inventions. The owner can also transfer the intellectual property right to the works/inventions to another party. The result of an assignment carried out by an engineering consultancy firm can be protected by copyright or patent.
- Confidentiality

#### **Principle**

The parties may need to consider which party shall own the intellectual property rights. It is often said that the intellectual property rights shall be vested in the party that has the best possibilities to use the rights. The goal should then be to find an allocation of the rights that creates economic incentives and gain for both parties. Allocation of and remuneration for intellectual property rights should therefore be discussed between the parties and defined in the contract.

The cost of the risk of intrusion upon intellectual property needs to be considered. It should be discussed with client who will handle and cover it.

The use of third party rights to works or inventions are usually handled in a contractual relationship between the client and the third party.

Conditions of confidentiality should be clearly defined between the engineering consultancy firm and the client (Scope of confidentiality, rules of applications, duration etc).